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Department of the Treasury
Internal Revenue Service

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Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

These principles of tax administration were previously published in the Internal Revenue Bulletin as Revenue Procedure 64-22, 1964-1 (Part I) C.B. 689. They are restated here to emphasize their importance to all employees of the Internal Revenue Service.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

Cumulative Bulletin 1984-1 is a consolidation of all items of a permanent nature published in the weekly Bulletins 1984-1 through 1984-26 for the period of January 1 through June 30, 1984. It includes a cumulative list of announcements relating to decisions of the Tax Court published in the Internal Revenue Bulletins.

The Internal Revenue Cumulative Bulletin is prepared in three parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954. Arrangement is sequential according to Code and regulations sections. The code section is shown at the top of each page.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Included in this Part is a list of persons disbarred or suspended from practice before the Internal Revenue Service.

Notice of Proposed Rulemaking

The preambles and text of proposed regulations that were published in the **Federal Register** during this six-month period are printed in this section.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Services No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valide portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B.—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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Cumulative List of Announcement Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1984 thru June 30, 1984

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

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Buse, Delmer H., et ux[3]	5619-76))	71	1129
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Carborundum Co., The[4]	2338-75	74	730
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Rockfeller, 3rd, Est. of John D., John D. Rockefeller IV, J. Richardson Dilworth & Donal C. O'Brien, Jr., executors, & Blanchette H. Rockefeller[16]	)) 9357-77)	76	178
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Stewart, Est. of Robert H., Robert E. Stewart & Mary June Stewart Roberts, Co-Executors[18]	11849-81) 11986-81)	79	1046
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T.J. Henry Associates, Inc., et al[20]	2826-81) 2827-81)	80	886
Widener, Joseph E., Trust No. 5, Provident National Bank, Trustee No. 55712[21]	2689-78))		
Widener, Peter A.B., Trust No. 5, Provident National Bank, Trustee No. 65972[21]	)) 2690-78)	80	304

The Commissioner does NOT ACQUIESCE in the following decisions:

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Abdalla, Jacob, et ux[22]	1783-74	69	697
Gladstone Foundation, J. David[23]	2964-80X	77	221

[1] Acquiescence relating to whether petitioners were members of a controlled group of corporations within the meaning of section 1563(a)(2) of the Code.

[2] Acquiescence relating to whether the Court had jurisdiction of the petitions filed by officers and directors of a dissolved corporation after the period during which applicable state law preserved the capacity of the former officers to act in the corporation's behalf, when the notice of deficiency was mailed to the corporation within the period.

[3] Acquiescence in the issue relating to whether the taxpayers held a contract right to cut for the required hold period thereby entitling them to elect section 631(a) of the Code treatment. Acquiescence in result in the issue relating to what was the fair market value of the timber for section 631(a) purposes. Acquiescence "in result" means acceptance of the Court but disagreement with some or all of the reasons assigned for the decision.

[4] Acquiescence relating to whether petitioner's purported sale of a "forward contract" for foreign currency shortly before the time set for performance but subsequent to the devaluation of the currency resulted in long-term capital gain, short-term capital gains, or ordinary income.

[5] Acquiescence relating to whether Alps Corporation's accumulations for the reasonable needs of the merged corporation were for its own reasonable needs such that the successor corporation (Chaney & Hope) is subject to the accumulated earnings tax pursuant to section 531 of the Code for the period October 1, 1974 through July 31, 1975.

[6] Acquiescence relating to, in purchasing a business, what is the proper method to determine the amount to be allocated to going concern value.

[7] Nonacquiescence published in 1974-2 C.B. 5, relating to whether an estate is eligible, under section 302(c)(2)(A) of the Code, to waive the family attribution rules of section 318(a)(1), is withdrawn and acquiescence is substituted therefore.

[8] Acquiescence in the issues relating to (1) whether losses of $518,000 from the sale of 41,000 shares of stock of Lomas & Nettleton were non-business capital losses to petitioners under section 172(d)(2) of the Code, and (2) whether respondent had borne his burden of proving in the alternative that 1967-1969 gains on the sale of stock of various corporations constituted ordinary income.

[9] Acquiescence in the issues relating to (1) whether petitioner, an automobile dealer, that used the dollar-value LIFO method if inventory valuation may include all new vehicles in a single pool or should include each method line of vehicle in a separate pool, and (2) whether respondent timely raised the issue of whether, assuming petitioner's use of one pool for all new vehicles is proper, petitioner may treat all of its vehicles as a single item for purposes of computing a price index.

[10] Acquiescence in the issues relating to (1) whether petitioners' disposition of one parcel of real property and acquisition of another qualified as a like exchange under section 1031(a) of the Code, and (2) if so, whether petitioners must recognize any gain on the exchange under section 1031(b).

[11] Nonacquiescence published in 1980-1 C.B. 2, relating to whether petitioner's purported sale of a "future sell contract" for foreign currency shortly before the time set for performance but subsequently to the devaluation of the currency resulted in short-term, rather than long-term, capital gain, is withdrawn and acquiescence is substituted therefore.

[12] Acquiescence relating to whether a trust is eligible under section 302(c)(2)(A) of the Code to waive the family attribution rules of section 318(a)(1).

[13] Acquiescence in result in the issues relating to (1) whether petitioner should be allowed to deduct that portion of prepaid intangible drilling costs attributable to work performed in the year of payment in connection with certain footage and daywork drilling contracts and third party well-serving contracts, and (2) whether payments of intangible drilling costs should be deductible in the year paid, when required pursuant to certain turnkey drilling contracts with independent third parties. Acquiescence "in result" means acceptance of the Court but disagreement with some or all of the reasons assigned for the decision.

[14] Acquiescence in result in the issues relating to (1) whether rental payments made by a professional corporation to a Clifford trust established by the sole shareholder for the benefit of his children are ordinary and necessary business expenses of the corporation, and (2) whether the rental payments are taxable to the grantor of the trust rather than the income beneficiaries of the trust. Acquiescence "in result" means acceptance of the Court but disagreement with some or all of the reasons assigned for the decision.

[15] Acquiescence in the issues relating to (1) whether a consent extending the statute of limitations for taxable years 1974, 1975, and 1977 is rendered invalid by respondent's unilateral removal of its application to the year 1977, and (2) whether petitioner is estopped to deny the validity of the altered consent with respect to taxable years 1974 and 1975.

[16] Nonacquiescence published in 1982-1 C.B. 1, relating to whether under section 170(b)(1) of the Code, unreimbursed out-of-

pocket expenses incurred while rendering services to charitable organizations are contributions "to", rather than "for the use of" the charities, is withdrawn and acquiescence is substituted therefore. See Rev. Rul. 84-61, page 39, this Bulletin.

[17] Acquiescence in the issue relating to (1) whether amounts paid under a written separation agreement by a husband to a cooperative apartment corporation for "rent" on an apartment which he owns but which is occupied by his wife free of charge pursuant to the terms of the agreement are deductible by the husband under section 215(a) of the Code, (2) whether amounts paid by the husband under the agreement for repairs on the apartment are deductible by the husband under section 215(a), and (3) whether premiums paid by the husband under the agreement for major medical insurance for the wife and their children were deductible by the husband under section 215(a).

[18] Acquiescence relating to whether the execution of a joint and mutual will between husband and wife providing that a one-half interest in real property held as tenants by the entirety pass immediately to their children upon the death of the first spouse converted the tenancies by the entirety into tenancies in common so that upon the death of the first spouse (wife), the one-half interest passed directly under her will to the children rather than to the surviving spouse by law and then by gift to the children.

[19] Acquiescence relating to whether, where petitioner used professional fund raisers over an extended period to promote and sell commercial advertising distributed to thousands of patrons of petitioner's annually sponsored professional vaudeville show, such activities constitute a nontaxable intermittent activity under section 1.513-1(c)(2)(iii) of the regulations.

[20] Acquiescence relating to whether a controlling shareholder in a subchapter S corporation terminated the subchapter S status of the corporation by failing to consent to that status after transferring one share of stock he owned to himself as custodian under the Uniform Gifts to Minors Act.

[21] Acquiescence relating to whether petitioner trusts may recognize capital losses generated by various stock sales between themselves.

[22] Nonacquiescence relating to whether the total worthlessness in 1966 of the petitioner's stock and his subchapter S corporation's indebtedness to him requires an adjustment to zero of the basis of the stock and the indebtedness, thereby precluding any net operating loss pass-through in 1967 pursuant to section 1374(c)(2) of the Code, or whether the petitioner is entitled to a deduction for his pro rata share of the loss computed with reference to the date of worthlessness of the stock and the debt.

[23] Nonacquiescence relating to whether the Tax Court has jurisdiction of a petition for declaratory judgment where the Service proposed to revoke nonprivate foundation status, the organization filed a protest, and some 900 days thereafter, filed a petition.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Subpart A.—Income Taxes
Chapter 1.—Normal Taxes and Surtaxes
Subchapter A.—Determination of Tax Liability
Part I.—Tax on Individuals

Section 1.—Tax Imposed

26 CFR 1.1-1: Income tax on individuals.

Whether a foster child who is a dependent of a taxpayer qualifies the taxpayer for head of household filing rates. See Rev. Rul. 84-89, below.

Section 2.—Definitions And Special Rules

26 CFR 1.2-2: Definitions and special rules. (Also Sections 1, 152; 1.1-1, 152-1.)

Head of household; foster child. A dependent foster child will qualify a taxpayer for head of household status under section 2(b)(1)(A)(ii) of the Code. However, if the foster child is not a dependent of the taxpayer, the taxpayer will not qualify for head of household status under section 2(b)(1)(A)(i) of the Code.

Rev. Rul. 84-89

ISSUE

Whether a foster child who is a dependent of a taxpayer qualifies the taxpayer for head of household filing rates under section 1(b) of the Internal Revenue Code.

FACTS

During 1983, *A* maintained as *A*'s principal place of abode a household consisting of *A* and *A*'s foster child. *A* provided over half the cost of maintaining such household and over half the cost of the support of the foster child during 1983. *A* was neither married nor a surviving spouse (as defined in section 2(a) of the Code) at the close of *A*'s taxable year.

LAW AND ANALYSIS

Section 2(b)(1)(A) of the Code provides, in part, that an individual may qualify for head of household filing rates under section 1(b) if such individual is not married at the close of that individual's taxable year, is not a surviving spouse (as defined in section 2(a)) and maintains as the individual's home a household that constitutes for such taxable year the principal place of abode, as a member of such household, of:

(i) a son, stepson, daughter, or stepdaughter of the taxpayer, or a descendant of a son or daughter of the taxpayer, but if such son, stepson, daughter, stepdaughter, or descendant is married at the close of the taxable year, only if the taxpayer is entitled to a deduction for the taxable year for such person under section 151, or

(ii) any other person who is a dependent of the taxpayer, if the taxpayer is entitled to a deduction for the taxable year for such person under section 151.

However, Section 2(b)(3)(B)(i) of the Code provides, in part, that a taxpayer shall not be considered to be a head of household by reason of an individual who would not be a dependent for the taxable year but for paragraph (9) of section 152(a).

Section 152(a) of the Code provides that the term "dependent" means any individual described in paragraphs (1) through (9) of section 152(a) and over half of whose support, for the calendar year in which the taxable year of a taxpayer begins, was received from the taxpayer. Section 152(a)(9) generally describes a class of unrelated persons that includes a foster child and provides that an individual (other than an individual who at any time during the taxable year was the spouse of the taxpayer) who, for the taxable year of the taxpayer, has as that individual's principal place of abode the home of the taxpayer and is a member of the taxpayer's household, shall be considered a dependent of the taxpayer.

However, section 152(b)(2) of the Code provides, in part, for purposes of that section, that in determining whether any of the relationships specified in section 152(a) exist, a foster child of an individual (if such child satisfies the requirements of section 152(a)(9) with respect to such individual), shall be treated as a child of such individual by blood. Further, section 1.151-3(a) of the Income Tax Regulations provides that for purposes of section 151(e), 152, and the regulations thereunder, a child is defined to include a foster child of the taxpayer.

Because a foster child is treated the same as a person described in section 152(a)(1) of the Code, i.e., a dependent son or daughter, it cannot be concluded that a foster child would not be a dependent of the taxpayer but for section 152(a)(9). Thus, section 2(b)(3)(B)(i) does not disqualify a taxpayer for head of household status on account of a dependent foster child. Rather, a dependent foster child does qualify a taxpayer for head of household status under section 2(b)(1)(A)(ii) of the Code.

HOLDING

Because the foster child is a dependent of *A*, *A* qualifies for head of household status under section 2(b)(1)(A)(ii) of the Code. However, if the foster child were not a dependent of *A*, *A* would not qualify for head of household status since there is no provision comparable to section 152(b)(2) that would qualify *A* for head of household status under section 2(b)(1)(A)(i).

Part IV.—Credits Against Tax
Subpart A.—Credits Allowable

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.

Whether a taxpayer who acquires a nonexclusive right to use a master tape sound recording is entitled to claim an investment tax credit with respect to the master tape sound recording. See Rev. Rul. 84-4, page 19.

Section 41.—Contributions to Candidates for Public Office

26 CFR 1.41-1: Credit or deduction for political and newsletter fund contributions-definitions of certain items.

Political contributions; public announcement. The filing of Federal Election Commission Form 2 or a letter containing the information required on Form 2 qualifies as a pub-

lic announcement for purposes of the credit allowed by section 41 of the Code.

Rev. Rul. 84-59

ISSUE

Does the filing of Federal Election Commission (FEC) Form 2 or a letter containing the information required on Form 2 qualify as a public announcement for purposes of the credit allowed by section 41 of the Internal Revenue Code for certain political contributions?

LAW

Section 41 of the Code provides that an individual who makes a contribution or gift of money to a candidate for public office is allowed an income tax credit of one-half of the contribution, up to a maximum of $50 ($100 in the case of a joint return).

Section 41(c)(2)(A) of the Code defines the term "candidate," in part, as an individual who "publicly announces" before the close of the calendar year following the calendar year in which the contribution or gift is made that he or she is a candidate for nomination or election to a federal, state, or local elective public office.

Section 1.41-1(h) of the Income Tax Regulations states that an individual "pubicly announces" that he or she is a candidate by making a positive statement available for media distribution that he or she is seeking nomination or election to a specific elective public office.

Section 432(e)(1) of title 2 U.S.C. (1982) requires that each candidate for federal office (other than the nominee for the office of Vice President) shall designate in writing within 15 days after becoming a candidate, a political committee to serve as the candidate's principal campaign committee. Under 11 CFR section 101.1 (1980), a candidate shall designate his or her principal campaign committee by filing a Statement of Candidacy on FEC Form 2 or by filing a letter containing the information required on Form 2 (the individual's name and address, party affiliation and office sought, the district and state in which federal office is sought, and the name and address of his or her principal campaign committee). The form or letter must be filed in accordance with 11 CFR section 100.19, in the place of filing specified in 11 CFR Part 105. Form 2 or a letter of designation must be made available for public inspection, under the provisions of 2 U.S.C. sections 432(g)(5) and 438(a)(4), within 48 hours after it is filed.

HOLDING

The filing of FEC Form 2 or a letter containing the information required on Form 2 meets the public announcement requirement of section 41(c)(2)(A) of the Code and section 1.41-1(h) of the regulations for purposes of the credit allowed by section 41.

Section 44A.—Expenses for Household and Dependent Care Services Necessary for Gainful Employment

26 CFR 1.44A-1: Expenses for household and dependent care services necessary for gainful employment.

T.D. 7951

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Credit for expenses for household and dependent care services necessary for gainful employment

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the credit for expenses for household and dependent care services necessary for gainful employment. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations provide the public with the guidance needed to comply with the changes to the credit made by the Act.

EFFECTIVE DATE: The amendments are effective for taxable years beginning on or after January 1, 1982.

FOR FURTHER INFORMATION CONTACT: Nerman Dobynes Hubbard of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 8, 1983, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 44A of the Internal Revenue Code of 1954 (48 FR 40528) [LR-214-81, 1983-2 C.B. 728]. The notice of proposed rulemaking published on September 8, 1983 was corrected by a correction notice published in the FEDERAL REGISTER for October 18, 1983 (48 FR 48255). These amendments were proposed to conform the regulations to changes made by section 124(a) through (d) and (f) of the Economic Recovery Tax Act of 1981 (Pub. Law 97-34) [1981-2 C.B. 256]. No public hearing on the proposed amendments was requested and, accordingly, none was held. After consideration of all comments regarding the proposed amendments, those amendments are adopted without change by this Treasury decision. The amendments to the regulations create no new recordkeeping or reporting requirements. Evaluation of the effectiveness of the regulations after issuance will be based on comments received from offices within the Internal Revenue Service, the Treasury Department, other governmental agencies, state and local governments, and the public.

In general, the amendments reflect the modification to section 44A made by the Economic Recovery Tax Act of 1981. The 1981 Act increases the credit from 20% of the employment-related expenses paid by a taxpayer in order to be gainfully employed to 30% of the employment-related expenses for a taxpayer whose adjusted gross income is $10,000 or less, phasing down to 20% where the adjusted gross income is above $28,000. The employment-related expenses on which the credit is based is increased from $2,000 to $2,400 for the care of one qualifying individual and from $4,000 to $4,800 if more than one qualifying individual is involved.

The Act also provides that a taxpayer may take into account employment-related expenses incurred outside the taxpayer's household for the care of a physically or mentally incapacitated dependent (age 15 or over) or spouse of the taxpayer who regularly spends at least eight hours each day in the taxpayer's household. Payment for services provided outside the taxpayer's household for a qualifying individual by a dependent care center are to be taken into account as employment-related expenses only if the center complies with all applicable State and local laws and regulations. A dependent care center is any facility which provides care for more than six individuals (other than residents) and receives a fee, payment, or grant for providing services for any of the individuals. The regulations provide, in general, that in order for a facility to be considered a dependent care center the care provided by the facility for more than six individuals must be on a regular basis during the taxpayer's taxable year. A rebuttable presumption is created when the center has six or less individuals (including the qualifying individual) enrolled on the day the qualifying individual enrolls in the center.

Finally, the Act increases the amount of income deemed to be earned by the taxpayer's spouse who is a full-time student or incapable of self-care from $166 to $200 per month if there is one qualifying individual and from $333 to $400 per month if there is more than one qualifying individual.

PUBLIC COMMENTS

One comment objected to the use of a taxpayer's adjusted gross income as a means of determining the applicable percentage of employment-related expenses to be taken into account for purposes of calculating the allowable credit. It was suggested that the applicable percentage be based on the lesser of the taxpayer's or spouse's earned income. Since the use of adjusted gross income is prescribed by the Code, the regulations cannot be amended in the manner suggested in the comment.

Another comment suggested that the ceiling on employment-related expenses on which the credit is based be changed from $2,400 for one qualifying individual and $4,800 for two or more qualifying individuals to $2,400 for each and every qualifying individual. This suggestion was not adopted because section 44A(d) of the Code specifies the maximum amount of employment-related expenses which may be taken into account for purposes of the credit.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that a Regulatory Impact Analysis under Executive Order 12291 is not required because this final rule is not a major legislative rule within the meaning of the April 29, 1983 agreement between the Treasury Department and OMB. The Internal Revenue Service has concluded that the final regulations contained herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these final regulations is Nerman Dobynes Hubbard of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 1.44A-1 is amended by revising paragraph (a)(2), by revising paragraph (c)(4), by redesignating subparagraphs (5) and (6) of paragraph (c) as subparagraphs (6) and (7), respectively, and inserting a new subparagraph (5), to read as follows:

§1.44A-1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.****

(2) Section 44A allows a credit against the tax imposed by chapter 1 of the Code to an individual who maintains a household (within the meaning of paragraph (d) of this section) which includes as a member one or more qualifying individuals (as defined in paragraph (b) of this section). The amount of the credit is equal to the applicable percentage of the employment-related expenses (as defined in paragraph (c) of this section) paid by the individual during the taxable year (but subject to the limits prescribed in §1.44A-2(a)). However, the credit cannot exceed the tax imposed by chapter 1, reduced by the sum of the allowable credits enumerated in section 44A(b). The term "applicable percentage" means 30 percent reduced by 1 percentage point for each $2,000 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds $10,000, but in no event shall the percent be less than 20 percent. Thus, for example, if a taxpayer's adjusted gross income is over $10,000, but less than $12,000.01, the applicable percentage is 29 percent. (For

expenses incurred in taxable years beginning before January 1, 1982, the applicable percentage is a flat 20 percent).

* * * * *

(c) *Employment-related expenses.* ***

(4) *Services outside the taxpayer's household.* The credit is allowed under section 44A with respect to employment-related expenses incurred for services performed outside the taxpayer's household only if those expenses are incurred for the care of—

(i) One or more qualifying individuals who are described in paragraph (b)(1)(i) of this section; or

(ii) One or more qualifying individuals (as to expenses incurred for taxable years beginning after December 31, 1981) who are described in paragraph (b)(1)(ii) or (iii) of this section and who regularly spend at least 8 hours each day in the taxpayer's household.

(5) *Dependent care centers.* The credit is allowed under section 44A with respect to employment-related expenses incurred in taxable years beginning after December 31, 1981, for services provided outside the taxpayer's household by a dependent care center only if—

(i) The center complies with all applicable laws and regulations of a State or unit of local government (*e.g.*, State or local requirements for licensing, if applicable, and building and fire Code regulations); and

(ii) The requirement provided in paragraph (c)(4)(i) or (ii) of this section is met.

The term "dependent care center" means any facility that provides full-time or part-time care for more than six individuals (other than residents of the facility) on a regular basis during the taxpayer's taxable year, and receives a fee, payment, or grant for providing services for any such individuals (regardless of whether such facility is operated for profit). For purposes of the preceding sentence, a facility will be presumed to provide full-time or part-time care for six or less individuals on a regular basis during the taxpayer's taxable year if the facility has six or less individuals (including the qualifying individual) enrolled for full-time or part-time care on the day the qualifying individual is enrolled in the facility (or on the first day of the taxable year the qualifying individual attends the facility in the case where the individual was enrolled in the facility in the preceding taxable year) unless the Internal Revenue Service demonstrates that the facility provides full-time or part-time care for more than six individuals on a regular basis during the taxpayer's taxable year.

(6) *Allocation of expenses.* ***

(7) *Illustrations.* ***

* * * * *

Par. 2. Section 1.44A-2 is amended by revising paragraph (a) and by revising subparagraphs (3)(i) and (4) of paragraph (b) to read as follows:

§1.44A-2 Limitations on amount creditable.

(a) *Annual dollar limit on amount creditable.* The amount of the employment-related expenses incurred during any taxable year which may be taken into account under §1.44A-1(a) cannot exceed—

(1) $2,400 ($2,000 in the case of expenses incurred in taxable years beginning before January 1, 1982) if there is one qualifying individual with respect to the taxpayer at any time during the taxable year, or

(2) $4,800 ($4,000 in the case of expenses incurred in taxable years beginning before January 1, 1982) if there are two or more qualifying individuals with respect to the taxpayer at any one time during the taxable year.

For example, a calendar year taxpayer whose only qualifying individual reaches age 15 on April 1, 1982, is subject for 1982 to the entire annual dollar limit of $2,400, without proration of the $2,400 limit. However, only expenses incurred prior to the child's 15th birthday may be employment-related expenses.

(b) *Earned income limitation.* ***

(3) *Special rule for spouse who is a student or incapable of self-care.* (i) For purposes of this section, a spouse is deemed for each month during which the spouse is a full-time student or is a qualifying individual described in §1.44A-1(b)(1)(iii), to be gainfully employed and to have earned income of not less than—

(A) $200 ($166 for taxable years beginning before January 1, 1982) if there is one qualifying individual with respect to the taxpayer at any one time during the taxable year, or

(B) $400 ($333 for taxable years beginning before January 1, 1982) if there are two or more qualifying individuals with respect to the taxpayer at any one time during the taxable year.

However, in the case of any husband and wife, this subparagraph shall apply with respect to only one spouse for any one month.

* * * * *

(4) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example (1). During the 1982 taxable year, A, a married taxpayer, incurs and pays employment-related expenses of $4,000 for the care of a qualifying individual. A's earned income for the taxable year is $20,000 and his wife's earned income is $1,500. Under these circumstances, the amount of employment-related expenses for the year which may be taken into account under §1.44A-1(a) is $1,500, determined as follows:

Employment-related expenses incurred during taxable year ($4,000, but limited to $2,400 by paragraph (a)(1) of this section) $2,400
Application of paragraph (b)(1)(ii) of this section (employment-related expenses may not exceed wife's earned income of $1,500) $1,500
Employment-related expenses taken into account $1,500

Example (2). Assume the same facts as in example (1) except that A's wife is a full-time student for nine months of the taxable year and earns no income for the year. Under these circumstances, the amount of employment-related expenses for the year which may be taken into account under §1.44A-1(a) is $1,800, determined as follows:

Employment-related expenses incurred during taxable year ($4,000, but limited to $2,400 by paragraph (a)(1) of this section) $2,400
Application of paragraph (b)(3) of this section [employment-related expenses may not exceed wife's earned income of $1,800 (200 × 9)] $1,800
Employment-related expenses taken into account $1,800

Par. 3. Paragraph (b) of §1.44A-4 is amended by revising examples (1) and (3) to read as follows:

§1.44A-4 Other special rules relating to employment-related expenses.

* * * * *

(b) *Expenses qualifying as medical expenses.* ***

Example (1). In 1982, a calendar year taxpayer incurs and pays $5,000 of employment-related expenses during the taxable year for the care of his child when the child is physically incapable of self-care. These expenses are incurred for services performed in the taxpayer's household and are of a nature which qualify as medical expenses under section 213. The taxpayer's adjusted gross income for the taxable year is $100,000. Of the total expenses, the taxpayer may take $2,400 into account under section 44A; the balance of the expenses, or $2,600, may be treated as medical expenses to which section 213 applies. However, this amount does not exceed 3 percent of the taxpayer's adjusted gross income for the taxable year and is thus not allowable as a deduction under section 213.

* * * * *

Example (3). In 1982, a calendar year taxpayer incurs and pays $12,000 of employment-related expenses during the taxable year for the care of his child. These expenses are incurred for services performed in the taxpayer's household, and they also qualify as medical expenses under section 213. The taxpayer's adjusted gross income for the taxable year is $18,000. The taxpayer takes $2,400 of such expenses into account under section 44A. The balance, or $9,600, he treats as medical expenses for purposes of section 213. The allowable deduction under section 213 for the expenses is limited to the excess of the balance of $9,600 over $540 (3 percent of the taxpayer's adjusted gross income of $18,000), or $9,060.

(This Treasury decision is issued under the authority contained in section 44A(g) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1565, 26 U.S.C. 44A(g); 68A Stat. 917, 26 U.S.C. 7805).)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved March 13, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 26, 1984, 8:45 a.m., and published in the issue of the Federal Register for April 27, 1984, 49 F.R. 18090)

Section 44C.—Residential Energy Credit

26 CFR 1.44C-2: Definitions.

Residential energy credit; passive solar system. Passive solar heating system components, whose sole purpose is to use or transmit solar radiation, qualify for the residential energy credit; other parts with a dual function do not qualify for the credit.

Rev. Rul. 84-34

ISSUE

What components of the passive solar heating system described below qualify for the residential energy credit.

FACTS

The taxpayer builds a lean-to addition onto the taxpayer's principal residence. The lean-to addition is a glass and metal enclosure (solarium) approximately 15 feet long, 8 feet wide and 8 feet high, with a sloping glass roof that attaches to the south wall of the dwelling. The first floor of the dwelling is approximately 3 feet above grade level and the floor of the solarium is constructed at the same level. To support both the solarium floor and its structure, a concrete foundation is built on the three sides. The floor of the solarium is covered with a dark colored ceramic tile. The space under the floor is converted into a heat storage area being completely lined with 2-inch thick rigid insulation and containing barrels filled with water. A duct has been provided to allow warm air from the storage area to flow through the wall of the original dwelling into the basement. This duct is equipped with a damper to regulate the flow of air and is connected to the return air pleum of the conventionally fueled house furnace. A sliding glass patio door is located between the residence and the solarium. An air louver is also installed in the original house wall into the solarium to allow cooler air to return to the solarium. All the glass areas of the solarium can be shaded by close fitting roll-up movable insulation. Grates in the solarium floor are connected to the ducts. The solarium also has closable vents in the walls near the floor and in the roof for ventilation. The dampers and vents are thermostatically controlled so that air can flow from the solarium into the heat storage area and back into the solarium, or from the solarium through the heat storage area and into the conventional heat distribution duct system of the house and back into the solarium. The solarium heating system can also be disconnected from the house duct system and directly ventilated to and from the outside.

The solarium is furnished with patio type chairs, a table and plants for decoration. The room is sometimes used as a sitting room.

LAW AND ANALYSIS

Section 1.44C-2(f)(3) of the Income Tax Regulations provides that in order to qualify as a passive solar heating system the system must contain all of the following: a solar collection area, an absorber, a storage mass, a heat distribution method, and heat regulation devices. A solar collection area is an expanse of transparent or translucent material that is positioned in such a manner that rays of the sun directly strike the absorber. An absorber is a surface such as a floor which converts solar radiation into heat and transfers the heat to a storage mass. A storage mass is material that receives and holds heat from the absorber and later releases heat to the interior of the dwelling. The storage mass must be located so that it is capable of distributing the stored heat directly to the habitable areas of the dwelling through a heat distribution method. The heat distribution method allows the release of heat by radiation or convection from the storage mass through airflow paths by openings or ducts to the habitable areas of the dwelling. Heat regulation devices are shading or venting mechanisms, to control the amount of solar heat admitted through solar collection areas and nighttime insulation to control the amount of heat permitted to escape.

Section 1.44C-2(f)(4) of the regulations provides that to the extent that a passive or active solar system utilizes portions of the structure of a residence, only materials and components whose sole purpose is to transmit or use solar radiation are included within the term "solar energy proper-

ty". Accordingly, materials and components that serve a dual purpose, e.g. are structural components of the dwelling, are not included in the term "solar energy property". For example, windows (including clerestories and skylights) and greenhouses do not qualify as solar energy property. Any shading, venting and heat distribution mechanisms or storage systems that do not have a dual function will qualify.

In order for any part of a passive solar heating system to qualify, the system must have the five features enumerated in section 1.44C-2(f)(3) of the regulations. The glass in the lean-to structure constitutes the solar collection area; the ceramic tile floor is an absorber, the barrels of water under the floor are the heat mass, the grates, ducts, louvers and thermostatic controls are part of the heat distribution system; the movable insulation and the vents in the walls and roof of the solarium are heat regulation devices. Thus, the system installed by the taxpayer meets the definition of a passive solar heating system and those parts that do not have a dual function are eligible for the residential energy credit.

Because the lean-to solarium adds a usable habitable area to the house, it is considered a dual function device, being both a part of the solar system and a structural component of the dwelling. Thus, the concrete foundation, all the glass area, which are windows or skylights, the rest of the structural parts of the lean-to, the floor including the ceramic tile, and the sliding patio door are all structural components of the dwelling that do not qualify because they have a dual function.

However, other parts of the passive solar heating system whose sole purpose is to transmit or use solar radiation do qualify. These parts consist of the water barrels in the heat storage area, the insulation for the heat storage area, louvers and grates, thermostatic controls, all duct work to the point it meets the conventional house duct work, and the special movable insulation for the glass area.

HOLDING

The system described is a passive solar heating system as defined in section 1.44C-2(f)(3) of the regulations. Parts of such a system whose sole purpose is that of transmitting or using solar radiation qualify for the residential energy credit. Other parts that have a dual function do not qualify for the credit even though they are required to meet the definition of such a system.

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26 CFR 1.44C-2: Definitions.

Residential energy credit; installation of leased solar hot water system. The cost of the installation of a leased solar domestic hot water system does not qualify for the residential energy credit under section 44C of the Code.

Rev. Rul. 84-63

ISSUE

Is a taxpayer eligible for the residential energy credit on an expenditure for the installation of a solar domestic hot water system that the taxpayer leases?

FACTS

The taxpayer leases a solar domestic hot water heater from Company *A*. In addition to the normal monthly lease payments, Company *A* charged the taxpayer a fee of $50*x* for installing the equipment.

LAW AND ANALYSIS

Section 44C(a) of the Code allows a residential energy credit for qualified renewable energy source expenditures.

Section 1.44C-2(b) of the Income Tax Regulations provides that the term renewable energy source expenditures means an expenditure made by a taxpayer for renewable energy source property (as defined in section 1.44C-2(e)), or for labor costs properly allocable to the onsite preparation, assembly or original installation of such property. The term renewable energy source expenditures does not include the cost of maintenance of an installed system or the cost of leasing renewable energy source property.

Section 1.44C-2(e)(1) of the regulations defines the term "renewable energy source property" to include solar energy property.

Section 1.44C-2(f)(1) of the regulations provides that the term "solar energy property" means equipment and materials of a solar energy system (and parts solely related to the functioning of such equipment) that when installed in connection with a building transmits or uses solar energy to heat or cool the dwelling or provide hot water for use within a dwelling.

A solar domestic hot water system is renewable energy source property as defined in section 1.44C-2(e) of the regulations. The cost of leasing renewable energy source property is not a renewable energy source expenditure under section 1.44C-2(b). Installation costs are only allowed if properly allocable to the renewable energy property. The installation costs, however, must be incurred by the taxpayer in connection with property that qualifies for the credit. Because the leased renewable energy source property does not qualify for the credit, any installation costs associated with the leased property also do not qualify for the credit.

HOLDING

The taxpayer is not eligible for the residential energy credit on an expenditure for the installation of a solar domestic hot water system that the taxpayer leases.

Subpart B.—Rules for Computing Credit for Investment in Certain Depreciable Property

Section 46.—Amount of Credit

26 CFR 1.46-3: Qualified investment.

Investment credit; first placed in service; solid waste disposal facility. A solid waste disposal facility was first placed in service for investment credit purposes on the date it became operational, although it was

not able to operate at its rated capacity. Rev. Rul. 79-98 clarified.

Rev. Rul. 84-85

ISSUE

Has the facility described below been "placed in service" within the meaning of section 1.46-3(d) of the Income Tax Regulations even though it is not able to operate at its rated capacity?

FACTS

X, a corporation, constructed a solid waste disposal facility to produce energy from solid waste. The facility is designed to (1) shred the solid waste to a uniform size; (2) separate the combustible materials in the shredded waste from the non-combustible materials; (3) separate, magnetically, the ferrous metal from the non-combustible waste (for recycling); and (4) use the combustible materials as boiler fuel for the production of steam. Steam is sold to *P* for distribution through *P*'s existing steam distribution system.

Soon after construction was completed in early 1981, start-up of the facility began. In April, all the boilers of the facility, which are designed primarily to burn the fuel derived from solid waste but are equipped to burn fuel oil, began producing steam, which *X* delivered to *P*'s distribution system. The initial production was from fuel oil. *X* began shredding solid waste in June, and one of the three boilers was first fired on the fuel derived from waste in July. The first steam produced from solid waste was supplied to *P* on August 20. As of September 30, 1981, all components of the facility were, or had been, in operation, and the facility was producing saleable steam. The facility was experiencing operational problems, however, and was processing solid waste and producing steam at well below its rated capacity.

LAW AND ANALYSIS

Section 38 of the Code allows a credit against federal income tax for qualified investment in section 38 property, and under section 46(c) the credit is allowable in any taxable year in which new or used section 38 property is placed in service.

Section 1.46-3(d)(1) of the Income Tax Regulations provides that for purposes of the investment tax credit, property shall be considered placed in service in the earlier of the following taxable years: (i) the taxable year in which, under the taxpayer's depreciation practice, the period for depreciation with respect to such property begins; or (ii) the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function.

Section 1.46-3(d)(2)(iii) of the regulations provides that equipment acquired by a taxpayer for a specifically assigned function in a taxpayer's trade or business that is operational but is undergoing testing to eliminate any defects is considered to be in a condition or state of readiness and availability for a specifically assigned function.

Rev. Rul. 76-256, 1976-2 C.B. 46, states that a coalfired electric generating unit was in a condition or state of readiness or availability for a specifically assigned function when the necessary permits and licenses had been approved, the critical tests for the various components were completed, synchronization was achieved, and daily operation of the unit had begun, notwithstanding that the generating unit would undergo further testing to eliminate any defects.

Similarly, Rev. Rul. 76-428, 1976-2 C.B. 47, states that a nuclear electric generating unit was fully operational and "placed in service" on December 23, 1975, even though it was still undergoing testing to eliminate any defects and to demonstrate reliability.

Rev. Rul. 79-98, 1979-1 C.B. 103, states that a nuclear electric generating unit was placed in service on the date it became operational, rather than the date the taxpayer formally accepted the unit from the contractor. Although the revenue ruling states that the unit was able to operate at its rated capacity without failure, this fact is not considered to be a prerequisite for operational status; consistent with Rev. Ruls. 76-256 and 76-428, it is only a fact demonstrative of operational status.

In this case, all three boiler units of the facility were producing steam from processed waste as of September 30, 1981. Although the facility was experiencing operational problems and was not able to operate at its rated capacity, it was being operated on a regular basis and saleable steam was being produced. Thus, the facility was operational on September 30, 1981.

HOLDING

The recovery property that makes up the subject facility was placed in service for investment credit purposes by September 30, 1981.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-98, 1979-1 C.B. 103, is clarified. The determination of when a facility is placed in service is not necessarily dependent on whether the facility is able to operate at its rated capacity.

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26 CFR 1.46-4: Limitations with respect to certain persons.

Limitations on the amount of credit in the case of regulated investment companies and real estate investment trusts. See T.D. 7936, page 162.

Section 48.—Definitions, Special Rules

26 CFR 1.48-1: Definition of section 38 property.

Investment credit; privately-owned dam used in the production of electricity for a manufacturing operation. The reconstructed portion of a dam that provides water pressure for the generation of hydroelectric power that is used to operate machinery in taxpayer's textile manufacturing mill is "section 38 property."

Rev. Rul. 84-40

ISSUE

Whether the reconstructed portion of a dam that provides water pressure for the generation of hydroelectric power that is used to operate machinery in taxpayer's textile manufacturing mill is "section 38 property" within the meaning of section 48(a)(1)(B) of the Internal Revenue Code.

FACTS

The taxpayer is in the business of manufacturing various types of cloth fabrics. The textile mill is located adjacent to a river over which a dam has been constructed to provide water pressure for the production of hydroelectric power. The hydroelectric generating equipment is owned by the taxpayer and was installed to generate electricity for the textile machinery used in the manufacturing activity. A portion of the dam was washed out by a sudden rise in the water level due to heavy spring rains and the rapid melting of snow and ice. In the same taxable year, the taxpayer rebuilt the dam. While the dam was being rebuilt, the mill was run entirely on power purchased from the local utility. The qualification of the capitalized cost of reconstructing the dam for the investment tax credit is the subject matter of this ruling.

LAW AND ANALYSIS

Section 38 of the Code allows a credit against Federal income tax for qualified investment in "section 38 property". The determination of what property qualifies as "section 38 property" is made in accordance with section 48.

Section 48(a)(1) of the Code defines the term "section 38 property" to include (A) "tangible personal property" and (B) "other tangible property" (not including a building and its structural components) used as an integral part of manufacturing, production or other specified activities. The term "section 38 property" includes recovery property (within the meaning of section 168 without regard to any useful life) and any other property with respect to which depreciation is allowable and having a useful life determined at the time such property is placed in service of 3 years or more.

Section 1.48-1(c) of the Income Tax Regulations provides that the term "tangible personal property" means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures. The term includes all property (other than structural components) which is contained in or attached to a building and all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structure) even though located outside a building.

Section 1.48-1(d)(1) of the Income Tax Regulations provides that other tangible property (but not including a building and its structural components) used as an integral part of manufacturing, production, or extraction, or used as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing such service may qualify as section 38 property.

Section 1-48-1(d)(2) of the regulations defines the terms "manufacturing", and "production" for purposes of the credit allowed by section 38. Section 38 property would include, for example, property used as an integral part of the fabrication or treatment of textiles.

Section 1.48-1(d)(4) of the regulations provides that property is used as an integral part of one of the specified activities if it is used directly in the activity and is essential to the completeness of the activity. Thus, for example, in determining whether property is used as an integral part of manufacturing, all properties used by the taxpayer in acquiring or transporting raw materials or supplies to the point where the actual processing commences (such as docks, railroad tracks, and bridges), or in processing raw materials into the taxpayer's final product, would be considered property used as an integral part of manufacturing.

Rev. Rul. 81-120, 1981-1 C.B. 20, concludes that a deep well constructed as part of a disposal system for liquid waste generated by an acid production process is used as an integral part of the manufacturing activity within the meaning of section 1.48-1(d)(4) of the regulations. Even though the waste products discharged into the deep well are not reused, the well is essential to the manufacturing process and used directly in the activity.

Rev. Rul. 73-420, 1973-2 C.B. 9, concludes that tailings disposal dams, constructed by a mining company to dispose of waste materials from its concentrator, qualify as "section 38 property" because they are an integral part of taxpayer's mineral extraction activity. When filled, the dams will be abandoned.

Rev. Rul. 72-96, 1972-1 C.B. 67, concludes that a reservoir, including a dam structure, roadway, and preparation of the reservoir site, constructed by an electric utility for use with a steam turbine generating plant is depreciable and is "other tangible property" for investment credit purposes.

Rev. Rul. 71-555, 1971-2 C.B. 65, concludes that roadways within a manufacturing complex that are devoted solely to truck traffic and those used regularly by trucks in transporting raw materials, supplies, and finished and semi-finished products, are used directly in, and are essential to, the completeness of the taxpayer's manufacturing activity and therefore, qualify, as "section 38 property." However, roadways that provide solely for employee and visitor vehicle traffic are not an integral part of the manufacturing activity and do not qualify.

Taxpayer's dam qualifies as section 38 property if it is other tangible property used as an integral part of manufacturing or production under section 48(a)(1)(B)(i) of the Code and section 1.48-1(d) of the regulations. Docks, railroad tracks, bridges (sec-

tion 1.48-1(d)(4)), roadways (Rev. Rul. 71-555), tailings disposal dams (Rev. Rul. 73-420), and deep wells (Rev. Rul. 81-120) are viewed as integral parts of a qualifying activity when used in the manner described. Although other alternatives may have been available to taxpayers in the situations described above, qualification of the property as "section 38 property" is dependent solely upon whether the property is an integral part of the described activity. In each situation, the test is whether the property is used directly in the activity and essential to the manufacturing process.

Here, the hydroelectric power generated by the dam provided the electricity used to operate the textile machinery. The taxpayer's final product was dependent on a proximate, dependable and uninterrupted source of electricity, and the dam was constructed specifically to be used in the textile manufacturing process. The dam was used directly in the manufacturing activity and was essential to its completeness. Thus, taxpayer's dam is an integral part of the textile manufacturing activity.

HOLDING

The reconstructed portion of a dam that provides water pressure for the generation of hydroelectric power that is used to operate machinery in taxpayer's textile manufacturing mill is "section 38 property" within the meaning of section 48(a)(1)(B) of the Internal Revenue Code.

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; structures used for storage; reasonably adapted to other uses. A structure that is used for the bulk storage of a fungible commodity, but can be reasonably adapted to other uses, is a building and is not section 38 property. Rev. Rul. 71-359 modified.

Rev. Rul. 84-60

ISSUE

Is a structure that is constructed and used for the bulk storage of a fungible commodity but that can be reasonably adapted to other uses section 38 property for purposes of the investment tax credit?

FACTS

The taxpayer's structure, which was constructed for the storage of grain, is 200 feet long and 70 feet wide, with two large sliding doors at each end. The structure encloses a flat, unobstructed concrete floor. The side walls are reinforced concrete from the base to a height of 5 feet with steel siding extending 22 feet from the top of the concrete to the roof. A beam is in place under the roof to support a device used to unload the grain. The taxpayer uses the structure in connection with the cultivation of the soil for the bulk storage of grain. Although the structure can be reasonably adapted to other uses, the taxpayer does not plan to change the use of the structure at this time. The structure is recovery property as described in section 168(c) of the Internal Revenue Code and was placed in service in 1981.

LAW AND ANALYSIS

Section 38 of the Internal Revenue Code of 1954 allows a credit against Federal income tax for qualified investment in section 38 property. The determination of what qualifies as section 38 property is made in accordance with the rules provided in section 48.

Section 48(a)(1)(B) of the Code defines section 38 property to include other tangible property (not including a building and its structural components) if the property is used in connection with a qualifying activity for the bulk storage of fungible commodities.

Section 1.48-1(d)(1) of the Income Tax Regulations provides, in part, that in addition to "tangible personal property," any other tangible property (but not including a building or its structural components) that constitutes a research or a storage facility, used in connection with any of the activities specified therein, may qualify as section 38 property.

Section 1.48-1(d)(5)(i) of the regulations states that if property (other than a building and its structural components) constitutes a research or storage facility and if it is used in connection with a qualifying activity, such property may qualify as section 38 property even though it is not used as an integral part of such activity. Examples of storage facilities include oil and gas tanks and grain storage bins.

Section 1.48-1(e)(1) of the regulations provides that buildings and structural components thereof do not qualify as section 38 property and defines the term "building" generally as a structure or edifice enclosing a space within its walls and usually covered by a roof, the purpose of which is to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term "building" includes such structures as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores.

Rev. Rul. 66-89, 1966-1 C.B. 7, gives examples of farm improvements that may qualify as section 38 property. Example 5 concerns storage facilities and states that if property (other than a building and its structural components) is a storage facility used in farming such as the cultivation of the soil or the raising of livestock and if the facility cannot be reasonably adapted to other uses, it qualifies as "other tangible property" within the meaning of section 48(a)(1) of the Internal Revenue Code, regardless of whether it is a temporary or a permanent facility. The ruling states that typical storage facilities on farms include grain storage bins, corn cribs and silos and that such structures are to be distinguished from farm buildings that do not qualify as section 38 property, such as barns, stables, etc.

In *Monk & Co., Inc. v. United States*, 686 F.2d 1058 (4th Cir. 1982), taxpayer, a tobacco exporter, built a plant in which to store and process tobacco. Included in the plant was a

large green storage room used to recieve, re-grade, and store tobacco. In claiming an investment credit for the cost of the structure attributable to the storage room, taxpayer argued that the green room did not function as a building but rather was a facility for the bulk storage of fungible commodities and was thus eligible for the credit under section 48(a)(1)(B)(iii). The court found that first a determination must be made whether the structure is a building. The court stated that to resolve the question whether a structure is a building or a storage facility it is appropriate to focus on whether the structure provides alternate uses. If a structure can only be used to store one type of commodity and has no other feasible use, it does not function as a building. Applying that test, the court concluded that taxpayer's structure was ineligible for the credit because the room was adaptable to other uses.

Section 48(a)(1)(B) of the Code permits a structure to qualify as section 38 property if it is not a building and constitutes a facility used in connection with a qualifying activity for the bulk storage of a fungible commodity. Section 1.48-1(e)(1) of the regulations defines the term "building" and states that buildings do not qualify as section 38 property.

Whether a structure is reasonably adaptable to other uses is determined, on a case-by-case basis, by the degree of specialization of the structure, by the amounts of space available for alternative uses, the economic cost required to convert the facility from one use to another, and the feasibility of other uses. The structure in the instant case has a floor, walls, is covered by a roof and has the appearance of a building. It can be used to store more than one type of commodity, or can be adapted to other uses. Therefore, the structure is a building and does not qualify for the investment tax credit.

HOLDING

The structure, which is used for the bulk storage of a fungible commodity but can be reasonably adapted to other uses, is a building and is not "section 38 property."

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 71-359, 1971-2 C.B. 61, concludes that certain peanut storage facilities qualify for the investment tax credit even though the taxapyer was not engaged in the business of growing peanuts. No mention is made of the requirement that the facilities cannot be reasonably adaptable to other uses.

Rev. Rul. 71-359 is modified to state that the structures described in the revenue ruling will qualify as section 38 property only if they cannot be reasonably adapted to other uses.

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26 CFR 1.48-1: Definition of section 38 property.

T.D. 7927

TITLE 26.—INTERNAL REVENUE CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amortization of Reforestation Expenditures

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to an election under which taxpayers may amortize up to $10,000 of qualified reforestation expenditures over a seven-year period. Changes to the applicable tax law were made by the Recreational Boating Safety and Facilities Improvement Act of 1980 [Pub. L. 96-451, 1980-2 C.B. 485] and the Subchapter S Revision Act of 1982 [Pub. L. 97-354, 1982-2 C.B. 702]. These regulations provide guidance to taxpayers who make expenditures to pay for planting or seeding areas for forestation or reforestation purposes. In addition, a clerical change is being made to the regulations under section 121 of the Internal Revenue Code of 1954 (Code), relating to the exclusion of gain on the sale of a personal residence.

DATES: Generally, the regulations are effective for qualifying reforestation expenditures added to capital accounts after December 31, 1979. The amendments made by the Subchapter S Revision Act of 1982 are effective for taxable years beginning after December 31, 1982.

FOR FURTHER INFORMATION CONTACT: Robert B. Coplan of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention CC:LR:T) 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

On March 15, 1983, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 48, 62, 194, and 1245 of the Code (48 FR 10860). The proposed regulations included as a portion thereof, temporary regulations which were published in the Rules and Regulations portion of the same issue of the FEDERAL REGISTER (48 FR 10816). The amendments were proposed to conform the regulations to section 301 of the Recreational Boating Safety and Facilities Improvement Act of 1980 (94 Stat. 1989) [1980-2 C.B. 485, 486]. The amendments contained in this document also conform the regulations to section 3(g)(1) and (2) of the Subchapter S Revision Act of 1982 (96 Stat. 1689) [1982-2 C.B. 702, 712]. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

CHANGES IN REGULATIONS IN RESPONSE TO COMMENTS

The proposed regulations have been clarified in three areas in response to a comment. First, §1.48-1(p) has been clarified to provide that

if a taxpayer incurs more than $10,000 of qualifying reforestation expenditures in connection with more than one qualified timber property, and an election to amortize such costs under section 194 is made, the allocation of the $10,000 limitation among such properties which is selected by the taxpayer under §1.194-2(b)(2) shall be controlling for purposes of determining which expenditures are eligible for the investment credit. Section 1.48-1(p) also provides that if the taxpayer does not elect to amortize reforestation costs under section 194, for purposes of the investment credit, the taxpayer may select the timber properties to which the $10,000 limitation is to be allocated.

Second, §1.46-3(d)(2) is revised to clarify that, for purposes of the investment credit, qualified reforestation expenditures will be considered to be in a condition or state of readiness and availability for a specifically assigned function (*i.e.*, placed in service) in the year in which the expenditures are incurred. This rule will eliminate any question as to when such property is considered to have been placed in service in those cases in which the taxpayer does not elect to amortize costs under section 194.

Finally, the example in §1.245(h)(2) is expanded in the final regulations to clarify how long a taxpayer must wait to dispose of timber property in order to avoid recapturing the amortization deductions claimed under section 194. The example, as revised, provides that amortization deductions attributable to reforestation expenditures incurred in 1981 will not be recaptured under section 1245 so long as the property to which the expenditures are attributable is not disposed of prior to 1992.

S CORPORATIONS

Section 1.194-2(b)(6) of the final regulations clarifies that, for taxable years beginning after December 31, 1982, the rules limiting both a partnership and each partner to $10,000 in amortizable expenditures each year, apply to S Corporations and their shareholders, as well.

CLERICAL AMENDMENT

A clerical amendment is being made to §1.121-4(c) of the regulations (relating to the exclusion of gain on the sale of a residence), in order to provide that the statement filed under such section may be filed with either the Internal Revenue Service Center with which the original election was filed, the Service Center nearest the taxpayer, or the taxpayer's local Internal Revenue office. This liberalizing change conforms the regulations to previously published IRS publications. This change applies to sales or exchanges after July 26, 1978, in taxable years ending after such date.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved at OMB.

DRAFTING INFORMATION

The principal author of this regulation is Robert B. Coplan of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 15b are amended as follows:

Paragraph 1. Section 1.46-3 is amended by adding a new paragraph (d)(2)(iv) immediately after paragraph (d)(2)(iii), thereof, and by revising paragraph (e)(4) to read as follows:

§1.46-3 Qualified Investment.

* * * * *

(d) ***

(2) ***

(iv) Reforestation expenditures (as defined in §1.194-3(c)) are incurred during the taxable year in connection with qualified timber property (as defined in §1.194-3(a)).

* * * * *

(e) *Estimated useful life*—***

(4) *Useful life of property subject to amortization*—(i) *In general.* In the case of property with respect to which amortization in lieu of depreciation is allowable, the term over which amortization deductions are taken shall be considered as the estimated useful life of such property.

(ii) *Qualified timber property.* In the case of qualified timber property (within the meaning of section 194(c)(1)), the normal growing period of such property shall be considered its estimated useful life.

* * * * *

Par. 2. Section 1.48-1 is amended by revising the first sentence of paragraph (b)(1) and by adding a new paragraph (p) in the appropriate place as follows:

§1.48-1 Definition of section 38 property.

* * * * *

(b) *Depreciation allowable.* (1) Property (with the exception of property described in section 48(a)(1)(F) and paragraph (p) of this section) is not section 38 property unless a deduction for depreciation (or amortization in lieu of depreciation) with respect to such property is allowable to the taxpayer for the taxable year. ***

* * * * *

(p) *Qualified timber property.* (1) Qualified timber property (within the meaning of section 194(c)(1)) shall be treated as section 38 property to the extent of the portion of the basis of such property which is the amortizable basis (as defined in §1.194-3(b)) acquired during the taxable year and taken into account under section 194 (after applying the limitation of section 194(b)(1). Such amortizable basis shall qualify as section 38 property whether or not an election is made under section 194. However, any portion of such amortizable basis which is attributable to property which otherwise qualifies as section 38 property shall not be treated as section 38 property under section 48(a)(1)(F) and this paragraph. For example, amortizable basis attributable to depreciation on equipment would not qualify as section 38 property under this paragraph if such equipment qualifies as section 38 property under sections 48(a)(1)(A) or (B). In determining the portion of amortizable basis which qualifies as section 38 property under this paragraph, the reduction in amortizable basis to account for depreciation sustained with respect to property used in the reforestation process (which otherwise qualifies as section 38 property) shall be applied before the $10,000 limitation on eligible costs under section 194(b)(1). For example, if in a taxable year a taxpayer incurs qualifying reforestation costs resulting in $12,000 of amortizable basis with respect to property for which an election is in effect, and $2,000 of these costs are attributable to depreciation of the taxpayer's equipment, such $12,000 would first be reduced by the $2,000 of depreciation, and the $10,000 limitation under section 194(b)(1) would be applied following such reduction.

(2) If a taxpayer makes an election to amortize reforestation expenditures under section 194, and allocates the $10,000 limitation among more than one property under §1.194-2(b)(2), then such allocation shall apply for purposes of determinng the amortizable basis that qualifies as section 38 property under paragraph (p)(1) of this section. If no election is made under section 194, the taxpayer may select the manner in which the $10,000 limitation is to be allocated among the qualified timber properties.

Par. 3. Section 1.62-1(c) is amended by changing the periods at the end of paragraphs (c)(15) and (16) to semicolons, and by adding a new paragraph (c)(17) to read as set forth below:

§1.62-1 Adjusted gross income.

* * * * *

(c) ***

(17) The deduction allowed by section 194 for the amortization of reforestation expenditures.

Par. 4. The third sentence of §1.121-4(c) is amended by removing the phrase "the district director with whom the election was filed", and inserting in lieu thereof, "either the Internal Revenue Service Center with which the election was filed, the Internal Revenue Service Center nearest the taxpayer at the time the statement is filed, or the taxpayer's local Internal Revenue office".

Par. 5. New §§1.194-1 through 1.194-4 are added in the appropriate place to read as follows:

§1.194-1 Amortization of reforestation expenditures.

(a) *In general.* Section 194 allows a taxpayer to elect to amortize over an 84-month period, up to $10,000 of reforestation expenditures (as defined in §1.194-3(c)) incurred by the taxpayer in a taxable year in connection with qualified timber property (as defined in §1.194-3(a)). The election is not available to trusts. Only those reforestation expenditures which result in additions to capital accounts after December 31, 1979 are eligible for this special amortization.

(b) *Determination of amortization period.* The amortization period must begin on the first day of the first month of the last half of the taxable year during which the taxpayer incurs the reforestation expenditures. For example, the 84-month amortization period begins on July 1 of a taxable year for a calendar year taxpayer, regardless of whether the reforestation expenditures are incurred in January or December of that taxable year. Therefore, a taxpayer will be allowed to claim amortization deductions for only six months of each of the first and eighth taxable years of the period over which the reforestation expenditures will be amortized.

(c) *Recapture.* If a taxpayer disposes of qualified timber property within ten years of the year in which the amortizable basis was created and the taxpayer has claimed amortization deductions under section 194, part or all of any gain on the disposition may be recaptured as ordinary income. See section 1245.

§1.194-2 Amount of deduction allowable.

(a) *General rule.* The allowable monthly deduction with respect to reforestation expenditures made in a taxable year is determined by dividing the amount of reforestation expenditures made in such taxable year (after applying the limitations of paragraph (b) of this section) by 84. In order to determine the total allowable amortization deduction for a given month, a taxpayer should add the monthly amortization deductions computed under the preceding sentence for qualifying expenditures made by the taxpayer in the taxable year and the preceding seven taxable years.

(b) *Dollar limitation*—(1) *Maximum amount subject to election.* A taxpayer may elect to amortize up to $10,000 of qualifying reforestation expenditures each year under section 194. However, the maximum amortizable amount is $5,000 in the case of a married individual (as defined in section 143) filing a separate return. No carryover or carryback of expenditures in excess of $10,000 is permitted. The maximum annual amortization deduction for expenditures incurred in any taxable year is $1,428.57 ($10,000/7). The maximum deduction in the first and eighth taxable years of the amortization period is one-half that amount, or $714.29,

because of the half-year convention provided in §1.194-1(b). Total deductions for any one year under this section will reach $10,000 only if a taxpayer incurs and elects to amortize the maximum $10,000 of expenditures each year over an 8-year period.

(2) *Allocation of amortizable basis among taxpayer's timber properties.* The limit of $10,000 on amortizable reforestation expenditures applies to expenditures paid or incurred during a taxable year on all of the taxpayer's timber properties. A taxpayer who incurs more than $10,000 in qualifying expenditures in connection with more than one qualified timber property during a taxable year may select the properties for which section 194 amortization will be elected as well as the manner in which the $10,000 limitation on amortizable basis is allocated among such properties. For example, A incurred $10,000 of qualifying reforestation expenditures on each of four properties in 1981. A may elect under section 194 to amortize $2,500 of the amount spent on each property, $5,000 of the amount spent on any two properties, the entire $10,000 spent on any one property, or A may allocate the $10,000 maximum amortizable basis among some or all of the properties in any other manner.

(3) *Basis*—(i) *In general.* Except as provided in paragraph (b)(3)(ii) of this section, the basis of a taxpayer's interest in qualified timber property for which an election is made under section 194 shall be adjusted to reflect the amount of the section 194 amortization deduction allowable to the taxpayer.

(ii) *Special rule for trusts.* Although a trust may be a partner of a partnership, income beneficiary of an estate, or (for taxable years beginning after December 31, 1982) shareholder of an S corporation, it may not deduct its allocable share of a section 194 amortization deduction allowable to such partnership, estate, or S corporation. In addition, the basis of the interest held by the partnership, estate, or S corporation in the qualified timber property shall not be adjusted to reflect the portion of the section 194 amortization deduction that is allocable to the trust.

(4) *Allocation of amortizable basis among component members of a controlled group.* Component members of a controlled group (as defined in 1.194-3(d)) on a December 31 shall be treated as one taxpayer in applying the $10,000 limitation of paragraph (b)(1) of this section. The amortizable basis may be allocated to any one such member or allocated (for the taxable year of each such member which includes such December 31) among the several members in any manner, provided that the amount of amortizable basis allocated to any member does not exceed the amount of amortizable basis actually acquired by the member in the taxable year. The allocation is to be made (1) by the common parent corporation if a consolidated return is filed for all component members of the group, or (2) in accordance with an agreement entered into by the members of the group if separate returns are filed. If a consolidated return is filed by some component members of the group and separate returns are filed by other component members, then the common parent of the group filing the consolidated return shall enter into an agreement with those members who do not join in filing the consolidated return allocating the amount between the group filing the return and the other component members of the controlled group who do not join in filing the consolidated return. If a consolidated return is filed, the common parent corporation shall file a separate statement attached to the income tax return on which an election is made to amortize reforestation costs under section 194. See §1.194-4. If separate returns are filed by some or all component members of the group, each component member to which is allocated any part of the deduction under section 194 shall file a separate statement attached to the income tax return in which an election is made to amortize reforestation expenditures. See §1.194-4. Such statement shall include the name, address, employer identification number, and the taxable year of each component member of the controlled group, a copy of the allocation agreement signed by persons duly authorized to act on behalf of those members who file separate returns, and a description of the manner in which the deduction under section 194 has been divided among them.

(5) *Partnerships*—(i) *Election to be made by partnership.* A partnership makes the election to amortize qualified reforestation expenditures of the partnership. See section 703(b).

(ii) *Dollar limitations applicable to partnerships.* The dollar limitations of section 194 apply to the partnership as well as to each partner. Thus, a partnership may not elect to amortize more than $10,000 of reforestation expenditures under section 194 in any taxable year.

(iii) *Partner's share of amortizable basis.* Section 704 and the regulations thereunder shall govern the determination of a partner's share of a partnership's amortizable reforestation expenditures for any taxable year.

(iv) *Dollar limitation applicable to partners.* A partner shall in no event be entitled in any taxable year to claim a deduction for amortization based on more than $10,000 ($5,000 in the case of a married taxpayer who files a separate return) of amortizable basis acquired in such taxable year regardless of the source of the amortizable basis. In the case of a partner who is a member of two or more partnerships that elect under section 194, the partner's aggregate share of partnership amortizable basis may not exceed $10,000 or $5,000, whichever is applicable. In the case of a member of a partnership that elects under section 194 who also has separately acquired qualified timber property, the aggregate of the member's partnership and nonpartnership amortizable basis may not exceed $10,000 or $5,000, whichever is applicable.

(6) *S corporations.* For taxable years beginning after December 31, 1982, rules similar to those contained in paragraph (b)(5)(ii) and (iv) of this

section shall apply in the case of S corporations (as defined in section 1361(a)) and their shareholders.

(7) *Estates.* Estates may elect to amortize in each taxable year up to a maximum of $10,000 of qualifying reforestation expenditures under section 194. Any amortizable basis acquired by an estate shall be apportioned between the estate and the income beneficiary on the basis of the income of the estate allocable to each. The amount of amortizable basis apportioned from an estate to a beneficiary shall be taken into account in determining the $10,000 (or $5,000) amount of amortizable basis allowable to such beneficiary under this section.

(c) *Life tenant and remainderman.* If property is held by one person for life with remainder to another person, the life tenant is entitled to the full benefit of any amortization allowable under section 194 on qualifying expenditures he or she makes. Any remainder interest in the property is ignored for this purpose.

Approved by the Office of Management and Budget under control number 1545-0735.

§1.194-3 Definitions.

(a) *Qualified timber property.* The term "qualified timber property" means property located in the United States which will contain trees in significant commercial quantities. The property may be a woodlot or other site but must consist of at least one acre which is planted with tree seedlings in the manner normally used in forestation or reforestation. The property must be held by the taxpayer for the growing and cutting of timber which will either be sold for use in, or used by the taxpayer in, the commercial production of timber products. A taxpayer does not have to own the property in order to be eligible to elect to amortize costs attributable to it under section 194. Thus, a taxpayer may elect to amortize qualifying reforestation expenditures incurred by such taxpayer on leased qualified timber property. Qualified timber property does not include property on which the taxpayer has planted shelter belts (for which current deductions are allowed under section 175) or ornamental trees, such as Christmas trees.

(b) *Amortizable basis.* The term "amortizable basis" means that portion of the basis of qualified timber property which is attributable to reforestation expenditures.

(c) *Reforestation expenditures—*

(1) *In general.* The term "reforestation expenditures" means direct costs incurred to plant or seed for forestation or reforestation purposes. Qualifying expenditures include amounts spent for site preparation, seed or seedlings, and labor and tool costs, including depreciation on equipment used in planting or seeding. Only those costs which must be capitalized and are included in the adjusted basis of the property qualify as reforestation expenditures. Costs which are currently deductible do not qualify.

(2) *Cost-sharing programs.* Any expenditures for which the taxpayer has been reimbursed under any governmental reforestation cost-sharing program do not qualify as reforestation expenditures unless the amounts reimbursed have been included in the gross income of the taxpayer.

(d) *Definitions of controlled group of corporations and component member of controlled group.* For purposes of section 194, the terms "controlled group of corporations" and "component member" of a controlled group of corporations shall have the same meaning assigned to those terms in section 1563(a) and (b), except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

§1.194-4 Time and manner of making election.

(a) *In general.* Except as provided in paragraph (b) of this section, an election to amortize reforestation expenditures under section 194 shall be made by entering the amortization deduction claimed at the appropriate place on the taxpayer's income tax return for the year in which the expenditures were incurred, and by attaching a statement to such return. The statement should state the amounts of the expenditures, describe the nature of the expenditures, and give the date on which each was incurred. The statement should also state the type of timber being grown and the purpose for which it is being grown. A separate statement must be included for each property for which reforestation expenditures are being amortized under section 194. The election may only be made on a timely return (taking into account extensions of the time for filing) for the taxable year in which the amortizable expenditures were made.

(b) *Special rule.* With respect to any return filed before March 15, 1984, on which a taxpayer was eligible to, but did not make an election under section 194, the election to amortize reforestation expenditures under section 194 may be made by a statement on, or attached to, the income tax return (or an amended return) for the taxable year, indicating that an election is being made under section 194 and setting forth the information required under paragraph (a) of this section. An election made under the provisions of this paragraph (b) must be made not later than,

(1) The time prescribed by law (including extensions thereof) for filing the income tax return for the year in which the reforestation expenditures were made, or

(2) March 15, 1984, whichever is later. Nothing in this paragraph shall be construed as extending the time specified in section 6511 within which a claim for credit or refund may be filed.

(c) *Revocation.* An application for consent to revoke an election under section 194 shall be in writing and shall be addressed to the Commissioner of Internal Revenue, Washington, D.C. 20224. The application shall set forth the name and address of the taxpayer, state the taxable years for which the election was in effect, and state the reason for revoking the election. The application shall be

signed by the taxpayer or a duly authorized representative of the taxpayer and shall be filed at least 90 days prior to the time prescribed by law (without regard to extensions thereof) for filing the income tax return for the first taxable year for which the election is to terminate. Ordinarily, the request for consent to revoke the election will not be granted if it appears from all the facts and circumstances that the only reason for the desired change is to obtain a tax advantage.

Approved by the Office of Management and Budget under control number 1545-0735.

Par. 6. Section 1.1245-4 is amended by adding new paragraphs (g) and (h) at the end thereof to read as follows:

§1.1245-4 Exceptions and limitations.

* * * * *

(g) [Reserved]

(h) *Timber property subject to amortization under section 194*—(1) *In general.* For purposes of section 1245(a)(2), in determining the recomputed basis of property with respect to which a deduction under section 194 was allowed for any taxable year, a taxpayer shall not take into account amortization deductions claimed under section 194 to the extent such deductions are attributable to the amortizable basis (within the meaning of section 194(c)(2)) of the taxpayer acquired before the tenth taxable year preceding the taxable year in which gain with respect to the property is recognized.

(2) *Example.* The principles of paragraph (h)(1) of this section are illustrated by the following example:

Example. Assume A owns qualified timber property (as defined in section 194(c)(1)) with a basis of $30,000. In 1981, A incurs $12,000 of qualifying reforestation expenditures and elects to amortize the maximum $10,000 of such expenses under section 194. The $10,000 of deductions are taken during the 8-year period from 1981 to 1988. If A sells the property in 1990 for $60,000 a gain of $28,000 ($60,000—adjusted basis of $32,000) is recognized on the sale. Since the sale took place within 10 years of the taxable year in which the reforestation expenditures were made, $10,000 of the gain is treated as ordinary income, and the remaining $18,000 of gain would be capital gain, if it otherwise qualifies for capital gain treatment. In order to avoid ordinary income treatment of the gain attributable to the reforestation expenditures incurred in 1981, A would have to wait until 1992 to dispose of the property.

Par. 7. 26 CFR Part 15b is removed.

This Treasury decision is issued under the authority contained in sections 194 (94 Stat. 1989; 26 U.S.C. 194) and 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 2, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

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26 CFR 1.48-4: Election of lessor of new section 38 property to treat lessee as purchaser. (Also Sections 38, 6659; 1.38-1.)

Investment credit; master tape sound recording. A taxpayer who acquires a nonexclusive right to use a master tape sound recording is not entitled to claim an investment credit with respect to the master tape sound recording.

Rev. Rul. 84-4

ISSUE

Is a taxpayer entitled to claim the investment tax credit with respect to a master tape sound recording, under the circumstances described below?

FACTS

In 1981 *X*, a newly-formed corporation, acquired all right, title, and interest in and to the use of master tape sound recordings of musical performances or songs by various groups. The rights acquired included those necessary for the preparation and sale of tapes and records made by using the master tape sound recordings. The rights and the master tape sound recordings for singles were purchased for 160*x* dollars each, and those for albums were purchased for 250*x* dollars each.

In the promotional materials *X* represented that it would lease the right to use the master tape sound recordings for the production and sale of records or tapes of the musical performance. Under the purported lease, the use of the master tape sound recording was to be nonexclusive and limited to the United States for a period of 8 years. The "lease" provides that the lessee is obligated to pay a fixed amount (8*x* dollars for a single and 16*x* dollars for an album) and 50 percent of the lessee's net proceeds from the production and sale of the records or tapes, up to a stated maximum amount.

According to the promotional materials, no tapes or records of the musical production have been released anywhere in the world, and an investment tax credit is available based on the amount paid by *X* to acquire the use of the master tape sound recording. *X* agreed to pass the investment tax credit through to the lessee in accordance with the provisions of section 48(d)(1) of the Internal Revenue Code. *X*, however, retained the right to use the master tape sound recording or a duplicate in the production and sale of tapes or records. *X* also retained the right to assign nonexclusive rights to other persons.

A, an individual, entered into an agreement with *X* whereby *X* purportedly leased to *A* the right to use the master tape sound recording in the production and sale of records for one album. *A* used the master tape in the process of making records that were sold beginning in 1981. On *A*'s 1981 federal income tax return, *A* claimed an investment credit with respect to the master tape sound recording in the amount of 25*x* dollars (10 percent of 250*x* dollars).

LAW AND ANALYSIS

Section 38 of the Code allows a credit against federal income tax for qualified investment in "section 38 property" as defined in section 48. Section 48(a)(1)(A) defines "section

38 property" to include only recovery property or property which is depreciable and has a useful life of 3 years or more.

Section 48(d)(1) of the Code allows the lessor of certain new "section 38 property" to elect to treat the lessee as having acquired the property of an amount equal to its fair market value at the time of the lease.

The agreement between *X* and *A*, although described as a lease, is in fact a license. *X* paid 250*x* dollars for the rights to the master tape. *X* then assigned a nonexclusive license to *A* to use the master within the United States, and *X* retained the right to exploit the recording itself both within and without the United States or to assign any rights in the master to a third party. Thus, it is possible that commercial exploitation of the master can be done simultaneously by a number of people at different locations, foreign and domestic. The distinction between a lease and license, as traditionally expressed, is that a lease is a conveyance of exclusive possession of specific property, for a term less than that of the grantor. 3 M. Friedman, *Friedman on Leases*, section 37.1 at 1259 (1978).

Section 48(d)(1) of the Code allows a lessor to elect to treat the lessee as the purchaser of the property. This section does not apply to nonexclusive licenses in which the assignor has retained rights to use the property simultaneously and to make additional assignments of those rights to others. Therefore, *A* cannot claim any investment tax credit pursuant to *X*'s election under section 48(d)(1).

Further, the facts may demonstrate that the amount on which the investment tax credit was computed exceeds 150 percent of the fair market value of the master tape sound recording. In such a situation, *A* may be subject to the additional tax under section 6659 of the Code equal to a certain percentage of the underpayment of tax attributable to the valuation overstatement.

HOLDING

A may not claim the investment tax credit with respect to the master tape sound recording.

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26 CFR 1.48-9: Definition of energy property.

Investment credit; energy property; recycling equipment; rendering process. Equipment acquired for use in a rendering process to produce commercial products from carcasses or animal parts is not recycling equipment that qualifies for the energy investment credit.

Rev. Rul. 84-64

ISSUE

Is equipment acquired by the taxpayer for use in a rendering process to produce commercial products from carcasses or animal parts, such as fat, bone, offal, and feathers, "recycling equipment" within the meaning of sections 48(l)(2)(A)(iv) and 48(l)(6) of the Internal Revenue Code of 1954 and section 1.48-9(g) of the Income Tax Regulations for purposes of the energy investment credit?

FACTS

The taxpayer is in the business of rendering. Rendering is the processing of animal carcasses and parts such as fat, offal, bone, and feathers into commercial products such as tallow, grease, and meat, bone or feather meal. On a regular basis, the taxpayer collects fat, bone trimmings, meat scraps, feathers, bone, and offal from a variety of sources including butcher shops, supermarkets, restaurants, poultry processors, slaughter houses, and meat packing plants. In addition, federal and state agriculture and public health departments work closely with the rendering industry to provide prompt collection services for fallen animals that have been accidentally killed or have died of old age. The market value of the material collected by renderers is limited to its value as a raw material for the rendering process.

The taxpayer's process consists essentially of the following four basic steps: (1) the animal parts, bones, offal, scraps, etc., are crushed and ground; (2) the ground material is heated or "cooked" to evaporate the moisture, melt the fat present in the material, and condition the animal fibrous tissue; (3) the melted fat is separated from the solid proteinaceous material; and (4) the fat is clarified and the solid proteinaceous material is ground and screened. The rendering process is accomplished without adding any additional materials to the animal parts. During 1982, the taxpayer purchased and installed equipment for a new continuous type rendering process at a new plant site. The new equipment represents an increase in the taxpayer's total rendering capacity.

LAW AND ANALYSIS

Section 48(l)(2)(A)(iv) of the Code defines the term "energy property" as including "recycling equipment."

Section 48(l)(6) of the Code defines "recycling equipment" as any equipment which is used exclusively to sort and prepare solid waste for recycling, or any equipment used exclusively in the recycling of solid waste.

Section 1.48-9(g)(1) of the regulations defines recycling equipment as equipment used exclusively to sort and prepare, or recycle, solid waste (other than animal waste) to recover usable raw materials ("recovery equipment") or to convert solid waste (including animal waste) into fuel or other useful forms of energy ("conversion equipment"). Recycling equipment may include certain other onsite related equipment.

Section 1.48-9(g)(1) of the regulations specifically excludes from the term "recovery equipment" any equipment used to sort and prepare, or recycle animal waste. As used in connection with recovery equipment, the term "animal waste" includes the remains or parts of dead animals, the type of waste material collected and used in the rendering industry. Thus, equipment used in rendering is not recovery equipment under the regulation.

Section 1.48-9(g)(1) of the regulations includes in the term "conver-

sion equipment" equipment used exclusively to convert solid waste into fuel or other useful forms of energy. However, the taxpayer's rendering process does not convert solid waste into fuel or other useful forms of energy, but produces commercial products from solid waste. Thus, the equipment used in the taxpayer's rendering process is not conversion equipment.

HOLDING

The equipment acquired by the taxpayer for use in a rendering process to produce commercial products from carcasses or animal parts, such as fat, bone, offal, and feathers, is not "recycling equipment" within the meaning of sections 48(l)(2)(A)(iv) and 48(l)(6) of the Code and section 1.48-9(g) of the regulations and, therefore, does not qualify for the energy investment credit.

Subpart C.—Rules for Computing Credit for Expenses of Work Incentive Programs

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Section 50B.—Definitions; Special Rules

26 CFR 1.50B-5: Limitations with respect to certain persons.

Limitations on the amount of the WIN credit in the case of regulated investment companies and real estate investment trusts. See T.D. 7936, page 162.

Subchapter B.—Computation of Taxable Income
Part I.—Definition of Gross Income, Adjusted Gross Income, Taxable Income, etc.

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Whether mortgage interest and other payments received by a mortgage pool come within the definition of the term "gross income". See Rev. Rul. 84-10, page 155.

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26 CFR 1.61-1: Gross income.

Whether any portion of cost-sharing payments received from the Federal government under the forestry incentives program is excludable from gross income. See Rev. Rul. 84-67, page 28.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Charity-payee; religious order; vow of poverty; member's outside earnings remitted to order. Amounts received by a member of a religious order, who has taken vows of poverty and obedience, from the member's private practice as a psychologist are includible in the member's gross income.

Rev. Rul. 84-13

ISSUE

Are amounts received by *A*, a member of a religious order who has taken vows of poverty and obedience, as compensation from *A*'s private practice as a psychologist includible in *A*'s gross income under section 61 of the Internal Revenue Code?

FACTS

A is a member of a religious order who, as a condition of membership in the order, has taken vows of poverty and obedience by which all claims to earnings from personal industry are renounced. The purposes of the order are teaching, sacred ministry, and missionary and charitable works.

A obtained permission from the order to establish a private practice as a psychologist. The order, except for the approval of *A*'s yearly budget, concerning estimated income and expenses for the practice, imposes no restrictions concerning whom *A* may counsel in *A*'s private practice or the manner in which *A* must operate the practice.

A's practice is not restricted to members of *A*'s religious order. *A* provides individual and group counseling services for members of religious orders and for non-members. *A* selects clients, establishes and charges competitive fees, maintains all records and pays all expenses.

ANALYSIS

Section 61 of the Code provides that gross income means all income from whatever source derived, including compensation for services.

Rev. Rul. 77-290, 1977-2 C.B. 26, holds that when a member of a religious order receives income as an agent of the order, such income is the income of the order and not of the member.

Rev. Rul. 76-323, 1976-2 C.B. 18, holds that in order for a member of a religious order to be considered as performing services constituting the exercise of duties required by such order, the services must be of the type that are ordinarily the duties of members of the order and must be performed by the member as part of the duties for or on behalf of the religious order. Ordinarily, a member is performing services as the agent of the religious order only if the order is engaged in the performance of the services as a principal.

Rev. Rul. 79-132, 1979-1 C.B. 62, holds that the vow of poverty does not cause the member to be considered an agent; rather, an agency relationship is established when it appears, based on all the facts and circumstances, that the payor of the income is looking directly to the order, rather than to the individual member, for the performance of the services.

It is the basic principle of income tax law that an assignment or similar transfer of compensation for personal services to another individual or entity is ineffectual to relieve the taxpayer of tax liability on such compensation, regardless of the motive behind the transfer. See *Lucas v. Earl*, 281 U.S. 111 (1930); *Helvering v. Horst*, 311 U.S. 112 (1940), 1940-2 C.B. 206; *Helvering v. Eubank*, 311 U.S. 122 (1940), 1940-2 C.B. 209.

A received permission from the order to establish a private practice as a psychologist and counsels members of religious orders as well as nonmembers. Although there is an annual review of *A*'s budget by the order, *A* controls not only the details of *A*'s practice but also the means by which *A*'s work as a psychologist is accomplished. *A*'s private practice as a psychologist does not make *A* an agent of the religious order. The psychology services provided by *A* are not the type of services that are provided by the order, and *A*'s clients look directly to *A* and not to the reli-

gious order for the performance of the services offered by *A*. The income earned or received by *A* as a psychologist is earned or received in *A*'s individual capacity. *A* selects clients, establishes and charges competitive fees, maintains all records and pays all expenses. See Rev. Ruls. 76-323, 77-290, and 79-132. Thus, the fact that *A*, pursuant to the vows of poverty, must turn over *A*'s income to the order is immaterial. See, *McGahen v. Commissioner*, 76 T.C. 468 (1981); *Kelly v. Commissioner*, 62 T.C. 131 (1974).

HOLDING

For federal income tax purposes, *A* is required, under section 61 of the Code, to include in *A*'s gross income the fees derived from *A*'s private practice as a psychologist.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Whether the value of lodging furnished to an employee and the amounts deducted from the employee's salary and applied against the household expenses of the employee are excludable from the employee's gross income under section 119(a)(2) of the Code. See Rev. Rul. 84-86, page 26.

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26 CFR 1.61-6: Gains derived from dealings in property.

Whether a partner has a single basis in a partnership interest, even if the partner is both a general partner and a limited partner in the same partnership. See Rev. Rul. 84-53, page 159.

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26 CFR 1.61-7: Interest.

Whether a city may invest the proceeds of an issue of its refunding bonds in materially higher yield obligations after those proceeds have been used to discharge a prior issue of the city's bonds. See Rev. Rul. 84-37, page 25.

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26 CFR 1.61-7: Interest.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

Part II.—Items Specifically Included in Gross Income

Section 74.—Prizes and Awards

26 CFR 1.74-1: Prizes and awards.

Exclusion from gross income; awards. An award in the form of annual payments measured by the age or retirement income of the recipient is excludable from gross income under section 74(b) of the Code as long as the award is made in recognition of achievement in one of the categories listed in section 74(b).

Rev. Rul. 84-9

ISSUE

Whether an award in the form of annual payments measured by the age or retirement income of the award recipient is excludable from gross income under section 74(b) of the Internal Revenue Code in the situations below?

FACTS

The *X* foundation, an organization exempt from income tax under section 501(c)(3) of the Code and a private foundation within the meaning of section 509(a), established a program under which two types of awards are granted to individuals for religious, charitable, scientific, educational, artistic, literary, or civic achievements. Under the program, potential recipients of an award are recommended to a selection committee by nominators, a diversified group of individuals in many fields of endeavor. The identity of the nominators is unknown to the general public from which the potential award recipients are selected. Nominators are responsible for providing the selection committee with detailed information concerning the achievement of a nominee.

The selection committee, which includes members of *X*'s board of directors, selects and recommends to the full board of directors the most outstanding candidates among the individuals nominated. The selection is based on the individual's achievements in the religious, charitable, scientific, educational, artistic, literary, or civic fields. An award will not be given to any individual because of the individual's employment relationship with any particular institution.

SITUATION (1)

X grants an award in the form of annual payments for a period of 10 years. The amount of the award per year depends on the age of the recipient. The older the recipient is, the greater the annual payments.

SITUATION (2)

X grants an award to an individual at or near retirement age. The award is in the form of annual payments for the lifetime of the recipients in the amount of $50x$ dollars per year less the recipient's annual retirement income.

In both situations the awards are designed to give recipients freedom from financial responsibility so that they may direct their creativity and energy to whatever effort they freely choose. The awards are irrevocable and the recipients are not required to perform any future services to receive them.

LAW AND ANALYSIS

Section 74(b) of the Code and section 1.74-1(b) of the Income Tax Regulations provide that gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if, (1) the recipient was selected without any action on the recipient's part to enter the contest or proceeding; and (2) the recipient is not required to render substantial future services as a condition to receiving the prize or award.

Section 74(b) of the Code does not limit the manner of payment of an award or the method of calculating the amount of the award amount, but requires that the award be made in recognition of an achievement set forth in that section. Paying the award over a period of 10 years or for the recipient's life merely establishes the mode of payment and calculating

the extent of the award on the age or retirement income of the recipient is considered as merely a measure of the amount of the award, as long as the award itself is in fact made primarily in recognition of achievement in one of the categories listed in section 74(b).

HOLDING

The awards in the form of annual payments measured by the age or retirement income of the award recipient made by *X* in situations (1) and (2) are not includible in the gross incomes of the award recipients under section 74(b) of the Code.

Section 79.—Group-Term Life Insurance Purchased for Employees

26 CFR 1.79-1: Group-term life insurance—in general.

T.D. 7924

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

Group-Term Life Insurance Uniform Premium Table

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations which revise the uniform premium table used to calculate the cost of group-term life insurance coverage provided to an employee by an employer. This revision is necessary because the existing uniform premium table is based on outdated mortality experience. These regulations provide guidance to employers who must use the uniform premium table to calculate the cost of group-term life insurance coverage in excess of $50,000 provided to and includible in the gross income of their employees.

DATE: The uniform premium table prescribed in this regulation is effective for group-term life insurance coverage provided after December 31, 1982.

FOR FURTHER INFORMATION CONTACT: Lou Ann Craner of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, Attention CC:LR:T, 202-566-3935 not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 6, 1983, the Federal Register published proposed amendments to the uniform premium rates used in determining the cost of group-term life insurance [LR-258-82, 1983-2 C.B. 769]. In response to the notice of proposed rulemaing, 104 comments were received. On October 20, 1983, a public hearing was held.

Section 79 requires an employee to include in gross income the cost of group-term life insurance coverage in excess of $50,000. The cost of group-term life insurance is determined on the basis of uniform premiums (computed on the basis of five-year age brackets) prescribed by regulations. Regulations under section 79 published in 1966 provided the table of uniform premium rates currently in effect (Table 1 in §1.79-3(d)(2)).

The proposed table was developed using 1975-1979 mortality experience as reported by the Society of Actuaries. The proposed table assumed that the pool of affected employees was 85 percent men and 15 percent women. The proposed table also assumed a 17.5 percent loading charge (that is, a charge in addition to mortality costs equal to 17.5 percent of the mortality costs).

In the notice of proposed rulemaking, the Service acknowledged that the assumptions used to develop the proposed table might not accurately reflect the cost of providing group-term life insurance. In particular, the notice solicited data on actual loading charges.

The Service has concluded that the cost of group-term life insurance should be calculated using the following assumptions:

(1) The most recent mortality experience available

(2) The gender mix of employees receiving group-term life insurance protection in excess of $50,000, and

(3) The weighted average of loading charges of employer-provided group-term life insurance coverage in excess of $50,000.

The comments and subsequent contacts with the insurance industry did not provide the data necessary to calculate precisely the cost of group-term life insurance. Rather than postpone any action until the necessary information could be collected, the Service has decided to publish a revised uniform table based on the following assumptions:

(1) The most recent mortality experience published by the Society of Actuaries (1975-1979 experience) updated to 1982 by extrapolation from past improvement in mortality experience. Although the Service does not intend to use extrapolation in future, it is persuaded that it is appropriate to extrapolate in this instance because the most recent mortality experience published by the Society of Actuaries is out of date. In addition, the validity of the extrapolation is corroborated by U.S. Public Health Service statistics. The Service understands that the Society of Actuaries has agreed to consider tabulating and publishing mortality experience more often, which will result in more current published mortality experience in the future.

(2) An 85 percent male/15 percent female gender mix. This assumption was used to develop the table proposed in the notice and the Service received no comments showing that for employees receiving coverage in excess of $50,000, this gender mix is inappropriate.

(3) A 10.5 percent loading charge. The 17.5 percent loading charge used to develop the proposed table approximates the arithmetic mean of loading charges on a policy-by-policy basis. Comments suggested that a more ap-

propriate loading charge would be the arithmetic mean of loading charges determined on an insured-by-insured basis. The Service has concluded that neither approach is appropriate and that the loading charge ought to be a weighted average of the loading charges applicable to group term life insurance in excess of $50,000. Since the Service does not yet have sufficient data to compute the loading charge in this manner, the loading factor of the existing table (10.5 percent of total cost) has been retained in the revised table. The Service intends to collect the data necessary to determine the weighted average loading charge and to revise the table to reflect its findings.

This table is effective for group-term life insurance provided after December 31, 1982. This effective date may cause problems certain for data processors preparing W-2s for 1983, but it was evident from public comments that most employers believe that the benefits of a lower table outweigh any inconvenience that may result.

This table will remain in effect until the Service has sufficient data to change any of the assumptions upon which it is based.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although these regulations satisfied the notice and public comment procedures, the Internal Revenue Service has concluded that these regulations are interpretative and therefore no Regulatory Flexibility Analysis is required.

DRAFTING INFORMATION

The principal author of this regulation is Phoebe A. Mix of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, on matters of both substance and style.

LISTS OF SUBJECTS IN 26 CFR PARTS 1.61-1—1.281-4

Income taxes, Taxable income, Deductions, Exemptions.

AMENDMENTS TO THE REGULATIONS

PART 1-[AMENDED]

Accordingly, the following amendments to §1.79-1 and §1.79-3 [26 CFR Part 1] are adopted.

Paragraph 1. Paragraph (d)(7) of §1.79-1 is revised to read as follows:

§1.79-1 Group-term life insurance—general rules.

* * * * *

(d) How much must an employee receiving permanent benefits include in income?

* * * * *

(7) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. An employer provides insurance to employee A under a policy that meets the requirements of this section. Under the policy; A, who is 47 years old, received $70,000 of group-term life insurance and elects to receive a permanent benefit under the policy. A pays $2 for each $1,000 of group-term life insurance through payroll deductions and the employer pays the remainder of the premium for the group-term life insurance. The employer also pays one-half of the premium specified in the policy for the permanent benefit. A pays the other one-half of the premium for the permanent benefit through payroll deductions. The policy specifies that the annual premium paid for the permanent benefit is $300. However, the amount of premium allocated to the permanent benefit by the formula in paragraph (d)(2) of this section is $350. A is a calendar year taxpayer, the policy year begins on January 1. In 1980, $200 is includible in A's income because of insurance provided by the employer. This amount is completed as follows:

(1) Cost of permanent benefits	$350
(2) Amounts considered paid by A for permanent benefits (½ x $300)	150
(3) Line (1) minus line (2)	200
(4) Cost of $70,000 of group-term life insurance under Table 1 of §1.79-3	243.60
(5) Cost of $50,000 of group-term life insurance under Table 1 of §1.79-3	174
(6) Cost of group-term life insurance in excess of $50,000 (line (4) minus line (5))	69.60
(7) Amount considered paid by A for group-term life insurance (70 x $2)	140
(8) Line (6) minus line (7) (but not less than 0)	0
(9) Amount includible in income (line (3) plus line (8))	200

Para. 2. Paragraph (d)(2) of §1.79-3 is revised to read as follows:

§1.79-3 Determination of amount equal to cost of group-term life insurance.

* * * * *

(d) *The cost of the portion of the group-term life insurance on an employee's life.*

* * * * *

(2) The following table sets forth the cost of $1,000 of group-term life insurance provided after December 31, 1982, for 1 month computed on the basis of 5-year age brackets. See 26 CFR 1.79-3(d)(2) (revised as of April 1, 1983) for a table setting forth the cost of group-term life insurance provided before January 1, 1983. For purposes of Table 1, the age of the employee is his attained age on the last day of his taxable year. However, if an employee has attained an age greater than age 64, he shall be treated as if he were in the 5-year age bracket 60 to 64.

Table 1.—Uniform Premiums for $1,000 of Group-Term Life Insurance Protection

5-year age bracket	Cost per $1,000 of protection for 1-month period
Under 30	$0.08
30 to 34	.09
35 to 39	.11
40 to 44	.17
45 to 49	.29
50 to 54	.48
55 to 59	.75
60 to 64	1.17

* * * * *

This Treasury decision is issued under the authority contained in sections 79(c) and 7805 of the Internal Revenue Code of 1954 (78 Stat. 36, 26 U.S.C. 79(c); 68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

Approved: December 1, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury

(Filed by the Office of the Federal Register on December 1, 1983; 5:04 p.m., and published in the issue of the Federal Register for December 6, 1983, 48 F.R. 54594)

Part III.—Items Specifically Excluded From Gross Income

Section 103.—Interest On Certain Governmental Obligations

26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Rev. Proc. 83-22, 1983-1 C.B. 680, is amplified to include circumstances under which the Service ordinarily will not issue ruling or determination letters regarding certain industrial development bonds. See Rev. Proc. 84-13, page 431.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Procedures for requesting letter rulings under section 103 of the Code to which section 7478 applies. See Rev. Proc. 84-48, page 547.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Procedures for persons other than the issuer of a prospective governmental obligation to request a ruling under section 103 of the Code. See Rev. Rul. 84-49, page 548.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Whether interest received by a corporation organized under the laws of the Commonwealth of Puerto Rico which is excluded from gross income under section 103(a)(1) of the Code is also excluded from gross income for purposes of computing the gross income tests described in sections 957(c)(1) and 957(c)(2). See Rev. Rul. 84-20, page 180.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

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26 CFR 1.103-13: Arbitrage bonds. (Also Section 61; 1.61-7.)

Arbitrage bonds; refunding issue; arbitrage yield restrictions. The escrow account in which the proceeds of refunding bonds are held may be invested in materially higher-yielding obligations for the benefit of the city between the discharge date and the date the refunded bonds are actually presented for payment without causing the refunding bonds to be arbitrage bonds under section 103(c) of the Code.

Rev. Rul. 84-37

ISSUE

Will refunding bonds issued by a city be "arbitrage bonds" under section 103(c)(2) of the Internal Revenue Code under the circumstances described below?

FACTS

On September 1, 1971, *CI*, a city, issued 30-year construction bonds to make improvements to its water system. All of the proceeds of the construction bonds were so used by 1973. The indenture for the bonds provides that *CI* may redeem them on any semi-annual interest payment date on or after September 1, 1981. The bonds were issued in bearer form.

On September 3, 1979, *CI* issued refunding bonds yielding 10 percent to redeem the construction bonds. *CI* deposited all of the proceeds of the refunding bonds in an escrow account with *BK*, a bank that is the trustee and paying agent for the construction bonds and the refunding bonds. *BK* invested all of the proceeds of the refunding bonds in United States Treasury Obligations—State and Local Government Series (SLGS) at a restricted yield of 10 percent. On September 1, 1981, the construction bonds were called for redemption and interest ceased to accrue thereon. Also, on September 1, 1981, the SLGS were redeemed.

After the SLGS were redeemed, *BK*, under the terms of an agreement it had made with *CI* when the refunding bonds were issued, began investing the escrow account in taxable obligations with a yield materially higher than the yield on the construction bonds and the refunding bonds. Under the agreement, *BK* remits to *CI* a large portion of the amounts earned on the investment of the escrow account. The investments made by *BK* do not interfere with the requirement in the indenture for the construction bonds that upon discharge of those bonds the amount held in the escrow account be available on demand to the bondholders.

A significant number of the holders of the construction bonds did not present their bonds on September 1, 1981 for payment but delayed presentment for several months after the discharge of the bonds. Therefore, a substantial amount of income was earned on the investment of the escrow account. *CI* used the amount it received from the investment of the escrow account for general city purposes.

CI complied with all requirements of local law and the construction bonds' indenture when notifying the bondholders that the bonds were being redeemed on September 1, 1981. Neither the construction bonds nor the refunding bonds are industrial development bonds within the meaning of section 103(b)(2) of the Code.

LAW AND ANALYSIS

Under section 103(a) of the Code, gross income does not include interest on the obligations of a state or a political subdivision of a state.

Generally, under section 103(c)(1) of the Code any arbitrage bond is treated as an obligation not described in section 103(a).

Section 103(c)(2) of the Code defines an "arbitrage bond" as any obligation that is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected, at the time of issuance of the issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of the issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Generally, under section 1.103-13(b)(5)(iii)(B) of the Income Tax Regulations, the yield on acquired obligations allocated to transferred

proceeds is materially higher than the yield on a refunding issue if the yield on such acquired obligations exceeds the yield on the refunding issue by more than one-eighth of one percentage point. The same yield restrictions apply to other proceeds of the refunding issue beginning on or after the date on which the last obligation of the prior issue is discharged.

Under section 1.103-13(b)(11) of the regulations an issue is discharged when (a) cash is available at the place of payment on the date that the issue is due (whether at maturity or upon prior call for redemption) and (b) interest ceases to accrue on the issue.

CI discharged the construction bonds on September 1, 1981, because on that date (1) cash was made available to pay the holders at the place of payment and (2) interest ceased to accrue on the bonds. Under section 1.103-13(b)(5)(iii)(B) of the regulations, the only proceeds of *CI*'s refunding bonds that would be subject to arbitrage yield restrictions after that date would be transferred proceeds of the construction bonds and other proceeds of the refunding issue. Sections 1.103-14(e)(3)(vii), (viii) and (ix) of the regulations indicate that other proceeds of a refunding issue are proceeds not used to discharge the prior issue. For example, proceeds used to pay accrued interest on or issuance costs of the refunding issue would be other proceeds.

In this case, all the proceeds of the construction issue were spent on construction by 1973, and so there were no transferred proceeds. In addition there were no other proceeds of *CI*'s refunding bonds. Therefore, none of the amounts held in the escrow account after August 31, 1981, is subject to arbitrage yield restrictions.

HOLDING

The refunding bonds issued by *CI* are not arbitrage bonds under section 103(c)(2) of the Code, and interest on the refunding bonds is excludable from the gross income of the bondholders under section 103(a).

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26 CFR 1.103-13: Arbitrage bonds.

Procedures for submitting ruling requests under section 103(c) of the Code by persons other than the issuers of prospective governmental obligations. See Rev. Proc. 84-50, page 550.

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26 CFR 1.103-14: Temporary investments, reserve funds, and refunding issues.

Procedures for requesting letter rulings under section 103(c) of the Code regarding "reasonably required reserve or replacement funds." See Rev. Proc. 84-26, page 468.

Section 103A.—Mortgage Subsidy Bonds

Procedures for requesting letter rulings under section 103A of the Code to which section 7478 applies. See Rev. Proc. 84-48, page 547.

Procedures for persons other than the issuer of a prospective governmental obligation to request a ruling under section 103A of the Code. See Rev. Proc. 84-49, page 548.

Section 118.—Contributions to the Capital of a Corporation

26 CFR 1.118-1: Contributions to the capital of a corporation.

Whether a wholly owned subsidiary may deduct as a business expense bonuses that its parent corporation pays to the employees of the subsidiary. See Rev. Rul. 84-68, page 31.

Section 119.—Meals or Lodging Furnished for the Convenience of the Employer

26 CFR 1.119-1: Meals and lodging furnished for the convenience of the employer. (Also Section 61; 1.61-2.)

Lodging furnished to U.S. Government employee. The value of lodging furnished to an U.S. Government employee permanently stationed in a foreign country, who is a "principal representative" of the U.S., and the amounts deducted from the employee's salary and applied against the household expenses of the employee are excludable from the employee's gross income under section 119(a)(2) of the Code. Rev. Rul. 58-545 modified and superseded; Rev. Rul. 59-307 clarified.

Rev. Rul. 84-86

ISSUE

Whether the value of lodging furnished to an employee and the amounts deducted from the employee's salary and applied against the household expenses of the employee are excludable from the employee's gross income under section 119(a)(2) of the Code.

FACTS

A, an individual, is an employee of the United States Government permanently stationed in a foreign country. Because *A* is a "principal representative" of the United States, *A* is furnished, without cost, with an official residence in a Government owned building, as well as with heat, fuel, and light.

Under 5 U.S.C. 5912 (1976), an employee of the United States permanently stationed in a foreign country who is a citizen of the United States may be furnished, without cost, living quarters, including heat, fuel, and light.

Section 410 of the Standardized Regulations (Government Civilians, Foreign Areas) (5-7-78) states that "principal representative" means a senior official of the United States Government serving in a foreign country who has been designated by the Secretary of State as occupying a position of such importance that the Government should defray the unusual expenses incident to the operation of his or her official residence. Section 412 states that the defraying of official residence expenses is intended to make possible the operation of official residences in which principal representatives can properly represent the United States abroad by extending official (as distinct from personal) hospitality to foreign dignitaries and important visitors, by receiving official deputations and callers, and by holding requisite and appropriate ceremonies smoothly and with dignity. Section 440 states that, subject

to certain exceptions not applicable here, the amount of annual usual household expenses that must be borne personally by a principal representative is 5 percent of salary.

Pursuant to section 440 of the Standardized Regulations, 5 percent of *A*'s salary is deducted by the United States. The amount so deducted does not exceed the Government's cost in furnishing the residence with heat, fuel, and light to *A*. *A* was not reimbursed or otherwise compensated for the amounts deducted from *A*'s salary.

A has met the three tests contained in section 1.119-1(b) of the regulations.

LAW AND ANALYSIS

Section 61 of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived.

Section 1.61-2(d)(3) of the regulations provides that the value of living quarters that an employee receives in addition to the employee's salary constitutes gross income unless it is furnished for the convenience of the employer and meets the conditions specified in sectino 119 of the Code.

Section 119(a)(2) of the Code provides that there shall be excluded from the gross income of an employee the value of any lodging furnished the employee, the employee's spouse, or any of the employee's dependents by or on behalf of the employer for the convenience of the employer, but only if the employee is required to accept such lodging on the employer's business premises as a condition of employment.

Section 1.119-1(b) of the regulations provides that the value of lodging furnished to an employee by the employer is excludable from the employee's gross income if three tests are met:

(1) The lodging is furnished on the business premises of the employer,

(2) The lodging is furnished for the convenience of the employer, and

(3) The employee is required to accept such lodging as a condition of employment.

The regulation further provides that the requirement of subparagraph (3) is met where the employee is required to accept the lodging in order to enable the employee to properly perform the duties of his or her employment, and that if the three tests are met, the exclusion applies irrespective of whether a charge is made, or whether, under an employment contract or statute fixing the terms of employment, the lodging is furnished as compensation.

With respect to the amounts deducted from *A*'s salary, Rev. Rul. 59-307, 1959-2 C.B. 48, holds that the Internal Revenue Service will follow the decision of *Boykin v. Commissioner*, 260 F.2d 249 (8th Cir. 1958), *rev'g* 29 T.C. 813 (1958). There, the court held that the rental value of living quarters furnished on business premises by the employer to the employee was properly excludable from the employee's gross income under section 119 of the Code, even though the rental value of the living quarters was considered a part of the employee's compensation and deducted from the employee's salary.

Section 1.119-1(b) of the regulations, as amended, provides that if the employer furnishes the employee lodging for which the employee is charged an unvarying amount irrespective of whether the employee accepts the lodging, the amount of the charge made by the employer for such lodging is not, as such, part of the compensation includible in the gross income of the employee. Whether the value of the lodging is excludable from the employee's gross income is determined under the other rules of section 119 of the Code.

Rev. Rul. 68-579, 1968-2 C.B. 61, holds that lodging furnished an employee for the convenience of the employer includes the value of any necessary utilities also furnished by the employer. *See also Inman v. Commissioner*, T.C.M. 1970-264.

HOLDINGS

The amounts deducted from *A*'s salary and applied against the household expenses of the official residence furnished *A* are excludable from *A*'s gross income under section 119(a)(2) of the Code. Further, the value of the lodging furnished *A* by the United States is excludable from *A*'s gross income under section 119(a)(2) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-545, 1958-2 C.B. 50, which limits the section 119 exclusion from gross income to the excess of the fair market value of the lodging provided over the amounts charged the employees for such lodging, is modified and, as modified, is superseded.

Rev. Rul. 59-307, 1959-2 C.B. 48, to the extent it indicates an exclusion from gross income is available only in the situation where the amount of salary deducted is equal to the full rental value of the furnished lodging, is clarified.

Section 121.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55

26 CFR 1.121-1: Gain from sale or exchange of residence of individual who has attained age 55.

Principal residence; sale of a life estate. The sale of a life estate in a principal residence qualifies under the provisions of section 121 of the Code, relating to the one-time exclusion of gain from the sale of a principal residence by a taxpayer over the age of 55, if the life estate is the taxpayer's entire interest in the residence.

Rev. Rul. 84-43

ISSUE

Under the circumstances described below, may *B*, an individual taxpayer, elect, under section 121 of the Internal Revenue Code, to exclude from gross income gain from the sale of a life estate in a principal residence?

FACTS

In 1982, *B* (60 years of age) sold a

life estate in a residence that *B* had used as a principal residence for ten years. *B*'s life estate was *B*'s entire interest in the residence.

LAW AND ANALYSIS

Section 121(a) of the Code provides that, at the election of the taxpayer, gross income does not include gain from the sale or exchange of property if (1) the taxpayer has attained age 55 before the date of the sale or exchange, and (2) during the 5-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 3 years or more. Under section 121(b), the amount of gain excluded from gross income may not exceed $125,000 ($100,000 for a sale or exchange before July 21, 1981).

The House of Representatives Committee Report, H.R. Rep. No. 749, 88th Cong., 1st Sess. (1963), 1964-1 (Part 2) C.B. 125, 169, pertaining to section 121 of the Code, states as follows:

> While present law generally provides adequately for the younger individual who is for one reason or another changing residences, it does not do so for the elderly person whose family has grown and who no longer has need for the family homestead. Such an individual may desire to purchase a less expensive home or move to an apartment or to a rental property at another location. He may also require some or all of the funds obtained from the sale of the old residence to meet his and his wife's living expenses. Nevertheless, under present law, such an individual must tie up all of his investment from the old residence in a new residence, if he is to avoid taxation on any of the gain which may be involved.
>
> Your committee concluded that this is an undesirable burden on our elderly taxpayers.

The Report further states, at paragraph 6(c)(ii)(3), that for purposes of this provision, tenant-stockholders in a cooperative housing corporation who sell their right to occupy the house or apartment are to be treated in the same manner for purposes of this provision as those who own their residence outright. See also section 121(d)(3) of the Code.

Section 121 of the Code, the regulations thereunder, and the legislative history contemplate that the section is to apply in the situation when an elderly taxpayer disposes of the taxpayer's entire interest (legal and equitable) in a principal residence. It is not necessary that the taxpayer own the entire fee interest in such residence.

HOLDING

B may elect, under section 121 of the Code, to exclude from gross income up to $125,000 gain from the sale of *B*'s life estate in *B*'s principal residence.

Section 126.—Certain Cost-Sharing Payments

26 CFR 16A.126-1: Certain cost-sharing payments—in general.
(Also Sections 61, 194, 611; 1.61-1, 1.611-3, 1.194-1, 16A.126-2.)

Reimbursements under the forestry incentives program. The excludable portion of cost-sharing payments received under the forestry incentives program (F.I.P.) is excludable from gross income, and the total costs of reforestation less the excludable portion are to be capitalized as a cost of timber. Under the election not to have section 126 of the Code apply to the F.I.P. payment, the entire payment is includable in gross income, and the total costs of reforestation (not reduced by any portion of the F.I.P. payment) are to be capitalized as a cost of timber. Rev. Rul. 76-6 modified and superseded.

Rev. Rul. 84-67

ISSUE

Are cost-sharing payments the taxpayer received under the forestry incentives program (F.I.P.) authorized by the Cooperative Forestry Assistance Act of 1978 excludable from the taxpayer's gross income and capitalized as a cost of timber?

FACTS

The cash basis taxpayer paid the total costs of reforesting the taxpayer's nonindustrial private forest land in 1982 by planting tree seedlings. Under the cost-sharing provisions of the F.I.P., the taxpayer received reimbursement from the Federal government equal to 65 percent of the reforestation costs.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides, in general, that gross income means all income from whatever source derived, unless excludable by law. As a general rule, gross income under section 61 of the Code includes government cost-sharing payments the taxpayer receives under soil conservation and similar programs. *Baboquivari Cattle Co. v. Commissioner*, 135 F.2d 114 (9th Cir. 1943), 1943 C.B. 1013, *aff'g* 47 B.T.A. 129 (1942); *Harding v. Commissioner*, T.C.M. 1970-179; *Driscoll v. Commissioner*, No. 13,716 (T.C.M. 1944), *aff'd in part and rev'd in part*, 147 F.2d 493 (5th Cir. 1945).

Section 126(a) of the Code, an exception to the general rule of section 61, provides that gross income does not include the excludable portion of cost-sharing payments, within the meaning of section 126(b), received under the F.I.P. Section 126(e) provides that notwithstanding any provision of section 1016 (relating to adjustments to basis) to the contrary, no adjustment to basis shall be made with respect to property acquired through the use of any F.I.P. payment when such adjustment would reflect any amount excluded from gross income under this section. Under section 126(c)(1), however, the taxpayer may elect not to have the provisions of section 126 apply to the excludable portion of an F.I.P. payment.

Section 1.611-3(a) of the Income Tax Regulations provides that

amounts paid in connection with the planting of timber shall be capitalized and recoverable through depletion allowances.

In Rev. Rul. 76-6, 1976-1 C.B. 176, the taxpayer received an F.I.P. payment in connection with reforestation of the taxpayer's nonindustrial private forest land. That revenue ruling holds that the F.I.P. payment is includable in the taxpayer's gross income in the tax year received. Rev. Rul. 76-6 no longer applies because the treatment of such payments received after September 30, 1979 was changed with the enactment of section 126 of the Code.

HOLDING

Under the provisions of section 126 of the Code, the excludable portion of the F.I.P. payment within the meaning of section 126(b) is excludable from the taxpayer's gross income. The total costs of reforestation less the amount of the excludable portion of the F.I.P. payment are to be capitalized as a cost of timber.

If the taxpayer elects not to have section 126 of the Code apply to the F.I.P. payment received, the entire F.I.P. payment is includable in gross income in the year received. In this situation, the total costs of reforestation (not reduced by the amount of the F.I.P. payment) are to be capitalized as a cost of timber.

In general, the capitalized amounts are recoverable through allowances for depletion as the timber is cut, or as adjusted basis in the event of sale or other disposition of the timber. However, all or a portion of the capitalizable reforestation costs may be recovered through an allowance for amortization under the provisions of section 194 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-6, 1976-1 C.B. 176, is modified and superseded.

Part V.—Deductions for Personal Exemptions

Section 152.—Dependent Defined

26 CFR 1.152-1: General definition of a dependent.

Whether a foster child who is a dependent of a taxpayer qualifies the taxpayer for head of household filing rates. See Rev. Rul. 84-89, page 5.

Part VI.—Itemized Deductions for Individuals and Corporations

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether certificate holders in a mortgage pool may deduct service fees as a business expense. See Rev. Rul. 84-10, page 155.

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26 CFR 1.162-1: Business expenses.

Whether costs charged to the inside wiring account of a public telephone company are to be currently expensed under section 162(a) of the Code. See Rev. Rul. 84-24, page 89.

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26 CFR 1.162-5: Expenses for education.

Business expenses; travel abroad; continuing education conferences. Expenses incurred in connection with a university's continuing education program that combines foreign travel with attendance at brief education-oriented conferences are nondeductible personal expenses, except to the extent that they are for registration fees and any other expenses incurred that are directly attributable and properly allocable to the taxpayer's trade or business, subject, where applicable, to the provisions of sections 274(d) and 274(h) of the Code.

Rev. Rul. 84-55

ISSUE

Are expenses for overseas travel in attending a "continuing education program" deductible under section 162 of the Internal Revenue Code under the factual situation set forth below?

FACTS

A taxpayer, a salesperson in a large corporation, is a member of a local university's alumni association. The university, through a travel agency, arranges trips by airline to more than 22 foreign countries for members of its alumni association. The university represents that the trips are part of a continuing education program and that the academic exercises and conferences it sets up are designed to acquaint individuals in most occupations with selected facilities in several regions of the world. However, none of the conferences are directed toward specific occupations or professions, and it is up to the initiative of each participant to seek out specialists and organizational settings appropriate to their occupational interests. The stated aim of the program is to improve and enhance the human relations and professional skills required of individuals in their work settings. The objectives of the program include increased self-understanding, understanding of others, and increased awareness of the factors which promote or inhibit interpersonal effectiveness in business, professional, educational and organizational settings. The participants may attend by themselves, or with friends or families.

Three-hour sessions are held each day over a five-day period at each of the selected overseas facilities where participants can meet with individual practitioners. These sessions are composed of a variety of activities, including workshops, mini-lectures, role playing, skill development, and exercises. Professional conference directors schedule and conduct the sessions. Participants are free to choose those sessions they wish to attend.

The taxpayer's spouse and two minor children accompanied the taxpayer. The taxpayer spent approximately two hours at each of the planned sessions, and the remainder of the time touring and participating in recreational and sight-seeing activities with the family. The trip lasted less than one week.

LAW AND ANALYSIS

Section 162(a) of the Code allows as a deduction ordinary and necessary expenses paid or incurred during the

taxable year in carrying on any trade or business.

Section 262 of the Code provides, with exceptions not here material, that no deduction is allowed for personal, living, or family expenses.

Section 1.162-2(a) of the Income Tax Regulations provides that only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel, are business expenses.

Under section 1.162-2(b)(1) of the regulations, if a taxpayer travels to a destination and while at such destination engages in both business and personal activities, traveling expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, the traveling expenses to and from the destination are not deductible even though the taxpayer engages in business activities while at such destination. However, expenses while at the destination that are properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible.

Section 1.162-2(b)(2) of the regulations provides that whether a trip is related primarily to the taxpayer's trade or business or is primarily personal in nature depends upon the facts and circumstances in each case. The amount of time during the period of the trip that is spent on personal activities compared to the amount of time spent on activities directly relating to the taxpayer's trade or business is an important factor in determining whether the trip is primarily personal.

Section 1.162-2(d) of the regulations provides that expenses paid or incurred by a taxpayer in attending a convention or other meeting may constitute an ordinary and necessary business expense depending upon the facts and circumstances of each case. No distinction will be made between self-employed persons and employees. The allowance of deductions depends upon whether there is a sufficient relationship between the taxpayer's trade or business and attendance at the convention so that the taxpayer is benefiting or advancing the interests of the trade or business by such attendance.

Section 1.162-5(e)(1) of the regulations provides that if an individual travels away from home primarily to obtain education, the expenses of which are deductible under this section, the taxpayer's expenditures for travel, meals and lodging while away from home are deductible. However, if as an incident of such a trip the individual engages in some personal activity such as sightseeing, social visiting, or entertaining, or other recreation, the portion of the expenses attributable to such personal activity constitutes nondeductible personal or living expenses and is not allowable as a deduction. If the individual's travel away from home is primarily personal, the individual's expenditures for travel, meals and lodging (other than meals and lodging during the time spent in participating in deductible education pursuits) are not deductible. Whether a particular trip is primarily personal or primarily to obtain education the expenses of which are deductible under this section depends upon all the facts and circumstances of each case. An important factor to be taken into consideration in making the determination is the relative amount of time devoted to personal activity as compared with the time devoted to educational pursuits. The rules set forth in this paragraph are subject to the provisions of section 162(a)(2), relating to deductibility of certain traveling expenses, and sections 274(c) and (d), relating to allocation of certain foreign travel expenses and substantiation required, respectively, and the regulations thereunder.

Section 274(h) of the Code provides for the disallowance of travel expenses incurred to attend a convention, seminar, or similar meeting outside the North American area unless the taxpayer establishes that the meeting is directly related to the active conduct of the taxpayer's trade or business and that, after taking into account certain specified factors, it is as reasonable for the meeting to be held outside the North American area as within the North American area.

In determining allowable deductions with respect to attendance at a foreign convention, the business purpose test of section 162 of the Code is a threshold test. If the convention trip is related primarily to the taxpayer's trade or business, then travel, transportation and subsistence expenses are deductible, provided it was as reasonable to hold the convention outside the North American area as within the North American area. If the nature of the trip is primarily personal, no deduction is allowable under section 162 for travel and transportation costs; however, those subsistence expenses that are properly allocable to the taxpayer's trade or business are deductible, subject to the provisions of section 274(h).

In this case, applying the principles described above, the fact that the taxpayer attended a continuing education program did not convert what was in all other respects a vacation into a business trip. The expenses incurred are not materially different from those reasonably incurred by any other tourist on a sight-seeing trip abroad. See *Kadivar v. Commissioner*, 32 T.C.M. 427 (1973), and *Gino v. Commissioner*, 60 T.C. 304 (1973) *rev'd* on another issue, 538 F.2d 833 (9th Cir. 1976), *cert. denied* 429 U.S. 979 (1976). The arrangements for the trip did not differ from those of any vacation or recreational trip. The taxpayer was accompanied by the taxpayer's spouse and children, and the major portion of the taxpayer's time was spent on personal, recreational, and sight-seeing activities. See Rev. Rul. 79-425, 1979-

2 C.B. 81, which reaches a similar nondeductible conclusion regarding a taxpayer attending six brief sessions of a ten-day annual convention of a local professional association held in a foreign country; and Rev. Rul. 74-292, 1974-1 C.B. 43, which reaches a similar nondeductible conclusion regarding a taxpayer attending six brief professional seminars held abroad during the 14-day trip.

HOLDING

The taxpayer's expenses for the trip are not deductible under section 162 of the Code, except to the extent they are for registration fees and any other expenses incurred by the taxpayer that are directly attributable and properly allocable to the taxpayer's trade or business, subject, where applicable, to the provisions of section 274(h) and section 274(d).

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26 CFR 1.162-9: Bonuses to employees. (Also Section 118; 1.118-1.)

Business expenses; bonuses paid to subsidiary's employees. A parent corporation may not deduct as a business expense under section 162 of the Code the cash bonuses it pays to employees of its wholly owned subsidiary. However, because the parent's payment of cash bonuses to its subsidiary's employees is a constructive contribution to the subsidiary's capital accompanied by a constructive payment by the subsidiary of the cash bonuses to its employees, the cash bonuses may be deducted by the subsidiary under section 162.

Rev. Rul. 84-68

ISSUE

May a parent corporation deduct as a business expense under section 162 of the Internal Revenue Code cash bonuses it pays to employees of its wholly owned subsidiary or may the bonuses be deducted by the subsidiary?

FACTS

In 1980 a domestic corporation, *P*, established a bonus program for the employees of its wholly owned domestic subsidiary, *S*. Under the program, *P* pays cash bonuses in December of each year to *S*'s employees for their past services performed for *S* during the calendar year. The total compensation paid to these employees, including the cash bonuses, is reasonable remuneration for the services rendered. None of these employees perform any services for *P*. The employees who receive the bonuses include them in income in the year received.

LAW AND ANALYSIS

Section 162(a) of the Code allows as a deduction all the ordinary and necessary business expenses paid or incurred during the tax year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 1.162-9 of the Income Tax Regulations specifies that bonuses to employees will constitute allowable deductions when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments, when added to the stipulated salaries, do not exceed reasonable compensation for the service performed.

Section 118 of the Code provides that in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

Section 83 of the Code prescribes the income tax treatment of property transferred to another in connection with the performance of services. Because section 83 does not apply to compensation paid in cash, this section of the Code has no application to the issues under consideration in the present situation.

It is implicit in section 162 that a taxpayer may not deduct the expenses of another, even though those expenses would otherwise be ordinary and necessary trade or business expenses. *See Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943), 1943 C.B. 1016; *Deputy v. Dupont*, 308 U.S. 488 (1940), 1940-1 C.B. 118. A parent corporation may not therefore deduct compensation paid by it to the employees of its wholly owned subsidiary, even though the indirect benefit of their services inures to the parent corporation as sole shareholder of the employer. *Columbian Rope Co. v. Commissioner*, 42 T.C. 800 (1964), *acq. on other issues*, 1965-1 C.B. 4.

A cash payment by a shareholder for the benefit of a corporation in which the shareholder owns stock is recognized for federal income tax purposes as a contribution of capital to the corporation. *Estate of A.P. Steckel v. Commissioner*, 26 T.C. 600 (1956), *aff'd per curiam*, 253 F.2d 267 (6th Cir. 1958); *South American Gold & Platinum Co. v. Commissioner*, 8 T.C. 1297 (1947), *aff'd per curiam*, 168 F.2d 71 (2d Cir. 1948).

In the present situation because the cash bonuses paid by *P* to employees of *S* is deemed to be a capital contribution by *P* to *S*, the bonuses paid to *S*'s employees is therefore deemed to be paid from *S*'s own funds. *See Anderson v. Commissioner*, 67 T.C. 522 (1976), *aff'd per curiam*, 583 F. 2d 953 (7th Cir. 1978).

HOLDINGS

The parent corporation may not deduct as a business expense under section 162 of the Code the cash bonuses that it pays to employees of its wholly owned subsidiary. Because the parent's payment of cash bonuses to its subsidiary's employees is treated as a contribution to the subsidiary's capital accompanied by a constructive payment by the subsidiary of the cash bonuses to its employees, the cash bonuses may be deducted by the subsidiary under section 162 of the Code, provided that each employee's total compensation is reasonable for the services performed.

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26 CFR 1.162-12: Trade or business expenses. (Also Section 263; 1.263(a)-1.)

Business expenses; livestock investment program; capital expenditures; farmers; cattle breeding serv-

ice agreements. A limited partnership that expended amounts pursuant to an agreement, under which the seller offered to sell cattle to the partnership for a specified amount plus a monthly maintenance fee and the partnership could cancel the agreement at any time, is not permitted to deduct the maintenance fee for periods prior to the date the cattle were purchased.

Rev. Rul. 84-35

ISSUE

What is the proper treatment, for federal income tax purposes, of certain amounts paid to the seller on the purchase of cattle under the circumstances described below?

FACTS

P is a limited partnership formed on January 4, 1982, to engage in integrated cattle breeding and feeding operations. Corporation *X*, an affiliate of *P*'s general partner, engages in the purchase and sale of cattle as both principal and agent.

On January 4, 1982, *P* and *X* entered into an agreement giving *P* the right to purchase from *X* a herd of up to 2,000 cattle at a price of 100*x* dollars per head. *P* also agreed to pay *X* 5*x* dollars a month for each animal purchased pursuant to the agreement to cover *X*'s maintenance expenses on the herd from the date of the agreement until the cattle are delivered to *P*. Under the terms of the agreement, *P* had no obligation to purchase any cattle and could cancel at any time in 1982 without further obligation.

During 1982, *X* entered into similar agreements with other parties, maintaining sufficient cattle to satisfy all outstanding agreements. None of the cattle that *X* owned were designated as being held for a specific party.

On November 1, 1982, *P* elected to purchase 1,000 cattle from *X*. *X* delivered the herd to *P* in accordance with the agreement and received 150,000*x* dollars (100*x* + 50*x* dollars per animal) from *P* in full payment.

On its 1982 federal income tax return, *P* treated 100,000*x* dollars of the payment to *X* as the capital cost of acquiring the herd. *P* reported the 50,000*x* dollar balance of the payment as maintenance expenses deductible in the year paid.

LAW AND ANALYSIS

Section 162 of the Internal Revenue Code allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-12(a) of the Income Tax Regulations, relating to expenses of farmers, provides that purchase of feed and other costs connected with raising livestock may be treated as expense deductions if the costs represent actual outlay. However, amounts expended in purchasing livestock for breeding are investments of capital and shall be depreciated unless the animals are included in an inventory in accordance with 1.61-4 of the regulations.

Section 263(a) of the Code provides generally that no deduction shall be allowed for capital expenditures.

A taxpayer who owns livestock can treat maintenance costs as expenses which are currently deductible. However, a taxpayer who pays the costs of maintaining animals prior to their purchase must treat such costs as part of the animals' purchase price. Rev. Rul. 79-176, 1979-1 C.B. 123; Rev. Rul. 78-411, 1978-2 C.B. 112; *Duggar v. Commissioner*, 71 T.C. 147 (1978); and *Wiener v. Commissioner*, 58 T.C. 81 (1972), *aff'd per curiam*, 494 F.2d 691 (9th Cir. 1974).

Under the terms of the agreement between *P* and *X*, *X* merely extended to *P* an offer to sell the cattle at a price that varied depending upon the date of sale. *P* did not purchase the cattle until November 1, 1982. Thus, the 50,000*x* dollar payment representing the cost of maintaining the cattle during the period before *P* acquired the cattle is not a deductible expense of *P*. Such costs are part of the animals' purchase price.

It should be noted that the purchase price in this class may be in excess of the animals' fair market value since the general partner of *P* is related to *X* and there is no indication that the terms of the purchase were arrived at through arm's length negotiation. Under these circumstances the transaction will be carefully scrutinized to ensure that the payment was not for a purpose other than the acquisition of the cattle and that entire payment should be reflected in the basis of the cattle. *See Lemmen v. Commissioner*, 77 T.C. 1326 (1981).

HOLDING

P may not deduct in 1982 the amount *P* paid to *X* for *X* to maintain the cattle prior to the date the cattle were sold to *P*.

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26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Mileage allowance for transportation paid by employers to employees. See Rev. Rul. 84-51, page 90.

Section 163.—Interest

26 CFR 1.163-1: Interest deduction in general. (Also Section 461; 1.461-1.)

Interest; deduction; nonrecourse obligation. A partnership that purchases timeshare units in a vacation home with a nonrecourse obligation calling for a large balloon payment of interest and principal in 30 years is not allowed a deduction for the interest purportedly accrued on the obligation because the obligation does not constitute a valid indebtedness.

Rev. Rul. 84-5

ISSUE

Under the circumstances described below, can a partnership deduct interest with respect to a nonrecourse note under section 163 of the Internal Revenue Code?

FACTS

X, a corporation, was engaged in the construction of vacation homes and the marketing of "timeshare units" therein. Each timeshare unit consisted of a 1/350th undivided in-

terest in a specific vacation home. Fifteen days during the year were reserved for maintenance and repairs. Purchasers held title as tenants in common with each owner having the exclusive right to possess the property one day per year for each timeshare unit purchased.

X also offered to finance a portion of the purchase price of the timeshare units. The finance agreement called for "add-on interest," whereby the entire amount of interest due on the 30-year obligation is calculated based on the sum of the outstanding principal balance and unpaid interest. The total amount of interest is then added to the original principal amount. The finance agreement also provided that the purchaser could retire the outstanding indebtedness on December 3 of any year. A purchaser who prepays the entire obligation will be entitled to a rebate of interest in accordance with Rule of 78's method. For example, using the Rule of 78's method, the amount that would be required to retire the loan at the end of the first year would be the principal amount plus 30/465ths of the total interest of the 30-year obligation. (The 30 numerator is the number of years of the loan remaining at the time the calculation is made, and the 465 denominator is the sum of the years digits for 30 years.) In its promotional materials, *X* represented that a taxpayer who uses the accrual method of accounting would be entitled to deduct interest allocated according to the Rule of 78's method.

At the suggestion of *X*'s sales agent, individuals *A* and *B* organized a general partnership, *P*, to acquire 7 timeshare units in a vacation home. *P* adopted the accrual method of accounting. *A* and *B* each contributed 2,500 dollars to *P* in exchange for a one-half interest therein.

On January 2, 1980, *P* entered into an installment contract with *X* for the purchase of the 7 timeshare units for a total purchase price of 14,000 dollars, the actual fair market value of the units. On January 3, 1980, *P* made a cash downpayment of 2,000 dollars and entered into a finance agreement with *X* for the 12,000 dollar balance of the purchase price. On the same day *X* conveyed a 7/350th interest in the vacation home to *P*, as a tenant in common.

Under the terms of the finance agreement, the total amount of finance charge over the 30-year period was calculated to be 318,500 dollars. *P* had a recourse obligation to make annual "interest" payments to *X* of 2,800 dollars on December 31 of each of the first 10 years. No additional payments were due until the 30th year, when *P* must pay *X* the principal balance, 12,000 dollars, and all accrued and unpaid interest, 290,500 dollars, for a total payment of 302,500 dollars. The obligation of 302,500 dollars was entirely nonrecourse with respect to *P*, *A*, and *B* and was secured only by the 7 timeshare units in the vacation home.

If *P* wanted to retire the debt on December 31, 1980, *P* would be required to pay the principal amount of 12,000 dollars plus interest of approximately 20,548 dollars (30/465 times 318,500), for a total of 32,548 dollars. Of this total amount, *P* would have been required to make the annual payment of 2,800 dollars even if *P* did not want to retire the entire obligation.

On December 31, 1980, *P* paid 2,800 dollars to *X*. *P* accrued and deducted an interest expense of 20,548 dollars for the 1980 tax year. *P* realized 848 dollars of rental income from the leasing of the 7 timeshare units to an unrelated party during 1980 and incurred incidental expenses of 80 dollars with respect to the leasing activity. *P*'s partnership return for 1980 showed an ordinary loss of 20,500 dollars, the calculation of which included a depreciation allowance of 720 dollars. *A* and *B* each claimed a deduction of 10,250 dollars on their 1980 individual income tax returns as their allocable share of *P*'s losses.

LAW AND ANALYSIS

Section 163(a) of the Code allows a deduction for all interest paid or accrued within the taxable year on indebtedness. In order for interest to be deductible under section 163(a), there must be a valid indebtedness to pay a principal sum and the interest thereon. With regard to debt incurred on the purchase of property, in the absence of personal liability, a debt will have substance and genuine existence, for federal tax purposes, only if the value of the underlying security bears a reasonable relationship to the amount of the indebtedness. *Estate of Franklin v. Commissioner*, 544 F.2d 1045, 1048 (9th Cir. 1976), *aff'g.* 64 T.C. 752 (1975); Rev. Rul. 77-110, 1977-1 C.B. 58.

In *Estate of Franklin* the court stated:

> For the debt to exist, the purchaser, in the absence of personal liability, must confront a situation in which it is presently reasonable from an economic point of view for him to make a capital investment in the amount of the unpaid purchase price.

It is not reasonable, at the time of purchase, to assume that *P* will ever pay any of the nonrecourse amounts. Although the principal amount of the nonrecourse obligation is nominally less than the fair market value of the property at the time of purchase, if *P* wanted to retire the debt on December 31 of the first year, the amount of the required payment would exceed twice the initial value of the 7 timeshare units. Consequently, the nonrecourse obligation does not constitute a valid indebtedness for federal income tax purposes, and *P* cannot accrue any interest expense or cost with respect to the purported interest and principal evidenced by the nonrecourse obligation.

Under the terms of the contract, however, *P* has a recourse obligation to make annual prepayments of "interest" to *X* of 2,800 dollars for each of the first 10 years. Because it can be concluded that the nonrecourse indebtedness is to be disregarded, it may be assumed that these recourse payments represent the remaining purchase price of *P*'s interest in the property. Furthermore, when discounted at 19.36 percent, an interest

rate within the limits charged on installment sales of similar real property, the payments of 2,800 dollars for each of the first 10 years reduce to a present value of 12,000 dollars, the balance of the purchase price remaining unpaid at the time of the sale. The 16,000 dollar difference between the total recourse payments (28,000 dollars) and the unpaid balance of the purchase price as stated in the contract (12,000 dollars) is interest that, in effect, has been agreed to by the parties. The ten recourse payments of 2,800 dollars each are self-amortizing level payments, and the amount of interest allocated to each payment is computed by applying the effective rate of interest (19.36 percent) to the unpaid balance of the 12,000 dollar obligation. *See* Rev. Rul. 83-84, 1983-1 C.B. 97.

HOLDING

P may not accrue any amount of interest attributable to the 302,500 dollar nonrecourse obligation. An interest deduction is allowed in 1980 for the portion of the 2,800 dollar payment that represents interest computed by applying the effective rate of interest to the unpaid balance of the 12,000 dollar obligation.

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26 CFR 1.163-1: Interest deduction in general.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed using the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-27, page 469.

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26 CFR 1.163-1: Interest deduction in general.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed under the Rule of 78's exceeds the loan payments made during any year of the term of the loan. See Rev. Proc. 84-28, page 475.

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26 CFR 1.163-1: Interest deduction in general.

A simplified procedure for individual borrowers to compute current and future years' interest deductions, with respect to certain loans, when they have been reporting interest deductions in accordance with the Rule of 78's computation. See Rev. Proc. 84-29, page 480.

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26 CFR 1.163-1: Interest deduction in general.

A procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to short-term consumer loans that are covered by the administrative exception of Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-30, page 482.

Section 166.—Bad Debts

26 CFR 1.166-2: Evidence of worthlessness. (Also Section 585; 1.585-2.)

Bad debts; allocated transfer risk reserve. The portion of an international loan that is subject to an allocated transfer risk reserve under federal banking regulations is conclusively presumed to be worthless under section 1.166-2(d)(1) of the regulations.

Rev. Rul. 84-94

ISSUE

Is the portion of an international loan that is subject to an allocated transfer risk reserve under federal banking regulations conclusively presumed to be worthless under section 1.166-2(d)(1) of the Income Tax Regulations?

FACTS

Section 905(a) of the International Lending Supervision Act of 1983, Pub. L. 98-181, 97 Stat. 1153, directs the federal banking agencies (Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation) to promulgate regulations requiring banks to establish special transfer risk reserves against certain international loans when the agencies determine that the quality of those assets has been impaired by a protracted inability of borrowers in the foreign country concerned to make payments on their external indebtedness. The regulations promulgated by the federal banking agencies require a bank to establish an allocated transfer risk reserve (ATRR) for an international loan found by the agencies to be affected by transfer risk problems as described above. 49 Fed. Reg. 5587 (1984) (to be codified at 12 C.F.R. 20.8, 211.42, 351.1).

Under the regulations, "transfer risk" means the possibility that a loan cannot be serviced in the currency of payment because of a lack of, or restraints on the availability of, needed foreign exchange in the country of the obligor. Factors considered by the agencies in determining whether an ATRR is required for particular international loans include whether 1) the obligors have failed to make full interest payments on external indebtedness, 2) the obligors have failed to comply with the terms of any restructured indebtedness, or 3) a foreign country has failed to comply with any International Monetray Fund or other suitable adjustment program, or whether no definite prospects exist for the orderly restoration of debt service. In determining what portion of the loan is subject to the ATRR, the agencies shall consider 1) the length of time the quality of the loan has been impaired, 2) recent actions taken to restore debt service capability, 3) prospects for restored loan quality, and 4) such other factors as the agencies may consider relevant to the quality of the loan.

The regulations promulgated by the federal banking agencies further provide that, for financial accounting purposes, a bank shall account for an ATRR separately from the allowance for possible loan losses. The ATRR must be established for each loan subject to the ATRR in the percentage amount specified. However, the regulations provide that a bank need not establish an ATRR if it charges off, in the period in which the ATRR is re-

quired, the requisite amount against the allowance for possible loan losses.

LAW AND ANALYSIS

Section 166(a) of the Internal Revenue Code provides that there shall be allowed as a deduction any debt that becomes worthless within the tax year.

Section 166(c) of the Code provides that in lieu of any deduction under section 166(a) there shall be allowed in the discretion of the Secretary a deduction for a reasonable addition to a reserve for bad debts.

Section 1.166-2(d)(1) of the regulations provides that if a corporation subject to supervision by federal authorities charges off a debt in whole or in part in obedience to the specific orders of the authorities then the debt shall, to the extent charged off within the tax year, be conclusively presumed to have become worthless in that year.

Section 585 of the Code and the regulations thereunder provide rules for the determination of a reasonable addition to a reserve for bad debts in the case of losses on the loans of banks.

In accordance with the regulations promulgated by the federal banking agencies, a bank with certain international loans affected by transfer risk will be directed by the agencies to establish on its books a separate ATRR, unless the bank charges off the requisite portion of each loan against the allowance for possible loan losses. The Internal Revenue Service will view either accounting treatment as the charge off of a debt in whole or in part pursuant to the specific orders of the federal authorities within the meaning of section 1.166-2(d)(1) of the regulations. For federal income tax purposes, a bank using the reserve method provided by section 166(c) of the Code will charge either the ATRR or the amount charged against the allowance for possible loan losses against its reserve for bad debts.

HOLDING

The portion of an international loan that is subject to an ATRR is conclusively presumed to be worthless under section 1.166-2(d)(1) of the regulations. The portion of the loan that is either charged to the ATRR or against the allowance for possible loan losses is excluded from the bank's loans or eligible loans outstanding for purposes of determining the reasonable addition to the reserve for bad debts under section 585 of the Code.

Section 167.—Depreciation

26 CFR 1.167(a)-1: Depreciation in general. (Also Section 263; 1.263(a)-1.)

Depreciation; railroad cross ties replaced. When a railroad company uses the retirement-replacement-betterment method of accounting, the cost of replacing wood cross ties with concrete ties is to be expensed as a replacement. Rev. Rul. 68-418 revoked.

Rev. Rul. 84-22

ISSUE

When a railroad company uses the "retirement-replacement-betterment" method (RRB) of accounting, should the cost of replacing wood cross ties with concrete ties be capitalized as a betterment or expensed as a replacement?

FACTS

In 1961, *X*, a railroad company, built an addition to its railroad tracks using wooden cross ties. *X* was using the RRB method of accounting for depreciation of its track structure. In 1972, *X* replaced some of the wooden cross ties with concrete cross ties and treated the cost of such installation as a current expense rather than a capital expenditure.

LAW AND ANALYSIS

Section 167(a) of the Internal Revenue Code provides as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, including obsolescence, of property used in the trade or business, or of property held for production of income. In taxable years before January 1, 1981, former Section 167(r) provided that in the case of railroad track used by a railroad company, "reasonable allowance" includes an allowance for such track computed under the RRB method.

Under the RRB method of depreciation, the initial investment in the track structure, including labor costs, is capitalized. The cost of replacements, less salvage value, is expensed. If there is replacement of part of the track structure with a betterment, the betterment portion is capitalized and the cost of the replacement portion, less salvage value, is expensed. See Rev. Rul. 67-22, 1967-1 C.B. 52.

Rev. Rul. 68-418, 1968-2 C.B. 115, holds that for purposes of RRB method, the installation of concrete cross ties to replace wooden ties is a betterment, the cost of which should be capitalized under section 263 of the Code. On the basis of the evidence presented with respect to the year in issue, 1968, the Court in *Florida East Coast Railway v. United States*, Trial Div. No. 22-78 (Ct. Cl. 1982), 82-2 USTC 9511, concluded that the concrete cross ties there had extensive developmental failures. Thus, those concrete cross ties could not be characterized as a betterment.

Section 263(f) of the Code, added by the Tax Reform Act of 1976, 1976-3 C.B. (Vol. 1) 1, provides that in the case of railroads using the RRB method of accounting, expenditures for acquiring and installing replacement ties of any material shall be accorded the same accounting treatment as expenditures for replacement ties.

In light of the enactment of section 263(f) of the Code and the evidence in *Florida East Coast Railway Co.* the Service will no longer advance the position that the installation of concrete cross ties for wood cross ties is a betterment the costs of which are to be capitalized. Rather, under the RRB method of depreciation accounting, such costs will be con-

sidered to be for replacements that can be expensed.

HOLDING

When a railroad company uses the retirement-replacement-betterment method of accounting, the cost of replacing wood cross ties with concrete ties is to be expensed as a replacement.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 68-418 is revoked.

The Economic Recovery Tax Act (ERTA) of 1981, section 203(c)(1), 1981-2 C.B. 256, 284, repealed section 167(r) of the Code. The accelerated cost recovery system (ACRS) of section 168(a) is applicable to recovery property placed in service after 1980.

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26 CFR 1.167(k)-2: Limitations.

T.D. 7945

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Amortization of rehabilitation expenditures for low-income housing

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to section 167(k) of the Internal Revenue Code of 1954 as amended by the Act of December 17, 1980, §3, (Pub. L. 96-541, 94 Stat. 3204) [1980-2 C.B. 596, 597] and the Economic Recovery Tax Act of 1981, §264, (Pub. L. 97-34, 94 Stat. 264) [1981-2 C.B. 256, 305]. Section 3 of the Act of December 17, 1980, extends the application of 167(k) to rehabilitation expenditures incurred prior to January 1, 1984. Section 264 of the Economic Recovery Tax Act of 1981, in certain circumstances, increases the maximum amount of rehabilitation expenditures which are properly amortizable over 60 months to $40,000. These regulations would provide taxpayers with the guidance needed to comply with the Acts.

DATE: These regulations are effective with respect to rehabilitation expenditures incurred after December 31, 1980.

FOR FURTHER INFORMATION CONTACT: George T. Magnatta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention:CC:LR:T) (202-566-3294)

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains final regulations which amend the Income Tax Regulations (26 CFR Part 1) under section 167(k) of the Internal Revenue Code of 1954. The regulations were published as a notice of proposed rulemaking in the Federal Register on July 15, 1982 (47 FR 30796) [LR-195-81, 1982-2 C.B. 901]. These amendments to the regulations are issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

IN GENERAL

Section 167(k) was amended by the Act of December 17, 1980, to extend the application of section 167(k) to rehabilitation expenditures incurred prior to January 1, 1984.

Section 167(k) was further amended by the Economic Recovery Tax Act of 1981, §264, to increase to $40,000, in certain circumstances, the maximum amount of rehabilitation expenditures which are properly amortizable over 60 months. In order for a taxpayer to be entitled to amortize the increased amount, the final regulations require that the rehabilitation be conducted pursuant to a program which is certified by the Department of Housing and Urban Development, a State, or other political subdivision of the United States as providing rental housing for families or individuals of low or moderate income. Further, the program must provide that tenants demonstrating home ownership capabilities be entitled to purchase the dwelling units and that the taxpayer limit the income received from the leasing and the sale of such rehabilitated units. To determine the maximum sales price with respect to such units, the taxpayer's cost basis in the property generally is to be reduced by the net tax benefit. Deductions under section 168 shall be deemed allowed under section 167 in accordance with provisions of section 167(a).

Several comments were received on the proposed regulations. Most comments recommended legislative changes to section 167(k). One comment recommended that the regulations prescribe a minimum quality standard for rehabilitated housing. That recommendation, however, was not adopted because such standards are more properly within the discretion of the administrator of the certified program.

Another comment recommended that the net tax benefit derived by the taxpayer from the rental of the unit should be reduced by any federal income tax incurred with respect to the gain from the sale of the property. The commentator reasoned that the tax on the gain is a "recapture" of the tax benefits that result from rental of the unit. This recommendation was not adopted.

Section 167(k)(2)(B)(iii) limits the sum of the taxable income from leasing residential property and the amount realized from the sale or disposition of the property to the excess of the taxpayer's cost basis in the property less any net tax benefit realized. The term "net tax benefit" is described in that section as the benefits from deductions allowable under section 167 (or under section 168) less the "tax incurred on taxable income *from leasing*, if any" (emphasis added). Tax on gain resulting from the disposition of property is not a direct result of leasing property or sim-

ply a "recapture" of prior benefits, even though in some cases a large measure of that gain may be attributable to reductions in basis available under section 167. Section 167 (k)(2)(B)(iii) explicitly makes provision for the tax consequences of deductions under section 167 and for leasing income. No similar provision is made with respect to the amount realized upon disposition of the unit.

The final regulations, therefore, are adopted without amendment except for a revision of example (3) and some editorial changes.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this final regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

The Internal Revenue Service has concluded that the final regulation is interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, this final regulation does not constitute a regulation subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of this regulation is George T. Magnatta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Adoption of amendment to the regulations

Accordingly, the regulations proposed to be prescribed as amendments to 26 CFR Part 1 are hereby adopted as follows:

1. Section 1.167(k)-1 is amended by removing "January 1, 1982", and "December 31, 1981", each place that they appear in such section and inserting in lieu thereof "January 1, 1984", and "December 31, 1983", respectively.

2. Section 1.167(k)-2 is amended as follows:

1. Paragraph (a) is amended by removing "December 31, 1981", and inserting in lieu thereof "December 31, 1983."

2. Paragraph (c) is amended by revising the first sentence of subparagraphs (1) thereof.

3. A new paragraph (f) is added immediately following paragraph (e). These new and revised provisions read as follows:

§1.167(k)-2 Limitations.

* * * * *

(c) *Maximum amount.* (1) In general, the maximum amount of rehabilitation expenditures paid or incurred by the taxpayer with respect to any dwelling unit which may be taken into account under section 167(k) is $20,000 or $40,000 in the case of expenses paid or incurred in connection with a certified program which satisfies the requirements of paragraph (f) of this section.***

* * * * *

(f) *Maximum amount for rehabilitation expenses incurred in connection with a certified program.* (1) In the case of expenditures paid or incurred after December 31, 1980, the maximum amount of rehabilitation expenditures which may be amortized pursuant to section 167(k) with respect to any dwelling unit is $40,000 but only if the other requirements of this paragraph (f) are satisfied.

(2) The rehabilitation of such dwelling unit must be conducted pursuant to a program that is certified as providing low-income rental housing (as defined in §1.167(k)-3(b)) by the Department of Housing and Urban Development or by the government of a State or other political subdivision of the United States. The program must require the taxpayer to certify to such authority the amount of rehabilitation expenditures (as defined in §1.167(k)-3(a)). For purposes of the foregoing, the program shall be deemed certified if such program is required by statute of by a contract with such authority to provide low-income rental housing, and such authority agrees to provide a direct or indirect benefit to the taxpayer in connection with such statute or agreement (*e.g.*, an agreement by the authority to repair neighborhood streets or to abate taxes).

(3) Each dwelling unit (as defined in §1.167(k)-3(c)) must be the principal residence of a family or individual of low or moderate income (as defined in §1.167(k)-3(b)).

(4) The program shall provide:

(i) That tenants demonstrating home ownership responsibility are entitled to purchase the dwelling units; and

(ii) That the sum of taxable income (as defined in section 63 and the regulations thereunder) from the rental of the dwelling unit and the amount realized (as provided in section 1001(b) and the regulations thereunder) from the sale or disposition of such dwelling unit, if sold, is reasonably expected not to be greater than an amount equal to:

(A) The taxpayer's adjusted basis (as provided by section 1016 and the regulations thereunder) without adjustment for deductions under section 167 or 168 reduced by

(B) The net tax benefit realized by the taxpayer from the rental of the dwelling unit.

The net tax benefit is the amount by which the taxpayer's federal income taxes are reduced as a result of deductions under section 167 or 168 for such unit, less the amount of tax properly attributable to the taxable income (as defined in section 63 and the regulation thereunder) from the rental of the dwelling unit. The net tax benefit shall not be less than zero. In determining the net tax benefit to the taxpayer, taxable income from the rental of the dwelling unit and the deduction under section 167 or 168 shall be taken into account annually by multiplying the difference between

such income and deduction (which may be less than zero) by the taxpayer's maximum marginal rate of tax on income (in the case of a partnership, the maximum marginal rate of tax imposed by section 1).

(5) The following examples illustrate the provisions of this paragraph (f):

Example (1). On January 1, 1983. A, who is subject to a 50 percent marginal tax rate, placed in service 25 substantially rehabilitated townhouses. The property was rehabilitated in connection with an agreement between City X and A as part of a program operated by City X which is intended to provide housing for low-income individuals. As part of the agreement, City X agreed to abate real property taxes on the rehabilitated property for 5 years and A agreed to certify the total expenditures for the rehabilitation of such housing units and to sell the units after 5 years to those tenants demonstrating home ownership responsibility for an amount not in excess of A's adjusted basis (without adjustment for deductions under section 167 or 168) in each unit less A's net tax benefit from rental of each unit. A purchased the 25 townhouses located in City X for $1 million. A also borrowed $40,000 per unit which is secured by a 13 percent mortgage on each townhouse. The borrowed money was used to rehabilitate the townhouse which have an adjusted basis (without adjustment for deductions under section 167 or 168) of $80,000 each. After completing rehabilitation, A leases the townhouses to low-income individuals for a monthly rental of $460, an amount equal to interest on the mortgage, hazard insurance, and maintenance and operating expenses. As a result, A reasonably expected to have no taxable income from the rental of the townhouses. In 1968, A realizes $49,600 (which includes the tenant's assumption of the unpaid balance of the mortgage) from the sale of each unit to tenants who have complied with the terms of the lease for the previous 5 years. During the 5 year period that A leased the townhouses, A received a net tax benefit from each unit under section 108 of $10,400 and under section 167(k) of $20,000. Since A and the program meet the requirements of section 167(k)(2)(B) and this paragraph, the maximum amount which A may amortize pursuant to section 167(k) is $40,000 per unit.

Example (2). The facts are the same as in example (1), with the additional fact that the program does not require A to rebuild any dwelling unit unexpectedly destroyed. In 1985, a fire destroys one of the dwelling units. The insurance proceeds received by A from the insurer of the unit exceed the difference between A's adjusted basis (without adjustments for section 167 or 168) in such unit and the net tax benefit received by A by virtue of such unit. Although the destruction is a disposition within the meaning of section 167, in 1981 A did not reasonably expect that a fire would occur. Since the program provided for the limitation of income as required by paragraph (f)(4) and since the disposition could not be reasonably forseen by A or X, the provisions of section 167(k)(2)(B) apply.

Example (3). The facts are the same as in example (1) except that A purchased the 25 townhouses for $250,000 and borrowed $25,000 per unit which is secured by a 5 percent mortgage on each townhouse. Each rehabilitated townhouse has an adjusted basis (without adjustment for deductions under section 167 or 168) of $35,000. A will lease the townhouses to low income individuals for a monthly rental of $620 per unit. A elects under section 168 to recover the $10,000 basis per unit attributable to the purchase price using the straight line method over 15 years. Over a 5-year period, mortgage interest, hazard insurance, and maintenance and operating expenses total $7,000 per unit. Thus, over a 5-year period, A reasonably expects to have taxable income from leasing each unit of $1,700 ($37,200 rental income less $7,000 expenses, $3,500 of section 168 deductions, and $25,000 of section 167(k) deductions). In 1988, A realizes $19,400 (which includes the tenant's assumption of the unpaid balance of the mortgage) from the sale of each unit to tenants who have complied with the terms of the lease for the previous 5 years. A's net tax benefit from each unit is $13,400 (the difference between $28,500 of deductions under sections 167 and 168 and $1,700 of taxable income from leasing, multiplied by A's 50% marginal rate of tax). The amount A realizes from the sale of each unit ($19,400) plus the taxable leasing income per unit ($1,700) does not exceed A's adjusted basis (without adjustment for deductions under section 167 or 168) or $35,000 per unit, reduced by A's net tax benefit ($13,400). Since A and the program meet the requirements of section 167(k)(2)(B) and this paragraph, A may amortize $25,000 pursuant to section 167(k).

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code (68 Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved February 7, 1984.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 23, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 24, 1984, 49 F.R. 6890).

Section 168.—Accelerated Cost Recovery System

ACRS; house converted to rental use after 1980. The taxpayer, who acquired a house in 1978 and used it as a personal residence until it was converted to rental use in 1982, may not recover its cost under the provisions of the Accelerated Cost Recovery System (ACRS) of section 168 of the Code.

Rev. Rul. 84-23

ISSUE

Whether the taxpayer, who acquired a house in 1978 and used it as a personal residence until it was converted to rental use in 1982, may recover its cost under the provisions of the Accelerated Cost Recovery System (ACRS) of section 168 of the Internal Revenue Code.

FACTS

A calendar year taxpayer purchased a house in 1978 and used it as a personal residence until it was converted to rental use in 1982. During the entire 1978 to 1982 time period the property was owned by the taxpayer.

LAW AND ANALYSIS

Section 167(a) of the Code provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business, or of property held for the production of income. In general, in the case of recovery property (within the meaning of section 168), the deduction allowable under section 168 shall be deemed to constitute the reasonable allowance provided by this section.

Section 168(a) of the Code provides that there shall be allowed as a deduction for any taxable year the amount determined under this section with respect to recovery property.

Section 168(c)(1) of the Code provides that, except as provided in subsection (e), the term "recovery property" means tangible property of a character subject to the allowance for depreciation that is used in a trade or business or held for the production of income.

Section 168(e)(1) of the Code provides that the term "recovery property" does not include property placed in service by the taxpayer before January 1, 1981. Property is considered placed in service when it is placed in a condition of readiness for a specifically assigned function,

whether in the taxpayer's trade or business or the production of income, in a tax-exempt activity, or in a personal activity.

In the situation described in the facts, the taxpayer acquired the property and placed it in service in 1978 as a residence, i.e., for use in a personal activity. Therefore, the property is excluded from the definition of "recovery property" by section 168(e)(1) of the Code.

HOLDING

The taxpayer, who acquired a house in 1978 and used it as a personal residence until it was converted to rental use in 1982, may not recover its cost under the provisions of the Accelerated Cost Recovery System (ACRS) of section 168 of the Code. Taxpayer must recover the cost of the house through depreciation deductions computed in accordance with the rules provided by section 167 of the Code and related sections of the Code (such as section 280A) and any regulations thereunder.

Whether cost charged to the inside wiring account of a public telephone company are recoverable under section 168 of the Code. See Rev. Rul. 84-24, page 89.

Section 170—Charitable, Etc. Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Charitable contributions; right to use of lodging and transportation. A radio station that donates to an agency of the U.S. Government its right to use of lodging and transportation acquired from hotels and airlines in exchange for radio advertising time may deduct, under section 170 of the Code, the fair market value of the rights donated. Rev. Ruls. 57-462 and 67-236 distinguished.

Rev. Rul. 84-1

SSUE

Whether a radio station is allowed a charitable contribution deduction under section 170 of the Internal Revenue Code for the donation to an agency of the United States Government of its rights to the use of certain lodging and transportation under the circumstances described below.

FACTS

A radio station entered into an arrangement with several hotels and airlines pursuant to which the station provided radio advertising time to the hotels and airlines in exchange for lodging and transportation provided by the hotels and airlines. The radio station included in its gross income the fair market value of the lodging and transportation, and the hotels and airlines included in their respective gross incomes the fair market values of the advertising time. Immediately after their receipt, the radio station donated its rights to the lodging and transportation to an agency of the United States Government, an organization described in section 170(c)(1) of the Code. Under applicable federal statutes, the agency director is authorized to accept and use gifts for the purpose of carrying out of any of the agency's functions. The radio station subsequently claimed a charitable contribution deduction for the fair market value of the donated rights.

LAW AND ANALYSIS

Section 170 of the Code allows, subject to certain limitations, a deduction for charitable contributions to or for the use of organizations described in section 170(c), payment of which is made during the taxable year.

Section 170(c)(1) of the Code defines a charitable contribution, in part, as a contribution or gift to or for the use of the United States, if the contribution or gift is made exclusively for public purposes.

Section 1.170A-1(g) of the Income Tax Regulations requires the disallowance of a charitable deduction for the contribution of services.

Here, the contribution by the radio station of the right to the lodging and transportation provided by the hotel and airlines is a contribution of property in the form of a contract right to receive purchased services. It is not a contribution of the donor's services. This situation is analogous to the situation described in Rev. Rul. 68-113, 1968-1 C.B. 80. In that revenue ruling, a taxpayer purchased dancing lessons from a dancing school and donated the right to receive the lessons to a charitable organization. That revenue ruling concluded that the value of the right to receive the dancing lessons is deductible as a charitable contribution.

Rev. Rul. 57-462, 1957-2 C.B. 157, and Rev. Rul. 67-236, 1967-2 C.B. 103, which disallow a charitable deduction for a donor's contribution of newspaper advertising space and radio broadcast time, respectively, are distinguishable, since they involve a contribution of services performed by the donor.

HOLDING

The contribution by the radio station of its rights to use the lodging and transportation is deductible as a charitable contribution under section 170(a) of the Code, subject to the limitations of section 170(b), in an amount equal to the fair market value of the rights contributed. Although this contribution of property is subject to the limitations of section 170(e)(1), no reduction is required in this case, because the donor's basis in the contributed property is equal to its fair market value.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 57-462 and Rev. Rul. 67-236 are distinguished.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance for deduction.

Charitable contribution; reimbursed expenditures. The Service will follow the decision of the U.S. Court of Appeals for the Second Circuit in *Rockefeller v. Commissioner* that unreimbursed expenses

incurred in rendering services to charitable organizations were contributions made "to" the charitable organization. Rev. Ruls. 56-508, 57-38, 58-279, 67-362, 67-364, 69-473, 70-519, 77-280, 79-142, and 80-45 modified.

Rev. Rul. 84-61

ISSUE

Whether unreimbursed expenditures qualify as contributions "to" a charity under section 170 of the Internal Revenue Code.

FACTS

A, an individual, incurred expenditures incident to the rendition of gratuitous services to *X*, an organization described in section 170(b)(1)(A) and 170(c) of the Code. *A* was not reimbursed for the expenditures.

LAW AND ANALYSIS

Subject to certain limitations, section 170(a) of the Code allows a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 170(b)(1)(A) of the Code allows individuals to claim charitable contribution deductions for gifts "to" certain qualified organizations to the extent that the aggregate of such contributions does not exceed 50 percent of the taxpayer's contribution base for the taxable year.

However, if the taxpayer makes a charitable contribution "for the use of" certain charitable organizations, the taxpayer may only deduct charitable contributions made during the taxable year to the extent of 20 percent of the taxpayer's contribution base during the taxable year. See section 170(b)(1)(B) of the Code and section 1.170A-8 of the Income Tax Regulations.

Section 1.170A-1(g) of the regulations provides that no deduction is allowable under section 170 of the Code for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization to which contributions are deductible may constitute a deductible contribution.

In *Rockefeller v. Commissioner*, 676 F.2d 35 (2nd Cir. 1982), *aff'g.* 76 T.C. 178 (1981), the taxpayer incurred unreimbursed expenses in rendering services to qualified charitable organizations. The court held that such contributions were made "to" these charitable entities, and the taxpayers were allowed a charitable contribution deduction under section 170(b)(1)(C) of the Code, repealed by the Tax Reform Act of 1976, section 1901(a)(28)(A)(ii), 1976-3 (Vol. 1) C.B. 1, 244.

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Second Circuit in *Rockefeller* as precedent in the disposition of similar cases involving either section 170 (b)(1)(C) of the Code, now repealed, or section 170(b)(1)(A).

Accordingly, in the instant case, *A* is entitled to a charitable contribution deduction, to the extent provided under section 170(b)(1)(A) of the Code, for the unreimbursed expenditures that were made incident to the rendition of services to *X*.

EFFECT ON OTHER RULINGS

Rev. Rul. 56-508, 1956-2 C.B. 126; Rev. Rul. 57-38, 1957-1 C.B. 96; Rev. Rul. 58-279, 1958-1 C.B. 145; Rev. Rul. 67-362, 1967-2 C.B. 117; Rev. Rul. 67-364, 1967-2 C.B. 120; Rev. Rul. 69-473, 1969-2 C.B. 37; Rev. Rul. 70-519, 1970-2 C.B. 62; Rev. Rul. 77-280, 1977-2 C.B. 14; Rev. Rul. 79-142, 1979-1 C.B. 58; and Rev. Rul. 80-45, 1980-1 C.B. 54, are modified to the extent that they imply that unreimbursed expenditures may not qualify as contributions "to" a charity for the purpose of qualifying under, now repealed, section 170(b)(1)(C) of the Code, or under section 170(b)(1)(A).

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts, allowance of deduction.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

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26 CFR 1.170A-12: Valuation of a remainder interest in real property for contributions made after July 31, 1969.
(Also Sections 642, 664, 2031, 2512; 1.642(c)-6, 1.664-4, 20.2031-7, 25.2512-5.)

T.D. 7955

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 11—TEMPORARY INCOME TAX REGULATIONS UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974; PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954; PART 25; GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Revision of actuarial tables and interest factors

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to tables for valuing annuities, life estates, terms for years, remainders, and reversions for purposes of Federal income, estate, and gift taxation. Changes to the applicable regulations are necessary because the interest rate used in constructing the tables no longer reflects prevailing interest rates. These regulations provide guidance to Internal Revenue Service personnel who administer the Code and members of the public who are subject to and must comply with these tables.

DATES: The regulations are generally effective for transfers occurring after November 30, 1983.

FOR FURTHER INFORMATION CONTACT: Neil W. Zyskind of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 31, 1983, the Federal Register (48 FR 50087) [LR-85-80, [1983-2 C.B. 649] published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 51, 101, 170, 642, and 664; the Temporary Income Tax Regulations under the Employee Retirement Security Act of 1974 (26 CFR Part 11) under section 414; the Estate Tax Regulations (26 CFR Part 20) under sections 2031, 2032, and 2055; and the Gift Tax Regulations (26 CFR Part 25) under sections 2512, 2522, and 2523 of the Internal Revenue Code of 1954 (Code). The proposed regulations contained tables based on a 10 percent income and discount factor. In addition, the proposed tables eliminated the distinction between male and female mortality and provided for tables which are gender neutral.

A public hearing was held on January 12, 1984. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury Decision.

This Treasury decision is issued under the authority contained in sections 170(f)(4), 642(c)(5), and 7805 of the Code (83 Stat. 544, 26 U.S.C. 170(f)(4); 83 Stat. 560, 26 U.S.C. 642(c)(5); 68A Stat. 917; 26 U.S.C. 7805).

POOLED INCOME FUNDS

The Service received many comments objecting to the proposed adoption of an assumed 10 percent rate of return for transfers to pooled income funds which have been in existence for less than 3 taxable years preceding the taxable year in which the transfer is made. Although most of these comments did not take issue with the proposal to increase the existing 6 percent rate, they indicated that a 10 percent rate of return is not generally a true reflection of the earnings of pooled income funds currently in existence.

As a result of these comments, the Service has solicited and compiled data from various pooled income funds to determine a more accurate picture of the rates of return earned during the last 3 years. Based on the information gathered, the Service has concluded that, on the average, the rate of return earned by pooled income funds in the past three years is approximately 9 percent. Hence, tables based on this 9 percent rate will be used for valuing contributions to pooled income funds in existence for less than 3 years. This rate will be effective as of December 1, 1983.

The Service is limiting this change to the pooled income fund area since the statutory scheme of section 642(c)(5) implies that deductions for transfers to such funds are to be based on the fund's yearly rate of return. With respect to transfers made to charitable remainder trusts and other types of charitable and noncharitable transfers, the primary focus is on an income and discount factor and not the yearly rate of return. Thus, the Service is adopting a 10 percent rate for these types of transfers.

TESTAMENTARY TRANSFERS; EFFECTIVE DATES

The Service also received a number of comments objecting to the short period of time between the filing of the proposed regulations (October 25, 1983) and the proposed effective date of the regulations (December 1, 1983). Because of this short time period, many people were unable to change their wills before the proposed effective date. Consequently, for decedents dying after November 30, 1983, but before having amended their wills, the new tables may result in significant distortions of estate plans. Moreover, some people who are unable to change their wills because of incompetency will be at a severe disadvantage.

As a result of these comments, the Service has decided to provide a transition period for testamentary transfers in the final regulations. For purposes of testamentary transfers, if the decedent dies after November 30, 1983, and before August 9, 1984, the 6 percent or 10 percent rate may be used, whichever is most beneficial to the taxpayer. Additionally, the final regulations allow the use of the 6 or 10 percent rate to a decedent who on December 1, 1983 was under a mental disability such that the disposition of that person's property could not be changed, and such person never regains competency before death, or dies within 90 days of the date on which such person first regains competency. For decedents dying on or after August 9, 1984 and not covered by the incompetency exception, the 10 percent rate applies.

CHARITABLE REMAINDER TRUSTS

The proposed regulations under §§1.664.1(a)(5)(i)(*a*) and (*b*) would have required that if payment of an amount to a beneficiary of a charitable remainder trust is overpaid or underpaid until the end of the taxable year in which the complete funding of the trust occurs, interest must be paid on the repayment or the deferred payment computed at 10 percent, effective December 1, 1983. As a result of the rate change, many difficulties were being encountered in amending existing trust governing instruments containing the 6 percent interest corrective payment provision which, under Revenue Rulings 72-395 (1972-2 C.B. 340), 80-123 (1980-1 C.B. 205), and 82-165 (1982-2 C.B. 117) was a mandatory provision of charitable remainder trusts. Thus, the Internal Revenue Service announced on December 22, 1983, (IR-83-158) that the 6 percent rate will apply to trust instruments executed before October 25, 1983, and not subsequently amended and that either the 6 percent or 10 percent rate may be used for in-

struments executed or amended after October 24, 1983, and before the end of the 30 day period after publication of the Treasury decision. The 10 percent rate applies to instruments executed or amended after the 30 day period after publication of the Treasury decision.

The final regulations extend the 30 day period announced in the news release to 90 days. Thus, under the final regulations, the 10 percent make-up rate will not apply to charitable remainder trusts created under instruments executed before October 25, 1983, and which are not later amended. For charitable remainder trust instruments executed or amended after October 24, 1983, but before August 9, 1984, either the 6 percent or 10 percent interest rate may be used. For instruments executed or amended on or after August 9, 1984, the 10 percent interest rate takes effect.

To avoid the need for further amendments to governing instruments upon future changes in the applicable interest rate, the Service intends to issue a Revenue Ruling modifying Revenue Rulings 72-395, 80-123, and 82-165 permitting taxpayers to insert in their trust governing instruments executed or amended after October 24, 1983, a reference to "the rate of interest prescribed under the section 644 regulations" rather than "6 percent a year compounded annually." The ruling will contain sample language which will satisfy these requirements.

JOINT LIFE TABLES

Many commentators were concerned with the lack of joint life tables. The Internal Revenue Service has recently issued Publication 723E which contain some of those tables. The remaining tables will be issued shortly in Publications 723C and 723D.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 533 do not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Neil W. Zyskind of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

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Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1, 11, 20, and 25 are amended as follows:

§1.52-1 [Amended]

Paragraph 1. The second sentence of paragraph (f) of §152-1 is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate."

§1.101-2 [Amended]

Par. 2. Section 1.101-2 is amended as follows:

a. Paragraph (e)(1)(iii)(*b*)(3) is amended by removing "as supplemented by "Actuarial Values for Estate and Gift Tax" (Internal Revenue Service Publication No. 11, Rev. 5-59)".

b. Example (1)(i) of paragraph (e)(2) is amended by inserting in the beginning of the example the sentence "A died on January 1, 1969."

§1.170A-6 [Amended]

Par. 3. Section 1.170A-6 is amended as follows:

a. Paragraph (c)(3)(i) is amended by removing §20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate,".

b. The second sentence of paragraph (c)(4) is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate,".

§1.170A-7 [Amended]

Par. 4. The third sentence of paragraph (c) of §1.170A-7 is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate,".

§1.170A-12 [Amended]

Par. 5. Section 1.170A-12 is amended as follows:

a. The fourth sentence of paragraph (a)(3) is amended by removing "§25.2512-9" and inserting in lieu thereof "§25.2512-5 or 25.2512-9, whichever is appropriate,".

b. The first sentence of paragraph (b)(1) is amended by removing "§25.2512-9 of this chapter (Gift Tax Regulations), using Table A(1) or A(2) (whichever is appropriate) contained in paragraph (f) of such section" and inserting in lieu thereof" §25.2512-5 or 25.2512-9 of this chapter (Gift Tax Regulations), using Table A, A(1), or A(2) (whichever is appropriate)".

c. The second sentence of paragraph (b)(1) is amended by removing "Table A(1) or A(2) in paragraph (f) of §25.2512-9 of this chapter (Gift Tax Regulations) before such figure is used in paragraph (d) of such section" and inserting in lieu thereof "Table A in paragraph (f) of §25.2512-5 or Table (A)(1) or A(2) in

›aragraph (f) of §25.2512-9 (which-ver is appropriate) of this chapter Gift Tax Regulations) before such igure is used in paragraph (d) of such ections".

d. Paragraph (b)(2) is revised to ead as set forth below.

e. Paragraph (c) is amended by re-noving "§25.2512-9" wherever it ap-›ears and inserting in lieu thereof '§25.2512-5 or 25.2512-9, whichever s appropriate" and by removing the erm "section" in the first sentence nd inserting in lieu thereof "sec-ions".

f. The second sentence of para-;raph (e)(1) is revised to read as set orth below.

g. Paragraph (e)(2) is amended by emoving "§20.2031-10(f)" and in-erting in lieu thereof "§20.2031-7(f) ›r 20.2031-10(f), whichever is appro-›riate,".

h. Paragraph (f) is amended by in-erting a new Table C immediately efore Table C(1) to read as set forth elow.

1.170A-12 Valuation of a remainder interest in real property for contributions made after July 31, 1969.

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(b) *Valuation of a remainder interest following only one life*—***

(2) *Computation of depreciation adjustment factor.* Computations under this paragraph (b)(2) are based upon Table C (Tables C(1) and C(2) for contributions made before December 1, 1983) contained in paragraph (f) of this section, which reflect interest at the rate of 10 percent (6 percent for contributions made before December 1, 1983) a year compounded annually, life contingencies determined from the values of lx that are set forth in Table LN of paragraph (f) of §20.2031-7 (§20.2031-10 for contributions made before December 1, 1983) of this chapter (Estate Tax Regulations), and depreciation on a straight line basis. The factor determined under this paragraph (b)(2) is the amount determined by dividing—

(i) The difference between—

(A) The R-factor in column 2 of each Table C opposite the initial age of the life tenant in column 1, and

(B) The R-factor in column 2 of such Table opposite the terminal age in column 1; by

(ii) The product of—

(A) The estimated useful life of the depreciable property, and

(B) The D-factor in column 3 of the Table opposite the initial age of the life tenant in column 1.

For purposes of this paragraph (b)(2), the term "initial age of the life tenant" means the age of the life tenant at the life tenant's birthday nearest the date of the contribution of the remainder interest, and the term "terminal age" is 110 or the sum of the initial age of the life tenant and the estimated useful life of the depreciable property, if that sum is less than 110. The factor determined under this paragraph (b)(2) is carried to the fifth decimal place.

* * * * *

(e) *Valuation of a remainder interest following more than one life or a term certain concurrent with one or more lives*—(1) ***The special factor is to be computed on the basis of (1) interest at the rate of 10 percent (6 percent for contributions made before December 1, 1983) a year, compounded annually, (ii) life contingencies determined from the values of lx that are set forth in Table LN of paragraph (f) of §20.2031-7 (§20.2031-10 for contributions made before December 1, 1983) of this chapter (Estate Tax Regulations). and (iii) if depreciation is involved, the assumption that the property depreciates on a straight line basis over its estimates useful life.***

(f) *Tables for computation of depreciation adjustment factor.****

'able C—Single Life, Unisex, 10 Percent Showing Commutation Factors for Reducing Assurances

(1) Age	(2) $\bar{R}$-Factors ($\bar{R}x$-0.5 $\bar{M}x$)	(3) D-Factors (Dx)
0	20601.8820	100000.0000
1	18745.1078	89089.0909
2	17896.7675	80889.2562
3	17134.4941	73472.5770
4	16429.7372	66746.8069
5	15767.6190	60644.1438
6	15138.2770	55103.3806
7	14535.8488	50070.3771
8	13956.0999	45498.9313
9	13394.8755	41346.9732
10	12848.7712	37575.0490
11	12315.0692	34148.6206
12	11791.7385	31034.9603
13	11278.4296	28203.7517
14	10776.5123	25627.9243

Table C—Continued (1)

(1) Age	(2) $\bar{R}$-Factors ($\bar{R}x$-0.5 $\bar{M}x$)	(3) D-Factors (Dx)
15	10288.4828	23283.5101
16	9817.2602	21149.4170
17	9365.3572	19207.3540
18	8934.3033	17440.9069
19	8524.5640	15835.0949
20	8135.6140	14376.2171
21	7766.4572	13050.9105
22	7416.1070	11847.0200
23	7083.4750	10753.7132
24	6767.2384	9761.1786
25	6465.8630	8860.4158
26	6177.7248	8043.0928
27	5901.3240	7301.3762
28	5635.3643	6628.2534
29	5378.8864	6016.9855

Table C—Continued (1)

(1) Age	(2) R-Factors (Rx-0.5 Mx)	(3) D-Factors (Dx)
30	5131.2180	5461.9063
31	4891.8674	4957.6067
32	4660.4462	4499.5740
33	4436.5638	4083.5035
34	4219.9416	3705.4651
35	4010.3324	3362.0572
36	3807.5065	3050.0428
37	3611.2994	2766.5317
38	3421.5937	2508.8798
39	3238.3061	2274.7237
40	3061.3521	2061.9429
41	2890.6420	1868.5882
42	2726.0615	1692.9463
43	2567.5085	1533.3316
44	2414.9086	1388.3088
45	2268.2027	1256.5015
46	2127.3361	1136.7490
47	1992.2392	1027.9431
48	1862.8255	929.1339
49	1738.9953	839.3916
50	1620.6495	757.9125
51	1507.6894	683.9235
52	1400.0247	616.7502
53	1297.5614	555.7731
54	1200.2136	500.4133
55	1107.8950	450.1766
56	1020.5111	404.5968
57	937.9552	363.2734
58	860.1101	325.8176
59	786.8483	291.8987
60	718.0316	261.1947
61	653.515988	233.425032
62	593.151050	208.323164
63	536.786458	185.646400
64	484.274647	165.169118
65	435.470923	146.691057
66	390.231191	130.029637
67	348.412484	115.018393
68	309.871028	101.510160
69	274.458723	89.373690

Table C—Continued (1)

(1) Age	(2) R-Factors (Rx-0.5 Mx)	(3) D-Factors (Dx)
70	242.023790	78.485899
71	212.410624	68.738934
72	185.462525	60.025503
73	161.030414	52.240720
74	138.978279	45.286194
75	119.181106	39.079472
76	101.516377	33.554790
77	85.857470	28.655743
78	72.071223	24.332315
79	60.017955	20.537735
80	49.554168	17.225638
81	40.539161	14.345119
82	32.838728	11.851619
83	26.322309	9.708333
84	20.861049	7.881796
85	16.329823	6.337738
86	12.612963	5.037938
87	9.606528	3.950395
88	7.213017	3.053341
89	5.337461	2.327112
90	3.88944207	1.74985139
91	2.78792754	1.29647139
92	1.96398998	.94419491
93	1.35941017	.67495018
94	.92475286	.47333801
95	.61870301	.32559372
96	.40767627	.21971148
97	.26494185	.14593989
98	.16999658	.09544351
99	.10779721	.06162281
100	.06756075	.03933062
101	.04187043	.02473831
102	.02567917	.01541272
103	.01555022	.00954095
104	.00927755	.00579891
105	.00543664	.00351449
106	.00307741	.00213000
107	.001629198	.001266081
108	.000746153	.000744754
109	.000205633	.000430849

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§1.642 [Amended]

Par. 6. Section 1.642(c)-6 is amended as follows:

a. Paragraph (a)(2) is amended by removing the sixth and seventh sentences and inserting in lieu thereof "A copy of the publication containing many such special factors, may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, D.C. 20402."

b. Paragraph (b)(1) is amended by removing "as to each male and female life involved, from the values of lx that are set forth in columns (2) and (3), respectively, of Table LN of paragraph (f) of §20.2031-10" and inserting in lieu thereof "from the values of lx that are set forth in Table LN of paragraph (f) of §20.2031-7 or 20.2031-10, whichever is appropriate,".

c. Paragraph (b)(2) is amended by removing "6 percent" wherever it appears and inserting in lieu thereof "9 percent (6 percent for transfers of property to pooled income funds made before December 1, 1983)".

d. Paragraphs (d)(1) through (3) are redesignated as paragraphs (e)(1) through (3), respectively, and new paragraphs (d)(1) through (3) are inserted immediately following paragraph (c)(5) to read as set forth below.

e. The heading of redesignated paragraph (e) and the first sentence of redesignated paragraph (e)(1) are revised to read as set forth below.

f. A new sentence is added at the end of redesignated paragraph (e)(1) to read as set forth below.

§1.642(c)-6 Valuation of a remainder interest in property transferred to a pooled income fund.

* * * * *

(d) *Present value of remainder interest dependent on the termination of one life; for transfers to pooled income funds made after November 30, 1983*—(1) *In general.* For transfers to pooled income funds made after November 30, 1983, the present value under this section of a remainder interest which is dependent on the termination of the life of one individual shall be determined under paragraphs (d)(1) through (3) of this section. The present value of such a remainder interest shall be computed by the use of Table G in paragraph (d)(3) of section. For purposes of the computations under this section, the age of an individual is to be taken as the age of the individual at the individual's nearest birthday. For transfers to pooled income funds made before December 1, 1983, see paragraphs (e)(1) through (3) of this section.

(2) *Computation of value of remainder interest.* The factor which is used in determining the present value of the remainder interest in the factor under the appropriate interest is the factor under the appropriate yearly rate of return in column (2) of Table G opposite the number in column (1) which corresponds to the age of the individual upon whose life the value of the remainder interest is based. If the yearly rate of return is a percentage which is between yearly rates of return for which factors are provided in Table G, a linear interpolation must be made. The present value of the remainder interest is determined by multiplying, by the factor determined under this paragraph (d)(2), the fair market value on the appropriate valuation date. If the yearly rate of return is below 2.2 percent or above 14 percent, see paragraph (a)(2) of this section. This paragraph (d)(2) may be illustrated by the following example:

Example. A, who will be 50 years old on April 15, 1985, transfers $100,000 to a pooled income fund on January 1, 1985, and retains a life income interest in such property. The highest yearly rate of return earned by the fund for its 3 preceding taxable years is 9.9 percent. In Table G the figure in column (2) opposite 50 years under 9.8 percent is .15653 and under 10 percent is .15257. The present value of the remainder interest is $15,455, computed as follows:

Factor at 9.8 percent for person aged 50	.15653
Factor at 10 percent for person aged 50	.15257
Difference	.00396

Interpolation adjustment:

$$\frac{9.9\% - 9.8\%}{.2\%} = \frac{x}{.00396}$$

$$x = .00198$$

Factor at 9.8 percent for person aged 50	0.15653
Less:	
Interpolation adjustment	.00198
Interpolated factor	.15455
Present value of remainder interest ($100,000 × .15455	$15,456

(3) *Actuarial tables.* The following tables shall be used in the application of the provisions of this section.

Table G—Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	2.2%	2.4%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%
0.....	.23930	.21334	.19077	.17112	.15401	.13908	.12603	.11461	.10461	.09583
1.....	.22891	.20224	.17903	.15880	.14114	.12570	.11220	.10036	.08998	.08086
2.....	.23297	.20610	.18265	.16218	.14429	.12862	.11489	.10284	.09225	.08293
3.....	.23744	.21035	.18669	.16600	.14787	.13198	.11802	.10576	.09496	.08544
4.....	.24212	.21485	.19098	.17006	.15171	.13559	.12141	.10893	.09793	.08821
5.....	.24701	.21955	.19547	.17434	.15577	.13943	.12503	.11234	.10112	.09121
6.....	.25207	.22442	.20015	.17880	.16001	.14345	.12884	.11593	.10451	.09439
7.....	.25726	.22944	.20497	.18342	.16441	.14763	.13280	.11968	.10805	.09773
8.....	.26259	.23461	.20995	.18820	.16898	.15198	.13694	.12360	.11176	.10125
9.....	.26809	.23995	.21511	.19315	.17373	.15652	.14126	.12771	.11567	.10495
10.....	.27373	.24544	.22043	.29828	.17865	.16123	.14576	.13200	.11975	.10883
11.....	.27953	.25110	.22592	.20358	.18375	.16613	.15045	.13648	.12402	.11290
12.....	.28546	.25690	.23156	.20904	.18902	.17119	.15531	.14113	.12847	.11715
13.....	.29149	.26280	.23731	.21462	.19440	.17638	.16029	.14591	.13304	.12152
14.....	.29757	.26877	.24312	.22026	.19986	.18164	.16535	.15076	.13769	.12597
15.....	.30368	.27476	.24896	.22593	.20535	.18693	.17044	.15565	.14238	.13045
16.....	.30978	.28075	.25481	.23161	.21085	.19224	.17554	.16055	.14707	.13494
17.....	.31589	.28676	.26068	.23732	.21637	.19756	.18066	.16547	.15178	.13945
18.....	.32204	.29280	.26659	.24306	.22193	.20294	.18584	.17044	.15655	.14401
19.....	.32825	.29892	.27257	.24889	.22759	.20840	.19110	.17550	.16140	.14866
20.....	.33457	.30514	.27867	.25484	.23336	.21399	.19650	.18069	.16639	.15344
21.....	.34099	.31148	.28489	.26092	.23927	.21972	.20203	.18602	.17152	.15836
22.....	.34751	.31794	.29124	.26712	.24532	.22559	.20771	.19151	.17680	.16344
23.....	.35416	.32452	.29773	.27348	.25152	.23162	.21356	.19716	.18225	.16869
24.....	.36096	.33127	.30439	.28002	.25791	.23784	.21960	.20301	.18791	.17414
25.....	.36793	.33821	.31124	.28676	.26452	.24429	.22588	.20910	.19380	.17984
26.....	.37509	.34535	.31832	.29374	.27136	.25098	.23240	.21545	.19996	.18581
27.....	.38244	.35269	.32560	.30093	.27844	.25792	.23918	.22206	.20639	.19205
28.....	.38998	.36023	.33311	.30836	.28577	.26512	.24623	.22894	.21310	.19858
29.....	.39767	.36795	.34080	.31599	.29330	.27253	.25350	.23605	.22004	.20534
30.....	.40553	.37584	.34868	.32382	.30104	.28016	.26100	.24341	.22724	.21236
31.....	.41352	.38388	.35672	.33182	.30897	.28799	.26871	.25097	.23464	.21961
32.....	.42165	.39208	.36494	.34001	.31710	.29603	.27664	.25877	.24230	.22710
33.....	.42993	.40044	.37333	.34839	.32543	.30428	.28478	.26679	.25018	.23484
34.....	.43834	.40894	.38188	.35694	.33395	.31273	.29314	.27504	.25830	.24280
35.....	.44689	.41760	.39060	.36567	.34266	.32139	.30172	.28351	.26665	.25102
36.....	.45556	.42640	.39947	.37458	.35156	.33024	.31050	.29220	.27523	.25948
37.....	.46435	.43534	.40850	.38365	.36063	.33929	.31949	.30111	.28404	.26816
38.....	.47325	.44440	.41767	.39288	.36987	.34851	.32867	.31022	.29305	.27707
39.....	.48226	.45358	.42696	.40225	.37927	.35791	.33804	.31953	.30228	.28620
40.....	.49136	.46288	.43640	.41177	.38884	.36749	.34759	.32904	.31172	.29555
41.....	.50056	.47228	.44596	.42143	.39856	.37724	.35733	.33874	.32137	.30512
42.....	.50988	.48182	.45566	.43125	.40846	.38717	.36727	.34866	.33124	.31493
43.....	.51927	.49145	.46547	.44120	.41850	.39727	.37739	.35877	.34132	.32495
44.....	.52874	.50118	.47540	.45128	.42869	.40752	.38768	.36906	.35159	.33518
45.....	.53828	.51099	.48543	.46146	.43899	.41791	.39811	.37952	.36204	.34560
46.....	.54788	.52088	.49554	.47176	.44943	.42844	.40871	.39014	.37267	.35621
47.....	.55754	.53083	.50574	.48216	.45998	.43910	.41944	.40092	.38347	.36701
48.....	.56726	.54087	.51604	.49267	.47065	.44990	.43034	.41188	.39446	.37801
49.....	.57703	.55097	.52652	.50327	.48144	.46083	.44137	.42299	.40562	.38929
50.....	.58685	.56114	.53677	.51398	.49234	.47189	.45256	.43427	.41695	.40056
51.....	.59670	.57136	.54740	.52476	.50333	.48306	.46386	.44567	.42844	.41209
52.....	.60658	.58161	.55798	.53560	.51441	.49432	.47528	.45721	.44006	.42378
53.....	.61647	.59189	.56859	.54651	.52556	.50567	.48679	.46886	.45182	.43562
54.....	.62635	.60217	.57923	.55744	.53675	.51708	.49838	.48060	.46367	.44756

Table G—Continued (1) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	2.2%	2.4%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%
55	.63622	.61246	.58987	.56840	.54798	.52854	.51004	.49242	.47563	.45962
56	.64606	.62273	.60052	.57937	.55923	.54004	.52175	.50430	.48766	.47177
57	.65589	.63299	.61117	.59037	.57052	.55159	.53352	.51626	.49978	.48402
58	.66569	.64324	.62181	.60136	.58183	.56316	.54533	.52827	.51196	.49636
59	.67546	.65347	.63246	.61237	.59316	.57478	.55719	.54036	.52424	.50879
60	.68521	.66368	.64309	.62338	.60450	.58643	.56910	.55250	.53658	.52131
61	.69492	.67388	.65372	.63440	.61587	.59811	.58107	.56471	.54901	.53393
62	.70461	.68406	.66434	.64542	.62726	.60982	.59307	.57697	.56150	.54662
63	.71425	.69420	.67494	.65643	.63865	.62155	.60510	.58928	.57405	.55940
64	.72384	.70430	.68550	.66742	.65002	.63327	.61714	.60161	.58664	.57222
65	.73336	.71434	.69602	.67837	.66137	.64498	.62918	.61395	.59926	.58508
66	.74281	.72431	.70647	.68926	.67267	.67666	.64120	.62628	.61188	.59796
67	.75216	.73419	.71684	.70009	.68391	.66829	.65319	.63859	.62448	.61083
68	.76143	.74399	.72714	.71085	.69509	.67986	.66512	.65086	.63706	.62370
69	.77060	.75370	.73735	.72153	.70622	.69139	.67702	.66311	.64963	.63656
70	.77969	.76334	.74750	.73215	.71728	.70286	.68888	.67533	.66218	.64942
71	.78870	.77290	.75758	.74272	.72830	.71431	.70073	.68754	.67474	.66231
72	.79764	.78240	.76760	.75323	.73928	.72572	.71255	.69974	.68730	.67520
73	.80646	.79178	.77751	.76364	.75016	.73704	.72429	.71188	.69980	.68805
74	.81511	.80099	.78725	.77387	.76086	.74819	.73586	.72384	.71214	.70075
75	.82353	.80995	.79674	.78386	.77132	.75909	.74718	.73557	.72424	.71320
76	.83169	.81866	.80596	.79357	.78149	.76971	.75822	.74700	.73606	.72538
77	.83960	.82710	.81491	.80301	.79139	.78004	.76897	.75815	.74758	.73726
78	.84727	.83530	.82360	.81218	.80101	.79010	.77944	.76902	.75883	.74886
79	.85473	.84328	.83207	.82112	.81041	.79993	.78968	.77965	.76984	.76023
80	.86201	.85106	.84034	.82986	.81960	.80955	.79971	.79008	.78064	.77140
81	.86905	.85861	.84837	.83835	.82853	.81891	.80948	.80024	.79118	.78230
82	.87585	.86589	.85612	.84655	.83717	.82796	.81894	.81009	.80140	.79288
83	.88239	.87291	.86360	.85447	.84552	.83672	.82810	.81962	.81131	.80314
84	.88873	.87971	.87085	.86216	.85362	.84524	.83700	.82891	.82096	.81314
85	.89487	.88630	.87789	.86963	.86150	.85352	.84567	.83795	.83037	.82291
86	.90070	.89258	.88459	.87674	.86901	.86141	.85394	.84659	.83936	.83224
87	.90609	.89838	.89079	.88332	.87597	.86874	.86162	.85461	.84771	.84092
88	.91106	.90372	.89650	.88939	.88234	.87549	.86870	.86201	.85542	.84893
89	.91570	.90872	.90184	.89507	.88839	.88182	.87534	.86895	.86266	.85645
90	.92014	.91350	.90696	.90051	.89416	.88789	.88171	.87562	.86961	.86369
91	.92435	.91804	.91182	.90569	.89964	.89367	.88779	.88198	.87625	.87059
92	.92822	.92222	.91630	.91045	.90469	.89900	.89338	.88784	.88237	.87697
93	.93170	.92597	.92032	.91474	.90923	.90379	.89842	.89312	.88788	.88271
94	.93477	.92929	.92387	.91853	.91325	.90803	.90288	.89780	.89277	.88781
95	.93743	.93216	.92695	.92181	.91673	.91171	.90675	.90185	.89701	.89223
96	.93967	.93458	.92955	.92458	.91966	.91481	.91001	.90527	.90058	.89594
97	.94167	.93674	.93186	.92704	.92228	.91757	.91291	.90831	.90376	.89926
98	.94342	.93863	.93389	.92921	.92457	.91999	.91546	.91098	.90655	.90217
99	.94508	.94041	.93580	.93124	.92673	.92227	.91786	.91349	.90917	.90490
100	.94672	.94218	.93770	.93326	.92887	.92453	.92023	.91598	.91177	.90761
101	.94819	.94377	.93940	.93508	.93080	.92656	.92236	.91821	.91410	.91003
102	.94979	.94550	.94125	.93704	.93288	.92875	.92467	.92063	.91662	.91266
103	.95180	.94766	.94357	.93952	.93550	.93152	.92758	.92367	.91980	.91597
104	.95377	.94979	.94585	.94194	.93806	.93423	.93042	.92665	.92291	.91920
105	.95663	.95288	.94916	.94547	.94181	.93818	.93458	.93101	.92747	.92395
106	.96101	.95762	.95425	.95091	.94760	.94430	.94104	.93779	.93457	.93137
107	.96688	.96398	.96110	.95824	.95539	.95256	.94975	.94696	.94418	.94143
108	.97569	.97354	.97141	.96928	.96717	.96507	.96298	.96090	.95883	.95676
109	.98924	.98828	.98733	.98638	.98544	.98450	.98356	.98263	.98170	.98077

Table G—Continued (2) Table, SIngle Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
0.....	.08811	.08132	.07534	.07006	.06539	.06126	.05759	.05433	.05143	.04884
1.....	.07283	.06576	.05952	.05400	.04912	.04480	.04096	.03754	.03450	.03179
2.....	.07471	.06746	.06106	.05539	.05037	.04591	.04194	.03841	.03527	.03246
3.....	.07704	.06962	.06304	.05722	.05205	.04745	.04336	.03972	.03646	.03355
4.....	.07962	.07202	.06528	.05930	.05398	.04924	.04502	.04125	.03789	.03487
5.....	.08243	.07464	.06773	.06159	.05612	.05124	.04689	.04300	.03952	.03639
6.....	.08542	.07745	.07037	.06406	.05844	.05342	.04893	.04492	.04131	.03808
7.....	.08857	.08042	.07316	.06669	.06091	.05574	.05112	.04697	.04324	.03990
8.....	.09189	.08355	.07612	.06948	.06354	.05822	.05346	.04918	.04533	.04186
9.....	.09540	.08687	.07926	.07245	.06635	.06089	.05598	.05156	.04759	.04400
10.....	.09908	.09037	.08258	.07560	.06934	.06372	.05866	.05411	.05000	.04630
11.....	.10296	.09406	.08609	.07894	.07251	.06673	.06153	.05684	.05260	.04877
12.....	.10701	.09793	.08977	.08245	.07586	.06992	.06457	.05973	.05536	.05141
13.....	.11119	.10191	.09358	.08608	.07932	.07322	.06772	.06274	.05824	.05415
14.....	.11544	.10597	.09745	.08978	.08285	.07659	.07093	.06581	.06117	.05695
15.....	.11972	.11007	.10136	.09350	.08640	.07998	.07417	.06890	.06411	.05976
16.....	.12402	.11416	.10527	.09723	.08995	.08337	.07739	.07197	.06704	.06255
17.....	.12832	.11827	.10919	.10096	.09351	.08675	.08062	.07504	.06996	.06533
18.....	.13268	.12243	.11315	.10474	.09711	.09018	.08387	.07813	.07290	.06813
19.....	.13712	.12667	.11720	.10860	.10078	.09367	.08720	.08130	.07591	.07099
20.....	.14170	.13105	.12138	.11259	.10459	.09730	.09065	.08458	.07904	.07397
21.....	.14642	.13557	.12570	.11671	.10853	.10106	.09423	.08800	.08229	.07707
22.....	.15129	.14024	.13017	.12099	.11261	.10496	.09796	.09155	.08568	.08030
23.....	.15634	.14508	.13481	.12544	.11687	.10903	.10185	.09526	.08923	.08368
24.....	.16159	.15013	.13967	.13009	.12133	.11330	.10594	.09918	.09297	.08726
25.....	.16709	.15543	.14477	.13500	.12604	.11782	.11028	.10334	.09696	.09108
26.....	.17286	.16101	.15014	.14018	.13103	.12262	.11489	.10778	.10122	.09518
27.....	.17891	.16686	.15580	.14564	.13630	.12771	.11979	.11249	.10576	.09955
28.....	.18525	.17301	.16175	.15140	.14187	.13309	.12499	.11751	.11060	.10421
29.....	.19183	.17940	.16796	.15742	.14700	.13873	.13044	.12278	.11570	.10914
30.....	.19867	.18606	.17443	.16370	.15380	.14464	.13617	.12833	.12107	.11433
31.....	.20574	.19295	.13114	.17023	.16013	.15079	.14214	.13412	.12668	.11977
32.....	.21307	.20010	.18811	.17702	.16674	.15722	.14838	.14018	.13256	.12548
33.....	.22064	.20751	.19535	.18407	.17362	.16391	.15490	.14652	.13873	.13147
34.....	.22846	.21516	.20283	.19138	.18075	.17087	.16168	.15312	.14515	.13772
35.....	.23653	.22307	.21058	.19896	.18816	.17811	.16874	.16001	.15186	.14426
36.....	.24484	.23124	.21859	.20681	.19584	.18562	.17608	.16717	.15886	.15108
37.....	.25340	.23966	.22685	.21492	.20379	.19340	.18369	.17462	.16613	.15819
38.....	.26219	.24831	.23536	.22328	.21199	.20144	.19157	.18233	.17368	.16557
39.....	.27120	.25720	.24411	.23188	.22044	.20974	.19971	.19031	.18149	.17322
40.....	.28045	.26633	.25311	.24075	.22916	.21830	.20812	.19856	.18959	.18115
41.....	.28992	.27569	.26236	.24986	.23814	.22714	.21681	.20710	.19797	.18938
42.....	.29965	.28532	.27188	.25926	.24741	.23627	.22579	.21594	.20665	.19791
43.....	.30960	.29518	.28163	.26890	.25693	.24566	.23606	.22505	.21562	.20673
44.....	.31977	.30527	.29164	.27880	.26671	.25532	.24458	.23445	.22488	.21585
45.....	.33013	.31557	.30185	.28892	.27673	.26522	.25436	.24410	.23440	.22523
46.....	.34071	.32609	.31230	.29929	.28700	.27538	.26441	.25402	.24420	.23490
47.....	.35148	.33681	.32296	.30988	.29750	.28579	.27471	.26421	.25427	.24484
48.....	.36246	.34777	.33387	.32072	.30826	.29647	.28529	.27469	.26463	.25508
49.....	.37364	.35893	.34499	.33179	.31927	.30739	.29613	.28543	.27527	.26562
50.....	.38503	.37030	.35634	.34310	.33053	.31859	.30724	.29646	.28620	.27645
51.....	.39659	.38187	.36790	.35462	.34201	.33001	.31860	.30774	.29740	.28755
52.....	.40832	.39362	.37965	.36636	.35371	.34167	.33020	.31928	.30886	.29893
53.....	.42021	.40554	.39158	.37829	.36562	.35355	.34204	.33105	.32057	.31056
54.....	.43222	.41760	.40367	.39039	.37771	.36562	.35407	.34304	.33250	.32243

Table G—Continued (3) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
55	.44436	.42980	.41591	.41264	.38997	.37787	.36630	.35523	.34465	.33452
56	.45660	.44212	.42828	.41504	.40239	.39029	.37870	.36761	.35699	.34682
57	.46897	.45456	.44079	.42760	.41498	.40289	.39130	.38020	.36956	.35935
58	.48142	.46712	.45342	.44030	.42771	.41565	.40408	.39297	.38231	.37208
59	.49399	.47980	.46620	.45314	.44062	.42859	.41704	.40595	.39529	.38504
60	.50666	.49260	.47910	.46613	.45367	.44170	.43019	.41912	.40847	.39822
61	.51944	.50552	.49214	.47927	.46690	.45499	.44353	.43250	.42187	.41164
62	.53232	.51856	.50531	.49256	.48028	.46845	.45706	.44607	.43548	.42527
63	.54529	.53169	.51860	.50598	.49381	.48208	.47076	.45984	.44930	.43913
64	.55832	.54491	.53198	.51950	.50746	.49583	.48461	.47377	.46329	.45317
65	.57140	.55819	.54544	.53312	.52121	.50971	.49859	.48784	.47744	.46738
66	.58451	.57152	.55895	.54681	.53506	.52369	.51269	.50204	.49173	.48175
67	.59763	.58486	.57251	.56054	.54896	.53774	.52688	.51635	.50614	.49625
68	.61076	.59823	.58609	.57432	.56292	.55187	.54115	.53075	.52066	.51088
69	.62390	.61162	.59971	.58816	.57695	.56607	.55551	.54526	.53530	.52563
70	.63705	.62503	.61337	.60204	.59104	.58035	.56997	.55987	.55006	.54053
71	.65023	.63849	.62709	.61600	.60522	.59474	.58455	.57463	.56498	.55559
72	.66344	.65199	.64086	.63003	.61949	.60923	.59924	.58952	.58004	.57082
73	.67661	.66547	.65463	.64407	.63378	.62375	.61398	.60446	.59518	.58613
74	.68964	.67882	.66827	.65798	.64796	.63818	.62864	.61933	.61026	.60140
75	.70243	.69193	.68168	.67168	.66192	.65240	.64310	.63402	.62515	.61649
76	.71495	.70477	.69482	.68411	.67563	.66636	.65731	.64836	.63981	.63135
77	.72717	.71731	.70768	.69826	.68905	.68005	.57124	.66263	.65420	.64596
78	.73912	.72959	.72026	.71114	.70221	.69347	.68492	.67655	.66836	.66033
79	.75083	.74163	.73262	.72379	.71515	.70669	.69840	.69028	.68232	.67452
80	.76235	.75348	.74479	.73627	.72792	.71973	.71171	.70384	.69613	.68856
81	.77360	.76506	.75669	.74848	.74043	.73252	.72377	.71717	.70970	.70237
82	.78452	.77632	.76827	.76036	.75260	.74499	.73751	.73016	.72295	.71587
83	.79513	.78725	.77952	.77192	.76446	.75713	.74992	.74284	.73589	.72905
84	.80547	.79792	.79051	.78322	.77606	.76901	.76208	.75527	.74857	.74198
85	.81557	.80836	.80126	.79429	.78742	.78067	.77402	.76748	.76104	.75471
86	.82524	.81835	.81157	.80489	.79832	.79185	.78548	.77921	.77304	.76695
87	.83423	.82764	.82115	.81477	.80847	.80228	.79617	.79015	.78423	.77838
88	.84253	.83623	.83002	.82390	.81787	.81193	.80607	.80029	.79460	.78899
89	.85033	.84430	.83836	.83250	.82672	.82102	.81540	.80985	.80438	.79899
90	.85784	.85208	.84639	.84079	.83525	.82979	.82441	.81909	.81384	.80867
91	.86502	.85951	.85408	.84871	.84342	.83820	.83304	.82795	.82292	.81796
92	.87164	.86638	.86118	.85605	.85098	.84598	.84104	.83616	.83134	.82657
93	.87761	.87257	.86759	.86267	.85781	.85300	.84826	.84357	.83894	.83437
94	.88290	.87806	.87327	.86854	.86386	.85924	.85468	.85017	.84570	.84130
95	.88750	.88282	.87820	.87364	.86913	.86466	.86025	.85589	.85158	.84732
96	.89136	.88683	.88236	.87793	.87355	.86922	.86494	.86071	.85652	.85238
97	.89481	.89041	.88606	.88176	.87750	.87329	.86913	.86501	.86093	.85690
98	.89783	.89354	.88930	.88511	.88096	.87685	.87279	.86877	.86479	.86085
99	.90067	.89649	.89235	.88826	.88420	.88019	.87622	.87230	.86814	.86456
100	.90349	.89941	.89538	.89138	.88743	.88351	.87964	.87580	.87200	.86824
101	.90600	.90202	.89807	.89416	.89029	.88646	.88267	.87891	.87519	.87150
102	.90873	.90484	.90099	.89717	.89339	.88965	.88594	.88227	.87863	.87503
103	.91217	.90841	.90468	.90099	.89733	.89370	.89011	.88654	.88301	.87952
104	.91553	.91188	.90827	.90469	.90114	.89763	.89414	.89068	.88725	.88385
105	.92047	.91701	.91358	.91018	.90680	.90345	.90013	.89683	.89356	.89032
106	.92819	.92504	.92191	.91880	.91571	.91265	.90961	.90658	.90358	.90060
107	.93868	.93596	.93325	.93056	.92788	.92522	.92258	.91995	.91734	.91474
108	.95471	.95267	.95064	.94862	.94661	.94461	.94262	.94063	.93866	.93670
109	.97985	.97893	.97801	.97710	.97619	.97529	.97438	.97348	.97259	.97170

Table G—Continued (4) Table, Single Life, Unisex, Showing Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
0.....	.04653	.04447	.04262	.04095	.03946	.03811	.03689	.03579	.03479	.03388
1.....	.02937	.02720	.02525	.02351	.02194	.02052	.01924	.01809	.01704	.01609
1.....	.02937	.02720	.02525	.02351	.02194	.02052	.01924	.01809	.01704	.01609
2.....	.02994	.02769	.02567	.02385	.02221	.02074	.01940	.01819	.01710	.01611
3.....	.03094	.02860	.02650	.02460	.02290	.02136	.01996	.01870	.01756	.01652
4.....	.03216	.02973	.02755	.02558	.02380	.02219	.02074	.01942	.01822	.01713
5.....	.03359	.03106	.02879	.02674	.02488	.02321	.02169	.02031	.01905	.01791
6.....	.03517	.03255	.03019	.02805	.02612	.02437	.02278	.02134	.02003	.01883
7.....	.93688	.03416	.03171	.02949	.02747	.02565	.02399	.02248	.02111	.01986
8.....	.03874	.03592	.03337	.03106	.02896	.02706	.02533	.02376	.02232	.02101
9.....	.04077	.03784	.03519	.03279	.03061	.02863	.02682	.02518	.02367	.02230
10.....	.04295	.03992	.03717	.03467	.03240	.03034	.02846	.02674	.02517	.02373
11.....	.04531	.04217	.03931	.03672	.03436	.03221	.03025	.02846	.02682	.02532
12.....	.04782	.04457	.04161	.03892	.03647	.03424	.03219	.03032	.02861	.02704
13.....	.05045	.04708	.04402	.04122	.03868	.03635	.03422	.03228	.03049	.02885
14.....	.05312	.04964	.04646	.04357	.04093	.03851	.03630	.03427	.03240	.03069
15.....	.05581	.05220	.04891	.04591	.04317	.04066	.03836	.03624	.03430	.03252
16.....	.05847	.05474	.05134	.04822	.04538	.04277	.04037	.03817	.03615	.03429
17.....	.06111	.05726	.05374	.05051	.04756	.04485	.04236	.04007	.03796	.03602
18.....	.06378	.05979	.05615	.05280	.04974	.04693	.04434	.04196	.03976	.03773
19.....	.06650	.06238	.05861	.05514	.05196	.04904	.04635	.04387	.04159	.03947
20.....	.06933	.06507	.06117	.05758	.05429	.05125	.04845	.04588	.04349	.04129
21.....	.07228	.06788	.06384	.06013	.05671	.05356	.05065	.04797	.04549	.04319
22.....	.07535	.07081	.06664	.06279	.05925	.05597	.05295	.05016	.04758	.04519
23.....	.07858	.07389	.06958	.06559	.06192	.05853	.05539	.05248	.04979	.04730
24.....	.08201	.07717	.07270	.06858	.06477	.06125	.05799	.05497	.05217	.04957
25.....	.08567	.08067	.07606	.07179	.06785	.06420	.06081	.05767	.05475	.05205
26.....	.08960	.08444	.07968	.07527	.07118	.06739	.06388	.06062	.05758	.05476
27.....	.09380	.08849	.08357	.07901	.07478	.07086	.06721	.06382	.06067	.05773
28.....	.09830	.09283	.08775	.08304	.07867	.07460	.07082	.06730	.06402	.06097
29.....	.10306	.09742	.09218	.08732	.08280	.07859	.07467	.07102	.06762	.06444
30.....	.10808	.10228	.09688	.09187	.08720	.08284	.07879	.07500	.07146	.06815
31.....	.11335	.10738	.10182	.09665	.09182	.08733	.08312	.07920	.07553	.07209
32.....	.11889	.11275	.10704	.10170	.09672	.09207	.08773	.08366	.07986	.07629
33.....	.12471	.11840	.11252	.10703	.10189	.09709	.09260	.08829	.08445	.08075
34.....	.13079	.12432	.11827	.11261	.10732	.10237	.09773	.09338	.08929	.08546
35.....	.13716	.13052	.12431	.11849	.11305	.10794	.10315	.09865	.09442	.09045
36.....	.14381	.13701	.13063	.12465	.11905	.11379	.10884	.10420	.09983	.09572
37.....	.15075	.14378	.13724	.13110	.12534	.11992	.11483	.11003	.10552	.10126
38.....	.15796	.15083	.14412	.13782	.13190	.12633	.12108	.11614	.11148	.10708
39.....	.16545	.15815	.15129	.14483	.13875	.13302	.12762	.12253	.11772	.11318
40.....	.17322	.16576	.15874	.15212	.14589	.14000	.13445	.12921	.12425	.11957
41.....	.18129	.17367	.16649	.15971	.15332	.14728	.14158	.13619	.13109	.12626
42.....	.18967	.18190	.17456	.16763	.16108	.15490	.14904	.14350	.13825	.13328
43.....	.19834	.19041	.18293	.17585	.16915	.16281	.15680	.15111	.14572	.14060
44.....	.20731	.19924	.19160	.18437	.17753	.17104	.16488	.15905	.15351	.14825
45.....	.21655	.20834	.20055	.19318	.18619	.17955	.17326	.16727	.16159	.15619
46.....	.22608	.21773	.20981	.20229	.19516	.18838	.18194	.17582	.16999	.16445
47.....	.23690	.22741	.21935	.21170	.20443	.19751	.19093	.18467	.17870	.17302
48.....	.24602	.23741	.22922	.22144	.21403	.20698	.20026	.19386	.18776	.18194
49.....	.25644	.24770	.23939	.23148	.22394	.21676	.20991	.20338	.19715	.19119
50.....	.26716	.25831	.24989	.24185	.23419	.22689	.21991	.21325	.20689	.20080
51.....	.27816	.26921	.26068	.25253	.24475	.23732	.23023	.22344	.21695	.21074
52.....	.28945	.28040	.27176	.26351	.25562	.24808	.24086	.23396	.22735	.22102
53.....	.30100	.29187	.28313	.27478	.26679	.25914	.25181	.24479	.23807	.23162
54.....	.31279	.30357	.29475	.28631	.27822	.27047	.26304	.25591	.24908	.24252

Table G—Continued (5) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
55	.32482	.31553	.30663	.29810	.28992	.28208	.27455	.26733	.26039	.25372
56	.33707	.32771	.31875	.31014	.30188	.29395	.28633	.27901	.27197	.26521
57	.34955	.34015	.33112	.32244	.31411	.30610	.29840	.29099	.28386	.27700
58	.36225	.35280	.34372	.33499	.32659	.31851	.31074	.30325	.29604	.28909
59	.37519	.36571	.35659	.34781	.33936	.33122	.32337	.31581	.30853	.30150
60	.38836	.37886	.36971	.36089	.35239	.34420	.33630	.32867	.32132	.31422
61	.41077	.39226	.38309	.37425	.36572	.35748	.34953	.34185	.33444	.32727
62	.41542	.40591	.39674	.38788	.37932	.37106	.36307	.35535	.34788	.34066
63	.42930	.41981	.41064	.40178	.39321	.38492	.37691	.36915	.36165	.35438
64	.44338	.43392	.42477	.41591	.40734	.39905	.39102	.38324	.37571	.36841
65	.45765	.44823	.43910	.43027	.42171	.41342	.40539	.39760	.39005	.38272
66	.47208	.46271	.45364	.44483	.43630	.42803	.42000	.41221	.40465	.39731
67	.48666	.47736	.46834	.45958	.45108	.44283	.43483	.42705	.41949	.41215
68	.50138	.49215	.48320	.47450	.46605	.45784	.44987	.44211	.43457	.42724
69	.51624	.50711	.49824	.48961	.48122	.47307	.46513	.45741	.44990	.44259
70	.53125	.52223	.51345	.50491	.49660	.48851	.48063	.47296	.46549	.45821
71	.54645	.53755	.52899	.52045	.51223	.50422	.49641	.48880	.48139	.47416
72	.56183	.55307	.54453	.53621	.52809	.52018	.51246	.50493	.49758	.49042
73	.57731	.56870	.56030	.55211	.54412	.53631	.52870	.52126	.51400	.50691
74	.59275	.58431	.57606	.56801	.56015	.55247	.54497	.53764	.53048	.52347
75	.60803	.59976	.59168	.58379	.57607	.56852	.56115	.55393	.54687	.53997
76	.62308	.61500	.60709	.59936	.59179	.58439	.57714	.57005	.56311	.55632
77	.63789	.63000	.62227	.61470	.60730	.60005	.59294	.58599	.57917	.57249
78	.65247	.64477	.63723	.62984	.62261	.61551	.60856	.60174	.59506	.58851
79	.66687	.65938	.65203	.64483	.63777	.63084	.62405	.61739	.61085	.60443
80	.68114	.67386	.66672	.65971	.65284	.64609	.63946	.63296	.62657	.62030
81	.69518	.68812	.68119	.67438	.66770	.66114	.65469	.64836	.64213	.63602
82	.70891	.70207	.69535	.68875	.68227	.67589	.66963	.66347	.65742	.65146
83	.72232	.71572	.70922	.70283	.69655	.69037	.68429	.67831	.67342	.66664
84	.73550	.72913	.72285	.71668	.71061	.70463	.69875	.69296	.68726	.68165
85	.74847	.74234	.73630	.73035	.72449	.71872	.71304	.70745	.70194	.69654
86	.76096	.75506	.74925	.74353	.73789	.73233	.72685	.72146	.71614	.71089
87	.77263	.76696	.76137	.75585	.75042	.74507	.73978	.73458	.72944	.72438
88	.78345	.77799	.77261	.76730	.76207	.75691	.75181	.74679	.74183	.73694
89	.79367	.78842	.78323	.77812	.77308	.76810	.76319	.75834	.75355	.74883
90	.80356	.79851	.79353	.78862	.78376	.77897	.77424	.76957	.76496	.76040
91	.81306	.80821	.80344	.79871	.79405	.78945	.78490	.78040	.77596	.77158
92	.82187	.81722	.81263	.80810	.80361	.79919	.79481	.79048	.78621	.78198
93	.82984	.82538	.82096	.81659	.81228	.80801	.80380	.79963	.79550	.79143
94	.83694	.83263	.32837	.83416	.81999	.81587	.81180	.80777	.80379	.79985
95	.84310	.83893	.83481	.83073	.82670	.82271	.81877	.81487	.81100	.80719
96	.84829	.84424	.84023	.83626	.83234	.82846	.82462	.83083	.81707	.81335
97	.85291	.84897	.84506	.84120	.83738	.83360	.82985	.82615	.82248	.81885
98	.85696	.85310	.84929	.84551	.84177	.83808	.83441	.83079	.82720	.82365
99	.86075	.85698	.85325	.84956	.84590	.84228	.83869	.83514	.83163	.82815
00	.86452	.86084	.85719	.85357	.85000	.84645	.84294	.83947	.83603	.83262
01	.86785	.86424	.86066	.85711	.85360	.85012	.84668	.84327	.83988	.83653
02	.87146	.86792	.86442	.86094	.85750	.85409	.85072	.84737	.84405	.84077
03	.87605	.87261	.86921	.86583	.86248	.85917	.85588	.85262	.84939	.84619
04	.88047	.87713	.87382	.87053	.86727	.86403	.86083	.85765	.85449	.85136
05	.88710	.88390	.88073	.87758	.87446	.87136	.86829	.86524	.86221	.85921
06	.89764	.89471	.89179	.88889	.88601	.88315	.88032	.87750	.87470	.87192
07	.91216	.90960	.90705	.90451	.90199	.89949	.89700	.89452	.89206	.88961
08	.93474	.93280	.93086	.92894	.92702	.92511	.92321	.92132	.91944	.91757
09	.97081	.96992	.96904	.96816	.96729	.96642	.96555	.96468	.96382	.96296

Table G—Continued (6) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
0	.03305	.03230	.03161	.03098	.03040	.02987	.02938	.02893	.02851	.02812
1	.01523	.01444	.01372	.01307	.01247	.01192	.01141	.01094	.01051	.01012
2	.01520	.01438	.01362	.01294	.01230	.01173	.01119	.01070	.01025	.00983
3	.01557	.01470	.01391	.01319	.01253	.01192	.01136	.01084	.01036	.00992
4	.01613	.01522	.01439	.01363	.01294	.01229	.01170	.01116	.01066	.01019
5	.01687	.01591	.01504	.01424	.01351	.01283	.01221	.01164	.01111	.01062
6	.01774	.01674	.01582	.01498	.01421	.01350	.01284	.01224	.01168	.01116
7	.01871	.01766	.01670	.01581	.01500	.01425	.01356	.01292	.01233	.01178
8	.01980	.01870	.01769	.01676	.01591	.01512	.01439	.01372	.01309	.01252
9	.02104	.01989	.01883	.01785	.01695	.01612	.01535	.01464	.01398	.01337
10	.02241	.02120	.02009	.01906	.01812	.01724	.01644	.01569	.01499	.01435
11	.02394	.02267	.02150	.02042	.01943	.01851	.01766	.01688	.01615	.01547
12	.02560	.02427	.02305	.02192	.02088	.01991	.01902	.01819	.01742	.01671
13	.02734	.02595	.02467	.02349	.02240	.02139	.02045	.01958	.01877	.01802
14	.02912	.02766	.02632	.02509	.02394	.02288	.02190	.02098	.02013	.01934
15	.03087	.02935	.02795	.02666	.02546	.02435	.02331	.02235	.02146	.02063
16	.03257	.03099	.02952	.02817	.02691	.02575	.02466	.02366	.02272	.20185
17	.03423	.03257	.03104	.02962	.02831	.02709	.02595	.02490	.02391	.02300
18	.03586	.03414	.03253	.03105	.02967	.02839	.02721	.02610	.02507	.02410
19	.03752	.03572	.03414	.03249	.03105	.02971	.02846	.02730	.02621	.02520
20	.03925	.03737	.03562	.03399	.03248	.03108	.02977	.02855	.02741	.02635
21	.04107	.03910	.03727	.03557	.03398	.03251	.03114	.02986	.02866	.02755
22	.04297	.04091	.03899	.03722	.03556	.03402	.03258	.03123	.02998	.02880
23	.04498	.04283	.04083	.03897	.03723	.03562	.03410	.03269	.03137	.03014
24	.04715	.04491	.04282	.04087	.03905	.03735	.03577	.03428	.03290	.03159
25	.04953	.04718	.04499	.04295	.04105	.03927	.03761	.03605	.03459	.03322
26	.05213	.04968	.04740	.04527	.04327	.04141	.03966	.03803	.03649	.03505
27	.05499	.05243	.05005	.04782	.04573	.04377	.04194	.04023	.03861	.03710
28	.05811	.05545	.05295	.05062	.04844	.04639	.04447	.04267	.04098	.03938
29	.06146	.05868	.05608	.05365	.05136	.04922	.04721	.04532	.04354	.04187
30	.06506	.06217	.05945	.05691	.05452	.05228	.05017	.04819	.04633	.04457
31	.06888	.06586	.06303	.06038	.05789	.05554	.05334	.05126	.04930	.04746
32	.07295	.06981	.06687	.06410	.06149	.05904	.05674	.05456	.05251	.05058
33	.07728	.07401	.07095	.06806	.06535	.06279	.06038	.05810	.05595	.05392
34	.08185	.07846	.07527	.07227	.06944	.06677	.06425	.06187	.05962	.05750
35	.08671	.08319	.07988	.07675	.07380	.07102	.06839	.06590	.06355	.06132
36	.09184	.08819	.08475	.08150	.07843	.07553	.07278	.07019	.06773	.06540
37	.09725	.09347	.08989	.08652	.08332	.08030	.07745	.07474	.07217	.06974
38	.10293	.09901	.09531	.09180	.08848	.08534	.08237	.07955	.07687	.07433
39	.10889	.01483	.10099	.09736	.09391	.09065	.08755	.08462	.08182	.07917
40	.11514	.11094	.10697	.10320	.09963	.09624	.09302	.08996	.08706	.08429
41	.12168	.11735	.11324	.10934	.10564	.10212	.09878	.09560	.09258	.08970
42	.12856	.12409	.11984	.11581	.11197	.10833	.10486	.10156	.09842	.09543
43	.13574	.13113	.12675	.12258	.11862	.11484	.11125	.10783	.10456	.10145
44	.14325	.13850	.13398	.12967	.12558	.12167	.11795	.11441	.11102	.10779
45	.15105	.14616	.14150	.13706	.13283	.12880	.12495	.12128	.11777	.11442
46	.15917	.15414	.14935	.14478	.14041	.13625	.13227	.12847	.12484	.12137
47	.16760	.16244	.15751	.15280	.14831	.14402	.13991	.13599	.13223	.12863
48	.17639	.17109	.16602	.16119	.15656	.15214	.14791	.14385	.13997	.13626
49	.18551	.18007	.17488	.16991	.16516	.16060	.15625	.15207	.14806	.14422
50	.19499	.18942	.18410	.17900	.17412	.16944	.16496	.16065	.15653	.15257
51	.20480	.19911	.19366	.18844	.18343	.17862	.17401	.16959	.16534	.16126
52	.21495	.20914	.20357	.19822	.19309	.18816	.18343	.17888	.17451	.17031
53	.22544	.21951	.21381	.20835	.20309	.19805	.19320	.18853	.18404	.17972
54	.23622	.23018	.22437	.21878	.21341	.20825	.20328	.19850	.19390	.18946

Table G—Continued (7) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
55	.24732	.24116	.23524	.22954	.22406	.21878	.21370	.20881	.20409	.19954
56	.25870	.25244	.24641	.24060	.23501	.22963	.22443	.21943	.21460	.20994
57	.27040	.26404	.25791	.25200	.24630	.24081	.23551	.23040	.22546	.22069
58	.28239	.27594	.26971	.26370	.25791	.25231	.24691	.24170	.23665	.23178
59	.29472	.28817	.28186	.27576	.26987	.26418	.25868	.25336	.24822	.24325
60	.30736	.30074	.29434	.28816	.28218	.27640	.27081	.26540	.26016	.25509
61	.32035	.31365	.30718	.30092	.29486	.28899	.28332	.27782	.27249	.26733
62	.33368	.32692	.32038	.31405	.30791	.30197	.29622	.29064	.28523	.27998
63	.34735	.34054	.33394	.32754	.32134	.31533	.30950	.30385	.29836	.29304
64	.36133	.35448	.34783	.34138	.33612	.32905	.32316	.31743	.31188	.30648
65	.37562	.36873	.36204	.35554	.34924	.34311	.33716	.33138	.32576	.32030
66	.39019	.38327	.37655	.37002	.36367	.35751	.35151	.34568	.34001	.33449
67	.40502	.39809	.39134	.38479	.37841	.37221	.36618	.36030	.35459	.34902
68	.42011	.41317	.40642	.39985	.39345	.38723	.38116	.37526	.36950	.36390
69	.43547	.42854	.42179	.41522	.40882	.40257	.39649	.39056	.38478	.37914
70	.45112	.44421	.43748	.43091	.42451	.41826	.41217	.40623	.40043	.39478
71	.46711	.46023	.45352	.44698	.44059	.43435	.42827	.42233	.41642	.41086
72	.48342	.47659	.46992	.46341	.45705	.45084	.44478	.43885	.43305	.42739
73	.49998	.49321	.48660	.48014	.47382	.46765	.46161	.45571	.44994	.44429
74	.51663	.50994	.50339	.49699	.49073	.48460	.47861	.47274	.46700	.64138
75	.53322	.52661	.52014	.51381	.50762	.50155	.49561	.48979	.48409	.47851
76	.54967	.54315	.53678	.53053	.52440	.51841	.41253	.50677	.50112	.49559
77	.56595	.55954	.55326	.54710	.54106	.53514	.52934	.52364	.51806	.51258
78	.58209	.57579	.56961	.56355	.55761	.55177	.54605	.54043	.53492	.52951
79	.59814	.59196	.58590	.57995	.57410	.56837	.56273	.55720	.55177	.54643
80	.61415	.60810	.60217	.59633	.59060	.58497	.57944	.57401	.56866	.56341
81	.63001	.62410	.61830	.61260	.60699	.60148	.59606	.59073	.58548	.58033
82	.64561	.63985	.63419	.62862	.62314	.61775	.61245	.60723	.60210	.59705
83	.66095	.65535	.64983	.64441	.63907	.63381	.62863	.62354	.61852	.61358
84	.67612	.67068	.66533	.66005	.65486	.64974	.64470	.63973	.63484	.63002
85	.69116	.68589	.68070	.67559	.67055	.66558	.66068	.65586	.65110	.64641
86	.70573	.70063	.69561	.69066	.68578	.68096	.67622	.67154	.66692	.66236
87	.71939	.71466	.70961	.70481	.70009	.69542	.69082	.68628	.68180	.67738
88	.73211	.72735	.72265	.71801	.71343	.70891	.70445	.70005	.69570	.69141
89	.74417	.73956	.73501	.73053	.72609	.72172	.71739	.71312	.70891	.70474
90	.75590	.75146	.74707	.74273	.73845	.73422	.73004	.72591	.72182	.71779
91	.76724	.76296	.75873	.75454	.75041	.74632	.74229	.73829	.73435	.73045
92	.77781	.77368	.76960	.76556	.76158	.75763	.75373	.74988	.74606	.74229
93	.78740	.78342	.77948	.77558	.77173	.76791	.76414	.76042	.75673	.75308
94	.79596	.79210	.78829	.78452	.78079	.77710	.77345	.76983	.76626	.76272
95	.80341	.79967	.79597	.79231	.78869	.78510	.78155	.77304	.77457	.77113
96	.80967	.80603	.80242	.79885	.79532	.79183	.78837	.78494	.78155	.77819
97	.81526	.81170	.80818	.80470	.80125	.79783	.79445	.79110	.78779	.78450
98	.82013	.81665	.81320	.80979	.80641	.80306	.79975	.79647	.79322	.79000
99	.82470	.82129	.81791	.81456	.81125	.80797	.80471	.80149	.79830	.79514
100	.82924	.82590	.82258	.81930	.81605	.81283	.80964	.80648	.80335	.80025
101	.83322	.82993	.82667	.82344	.82024	.81708	.81394	.81082	.80774	.80468
102	.83751	.83428	.83108	.82791	.82477	.82165	.81856	.81550	.81247	.80946
103	.84301	.83986	.83674	.83365	.83058	.82754	.82452	.82153	.81857	.81563
104	.84826	.84518	.84213	.83910	.83610	.83312	.83017	.82723	.82433	.82144
105	.85623	.85327	.85033	.84741	.84452	.84165	.83880	.83597	.83316	.83038
106	.86915	.86641	.86369	.86098	.85829	.85562	.85297	.85034	.84772	.84512
107	.88718	.88476	.88236	.87997	.87759	.87523	.87288	.87054	.86822	.86591
108	.91571	.91385	.91201	.91017	.90834	.90652	.90471	.90291	.90111	.89932
109	.96211	.96125	.96041	.95966	.95872	.95788	.95704	.95620	.95537	.95455

Table G—Continued (8) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
0.....	.02776	.02743	.02712	.02682	.02655	.02630	.02606	.02583	.02562	.02542
1.....	.00975	.00941	.00909	.00880	.00852	.00827	.00803	.00780	.00759	.00739
2.....	.00945	.00909	.00875	.00844	.00816	.00789	.00763	.00740	.00718	.00697
3.....	.00952	.00914	.00879	.00846	.00815	.00787	.00760	.00736	.00712	.00690
4.....	.00976	.00936	.00899	.00865	.00832	.00802	.00774	.00748	.00723	.00700
5.....	.01016	.00974	.00935	.00898	.00864	.00832	.00802	.00774	.00748	.00724
6.....	.01068	.01023	.00981	.00943	.00907	.00873	.00841	.00812	.00784	.00758
7.....	.01128	.01080	.01036	.00995	.00957	.00921	.00888	.00856	.00827	.00799
8.....	.01198	.01148	.01101	.01058	.01017	.00979	.00944	.00910	.00879	.00850
9.....	.01281	.01228	.01179	.01133	.01090	.01049	.01012	.00976	.00943	.00912
10.....	.01375	.01319	.01267	.01219	.01173	.01131	.01091	.01053	.01018	.00985
11.....	.01483	.01425	.01370	.01318	.01270	.01225	.01183	.01143	.01106	.01070
12.....	.01604	.01542	.01484	.01430	.01379	.01331	.01286	.01244	.01205	.01168
13.....	.01732	.01666	.01605	.01548	.01494	.01444	.01397	.01352	.01311	.01271
14.....	.01860	.01792	.01727	.01667	.01610	.01558	.01508	.01461	.01417	.01375
15.....	.01986	.01913	.01845	.01782	.01723	.01667	.01614	.01565	.01519	.01475
16.....	.02103	.02027	.01956	.01889	.01827	.01768	.01713	.01661	.01612	.01566
17.....	.02214	.02134	.02059	.01989	.01923	.01862	.01803	.01749	.01697	.01649
18.....	.02320	.02236	.02157	.02084	.02014	.01949	.01888	.01831	.01776	.01725
19.....	.02426	.02337	.02254	.02177	.02104	.02035	.01971	.01910	.01853	.01799
20.....	.02536	.02442	.02355	.02273	.02197	.02124	.02056	.01992	.01932	.01875
21.....	.02650	.02552	.02460	.02374	.02293	.02217	.02145	.02078	.02014	.01954
22.....	.02770	.02667	.02570	.02479	.02394	.02313	.02238	.02166	.02099	.02035
23.....	.02898	.02789	.02687	.02591	.02501	.02416	.02336	.02261	.02190	.02122
24.....	.03037	.02923	.02815	.02714	.02619	.02529	.02445	.02365	.02290	.02218
25.....	.03194	.03073	.02960	.02853	.02752	.02657	.02568	.02484	.02404	.02328
26.....	.03370	.03243	.03123	.03010	.02904	.02804	.02710	.02620	.02536	.02456
27.....	.05688	.03434	.03307	.03188	.03076	.02970	.02870	.02776	.02686	.02601
28.....	.03789	.03647	.03614	.03389	.03271	.03159	.03053	.02953	.02858	.02768
29.....	.04029	.03880	.03740	.03608	.03483	.03365	.03253	.03147	.03047	.02951
30.....	.04291	.04135	.03987	.03848	.03716	.03591	.03473	.03361	.03255	.03154
31.....	.04572	.04407	.04252	.04105	.03966	.03834	.03709	.03591	.03478	.03372
32.....	.04875	.04702	.04538	.04384	.04237	.04098	.03966	.03841	.03722	.03610
33.....	.05200	.05019	.04847	.04684	.04530	.40383	.04244	.04112	.03987	.03867
34.....	.05548	.05358	.05177	.05006	.04843	.04689	.04543	.04403	.04271	.04145
35.....	.05921	.05722	.05532	.05352	.05181	.05019	.04865	.04718	.04578	.04445
36.....	.06319	.06110	.05911	.05722	.05543	.05372	.05210	.05055	.04907	.04767
37.....	.06743	.06524	.06315	.06117	.05929	.05749	.05578	.05416	.05260	.05112
38.....	.07191	.06962	.06744	.06536	.06338	.06150	.05970	.05799	.05636	.05480
39.....	.07665	.07425	.07197	.06980	.06773	.06575	.06387	.06207	.06035	.05871
40.....	.08166	.07916	.07677	.07450	.07233	.07026	.06828	.06639	.06459	.06286
41.....	.08696	.08434	.08185	.07947	.07721	.07504	.07297	.07099	.06909	.06728
42.....	.09257	.08985	.08725	.08477	.08239	.08018	.07796	.07589	.07390	.07200
43.....	.09848	.09564	.09293	.09034	.08787	.08550	.08323	.08106	.07898	.07699
44.....	.10470	.10175	.09893	.09623	.09365	.09118	.08881	.08654	.08437	.08228
45.....	.11121	.10815	.10522	.10241	.09972	.09714	.09467	.09230	.09003	.08784
46.....	.11805	.11486	.11182	.10890	.10610	.10341	.10084	.09837	.09599	.09371
47.....	.12519	.12189	.11873	.11569	.11279	.10999	.10731	.10473	.10226	.09988
48.....	.13269	.12927	.12600	.12285	.11983	.11693	.11414	.11145	.10888	.10639
49.....	.14054	.13700	.13361	.13035	.12721	.12721	.12130	.11852	.11583	.11325
50.....	.14876	.14511	.14160	.13822	.13497	.13185	.12884	.12595	.12316	.12047
51.....	.15734	.15356	.14994	.14645	.14309	.13985	.13674	.13373	.13084	.12805
52.....	.16627	.16238	.15864	.15504	.15156	.14822	.14499	.14188	.13888	.13598
53.....	.17557	.17156	.16770	.16399	.16040	.15695	.15361	.15039	.14729	.14428
54.....	.18519	.18107	.17710	.17327	.16957	.16601	.16256	.15924	.15602	.15292

Table G—Continued (9) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest In Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
55	.19515	.19092	.18684	.18290	.17909	.17542	.17186	.16843	.16511	.16190
56	.20544	.20110	.19691	.19286	.18894	.18516	.18150	.17796	.17454	.17122
57	.21609	.21164	.20734	.20318	.19916	.19527	.19150	.18786	.18733	.18091
58	.22707	.22252	.21811	.21385	.20972	.20573	.20186	.19811	.19448	.19096
59	.23844	.23378	.22928	.22491	.22068	.21659	.21262	.20877	.20504	.20142
60	.25018	.24543	.24082	.23636	.23203	.22784	.22377	.21982	.21599	.21227
61	.26233	.25749	.25279	.24823	.24381	.23952	.23535	.23131	.22738	.22357
62	.27490	.26996	.26517	.26052	.25601	.25163	.24737	.24324	.23922	.23531
63	.28787	.28286	.27798	.27325	.26865	.26418	.25984	.25561	.25151	.24751
64	.30124	.29615	.29120	.28639	.28171	.27716	.27273	.26842	.26423	.26015
65	.31500	.30983	.30481	.29993	.29517	.29054	.28604	.28165	.27738	.27322
66	.32912	.32390	.31881	.31386	.30904	.30434	.29976	.29530	.29096	.28672
67	.34360	.33832	.33318	.32817	.32328	.31852	.31388	.30935	.30494	.30063
68	.35843	.35311	.34791	.34285	.33791	.33310	.32840	.32381	.31933	.31496
69	.37365	.36828	.36305	.35794	.35296	.34809	.34334	.33870	.33417	.32975
70	.38925	.38386	.37860	.37346	.36844	.36353	.35874	.35405	.34948	.34500
71	.40532	.39991	.39463	.38945	.38442	.37948	.37466	.36994	.36532	.36081
72	.42185	.41644	.41115	.40597	.40091	.39595	.39111	.38636	.38172	.37718
73	.43876	.43336	.42807	.42289	.41782	.41286	.40801	.40325	.39859	.39403
74	.45588	.45050	.44522	.44005	.43499	.43004	.42518	.42042	.41575	.41118
75	.47304	.46769	.46244	.45729	.45225	.44730	.44245	.43770	.43304	.42846
76	.49016	.48485	.47963	.47451	.46949	.46457	.45974	.45500	.45035	.44579
77	.50721	.50193	.49676	.49168	.48670	.48181	.47700	.47229	.46766	.46311
78	.52419	.51898	.51385	.50882	.50388	.49903	.49426	.48958	.48497	.48045
79	.54119	.53604	.64097	.52600	.52111	.51631	.51159	.50694	.50238	.49789
80	.55825	.55318	.54819	.54328	.53846	.53371	.52905	.52446	.41994	.51550
81	.57526	.57027	.56536	.56053	.55578	.55110	.54650	.54197	.53752	.53313
82	.59208	.58718	.58236	.57762	.57295	.56835	.56382	.55937	.55497	.55065
83	.60871	.60392	.59920	.59455	.58997	.58546	.58101	.57663	.57231	.56806
84	.62527	.62959	.62597	.61143	.60695	.50253	.59817	.59388	.58965	.58547
85	.64179	.63723	.63273	.62830	.62393	.61961	.61536	.61116	.60703	.60294
86	.65787	.65344	.64907	.64475	.64050	.63630	.63215	.62806	.62402	.62004
87	.67302	.66871	.66446	.66026	.65612	.65203	.64800	.64401	.64007	.63619
88	.68717	.68298	.67885	.67477	.67074	.66676	.66282	.65894	.65510	.65131
89	.70063	.69656	.69255	.68858	.68466	.68079	.67696	.67318	.66944	.66574
90	.71380	.70986	.70597	.70212	.69831	.69455	.69084	.68716	.68353	.67993
91	.72659	.72278	.71901	.71528	.71160	.70795	.70435	.70078	.69726	.69377
92	.78356	.73488	.73123	.72762	.72405	.72052	.71703	.71357	.71015	.70677
93	.74947	.74590	.74236	.73887	.73541	.73198	.72860	.72524	.72192	.71864
94	.75922	.75575	.75233	.74893	.74557	.74225	.73896	.73570	.73248	.72928
95	.76773	.76436	.76102	.75772	.75445	.75121	.74801	.74483	.74169	.73858
96	.77487	.77158	.76832	.76510	.76190	.75874	.75561	.75250	.74943	.74639
97	.78125	.77803	.77485	.77169	.76856	.76546	.76240	.75936	.75635	.75336
98	.78681	.78365	.78052	.77742	.77435	.77131	.76830	.76531	.76235	.75942
99	.79201	.78891	.78583	.78279	.77977	.77678	.77382	.77088	.76798	.76509
100	.79717	.79412	.79111	.78811	.78515	.78221	.77930	.77642	.77356	.77072
101	.80165	.79865	.79568	.79273	.78981	.78691	.78404	.78119	.77837	.77557
102	.80648	.80353	.80060	.79769	.79481	.79196	.78912	.78632	.78353	.78077
103	.81271	.80982	.80695	.80411	.80129	.79849	.79572	.79297	.79024	.78753
104	.81858	.81574	.81292	.81013	.80736	.80460	.80188	.79917	.79648	.79381
105	.82761	.82487	.82214	.81943	.81675	.81408	.81143	.80881	.80620	.80361
106	.84254	.83998	.83743	.83490	.83238	.82989	.82740	.82494	.82249	.82006
107	.86362	.86133	.85906	.85681	.85456	.85233	.85012	.84791	.84572	.84353
108	.89755	.89577	.89401	.89226	.89051	.88877	.88704	.88532	.88361	.88190
109	.95372	.95290	.95208	.95126	.95045	.94964	.94883	.94803	.94723	.94643

Table G—Continued (10) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
0.....	.02523	.02505	.02488	.02472	.02456	.02442	.02428	.02414	.02402	.02389
1.....	.00721	.00703	.00687	.00671	.00657	.00643	.00629	.00617	.00605	.00594
2.....	.00678	.00659	.00642	.00626	.00610	.00596	.00582	.00569	.00556	.00544
3.....	.00670	.00650	.00632	.00615	.00599	.00583	.00569	.00555	.00542	.00529
4.....	.00678	.00658	.00638	.00620	.00603	.00586	.00571	.00556	.00542	.00529
5.....	.00701	.00679	.00658	.00639	.00620	.00603	.00587	.00571	.00556	.00542
6.....	.00733	.00710	.00688	.00668	.00648	.00630	.00612	.00595	.00580	.00565
7.....	.00773	.00748	.00725	.00703	.00682	.00663	.00644	.00626	.00610	.00594
8.....	.00822	.00796	.00771	.00748	.00726	.00705	.00685	.00666	.00648	.00631
9.....	.00882	.00854	.00828	.00803	.00780	.00757	.00736	.00716	.00697	.00679
10.....	.00953	.00924	.00896	.00869	.00844	.00821	.00798	.00777	.00756	.00737
11.....	.01037	.01006	.00976	.00948	.00922	.00896	.00872	.00850	.00828	.00807
12.....	.01132	.01099	.01068	.01038	.01010	.00983	.00958	.00934	.00911	.00889
13.....	.01234	.01199	.01166	.01134	.01104	.01076	.01049	.01024	.00999	.00976
14.....	.01336	.01299	.01264	.01231	.01199	.01170	.01141	.01114	.01088	.01064
15.....	.01434	.01395	.01358	.01323	.01289	.01258	.01228	.01200	.01172	.01147
16.....	.01552	.01481	.01442	.01405	.01371	.01337	.01306	.01275	.01247	.01220
17.....	.01603	.01559	.01518	.01480	.01443	.01408	.01375	.01343	.01313	.01284
18.....	.01677	.01631	.01588	.01547	.01508	.01471	.01436	.01403	.01371	.01341
19.....	.01748	.01700	.01654	.01611	.01570	.01531	.01494	.01459	.01426	.01394
20.....	.01821	.01770	.01722	.01677	.01633	.01592	.01553	.01516	.01481	.01447
21.....	.01897	.01843	.01792	.01744	.01698	.01655	.01614	.01574	.01537	.01502
22.....	.01975	.01918	.01864	.01813	.01765	.01719	.01675	.01634	.01594	.01557
23.....	.02059	.01998	.01941	.01887	.01836	.01787	.01741	.01697	.01655	.01615
24.....	.02151	.02087	.02027	.01970	.01915	.01863	.01814	.01768	.01723	.01681
25.....	.02257	.02189	.02125	.02064	.02006	.01952	.01899	.01850	.01802	.01757
26.....	.02380	.02308	.02240	.02175	.02114	.02056	.02000	.01947	.01897	.01849
27.....	.02521	.02445	.02373	.02304	.02239	.02177	.02118	.02061	.02008	.01956
28.....	.02683	.02602	.02525	.02452	.02382	.02317	.02254	.02194	.02137	.02082
29.....	.02861	.02775	.02694	.02616	.02543	.02472	.02405	.02342	.02281	.02223
30.....	.03058	.02967	.03881	.02798	.02720	.02645	.02574	.02506	.02441	.02379
31.....	.03270	.03174	.03082	.02995	.02911	.02832	.02756	.02684	.02615	.02549
32.....	.03502	.03400	.03303	.03210	.03122	.03037	.02957	.02880	.02806	.02736
33.....	.03754	.03646	.03543	.03444	.03350	.03261	.03175	.03093	.03015	.02940
34.....	.04025	.03910	.03801	.03697	.03597	.03502	.03411	.03324	.03241	.03162
35.....	.04318	.04197	.04081	.03971	.03865	.03764	.03668	.03576	.03488	.03403
36.....	.04633	.04505	.04383	.04266	.04154	.04048	.03945	.03847	.03754	.03664
37.....	.04971	.04836	.04707	.04583	.04465	.04352	.04244	.04140	.04040	.03945
38.....	.05331	.05188	.05052	.04922	.04797	.04677	.04563	.04453	.04347	.04246
39.....	.05714	.05564	.05420	.05282	.05150	.05024	.04903	.04787	.04675	.04568
40.....	.06121	.05963	.05812	.05667	.05528	.05394	.05266	.04143	.05025	.04912
41.....	.06554	.06388	.06229	.06076	.05929	.05789	.05653	.05524	.05399	.05279
42.....	.07018	.06843	.06675	.06514	.06360	.06212	.06069	.05932	.05800	.05674
43.....	.07508	.07324	.07148	.06979	.06817	.06661	.06511	.06366	.06227	.06093
44.....	.08028	.07835	.07651	.07473	.07303	.07138	.06980	.06828	.06682	.06541
45.....	.08575	.08373	.08180	.07993	.07814	.07642	.07476	.07316	.07162	.07013
46.....	.09152	.08941	.08738	.08543	.08355	.08174	.08000	.07832	.07670	.07514
47.....	.09759	.09539	.09326	.09122	.08926	.08736	.08553	.08377	.08207	.08042
48.....	.10410	.10171	.09949	.09735	.09530	.09331	.09140	.08955	.08776	.08604
49.....	.11076	.10836	.10605	.10382	.10167	.09959	.09759	.09565	.09378	.09198
50.....	.11788	.11538	.11297	.11065	.10840	.10624	.10414	.10212	.10016	.09827
51.....	.12535	.12276	.12025	.11782	.11548	.11322	.11104	.10892	.10688	.10490
52.....	.13319	.13049	.12788	.12536	.12292	.12057	.11829	.11608	.11395	.11188
53.....	.14139	.13858	.13588	.13326	.13072	.12827	.12590	.12360	.12138	.11922
54.....	.14992	.14701	.14420	.14149	.13885	.13631	.13384	.13145	.12913	.12689

Table G—Continued (11) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Pooled Income Fund Having the Yearly Rate of Return Shown

(1)	(2) Yearly Rate of Return									
Age	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
55	.15880	.15579	.15288	.15006	.14733	.14469	.14213	.13964	.13724	.13490
56	.16801	.16491	.16190	.15898	.15615	.15341	.15075	.14817	.14567	.14324
57	.17760	.17439	.17128	.16827	.16534	.16250	.15975	.15708	.15448	.15196
58	.18755	.18424	.18103	.17792	.17489	.17196	.16911	.16634	.16365	.16104
59	.19790	.19450	.19119	.18798	.18486	.18183	.17888	.17602	.17324	.17053
60	.20866	.20516	.20175	.19844	.19523	.19210	.18906	.18611	.18323	.18043
61	.21986	.21626	.21276	.20936	.20695	.20283	.19970	.19665	.19368	.19079
62	.23151	.22782	.22423	.22073	.21733	.21402	.21079	.20766	.20460	.20162
63	.24362	.23984	.23616	.23257	.22908	.22568	.22237	.21914	.21600	.21293
64	.25617	.25231	.24854	.24487	.24129	.23780	.23440	.23109	.22786	.22471
65	.26917	.26522	.26137	.25761	.25395	.25038	.24690	.24350	.24019	.23695
66	.28259	.27857	.27464	.27081	.26707	.26342	.25986	.25638	.25298	.24967
67	.29643	.29233	.28833	.28443	.28061	.27689	.27325	.26970	.26623	.26284
68	.31070	.30653	.30246	.29849	.29461	.29081	.28711	.28348	.27994	.27647
69	.32542	.32120	.31707	.31303	.30908	.30523	.30145	.29776	.29415	.29062
70	.34063	.33635	.33217	.32807	.32407	.32015	.31632	.31257	.30890	.30530
71	.35639	.35207	.34784	.34370	.33965	.33568	.33179	.32799	.32426	.32061
72	.37273	.36837	.36410	.35993	.35583	.35182	.34789	.34404	.34027	.33657
73	.38955	.38517	.38088	.37667	.37255	.36815	.36455	.36066	.35685	.35311
74	.40670	.40230	.39799	.39377	.38962	.38555	.38156	.37765	.37381	.37004
75	.42398	.41958	.41526	.41102	.40686	.40278	.39877	.39484	.39098	.38719
76	.44131	.43691	.43259	.42835	.42419	.42010	.41608	.41213	.40826	.40445
77	.45864	.45425	.44994	.44571	.44155	.43746	.43344	.42949	.42561	.42179
78	.47601	.47164	.46734	.46312	.45897	.45489	.45088	.44693	.44305	.43923
79	.49348	.48914	.48487	.48067	.47654	.47248	.46848	.46454	.46067	.45686
80	.51112	.50682	.50259	.49842	.49432	.49028	.48631	.48240	.47854	.47475
81	.52881	.52455	.52036	.51624	.51218	.50818	.50423	.50035	.49653	.49276
82	.54639	.54219	.53805	.53398	.52996	.52600	.52210	.51826	.51447	.51074
83	.56386	.55973	.55566	.55164	.54768	.54377	.53992	.53613	.53238	.52869
84	.58136	.57730	.57329	.56934	.56545	.56160	.55781	.55407	.55038	.54674
85	.59891	.59494	.59102	.58715	.58333	.57956	.57584	.57216	.56854	.56496
86	.61610	.61222	.60839	.60460	.60086	.59717	.59353	.58993	.58638	.58287
87	.63235	.62856	.62481	.62111	.61746	.61385	.61028	.61676	.60328	.59984
88	.64757	.64386	.64021	.63659	.63302	.62950	.62601	.62256	.61915	.61578
89	.66209	.65848	.65491	.65149	.64790	.64445	.64104	.63767	.63434	.63105
90	.67638	.67387	.66939	.66596	.66256	.62920	.65588	.65259	.64934	.64612
91	.69032	.68691	.68353	.68019	.67689	.67362	.67039	.66719	.66402	.66089
92	.70342	.70011	.69683	.69359	.69038	.68720	.68405	.68094	.67786	.67481
93	.71539	.71217	.70899	.70584	.70271	.69962	.69657	.69354	.69054	.68757
94	.72612	.72299	.71989	.71683	.71379	.71078	.70780	.70485	.70193	.69903
95	.73550	.73245	.73943	.72643	.72347	.72053	.71763	.71475	.71189	.70906
96	.74337	.74039	.73743	.73450	.73160	.73872	.72587	.72305	.72026	.71748
97	.75041	.74748	.74458	.74171	.73886	.73604	.73325	.73048	.72773	.72501
98	.75652	.75364	.75079	.74797	.74517	.74329	.73964	.73692	.73422	.73154
99	.76224	.75941	.75660	.75882	.75106	.74833	.74562	.74294	.74028	.73764
100	.76791	.76521	.76237	.75963	.75692	.75423	.75156	.74892	.74630	.74370
101	.77280	.77005	.75732	.76462	.76194	.75928	.75664	.75403	.75144	.74887
102	.77804	.77532	.77263	.76996	.76732	.76469	.76209	.75950	.75694	.75440
103	.78485	.78218	.77954	.77692	.77432	.77174	.76918	.76664	.76413	.76163
104	.79117	.78854	.78594	.78335	.78078	.77824	.77571	.77320	.77071	.76824
105	.80103	.79848	.79595	.79343	.79093	.78845	.78599	.78354	.78111	.77870
106	.81764	.81524	.81285	.81048	.80813	.80579	.80346	.80115	.79885	.79657
107	.84137	.83921	.83706	.83493	.83281	.83070	.82860	.82652	.82444	.82238
108	.88020	.87851	.87682	.87515	.87348	.87182	.87016	.86852	.86688	.86525
109	.94563	.94484	.94405	.94326	.94248	.94170	.94092	.94014	.93937	.93860

(e) *Present value of remainder interest dependent on the termination of one life; for transfers to pooled income funds made before December 1, 1983*—(1) *In general.* For transfers to pooled income funds made before December 1, 1983, the present value under this section of a remainder interest which is dependent on the termination of the life of one individual shall be determined under paragraphs (e)(1) through (3) of this section.*** For transfers to pooled income funds made after November 30, 1983, see paragraphs (d)(1) through (3) of this section.

* * * * *

§1.664-1 [Amended]

Par. 7. Section 1.664-1 is amended as follows:

a. Paragraphs (a)(5)(i)(*a*) and (*b*) are amended by removing "6 percent a year," and inserting in lieu thereof "the rate of interest specified in paragraph (a)(5)(iv) of this section,".

b. Paragraph (a)(5)(ii)(*a*)(3) is amended by removing "6 percent a year," and inserting in lieu thereof "the rate of interest specified in paragraph (a)(5)(iv) of this section,".

c. A new paragraph (a)(5)(iv) is added immediately following paragraph (a)(5)(iii) to read as set forth below.

§1.644-1 Charitable remainder trusts.

(a) *In general.****

(5) *Rules applicable to testamentary transfers.****

(iv) *Rate of interest.* The following rates of interest shall apply for purposes of paragraphs (a)(5)(i) through (iii) of this section:

(*a*) 10 percent for instruments executed or amended on or after August 9, 1984;

(*b*) 6 percent or 10 percent for instruments executed or amended after October 24, 1983, and before August 9, 1984; and

(*c*) 6 percent for instruments executed before October 25, 1983, and not subsequently amended.

§1.664-2 [Amended]

Par. 8. The last sentence of paragraph (c) of §1.664-2 is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate,".

§1.664-4 [Amended]

Par. 9. Section 1.664-4 is amended as follows:

a. Paragraph (a)(1) is revised to read as set forth below.

b. Paragraphs (a)(2) through (4) are redesignated as paragraphs (a)(3) through (5) and a new paragraph (a)(2) is inserted immediately following paragraph (a)(1) to read as set forth below.

c. Redesignated paragraph (a)(4) is amended by removing the second and third to last sentences and inserting in lieu thereof "A copy of the publication containing many such special factors, may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, D.C. 20402."

d. Paragraphs (b)(1) through (5) are redesignated as paragraphs (d)(1) through (5), respectively, and new paragraphs (b)(1) through (5) and (c) are inserted immediately following redesignated paragraph (a)(5) to read as set forth below.

e. The heading of redesignated paragraph (d) and the first sentence of redesignated paragraph (d)(1) are revised to read as set forth below.

f. A new sentence is added at the end of redesignated paragraph (d)(1) to read as set forth below.

g. The second sentence of redesignated paragraph (d)(2) is amended by removing "paragraph (a)(3)" and inserting in lieu thereof "paragraph (a)(4)".

h. The fifth sentence of redesignated paragraph (d)(3) is amended by removing "paragraph (a)(3)" and inserting in lieu thereof "paragraph (a)(4)".

i. The sixth sentence of redesignated paragraph (d)(4) is amended by removing "paragraph (a)(3)" and inserting in lieu thereof "paragraph (a)(4).".

§1.664-4 Calculation of the fair market value of the remainder interest in a charitable remainder interest.

(a) *General rule*—(1) *Rule for determining present value.* Except as otherwise provided in paragraph (a)(2) of this section, for purposes of section 170, 2055, 2106, or 2522, the fair market value of a remainder interest in a charitable remainder unitrust (as described in §1.664-3) is its present value determined under this section. The present value determined under this section shall be computed on the basis of—

(i) Life contingencies determined as to each life involved, from the values of 1 x set forth in column 2 of Table LN, paragraph (f) of §20.2031-7 (columns 2 and 3, respectively, of Table LN of paragraph (f) of §20.2031-10 for transfers made before December 1, 1983);

(ii) Interest at the rate of 10 percent (6 percent for transfers to charitable remainder unitrusts made before December 1, 1983); and

(iii) The assumption that the amount described in paragraph (a)(1)(i)(*a*) of §1.664-3 shall be distributed in accordance with the payout sequence described in the governing instrument.

If the governing instrument does not prescribe when the distribution shall be made during the period for which the payment is made, for purposes of this section, the distribution shall be considered payable on the first day of the period for which the payment is made.

(2) *Rules for determining present value for testamentary transfers where the decedent dies after November 30, 1983, and before August 9, 1984.* For purposes of section 2055 or 2106, if—

(i) the decedent dies after November 30, 1983, and before August 9, 1984, or

(ii) on December 1, 1983, the decedent is under a mental disability such that the disposition of the property cannot be changed, and such decedent dies any time on or after December 1, 1983 without ever regaining competency to dispose of such decedent's property, or dies within 90 days of the date on which such de-

cedent first regains competency, paragraph (a)(1)(ii) of this section shall be applied by substituting the phrase "6 percent or 10 percent, whichever is most beneficial to the taxpayer" for "10 percent." However, if the taxpayer uses 6 percent, the life contingencies under Table LN of §20.2031-10(f) must be used.

(b) *Valuation of charitable remainder unitrusts having certain payout sequences for transfers made after November 30, 1983*—(1) *In general.* Except as otherwise provided in paragraph (c) of this section, for transfers made after November 30, 1983, the present value determined under this section of a remainder interest which is dependent on a term of years or the termination of the life of one individual shall be determined under paragraphs (b)(1) through (5) of this section provided that the amount of the payout as of any payout date during any taxable year of the trust is not larger than the amount which the trust could distribute on such date under paragraph (a)(1)(v) of §1.664-3 if the taxable year of the trust were to end on such date. The present value of the remainder interest in such trust shall be determined by computing the adjusted payout rate (as defined in paragraph (b)(2) of this section) and following the procedure outlined in paragraph (b)(3) or (b)(4) of this section, whichever is applicable. The present value of a remainder interest which is dependent on a term of years is computed under paragraph (b)(3) of this section. The present value of a remainder interest which is dependent on the termination of the life of one individual is computed under paragraph (b)(4) of this section. See paragraph (c) of this section for testamentary transfers occurring after November 30, 1983, and before August 9, 1984. For transfers made before December 1, 1983, see paragraphs (d)(1) through (5) of this section.

(2) *Adjusted payout rate.* The adjusted payout rate is determined by multiplying the fixed percentage described in paragraph (a)(1)(i)(*a*) of §1.664-3 by the figure in column (2) of Table F(1) which describes the payout sequence of the trust opposite the number in column (1) of Table F(1) which corresponds to the number of months by which the valuation date for the first full taxable year of the trust precedes the first payout date for such taxable year. If the governing instrument does not prescribe when the distribution shall be made during the taxable year of the trust, see paragraph (a)(4) of this section. In the case of a trust having a payout sequence for which no figures have been provided by Table F(1) and in the case of a trust which determines the fair market value of the trust assets by taking the average of valuations on more than one date during the taxable year, see paragraph (a)(3) of this section.

(3) *Period is a term of years.* If the period described in paragraph (a)(5) of §1.664-3 is a term of years, the factor which is used in determining the present value of the remainder interest is the factor under the appropriate adjusted payout rate in column (2) of Table D in paragraph (b)(5) of this section opposite the number in column (1) of Table D which corresponds to the number of years in the term. If the adjusted payout rate is an amount which is between adjusted payout rates for which factors are provided in Table D, a linear interpolation must be made. The present value of the remainder interest is determined by multiplying the net fair market value (as of the appropriate valuation date) of the property placed in trust by the factor determined under this paragraph (b)(3). For purposes of this section, the term "appropriate valuation date" means the date on which the property is transferred to the trust by the donor except that, for purposes of section 2055 or 2106, it means the date of death unless the alternate valuation date is elected in accordance with section 2032 and the regulations thereunder in which event it means the alternate valuation date. If the adjusted payout rate is greater than 15 percent, see paragraph (a)(4) of this section. The application of this paragraph (b)(3) may be illustrated by the following example:

Example. D transfers $100,000 to a charitable remainder unitrust on January 1, 1985. The trust instrument requires that the trust pay to D semiannually (on June 30 and December 31) 10 percent of the fair market value of the trust assets as of June 30th for a term of 15 years. The adjusted payout rate is 9.787 percent (10% × 0.976731). The present value of the remainder interest is $21,404.90, computed as follows:

Factor at 9.6 percent for 15 years	0.220053
Factor at 9.8 percent for 15 years	.212862
Difference	.007191

$$\frac{9.767\% - 9.6\%}{0.2\%} = \frac{X}{.007191}$$

Factor at 9.6 percent for 15 years	0.220053
Less X	.006004
Interpolated factor	.214049

Present value of remainder interest = $100,000 × 0.214049 = $21,404.90.

(4) *Period is the life of one individual.* If the period described in paragraph (a)(5) of §1.664-3 is the life of one individual, the factor which is used in determining the present value of the remainder interest is the factor under the appropriate adjusted payout rate in column (2) of Table E in paragraph (b)(5) of this section opposite the number in column (1) which corresponds to the age of the individual whose life measures the period. For purposes of the computations described in this paragraph (b)(4), the age of an individual is to be taken as the age of that individual at the individual's birthday. If the adjusted payout rate is an amount which is between adjusted payout rates for which factors are provided for in Table E, a linear interpolation must be made. The present value of the remainder interest is determined by multiplying the net fair market value (as of the appropriate valuation date) of the property placed in trust by the factor determined under this paragraph (b)(4). If the adjusted payout rate is greater than 14 percent, see paragraph (a)(4) of this section. The application of this paragraph may be illustrated by the following example:

Example. A. who will be 50 years old on April 15, 1985, transfers $100,000 to a charitable remainder unitrust on January 1, 1985. The trust instrument requires that the trust pay to A at the end of each taxable year of the trust 10 percent of the fair market value of the trust

assets as of the beginning of each taxable year of the trust. The adjusted payout rate is 9.091 percent (10 percent × .909091). The present value of the remainder interest is $15,259.00 computed as follows:

Factor at 9 percent at age 50	0.15472
Factor at 9.2 percent at age 50	.15003
Difference	.00469

$$9.091\% - 9\% \div 0.2\% = X \div 0.00469$$
$$x = 0.00213$$

Factor at 9 percent at age 50	.15472
Less: X	.00213
Interpolated factor	.15259

Present value of remainder interest = $100,000 × 0.15259 = $15,259.00

(5) *Actuarial Tables.* The following tables shall be used in the application of the provisions of this section:

Table D—Table Showing the Present Worth of a Remainder Interest Postponed for a Term of Years in a Charitable Remainder Unitrust Having the Adjusted Payout Rate Shown

(1) Years	(2) Adjusted Payout Rate 2.2%	2.4%	2.6%	2.8%	3.0%
1	.978000	.976000	.974000	.972000	.970000
2	.956484	.952576	.948676	.944784	.940900
3	.935441	.929714	.924010	.918330	.912673
4	.914862	.907401	.899986	.892617	.885293
5	.894735	.885623	.876587	.867624	.858734
6	.875051	.864368	.853795	.843330	.832972
7	.855799	.843624	.831597	.819717	.807983
8	.836972	.823377	.809975	.796765	.783743
9	.818558	.803616	.788916	.774455	.760231
10	.800550	.784329	.768404	.752771	.737424
11	.782938	.765505	.748425	.731693	.715301
12	.765713	.747133	.728966	.711206	.693842
13	.748868	.729202	.710013	.691292	.673027
14	.732393	.711701	.691553	.671936	.652836
15	.716280	.694620	.673573	.653121	.633251
16	.700522	.677949	.656060	.634834	.614254
17	.685110	.661678	.639002	.617059	.595826
18	.670038	.645798	.622388	.599781	.577951
19	.655297	.630299	.606206	.582987	.560613
20	.640881	.615172	.590445	.566664	.543794

Table D—Continued (1)

(1) Years	(2) Adjusted Payout Rate 3.2%	3.4%	3.6%	3.8%	4.0%
1	.968000	.966000	.964000	.962000	.960000
2	.937024	.933156	.929296	.925444	.921600
3	.907039	.901429	.895841	.890277	.884736
4	.878014	.870780	.863591	.856447	.849347
5	.849918	.941174	.832502	.823902	.815373
6	.822720	.812574	.802532	.792593	.782758
7	.796393	.784946	.773641	.762475	.751447
8	.770909	.758258	.745790	.733501	.721390
9	.746239	.732477	.718941	.705628	.692534
10	.722360	.707573	.693059	.678814	.664833
11	.699244	.683516	.668109	.653019	.638239
12	.676868	.660276	.644057	.628204	.612710
13	.655209	.637827	.620871	.604332	.588201
14	.634242	.616141	.598520	.581368	.564673
15	.613946	.595192	.576973	.559276	.542086
16	.594300	.574955	.556202	.538023	.520403
17	.575282	.555407	.536179	.517578	.499587
18	.556873	.536523	.516876	.497911	.479603
19	.539053	.518281	.498269	.478990	.460419
20	.521804	.500660	.480331	.460788	.442002

Table D—Continued (2)

(1)	(2) Adjusted Payout Rate				
Years	4.2%	4.4%	4.6%	4.8%	5.0%
1	.958000	.956000	.954000	.952000	.950000
2	.917764	.913936	.910116	.906304	.902500
3	.879218	.873723	.868251	.862801	.857375
4	.842291	.835279	.828311	.821387	.814506
5	.806915	.798527	.790209	.781960	.773781
6	.773024	.763392	.753859	.744426	.735902
7	.740557	.729802	.719182	.708694	.698337
8	.709454	.697691	.686099	.674677	.663420
9	.679657	.666993	.654539	.642292	.630249
10	.651111	.637645	.624430	.611462	.598737
11	.623764	.609589	.595706	.582112	.568800
12	.597566	.582767	.568304	.554170	.540360
13	.572469	.557125	.542162	.527570	.513342
14	.548425	.532611	.517222	.502247	.487675
15	.525391	.509177	.493430	.478139	.463291
16	.503325	.486773	.470732	.455188	.440127
17	.482185	.465355	.449079	.433339	.418120
18	.461933	.444879	.428421	.412539	.397214
19	.442532	.425304	.408714	.392737	.377354
20	.423946	.406591	.389913	.373886	.358486

Table D—Continued (3)

(1)	(2) Adjusted Payout Rate				
Years	5.2%	5.4%	5.6%	5.8%	6.0%
1	.948000	.946000	.944000	.942000	.940000
2	.898704	.894916	.891136	.887364	.883600
3	.851971	.846591	.841232	.835897	.830584
4	.807669	.800875	.794123	.787415	.780749
5	.765670	.757627	.749652	.741745	.733904
6	.725855	.716716	.707672	.698724	.689870
7	.688111	.678013	.668042	.658198	.648478
8	.652329	.641400	.630632	.620022	.609569
9	.618408	.606765	.595317	.584061	.572995
10	.586251	.573999	.561979	.550185	.538615
11	.555766	.543003	.530508	.518275	.506298
12	.526866	.513681	.500800	.488215	.475920
13	.499469	.485942	.472755	.459898	.447365
14	.473496	.459701	.446281	.433224	.420523
15	.448875	.434878	.421289	.408097	.395292
16	.425533	.411394	.397697	.384427	.371574
17	.403405	.389179	.375426	.362131	.349280
18	.382428	.368163	.354402	.341127	.328323
19	.362542	.348282	.334555	.321342	.308624
20	.343690	.329475	.315820	.302704	.290106

Table D—Continued (4)

(1) Years	(2) Adjusted Payout Rate				
	6.2%	6.4%	6.6%	6.8%	7.0%
1	.938000	.936000	.934000	.932000	.930000
2	.879844	.876096	.872356	.868624	.864900
3	.825294	.820026	.814781	.809558	.804357
4	.774125	.767544	.761005	.754508	.748052
5	.726130	.718421	.710779	.703201	.695688
6	.681110	.672442	.663867	.655383	.646990
7	.638881	.629406	.620052	.610817	.601701
8	.599270	.589124	.579129	.569282	.559582
9	.562115	.551420	.540906	.530571	.520411
10	.527264	.516129	.505206	.494492	.483982
11	.494574	.483097	.471863	.460866	.450104
12	.463910	.452179	.440720	.429527	.418596
13	.435148	.423239	.411632	.400320	.389295
14	.408169	.396152	.384465	.373098	.362044
15	.382862	.370798	.359090	.347727	.336701
16	.359125	.347067	.335390	.324082	.313132
17	.336859	.324855	.313254	.302044	.291213
18	.315974	.304064	.292579	.281505	.270828
19	.296383	.284604	.273269	.262363	.251870
20	.278008	.266389	.255233	.244522	.234239

Table D—Continued (5)

(1) Years	(2) Adjusted Payout Rate				
	7.2%	7.4%	7.6%	7.8%	8.0%
1	.928000	.926000	.924000	.922000	.920000
2	.861184	.857476	.853776	.850084	.846400
3	.799179	.794023	.788889	.783777	.778688
4	.741638	.735265	.728933	.722643	.716393
5	.688240	.680855	.673535	.666277	.659082
6	.638687	.630472	.622346	.614307	.606355
7	.592701	.583817	.575048	.566391	.557847
8	.550027	.540615	.531344	.522213	.513219
9	.510425	.500609	.490962	.481480	.472161
10	.473674	.463564	.453649	.443925	.434388
11	.439570	.429260	.419171	.409298	.399637
12	.407921	.397495	.387314	.377373	.367666
13	.378550	.368081	.357879	.347938	.338253
14	.351295	.340843	.330680	.320799	.311193
15	.326002	.315620	.305548	.295777	.286297
16	.302529	.292264	.282326	.272706	.263394
17	.280747	.270637	.260870	.251435	.242322
18	.260533	.250610	.241044	.231823	.222936
19	.241775	.232065	.222724	.213741	.205101
20	.224367	.214892	.205797	.197069	.188693

Table D—Continued (6)

(1) Years	(2) Adjusted Payout Rate 8.2%	8.4%	8.6%	8.8%	9.0%
1	.918000	.916000	.914000	.912000	.910000
2	.842724	.839056	.835396	.831744	.828100
3	.773621	.768575	.763552	.758551	.753571
4	.710184	.704015	.697886	.691798	.685750
5	.651949	.644878	.637868	.630920	.624032
6	.598489	.590708	.583012	.575399	.567869
7	.549413	.541089	.532873	.524764	.516761
8	.504361	.495637	.487046	.478585	.470253
9	.463003	.454004	.445160	.436469	.427930
10	.425037	.415867	.406876	.398060	.389416
11	.390184	.380934	.371885	.363031	.354369
12	.358189	.348936	.339902	.331084	.322475
13	.328817	.319625	.310671	.301949	.293453
14	.301854	.292777	.283953	.275377	.267042
15	.277102	.268184	.259533	.251144	.243008
16	.254380	.245656	.237213	.229043	.221137
17	.233521	.225021	.216813	.208887	.201235
18	.214372	.206119	.198167	.190505	.183124
19	.196794	.188805	.181125	.173741	.166643
20	.180657	.172946	.165548	.158452	.151645

Table D—Continued (7)

(1) Years	(2) Adjusted Payout Rate 9.2%	9.4%	9.6%	9.8%	10.0%
1	.908000	.906000	.904000	.902000	.900000
2	.824464	.820836	.817216	.813604	.810000
3	.748613	.743677	.738763	.733871	.729000
4	.679741	.673772	.667842	.661951	.656100
5	.617205	.610437	.603729	.597080	.590490
6	.560422	.553056	.545771	.538566	.531441
7	.508863	.501069	.493377	.485787	.478297
8	.462048	.453968	.446013	.438180	.430467
9	.419539	.411295	.403196	.395238	.387420
10	.380942	.372634	.364489	.356505	.348678
11	.345895	.337606	.329498	.321567	.313811
12	.314073	.305871	.297866	.290054	.282430
13	.285178	.277119	.269271	.261628	.254187
14	.258942	.251070	.243421	.235989	.228768
15	.235119	.227469	.220053	.212862	.205891
16	.213488	.206087	.198928	.192001	.185302
17	.193847	.186715	.179830	.173185	.166772
18	.176013	.169164	.162567	.156213	.150095
19	.159820	.153262	.146960	.140904	.135085
20	.145117	.138856	.132852	.127096	.121577

Table D—Continued (8)

(1) Years	(2) Adjusted Payout Rate				
	10.2%	10.4%	10.6%	10.8%	11.0%
1	.898000	.896000	.894000	.892000	.890000
2	.806404	.802816	.799236	.795664	.792100
3	.724151	.719323	.714517	.709732	.704969
4	.650287	.644514	.638778	.633081	.627422
5	.583958	.577484	.571068	.564708	.558406
6	.524394	.517426	.510535	.503720	.496981
7	.422874	.415398	.408038	.449318	.442313
8	.422874	.415398	.408038	.400792	.383659
9	.379741	.372196	.364786	.357506	.350356
10	.341007	.333488	.326118	.318896	.311817
11	.306224	.298805	.291550	.284455	.277517
12	.274989	.267729	.260645	.253734	.246990
13	.246941	.239886	.233017	.226331	.219821
14	.221753	.214937	.208317	.201887	.195641
15	.199134	.192584	.186236	.180083	.174121
16	.178822	.172555	.166495	.160534	.154967
17	.160582	.154609	.148846	.143286	.137921
18	.144203	.138530	.133069	.127811	.122750
19	.129494	.124123	.118963	.114007	.109247
20	.116286	.111214	.106353	.101694	.097230

Table D—Continued (9)

(1) Years	(2) Adjusted Payout Rate				
	11.2%	11.4%	11.6%	11.8%	12.0%
1	.888000	.886000	.884000	.882000	.880000
2	.788544	.784996	.781456	.777924	.774400
3	.700227	.695506	.690807	.686129	.681472
4	.621802	.616219	.610673	.605166	.599695
5	.552160	.545970	.539835	.533756	.527732
6	.490318	.483729	.477214	.470773	.464404
7	.435402	.428584	.421858	.415222	.408676
8	.386637	.379726	.372922	.366226	.359635
9	.343334	.336437	.329663	.323011	.316478
10	.304881	.298083	.291422	.284896	.278501
11	.270734	.264102	.257617	.251278	.245081
12	.240412	.233994	.227734	.221627	.215671
13	.213486	.207319	.201317	.195475	.189791
14	.189575	.183684	.177964	.172409	.167016
15	.168343	.162744	.157320	.152065	.146974
16	.149488	.144191	.139071	.134121	.129337
17	.132746	.127754	.122939	.118295	.113817
18	.117878	.113190	.108678	.104336	.100159
19	.104676	.100286	.096071	.092024	.088140
20	.092952	.088853	.084927	.081166	.077563

Table D—Continued (10)

(1) Years	(2) Adjusted Payout Rate 12.2%	12.4%	12.6%	12.8%	13.0%
1	.878000	.876000	.874000	.872000	.870000
2	.770884	.767376	.763876	.760384	.756900
3	.676836	.672221	.667628	.663055	.658503
4	.594262	.588866	.583507	.578184	.572898
5	.521762	.515847	.509985	.504176	.498421
6	.458107	.451882	.445727	.439642	.433626
7	.402218	.395848	.389565	.383368	.377255
8	.353147	.346763	.340080	.334297	.328212
9	.310063	.303764	.297579	.291507	.285544
10	.272236	.266098	.260084	.254194	.248423
11	.239023	.233102	.227314	.221657	.216128
12	.209862	.204197	.198672	.193285	.188032
13	.184259	.178877	.173640	.168544	.163588
14	.161779	.156696	.151761	.146971	.142321
15	.142042	.137266	.132639	.128158	.123819
16	.124713	.120245	.115927	.111754	.107723
17	.109498	.105334	.101320	.097450	.093719
18	.096139	.092273	.088554	.084976	.081535
19	.084410	.080831	.077396	.074099	.070936
20	.074112	.070808	.067644	.064614	.061714

Table D—Continued (11)

(1) Years	(2) Adjusted Payout Rate 13.2%	13.4%	13.6%	13.8%	14.0%
1	.868000	.866000	.864000	.862000	.860000
2	.753424	.749956	.746496	.743044	.739600
3	.653972	.649462	.644973	.640504	.646056
4	.567648	.562434	.557256	.552114	.547008
5	.492718	.487068	.481469	.475923	.470427
6	.427679	.421801	.415990	.410245	.404567
7	.371226	.365279	.359415	.353631	.347928
8	.322224	.316332	.310535	.304830	.299218
9	.279690	.273944	.268302	.262764	.257327
10	.242771	.237235	.231813	.226502	.221302
11	.210725	.205446	.200286	.195245	.190319
12	.182910	.177916	.173047	.168301	.163675
13	.158766	.154075	.149513	.145076	.140760
14	.137809	.133429	.129179	.125055	.121054
15	.119618	.115550	.111611	.107798	.104106
16	.103828	.100066	.096432	.092922	.089531
17	.090123	.086657	.083317	.080098	.076997
18	.078227	.075045	.071986	.069045	.066217
19	.067901	.064989	.062196	.059517	.056947
20	.058938	.056280	.053737	.051303	.048974

Table D—Continued (12)

(1) Years	(2) Adjusted Payout Rate				
	14.2%	14.4%	14.6%	14.8%	15.0%
1	.858000	.856000	.854000	.852000	.850000
2	.736164	.732736	.729316	.725904	.722500
3	.631629	.627222	.622836	.618470	.614125
4	.541937	.536902	.531902	.526937	.522006
5	.464982	.459588	.454244	.448950	.443705
6	.398955	.393407	.387925	.382505	.377150
7	.342303	.336757	.331288	.325895	.320577
8	.293696	.288264	.282920	.277662	.272491
9	.251991	.246754	.241613	.236568	.231617
10	.216209	.211221	.206338	.201556	.196874
11	.185507	.180805	.176212	.171726	.167343
12	.159165	.154769	.150485	.146310	.142242
13	.136564	.132483	.128515	.124656	.120905
14	.117172	.113405	.109751	.106207	.102770
15	.100533	.097075	.093728	.090489	.087354
16	.086257	.083096	.080043	.077096	.074251
17	.074009	.071130	.068357	.065686	.063113
18	.063500	.060887	.058377	.055965	.053646
19	.054483	.052120	.049854	.047682	.045599
20	.046746	.044614	.042575	.040625	.038760

Table E—Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	2.2%	2.4%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%
0	.23253	.20635	.18364	.16394	.14683	.13196	.11901	.10774	.09791	.08933
1	.22196	.19506	.17170	.15139	.13372	.11834	.10493	.09324	.08303	.07410
2	.22597	.19884	.17523	.15468	.13676	.12113	.10749	.09557	.08514	.07601
3	.23039	.20304	.17920	.15840	.14024	.12437	.11050	.09835	.08770	.07837
4	.23053	.20747	.18340	.16237	.14397	.12787	.11376	.10138	.09052	.08098
5	.23988	.21211	.18783	.16656	.14793	.13159	.11725	.10465	.09357	.08382
6	.24489	.21693	.19243	.17094	.15207	.13549	.12092	.10810	.09680	.08684
7	.25004	.22189	.19718	.17546	.15637	.13956	.12476	.11171	.10019	.09002
8	.25534	.22701	.20209	.18016	.16084	.14380	.12877	.11549	.10376	.09337
9	.26080	.23230	.20718	.18503	.16549	.14822	.13296	.11946	.10751	.09691
10	.26640	.23774	.21243	.19008	.17031	.15282	.13734	.12361	.11144	.10063
11	.27217	.24335	.21786	.19530	.17532	.15761	.14190	.12795	.11556	.10454
12	.27807	.24911	.22344	.20068	.18049	.16257	.14663	.13247	.11986	.10863
13	.28407	.25497	.22913	.20618	.18579	.16764	.15149	.13711	.12428	.11283
14	.29013	.26089	.23489	.21175	.19115	.17279	.15643	.14182	.12878	.11712
15	.29621	.26684	.24067	.21735	.19655	.17798	.16140	.14657	.13331	.12143
16	.30229	.27279	.24647	.22296	.20196	.18318	.16638	.15133	.13785	.12576
17	.30838	.27876	.25228	.22859	.20739	.18840	.17138	.15611	.14241	.13010
18	.31451	.28477	.25813	.23427	.21287	.19367	.17643	.16094	.14702	.13449
19	.32070	.29085	.26407	.24003	.21844	.19903	.18157	.16586	.15172	.13897
20	.32699	.29704	.27012	.24591	.22413	.20452	.18685	.17092	.15655	.14358
21	.33339	.30335	.27629	.25192	.22996	.21014	.19226	.17612	.16153	.14833
22	.33991	.30977	.28259	.25807	.23592	.21591	.19783	.18146	.16665	.15324
23	.34655	.31634	.28904	.26437	.24205	.22185	.20356	.18698	.17195	.15832
24	.35334	.32306	.29566	.27085	.24836	.22798	.20949	.19270	.17746	.16361
25	.36031	.32998	.30248	.27754	.25490	.23434	.21565	.19866	.18321	.16914
26	.36746	.33710	.30952	.28446	.26167	.24094	.22207	.20489	.18922	.17494
27	.37481	.34443	.31678	.29161	.26869	.24780	.22875	.21138	.19551	.18102
28	.38236	.35197	.32427	.29901	.27596	.25492	.23570	.21814	.20208	.18739
29	.39006	.35968	.33194	.30660	.28344	.26226	.24288	.22514	.20889	.19400
30	.39793	.36757	.33980	.31439	.29113	.26982	.25029	.23239	.21596	.20088
31	.40594	.37561	.34783	.32237	.29902	.27759	.25792	.23985	.22324	.20798
32	.41410	.38383	.35605	.33054	.30711	.28557	.26577	.24755	.23078	.21533
33	.42240	.39220	.36444	.33890	.31541	.29377	.27385	.25548	.23855	.22293
34	.43084	.40072	.37299	.34744	.32389	.30217	.28214	.26364	.24656	.23077
35	.43942	.40941	.38172	.35617	.33258	.31079	.29065	.27203	.25481	.23887
36	.44813	.41824	.39061	.36508	.34146	.31961	.29939	.28065	.26330	.24721
37	.45696	.42720	.39966	.37416	.35053	.32863	.30833	.28950	.27202	.25579
38	.46591	.43630	.40885	.38339	.35977	.33784	.31747	.29855	.28096	.26460
39	.47496	.44552	.41818	.39378	.36917	.34722	.32680	.30780	.29011	.27363
40	.48412	.45486	.42765	.40232	.37875	.35679	.33633	.31727	.29948	.28290
41	.49338	.46432	.43725	.41201	.38849	.36654	.34606	.32693	.30908	.29239
42	.50275	.47391	.44700	.42187	.39840	.37648	.35599	.33683	.31890	.30213
43	.51221	.48360	.45686	.43186	.40847	.38659	.36610	.34691	.32894	.31209
44	.52175	.49340	.46685	.44199	.41870	.39687	.37640	.35720	.33918	.32227
45	.53136	.50327	.47693	.45223	.42905	.40728	.38685	.36765	.34961	.33265
46	.54104	.51323	.48712	.46259	.43953	.41785	.39746	.37828	.36023	.34323
47	.55077	.52327	.49739	.47305	.45013	.42856	.40823	.38908	.37103	.35400
48	.56058	.53339	.50777	.48363	.46087	.43941	.41917	.40006	.38202	.36499
49	.57043	.54358	.51823	.49432	.47173	.45040	.43025	.41121	.39320	.37617
50	.58035	.55384	.52879	.50510	.48271	.46153	.44149	.42252	.40457	.38756
51	.59029	.56415	.53940	.51597	.49379	.47277	.45286	.43398	.41609	.39911
52	.60027	.57450	.55008	.52692	.50496	.48412	.46435	.44558	.42776	.41084
53	.61026	.58488	.56080	.53793	.51620	.49556	.47595	.45731	.43958	.42272
54	.62025	.59528	.57154	.54897	.52750	.50707	.48763	.46913	.45151	.43473

Table E—Continued (1) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	2.2%	2.4%	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%
55	.63022	.60567	.58230	.56004	.53884	.51864	.49939	.48104	.46354	.44685
56	.64018	.61606	.59306	.57113	.55021	.53026	.51121	.49303	.47567	.45908
57	.65012	.62644	.60384	.58225	.56163	.54192	.52310	.50510	.48789	.47143
58	.66004	.63681	.61461	.59337	.57306	.55363	.53503	.51723	.50019	.48387
59	.66993	.64717	.62538	.60452	.58453	.56538	.54703	.52945	.51258	.49642
60	.67979	.65751	.63615	.61567	.59602	.57717	.55909	.54173	.52506	.50906
61	.68963	.66784	.64692	.62683	.60754	.58901	.57120	.55408	.53763	.52181
62	.69944	.67815	.65769	.63801	.61908	.60087	.58336	.56650	.55028	.53466
63	.70922	.68844	.66843	.64918	.63063	.61277	.59556	.57898	.56300	.54760
64	.71893	.69868	.67915	.66032	.64217	.62467	.60778	.59149	.57577	.56060
65	.72859	.70886	.68982	.67144	.65369	.63655	.62000	.60402	.58857	.57365
66	.73817	.71897	.70043	.68250	.66517	.64842	.63221	.61654	.60139	.58672
67	.74766	.72901	.71096	.69350	.67660	.66023	.64439	.62905	.61420	.59980
68	.75706	.73896	.72142	.70443	.68796	.67200	.65653	.64154	.62699	.61289
69	.76637	.74882	.73181	.71530	.69928	.68373	.66865	.65400	.63978	.62598
70	.77559	.75861	.74212	.72610	.71053	.69541	.68072	.66645	.65257	.63908
71	.78475	.76833	.75237	.73685	.72176	.70708	.69279	.67890	.66538	.65222
72	.79383	.77799	.76257	.74756	.73294	.71870	.70484	.69134	.67819	.66538
73	.80279	.78753	.77266	.75816	.74403	.73025	.71682	.70372	.69095	.67850
74	.81158	.79689	.78256	.76858	.75494	.74163	.72863	.71595	.70356	.69147
75	.82013	.80602	.79223	.77876	.76561	.75275	.74019	.72792	.71593	.70421
76	.82844	.81488	.80163	.78867	.77599	.76360	.75147	.73962	.72802	.71667
77	.83648	.82347	.81075	.79829	.78609	.77415	.76246	.75102	.73981	.72883
78	.84428	.83182	.81961	.80764	.79592	.78443	.77318	.76214	.75133	.74073
79	.85187	.83994	.82824	.81677	.80552	.79448	.78365	.77303	.76261	.75238
80	.85927	.84787	.83668	.82569	.81491	.80432	.79392	.78371	.77369	.76384
81	.86645	.85556	.84487	.83437	.82404	.81390	.80393	.79413	.78450	.77504
82	.87336	.86299	.85278	.84275	.83288	.82317	.81362	.80423	.79499	.78590
83	.88003	.87014	.86042	.85084	.84142	.83214	.82301	.81402	.80517	.79645
84	.88648	.87708	.86782	.85870	.84971	.84086	.83214	.42355	.81508	.80674
85	.89273	.88381	.87501	.86633	.85778	.84935	.84104	.83284	.82476	.81679
86	.89868	.89021	.88185	.87360	.86547	.85745	.84953	.84172	.83401	.82540
87	.90417	.89613	.88818	.88034	.87260	.86496	.85741	.84996	.84260	.83533
88	.90923	.90158	.89402	.88655	.87917	.87189	.86468	.85757	.85054	.84359
89	.91396	.90668	.89948	.89237	.88533	.87838	.87150	.86471	.85799	.85135
90	.91849	.91156	.90471	.89794	.89124	.88461	.87806	.87157	.86516	.85881
91	.92278	.91620	.90968	.90324	.89686	.89055	.88430	.87812	.87200	.86594
92	.92673	.92046	.91426	.90812	.90204	.89602	.89006	.88416	.87831	.87252
93	.93027	.92429	.91837	.91251	.90670	.90094	.89524	.88959	.88400	.87846
94	.93341	.92768	.92201	.91639	.91082	.90530	.89983	.89441	.88904	.88372
95	.93612	.93062	.92516	.91976	.91440	.90908	.90381	.89859	.89341	.88828
96	.93841	.93309	.92782	.92259	.91740	.91226	.90716	.90211	.89709	.89212
97	.94044	.93529	.93018	.92512	.92009	.91510	.91015	.90525	.90038	.89555
98	.94223	.93723	.93226	.92733	.92244	.91759	.91277	.90800	.90326	.89855
99	.94392	.93905	.93421	.92942	.92466	.91993	.91524	.81058	.90596	.90137
100	.94559	.94086	.93615	.93149	.92685	.92225	.91768	.91315	.90865	.90417
101	.94709	.94248	.93790	.93334	.92882	.92433	.91987	.91544	.91104	.90667
102	.94873	.94424	.93979	.93536	.93096	.92659	.92225	.91793	.91364	.90938
103	.95077	.94645	.94216	.93789	.93365	.92943	.92524	.92107	.91692	.91280
104	.95278	.94862	.94449	.94037	.93628	.93221	.92816	.92413	.92012	.91614
105	.95570	.95178	.94787	.94399	.94012	.93627	.93244	.92863	.92483	.92105
106	.96017	.95662	.95309	.94957	.94607	.94257	.93909	.93562	.93217	.92872
107	.96616	.96313	.96010	.95709	.95408	.95107	.94808	.84509	.94211	.93914
108	.97515	.97291	.97067	.96843	.96620	.96396	.96173	.95950	.95728	.95505
109	.98900	.98800	.98700	.98600	.98500	.98400	.98300	.98200	.98100	.98000

Table E—Continued (2) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Show

(1)	(2) Adjusted Payout Rate									
Age	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
0	.08183	.07527	.06952	.06448	.06005	.05615	.05272	.04969	.04701	.04464
1	.06629	.05945	.05344	.04817	.04354	.03945	.03585	.03268	.02986	.02737
2	.06801	.06098	.05481	.04939	.04460	.04039	.03667	.03337	.03046	.02787
3	.07017	.06297	.05663	.05104	.04611	.04176	.03791	.03450	.03147	.02879
4	.07259	.06520	.05868	.05294	.04786	.04336	.03938	.03585	.03272	.02993
5	.07523	.06765	.06096	.05505	.04982	.04518	.04107	.03741	.03416	.03127
6	.07805	.07029	.06342	.05734	.05195	.04717	.04292	.03914	.03577	.03276
7	.08103	.07307	.06603	.05978	.05423	.04929	.04490	.04099	.03750	.03438
8	.08418	.07603	.06880	.06238	.05666	.05158	.04704	.04300	.03938	.03615
9	.08752	.07917	.07175	.06516	.05928	.05404	.04936	.04518	.04143	.03808
10	.09103	.08249	.07488	.06811	.06206	.05666	.05183	.04751	.04364	.04016
11	.09473	.08600	.07820	.07125	.06503	.05947	.05449	.05003	.04602	.04242
12	.09861	.08968	.08169	.07456	.06817	.06245	.05731	.05271	.04856	.04484
13	.10261	.09348	.08530	.07799	.07142	.06554	.06025	.05549	.05121	.04735
14	.10669	.09735	.08899	.08148	.07474	.06869	.06324	.05834	.05391	.04992
15	.11080	.10126	.09269	.08500	.07808	.07186	.06625	.06119	.05662	.05250
16	.11491	.10516	.09640	.08852	.08142	.07502	.06924	.05403	.05931	.05504
17	.11903	.10908	.10012	.09204	.08475	.07817	.07223	.06685	.06199	.05757
18	.12321	.11304	.10387	.09560	.08812	.08136	.07524	.06970	.06468	.06012
19	.12747	.11709	.10771	.09923	.09156	.08462	.07832	.07261	.06743	.06272
20	.13186	.12126	.11168	.10300	.095$3	.08800	.08152	.07564	.07029	.06542
21	.13639	.12558	.11578	.10690	.09883	.09151	.08485	.07879	.07327	.06824
22	.14108	.13005	.12004	.11094	.10268	.09516	.08831	.08207	.07638	.07119
23	.14594	.13469	.12446	.11516	.10669	.09897	.09193	.08551	.07964	.07428
24	.15101	.13954	.12910	.11958	.11091	.10299	.09576	.08915	.08310	.07756
25	.15632	.14464	.13398	.12426	.11537	.10725	.09982	.09302	.08679	.08108
26	.16191	.15001	.13914	.12920	.12011	.11179	.10416	.09717	.09075	.08486
27	.16778	.15567	.14459	.13444	.12514	.11661	.10878	.10160	.09500	.08892
28	.17394	.16162	.15032	.13997	.13046	.12173	.11370	.10632	.09953	.09328
29	.18035	.16782	.15632	.14575	.13604	.12710	.11888	.11130	.10432	.09788
30	.18702	.17429	.16259	.15181	.14189	.13276	.12433	.11656	.10938	.10276
31	.19393	.18100	.16909	.15811	.14799	.13865	.13002	.12205	.11469	.10787
32	.20109	.18797	.17586	.16468	.15436	.14482	.13599	.12783	.12026	.11326
33	.20851	.19520	.18290	.17152	.16100	.15126	.14223	.13387	.12612	.11892
34	.21618	.20268	.19018	.17861	.16789	.15796	.14874	.14018	.13223	.12485
35	.22411	.21043	.19775	.18599	.17508	.16494	.15553	.14678	.13864	.13107
36	.23228	.21844	.20558	.19363	.18253	.17221	.16260	.15366	.14533	.13757
37	.24071	.22670	.21367	.20154	.19026	.17975	.16996	.16082	.15231	.14435
38	.24938	.23521	.22201	.20971	.19825	.18756	.17758	.16826	.15955	.15142
39	.25827	.24396	.23060	.21814	.20650	.19563	.18547	.17597	.16708	.15875
40	.26741	.25295	.23945	.22682	.21502	.20397	.19364	.18395	.17488	.16638
41	.27679	.26220	.24855	.23577	.22381	.21259	.20209	.19223	.18298	.17430
42	.28642	.27172	.25793	.24501	.23289	.22152	.21084	.20082	.19140	.18254
43	.29629	.28147	.26756	.25450	.24224	.23071	.21988	.20969	.20010	.19107
44	.30639	.29147	.27745	.26426	.25186	.24019	.22920	.21885	.20910	.19991
45	.31669	.30169	.28756	.27426	.26173	.24992	.23878	.22828	.21837	.20902
46	.32722	.31213	.29791	.28450	.27185	.25991	.24864	.23799	.22793	.21842
47	.33795	.32280	.30849	.29498	.28222	.27016	.25876	.24798	.23777	.22812
48	.34890	.33370	.31932	.30573	.29287	.28070	.26918	.25826	.24792	.23812
49	.36007	.34482	.33039	.31672	.30377	.39150	.27987	.26883	.25837	.24843
50	.37144	.35617	.34170	.32797	.31494	.30258	.29084	.27970	.26911	.25905
51	.38301	.36773	.35322	.33944	.32635	.31391	.30208	.29084	.28014	.26996
52	.39476	.37948	.36495	.35113	.33799	.32548	.31358	.30224	.29144	.28115
53	.40668	.39141	.37688	.36304	.34896	.33729	.32532	.31390	.30302	.29263
54	.41874	.40350	.38897	.37512	.36191	.34931	.33728	.32579	.31482	.30434

Table E—Continued (3) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
55	.43093	.41574	.40123	.38739	.37416	.36152	.34945	.33790	.32686	.31631
56	.44324	.42811	.41364	.39980	.38657	.37392	.36181	.35022	.33912	.32850
57	.45568	.44062	.42620	.41240	.39918	.38652	.37438	.36276	.35162	.34093
58	.48623	.45325	.43890	.42514	.41194	.39929	.38715	.37550	.36432	.35359
59	.48091	.46603	.45175	.43805	.42489	.41226	.40013	.38847	.37727	.36650
60	.49370	.47893	.46475	.45112	.43802	.42542	.41331	.40165	.39044	.37965
61	.50661	.49198	.47790	.46436	.45133	.43878	.42670	.41506	.40386	.39306
62	.51963	.50515	.49120	.47776	.46481	.45233	.44029	.42869	.41750	.40671
63	.53275	.51844	.50463	.49131	.47846	.46606	.45409	.44253	.43138	.42060
64	.54596	.53182	.51817	.50498	.49225	.47994	.46805	.45656	.44545	.43471
65	.55922	.54528	.53180	.51877	.50616	.49397	.48217	.47076	.45971	.44902
66	.57253	.55880	.54551	.53264	.52018	.50811	.49642	.48510	.47413	.46350
67	.58586	.57235	.55926	.54657	.53427	.52235	.51079	.49957	.48869	.47814
68	.59921	.58594	.57306	.56057	.54845	.53668	.52525	.51416	.50339	.49293
69	.61258	.59956	.58692	.57463	.56270	.55110	.53983	.52888	.51823	.50788
70	.62597	.61322	.60082	.58877	.57704	.56563	.55453	.54373	.53322	.52299
71	.63941	.62695	.61481	.60300	.59149	.58029	.56938	.55875	.54839	.53830
72	.65289	.64073	.62887	.61731	.60605	.59507	.58436	.57392	.56374	.55380
73	.66635	.65449	.64293	.63165	.62064	.60990	.59941	.58917	.57918	.56942
74	.67967	.66814	.65688	.64588	.63514	.62465	.61439	.60437	.59458	.58502
75	.69275	.68156	.67061	.65990	.64944	.63920	.62919	.61940	.60983	.60046
76	.70557	.69470	.68407	.67366	.66348	.65351	.64375	.63419	.62484	.61568
77	.71809	.70756	.69724	.68714	.67724	.66755	.65804	.64873	.63961	.63066
78	.73033	.72014	.71015	.70036	.69075	.68133	.67209	.66303	.65414	.64542
79	.74235	.73251	.72284	.71336	.70405	.69492	.68595	.67714	.66850	.66001
80	.74417	.74468	.73535	.72619	.71718	.70834	.69965	.69111	.68272	.67448
81	.76573	.75659	.74759	.73875	.73006	.72151	.71311	.70484	.69671	.68872
82	.77696	.76816	.75951	.75099	.74261	.73436	.72624	.71825	.71039	.70265
83	.78787	.77942	.77110	.86291	.75484	.74689	.73906	.73135	.72376	.71627
84	.79852	.79042	.78243	.77457	.76681	.75917	.75163	.74421	.73688	.72967
85	.80893	.80118	.79353	.78599	.77856	.77122	.76398	.75685	.74980	.74286
86	.81889	.81148	.80417	.79695	.78983	.78280	.77586	.76901	.76224	.75556
87	.82816	.82107	.81408	.80716	.80034	.79359	.78693	.78036	.77386	.76744
88	.83673	.82994	.82324	.81662	.81007	.80360	.79720	.79088	.78463	.77846
89	.84478	.83829	.83186	.82551	.81923	.81302	.80688	.80081	.79480	.78886
90	.85253	.84632	.84018	.83410	.82808	.82213	.81624	.81041	.80465	.79894
91	.85994	.85401	.84813	.84232	.83656	.83086	.82522	.81963	.81410	.80862
92	.86679	.86111	.85549	.84993	.84441	.83895	.83354	.82818	.82287	.81762
93	.87296	.86752	.86213	.85679	.85150	.84626	.84106	.83591	.83081	.82575
94	.87844	.87321	.86803	.86289	.85780	.85275	.84774	.84278	.83787	.83299
95	.88319	.87815	.87314	.86818	.86327	.85839	.85355	.84876	.84400	.83929
96	.88719	.88230	.87745	.87264	.86787	.86313	.85844	.85378	.84916	.84458
97	.89076	.88601	.88129	.87661	.87197	.86737	.86280	.85826	.85377	.84930
98	.89388	.88925	.88465	.88009	.87556	.87107	.86661	.86218	.85779	.85343
99	.89682	.89230	.88781	.88336	.87894	.87455	.87019	.86586	.86157	.85730
100	.89973	.89533	.89095	.88660	.88228	.87800	.87374	.86951	.86532	.86115
101	.90233	.89802	.89374	.88948	.88526	.88106	.87689	.87275	.86863	.86455
102	.90515	.90094	.89676	.89260	.88848	.88437	.88030	.87625	.87222	.86822
103	.90871	.90464	.90059	.89656	.89256	.88858	.88463	.88070	.87679	.87290
104	.91217	.90823	.90431	.90040	.89652	.89266	.88882	.88500	.88120	.87741
105	.91729	.91354	.90981	.90610	.90240	.89872	.89506	.89141	.88778	.88417
106	.92529	.92187	.91846	.91507	.91169	.90832	.90496	.90161	.89828	.89496
107	.93617	.93322	.93027	.92732	.92439	.92146	.91854	.91562	.91271	.90981
108	.95283	.95062	.94840	.94619	.94398	.94177	.93956	.93736	.93516	.93296
109	.97900	.97800	.97700	.97600	.97500	.97400	.97300	.97200	.97100	.97000

Table E—Continued (4) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
0	.04253	.04066	.03899	.03751	.03618	.03499	.03392	.03296	.03209	.03130
1	.02516	.02320	.02145	.01989	.01850	.01725	.01613	.01513	.01422	.01340
2	.02557	.02353	.02171	.02008	.01862	.01732	.01615	.01509	.01414	.01329
3	.02640	.02427	.02237	.02067	.01915	.01778	.01656	.01545	.01446	.01356
4	.02744	.02523	.02325	.02147	.01988	.01846	.01717	.01601	.01497	.01402
5	.02868	.02638	.02431	.02246	.02080	.01930	.01796	.01674	.01565	.01465
6	.03008	.02767	.02552	.02359	.02185	.02029	.01888	.01761	.01645	.01541
7	.03159	.02909	.02685	.02483	.02302	.02138	.01991	.01857	.01736	.01627
8	.03325	.03065	.02831	.02621	.02432	.02261	.02106	.01966	.01839	.01724
9	.03507	.03236	.02993	.02774	.02576	.02397	.02236	.02089	.01956	.01835
10	.03704	.03423	.03170	.02941	.02735	.02548	.02379	.02225	.02086	.01959
11	.03918	.03626	.03363	.03125	.02910	.02715	.02538	.02377	.02231	.02098
12	.04148	.03845	.03571	.03323	.03099	.02895	.02710	.02542	.02389	.02240
13	.04387	.04073	.03788	.03531	.03297	.03085	.02892	.02716	.02556	.02410
14	.04632	.04305	.04010	.03742	.03499	.03278	.03076	.02893	.02725	.02572
15	.04876	.04538	.04231	.03953	.03699	.03469	.03259	.03067	.02892	.02732
16	.05118	.04767	.04449	.04159	.03896	.03656	.03437	.03237	.03054	.02286
17	.05357	.04994	.04663	.04362	.04088	.03838	.03610	.03401	.03210	.03035
18	.05598	.05221	.04878	.04565	.04280	.04020	.03782	.03564	.03364	.03181
19	.05843	.05453	.05097	.04772	.04476	.04204	.03956	.03729	.03520	.03328
20	.06099	.05694	.05325	.04988	.04679	.04397	.04138	.03901	.03683	.03483
21	.06265	.05946	.05564	.05213	.04893	.04599	.04329	.04081	.03853	.03644
22	.06644	.06210	.05813	.05449	.05116	.04810	.04529	.04270	.04032	.03813
23	.06937	.06488	.06076	.05699	.05352	.05033	.04740	.04470	.04222	.03992
24	.07249	.06784	.06357	.05965	.05605	.05273	.04968	.04686	.04427	.04187
25	.07584	.07103	.06660	.06254	.05879	.05534	.05216	.04922	.04651	.04400
26	.07945	.07447	.06989	.06567	.06178	.05819	.05488	.05182	.04899	.04636
27	.08334	.07819	.07345	.06907	.06503	.06130	.05785	.05466	.05170	.04896
28	.08751	.08219	.07729	.07275	.06856	.06468	.06109	.05777	.05468	.05182
29	.09194	.08634	.08137	.07667	.07233	.06830	.06457	.06110	.05789	.05490
30	.09663	.09096	.08572	.08086	.07635	.07217	.06829	.06469	.06134	.05822
31	.10156	.09572	.09030	.08527	.08060	.07627	.07224	.06849	.06500	.06174
32	.10677	.10074	.09515	.08995	.08512	.08062	.07644	.07254	.06891	.06552
33	.11224	.10604	.10027	.09490	.08990	.08524	.08090	.07686	.07308	.06955
34	.11798	.11159	.10564	.10010	.09494	.09012	.08562	.08142	.07749	.07382
35	.12401	.11744	.11131	.10560	.10026	.09528	.09062	.08626	.08218	.07836
36	.13033	.12357	.11727	.11137	.10586	.10071	.09589	.09137	.08714	.08317
37	.13693	.12999	.12350	.11743	.11175	.10643	.10144	.09676	.09237	.08825
38	.14380	.13668	.13002	.12377	.11791	.11242	.10727	.10243	.09788	.09361
39	.15096	.14366	.13681	.13038	.12436	.11869	.11337	.10837	.10366	.09923
40	.15841	.15092	.14390	.13729	.13109	.12526	.11977	.11460	.10973	.10514
41	.16615	.15848	.15128	.14450	.13812	.13212	.12646	.12113	.11609	.11135
42	.17421	.16637	.15899	.15204	.14549	.13931	.13349	.12799	.12279	.11789
43	.18257	.17456	.16700	.15988	.15316	.14681	.14082	.13515	.12980	.12473
44	.19124	.18306	.17533	.16804	.16115	.15463	.14847	.14264	.13712	.13189
45	.20018	.19184	.18395	.17649	.16943	.16274	.15642	.15042	.14474	.13935
46	.20943	.20092	.19287	.18524	.17802	.17117	.16468	.15853	.15268	.14713
47	.21897	.21030	.20209	.19431	.18692	.17991	.17326	.16694	.16094	.15523
48	.22883	.22001	.21165	.20371	.19616	.18900	.18219	.17571	.16955	.16368
49	.23900	.23004	.22152	.21343	.20573	.19841	.19145	.18481	.17850	.17248
50	.24948	.24039	.23173	.22349	.21565	.20818	.20106	.19428	.18781	.18163
51	.26027	.25104	.24225	.23387	.22589	.21827	.21101	.20407	.19745	.19113
52	.27135	.26200	.25308	.24457	.23645	.22869	.22129	.21421	.20745	.20098
53	.28271	.27325	.26421	.25558	.24733	.23944	.23190	.22468	.21778	.21117
54	.29433	.28476	.27561	.26686	.25848	.25047	.24280	.23545	.22841	.22167

Table E—Continued (5) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
55	.30621	.29654	.28728	.27842	.26993	.26180	.25400	.24653	.23936	.23249
56	.31832	.30856	.29921	.29025	.28165	.27341	.26550	.25790	.25061	.24361
57	.33068	.32085	.31142	.30236	.29367	.28532	.27729	.26959	.26218	.25505
58	.34329	.33339	.32388	.31474	.30595	.29751	.28938	.28157	.27405	.26681
59	.35615	.34620	.33662	.32741	.31855	.31001	.30180	.29388	.28626	.27892
60	.36927	.35927	.34964	.34037	.33143	.32282	.31452	.30652	.29880	.29136
61	.38265	.37262	.37295	.35362	.34463	.33595	.32758	.31950	.31169	.30416
62	.39630	.38625	.37655	.36718	.35814	.34941	.34097	.33282	.32494	.31733
63	.41020	.40014	.39043	.38104	.37196	.36318	.35469	.34648	.33854	.33085
64	.42432	.41428	.40456	.39516	.38606	.37725	.36872	.36046	.35246	.34472
65	.43866	.42864	.41893	.40953	.40042	.39159	.38304	.37474	.36670	.35891
66	.45320	.44321	.43353	.42414	.41503	.40620	.39763	.38931	.38124	.37340
67	.46790	.45796	.44832	.43896	.42987	.42104	.41247	.40414	.39605	.38819
68	.48277	.47289	.46330	.45398	.44492	.43611	.42755	.41923	.41113	.40326
69	.49781	.48802	.47849	.46923	.46021	.45144	.44290	.43459	.42650	.41863
70	.51303	.50333	.49389	.48470	.47574	.46702	.45852	.45025	.44218	.43432
71	.52847	.51888	.50954	.50044	.49156	.48291	.47447	.46623	.45820	.45037
72	.54412	.53466	.52544	.51644	.50766	.49909	.49072	.48255	.47458	.46679
73	.55990	.55059	.54151	.53263	.52396	.51549	.50721	.49912	.49122	.48349
74	.57566	.56652	.55758	.54885	.54030	.53195	.52377	.51578	.50796	.50031
75	.59129	.58232	.57354	.56496	.55655	.54832	.54027	.53238	.52466	.51710
76	.60671	.59792	.58932	.58089	.57263	.56454	.55661	.54884	.54123	.53377
77	.62189	.61330	.60487	.59661	.58851	.58057	.57278	.56514	.55765	.55030
78	.63687	.62847	.62024	.61215	.60422	.59644	.58879	.58129	.57393	.56670
79	.65168	.64349	.63546	.62756	.61981	.61219	.60471	.59736	.59013	.58304
80	.66637	.65841	.65058	.64289	.63532	.62788	.62057	.61338	.60632	.59936
81	.68085	.67312	.66551	.65802	.65066	.64341	.63628	.62926	.62236	.61556
82	.69503	.68753	.68014	.67287	.66571	.65866	.65172	.64488	.63815	.63151
83	.70890	.70164	.69448	.68743	.68048	.67364	.66689	.66024	.65369	.64723
84	.72255	.71553	.70861	.70179	.69506	.68843	.68189	.67544	.66907	.66279
85	.73600	.72924	.72257	.71598	.70948	.70307	.69674	.69050	.68433	.67825
86	.74897	.74246	.73603	.72969	.72342	.71723	.71112	.70508	.69912	.69323
87	.76109	.75483	.74864	.74252	.73647	.73050	.72460	.71877	.71300	.70731
88	.77235	.76631	.76035	.75445	.74862	.74285	.73715	.73151	.72593	.72042
89	.78298	.77717	.77142	.76573	.76011	.75454	.74903	.74358	.73819	.73286
90	.79329	.78770	.78217	.77669	.77127	.76591	.76060	.75534	.75014	.74499
91	.80320	.79783	.79252	.78725	.78204	.77688	.77176	.76670	.76169	.75672
92	.81241	.80725	.80214	.79708	.79206	.78709	.78217	.77729	.77245	.76766
93	.83074	.81578	.81086	.80598	.80115	.79635	.79160	.78690	.78223	.77761
94	.82816	.82337	.81862	.81391	.80924	.80461	.80002	.79547	.79096	.78648
95	.83461	.82997	.82537	.82081	.81629	.81180	.80735	.80294	.79856	.79421
96	.84003	.83552	.83105	.82661	.82221	.81784	.81351	.80921	.80494	.80071
97	.84487	.84048	.83612	.83179	.82750	.82324	.81901	.81481	.81065	.80651
98	.84910	.84481	.84054	.83631	.83211	.82794	.82380	.81969	.81562	.81157
99	.85307	.84887	.84469	.84055	.83644	.83235	.82830	.82427	.82028	.81631
100	.85701	.85290	.84882	.84476	.84803	.83674	.83276	.82882	.82490	.82101
101	.86049	.85645	.85244	.84846	.84451	.84058	.83668	.83280	.82895	.82512
102	.86424	.86029	.85637	.85247	.84859	.84474	.84091	.83710	.83332	.82956
103	.86904	.86520	.86138	.85758	.85381	.85006	.84633	.84262	.83893	.83526
104	.87365	.86991	.86619	.86249	.85880	.85514	.85150	.84787	.84427	.84068
105	.88058	.87700	.87343	.86988	.86635	.86284	.85934	.85585	.85239	.84893
106	.89165	.88835	.88506	.88179	.87852	.87527	.87204	.86881	.86559	.86239
107	.90692	.90404	.90116	.89829	.89542	.89257	.88972	.88688	.88404	.88121
108	.93077	.92858	.92639	.92420	.92201	.91983	.91765	.91547	.91330	.91113
109	.96900	.96800	.96700	.96600	.96500	.96400	.96300	.96200	.96100	.96000

Table E—Continued (6) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
0.....	.03059	.02995	.02936	.02882	.02833	.02788	.02747	.02709	.02673	.02641
1.....	.01267	.01200	.01139	.01084	.01033	.00987	.00945	.00906	.00871	.00838
2.....	.01251	.01181	.01117	.01059	.01006	.00957	.00913	.00872	.00835	.00800
3.....	.01274	.01200	.01133	.01072	.01016	.00965	.00918	.00875	.00836	.00799
4.....	.01316	.01239	.01168	.01103	.01044	.00991	.00941	.00896	.00854	.00815
5.....	.01375	.01293	.01218	.01150	.01088	.01031	.00979	.00931	.00887	.00846
6.....	.01446	.01360	.01281	.01209	.01144	.01084	.01028	.00978	.00931	.00888
7.....	.01527	.01436	.01353	.01277	.01208	.01144	.01086	.01032	.00983	.00937
8.....	.01619	.01523	.01436	.01356	.01283	.01216	.01154	.01097	.01044	.00996
9.....	.01725	.01624	.01532	.01448	.01370	.01299	.01234	.01174	.01118	.01067
10.....	.01843	.01737	.01640	.01551	.01470	.01395	.01326	.01262	.01204	.01149
11.....	.01976	.01865	.01763	.01669	.01583	.01504	.01432	.01364	.01302	.01245
12.....	.02122	.02055	.01898	.01800	.01709	.01626	.01549	.01478	.01413	.01352
13.....	.22076	.02153	.02041	.01937	.01842	.01755	.01674	.01599	.01530	.01466
14.....	.02432	.02303	.02185	.02077	.01977	.01885	.01800	.01721	.01648	.01581
15.....	.02585	.02451	.02327	.02213	.02108	.02011	.01922	.01839	.01762	.01691
16.....	.02732	.02591	.02462	.02342	.02232	.02130	.02036	.01949	.01869	.01794
17.....	.02874	.02726	.02590	.02465	.02349	.02243	.02144	.02052	.01967	.01888
18.....	.03013	.02858	.02715	.02584	.02462	.02350	.02246	.02150	.02061	.01978
19.....	.03152	.02990	.02841	.02703	.02575	.02457	.02348	.02247	.02153	.02065
20.....	.03298	.03128	.02971	.02826	.02692	.02569	.02454	.02347	.02248	.02156
21.....	.03451	.03272	.03108	.02956	.02815	.02685	.02564	.02452	.02347	.02250
22.....	.03611	.03424	.03251	.03091	.02944	.02806	.02679	.02561	.02451	.02348
23.....	.03781	.03585	.03404	.03236	.03081	.02936	.02802	.02677	.02561	.02453
24.....	.03965	.03760	.03570	.03393	.03230	.03078	.02937	.02805	.02683	.02569
25.....	.04168	.03953	.03753	.03568	.03396	.03236	.03087	.02949	.02820	.02699
26.....	.04393	.04168	.03958	.03764	.03583	.03415	.03258	.03112	.02975	.02848
27.....	.04642	.04406	.04186	.03982	.03792	.03615	.03450	.03295	.03151	.03017
28.....	.04916	.04669	.04439	.04224	.04025	.03838	.03664	.03502	.03350	.03208
29.....	.05212	.04953	.04712	.04487	.04277	.04081	.03898	.03727	.03567	.03416
30.....	.05531	.05260	.05008	.04772	.04552	.04346	.04154	.03973	.03804	.03646
31.....	.05871	.05588	.05324	.05077	.04846	.04630	.04427	.04237	.04059	.03892
32.....	.06236	.05940	.05663	.05405	.05163	.04936	.04723	.04523	.04335	.04159
33.....	.06625	.06316	.06027	.05756	.05502	.05264	.05041	.04831	.04633	.04448
34.....	.07038	.06716	.06414	.06131	.05865	.05615	.05381	.05160	.04952	.04757
35.....	.07478	.07142	.06827	.06531	.06253	.05992	.05746	.05514	.05296	.05090
36.....	.07944	.07595	.07266	.06957	.06667	.06393	.06135	.05892	.05663	.05447
37.....	.08438	.08074	.07732	.07410	.07106	.06820	.06550	.06295	.06055	.05828
38.....	.08958	.08580	.08223	.07888	.07571	.07272	.06990	.06723	.06471	.06233
39.....	.09506	.09112	.08742	.08392	.08061	.07749	.07454	.07175	.06912	.06662
40.....	.10081	.09673	.09288	.08924	.08580	.08254	.07946	.07655	.07379	.07117
41.....	.10687	.10263	.09863	.09484	.09126	.08787	.08466	.08162	.07873	.07599
42.....	.11325	.10886	.10471	.10078	.09705	.09352	.09018	.08700	.08399	.08112
43.....	.11993	.11539	.11109	.10701	.10314	.09947	.09599	.09268	.08953	.08654
44.....	.12694	.12224	.11779	.11356	.10955	.10573	.10211	.09866	.09539	.09227
45.....	.13424	.12939	.12478	.12040	.11624	.11229	.10852	.10494	.10152	.09827
46.....	.14186	.13686	.13210	.12757	.12326	.11916	.11525	.11153	.10798	.10459
47.....	.14980	.14464	.13973	.13505	.13059	.12634	.12229	.11843	.11474	.11122
48.....	.15810	.15278	.14772	.14289	.13828	.13388	.12969	.12568	.12186	.11820
49.....	.16674	.16127	.15605	.15107	.14631	.14177	.13743	.13329	.12932	.12553
50.....	.17574	.17012	.16475	.15962	.15472	.15003	.14555	.14126	.13716	.13322
51.....	.18150	.17932	.17381	.16853	.16348	.15865	.15402	.14959	.14534	.14127
52.....	.19480	.18888	.18322	.17779	.17260	.16763	.16286	.15828	.15390	.14969
53.....	.20484	.19878	.19298	.18741	.18208	.17696	.17205	.16734	.16281	.15847
54.....	.21520	.20901	.20306	.19735	.19188	.18662	.18157	.17672	.17206	.16758

Table E—Continued (7) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
55	.22589	.21955	.21347	.20763	.20202	.19662	.19144	.18645	.18165	.17703
56	.23688	.23041	.22420	.21822	.21248	.20695	.20163	.19651	.19157	.18682
57	.24820	.24161	.23527	.22917	.22329	.21763	.21218	.20693	.20186	.19698
58	.25984	.25313	.24667	.24044	.23444	.22865	.22307	.21769	.21250	.20749
59	.27184	.26501	.25843	.25209	.24596	.24005	.23435	.22885	.22353	.21839
60	.28417	.27724	.27055	.26409	.25786	.25183	.24601	.24038	.23494	.22969
61	.29688	.28985	.28306	.27650	.27015	.26401	.25808	.25234	.24678	.24141
62	.30996	.30284	.29596	.28929	.28285	.27661	.27056	.26471	.25905	.25356
63	.32341	.31621	.30924	.30249	.29595	.28961	.28347	.27752	.27175	.26615
64	.33721	.32994	.32289	.31605	.30943	.30300	.29677	.29072	.28486	.27916
65	.35134	.34401	.33689	.32999	.32329	.31678	.31046	.30433	.29837	.29259
66	.36580	.35841	.35124	.34427	.33750	.33093	.32454	.31832	.31228	.30641
67	.38055	.37312	.36590	.35889	.35206	.34542	.33897	.33268	.32657	.32062
68	.39559	.38814	.38089	.37383	.36696	.36027	.35376	.34742	.34124	.33522
69	.41096	.40349	.39622	.38913	.38222	.37550	.36894	.36255	.35632	.35024
70	.42665	.41918	.41190	.40480	.39787	.39111	.38452	.37809	.37182	.36570
71	.44273	.43527	.42799	.42089	.41395	.40719	.40058	.39412	.38782	.38166
72	.45919	.45176	.44450	.43741	.43049	.42372	.41710	.41064	.40432	.39814
73	.47594	.46856	.46134	.45428	.44738	.44062	.43402	.42756	.42124	.41506
74	.49283	.48550	.47834	.47132	.46446	.45774	.45116	.44471	.43840	.43223
75	.50969	.50244	.49534	.48838	.48157	.47489	.46834	.46193	.45565	.44949
76	.52646	.51929	.51226	.50537	.49862	.49199	.48550	.47913	.47288	.46675
77	.54309	.53601	.52907	.52226	.51558	.50902	.50258	.49626	.49006	.48397
78	.55960	.55263	.54579	.53907	.53247	.52598	.51962	.51336	.50721	.50117
79	.57606	.56921	.56248	.55586	.54935	.54295	.53667	.53049	.52441	.51843
80	.59253	.58580	.57919	.57269	.56629	.55999	.55380	.54771	.54171	.53581
81	.60887	.60229	.59581	.58943	.58315	.57697	.57088	.56489	.55899	.55317
82	.62498	.61855	.61221	.60597	.59982	.59375	.58778	.58190	.57610	.57039
83	.64086	.63459	.62840	.62230	.61629	.61036	.60451	.59875	.59306	.58746
84	.65660	.65049	.64447	.63852	.63266	.62687	.62116	.61553	.60997	.60448
85	.67224	.66631	.66046	.65468	.64898	.64335	.63779	.63230	.62688	.62152
86	.68742	.68167	.67600	.67040	.66486	.65939	.65398	.64864	.64337	.63816
87	.70168	.69611	.69061	.68518	.67980	.67449	.66924	.66405	.65892	.65384
88	.71497	.70958	.70425	.69897	.69376	.68860	.68350	.67845	.67346	.66852
89	.72758	.72236	.71720	.71208	.70702	.70202	.69706	.69216	.68731	.68250
90	.63989	.73484	.72985	.72490	.72000	.71515	.71035	.70559	.70088	.69622
91	.75180	.74693	.74210	.73732	.73259	.72790	.72325	.71865	.71409	.70957
92	.76292	.75821	.75355	.74894	.74436	.73982	.73533	.73087	.72646	.72208
93	.77302	.76848	.76397	.75951	.75508	.75069	.74634	.74202	.73774	.73350
94	.78204	.77764	.77328	.76895	.76466	.76040	.75618	.75199	.74784	.74372
95	.78991	.78563	.78139	.77719	.77302	.76888	.76477	.76070	.75666	.75265
96	.79651	.79234	.78821	.78411	.78003	.77599	.77199	.76801	.76406	.76014
97	.80241	.79834	.79430	.79029	.78630	.78235	.77843	.77454	.77067	.76684
98	.80755	.80356	.79960	.79567	.79176	.78789	.78404	.78022	.77642	.77266
99	.81236	.80845	.80456	.80071	.79687	.79307	.78929	.78554	.78181	.77811
100	.81715	.81331	.80949	.80571	.80195	.79821	.79450	.79081	.78715	.78351
101	.82132	.81754	.81379	.81006	.80636	.80268	.79902	.79539	.79178	.78819
102	.82582	.82211	.81842	.81476	.81111	.80749	.80389	.80031	.79676	.79322
103	.83162	.82799	.82439	.82080	.81724	.81370	.81018	.80668	.80319	.79973
104	.83711	.83356	.83003	.82652	.82302	.81955	.81609	.81265	.80923	.80582
105	.84550	.84208	.83867	.83528	.83191	.82855	.82520	.82187	.81856	.81526
106	.85920	.85602	.85285	.84969	.84655	.84341	.84029	.83718	.83408	.83099
107	.87839	.87558	.87277	.86997	.86718	.86439	.86162	.85884	.85608	.85332
108	.90896	.90679	.90463	.90246	.90030	.89815	.89599	.89384	.89169	.88955
109	.95900	.95800	.95700	.95600	.95500	.95400	.95300	.95200	.95100	.95000

Table E—Continued (8) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
0.....	.02610	.02582	.02556	.02531	.02508	.02487	.02466	.02447	.02429	.02412
1.....	.00807	.00779	.00753	.00729	.00707	.00686	.00666	.00648	.00631	.00615
2.....	.00769	.00739	.00712	.00686	.00663	.00641	.00620	.00601	.00583	.00566
3.....	.00766	.00735	.00706	.00679	.00654	.00631	.00609	.00589	.00570	.00552
4.....	.00780	.00747	.00716	.00688	.00662	.00637	.00614	.00593	.00573	.00554
5.....	.00808	.00773	.00741	.00711	.00683	.00657	.00633	.00610	.00588	.00568
6.....	.00848	.00811	.00776	.00744	.00715	.00687	.00661	.00637	.00614	.00593
7.....	.00894	.00855	.00819	.00785	.00753	.00724	.00696	.00670	.00646	.00623
8.....	.00951	.00909	.00871	.00835	.00801	.00770	.00740	.00713	.00687	.00633
9.....	.01019	.00975	.00934	.00896	.00860	.00827	.00795	.00766	.00739	.00713
10.....	.01099	.01052	.01008	.00967	.00930	.00894	.00861	.00830	.00800	.00773
11.....	.01191	.01142	.01095	.01052	.01012	.00974	.00939	.00906	.00875	.00846
12.....	.01295	.01243	.01194	.01148	.01106	.01066	.01029	.00993	.00961	.00929
13.....	.01406	.01351	.01299	.01251	.01206	.01164	.01124	.01087	.01052	.01019
14.....	.01518	.01459	.01405	.01354	.01306	.01262	.01220	.01181	.01144	.01109
15.....	.01625	.01563	.01506	.01452	.01402	.01355	.01311	.01270	.01231	.01194
16.....	.01724	.01659	.01599	.01542	.01489	.01440	.01394	.01350	.01309	.01271
17.....	.01815	.01747	.01683	.01624	.01568	.01516	.01467	.01421	.01378	.01337
18.....	.01901	.01829	.01761	.01699	.01640	.01585	.01534	.01485	.01440	.01397
19.....	.01984	.01908	.01837	.01771	.01709	.01651	.01597	.01546	.01498	.01453
20.....	.02070	.01990	.01915	.01846	.01780	.01719	.01662	.01608	.01557	.01510
21.....	.02160	.02075	.01996	.01923	.01854	.01789	.01728	.01672	.01618	.01568
22.....	.02253	.02164	.02080	.02003	.01930	.01861	.01797	.01737	.01680	.01627
23.....	.02352	.02258	.02170	.02088	.02010	.01938	.01870	.01806	.01746	.01689
24.....	.02462	.02362	.02269	.02182	.02100	.02023	.01951	.01883	.01819	.01759
25.....	.02586	.02481	.02382	.02289	.02203	.02121	.02045	.01973	.01905	.01841
26.....	.02729	.02617	.02512	.02414	.02322	.02236	.02155	.02078	.02006	.01938
27.....	.02891	.02772	.02662	.02558	.02460	.02368	.02282	.02200	.02124	.02051
28.....	.03074	.02949	.02832	.02722	.02618	.02521	.02429	.02342	.02261	.02183
29.....	.03276	.03143	.03019	.02902	.02792	.02689	.02591	.02499	.02412	.02330
30.....	.03497	.03357	.03225	.03102	.02985	.02875	.02772	.02674	.02581	.02494
31.....	.03735	.03587	.03448	.03317	.03193	.03076	.02966	.02863	.02764	.02671
32.....	.03993	.03837	.03690	.03551	.03420	.03297	.03180	.03070	.02965	.02866
33.....	.04273	.04108	.03952	.03806	.03667	.03536	.03412	.03295	.03184	.03079
34.....	.04572	.04399	.04234	.04079	.03933	.03794	.03663	.03539	.03421	.03309
35.....	.04896	.04713	.04539	.04376	.04221	.04074	.03935	.03803	.03678	.03559
36.....	.05243	.05049	.04867	.04694	.04530	.04375	.04228	.04089	.03956	.03830
37.....	.05613	.05410	.05217	.05035	.04862	.04699	.04543	.04395	.04255	.04122
38.....	.06007	.05793	.05591	.05399	.05217	.05044	.04879	.04723	.04575	.04433
39.....	.06425	.06200	.05987	.05785	.05593	.05411	.05238	.05073	.04916	.04766
40.....	.06869	.06633	.06409	.06197	.05995	.05802	.05620	.05445	.05279	.05121
41.....	.07339	.07092	.96857	.06634	.06421	.06219	.06026	.05843	.05668	.05500
42.....	.07840	.07581	.07335	.07101	.06878	.06665	.06462	.06269	.06084	.05908
43.....	.08370	.08099	.07841	.07595	.07361	.07138	.06924	.06721	.06526	.06341
44.....	.08930	.08646	.08377	.08119	.07874	.07639	.07415	.07202	.06997	.06801
45.....	.09517	.09222	.08940	.08670	.08413	.08168	.07933	.07708	.07493	.07287
46.....	.10136	.09828	.09533	.09252	.08983	.08726	.08480	.08244	.08018	.07802
47.....	.10786	.10464	.10157	.09864	.09582	.09313	.09056	.08809	.08572	.08345
48.....	.11470	.11136	.10816	.10510	.10216	.09935	.09666	.09408	.09160	.08922
49.....	.12189	.11842	.11509	.11190	.10884	.10591	.10309	.10039	.09780	.09531
50.....	.12946	.12585	.12239	.11907	.11588	.11282	.10989	.10707	.10436	.10176
51.....	.13737	.13363	.13003	.12659	.12327	.12009	.11703	.11409	.11127	.10855
52.....	.14565	.14177	.13805	.13447	.13103	.12772	.12454	.12147	.11853	.11569
53.....	.15429	.15028	.14642	.14271	.13914	.13571	.13240	.12922	.12615	.12319
54.....	.16327	.15912	.15513	.15129	.14759	.14403	.14060	.13729	.13410	.13102

Table E—Continued (9) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
55	.17259	.16831	.16419	.16022	.15639	.15270	.14914	.14571	.14240	.13920
56	.18225	.17784	.17358	.16948	.16553	.16171	.15802	.15447	.15103	.14771
57	.19227	.18773	.18335	.17912	.17503	.17109	.16728	.16360	.16004	.15660
58	.20265	.19798	.19347	.18911	.18490	.18083	.17690	.17309	.16941	.16585
59	.21343	.20863	.20400	.19951	.19518	.19098	.18692	.18299	.17919	.17551
60	.22460	.21968	.21492	.21032	.20586	.20154	.19736	.19331	.18938	.18558
61	.23620	.23117	.22629	.22156	.21698	.21254	.20824	.20407	.20003	.19610
62	.24824	.24309	.23810	.23325	.22856	.22400	.21958	.21530	.21113	.20709
63	.26073	.25546	.25036	.24540	.24060	.23593	.23139	.22699	.22272	.21856
64	.27364	.26827	.26306	.25800	.25308	.24830	.24366	.23915	.23476	.23050
65	.28696	.28150	.27619	.27103	.26601	.26113	.25638	.25176	.24727	.24290
66	.30070	.29515	.28974	.28449	.27937	.27439	.26955	.26483	.26023	.25576
67	.31483	.30919	.30371	.29836	.29316	.28808	.28314	.27833	.27364	.26906
68	.32936	.32365	.31808	.31266	.30737	.30221	.29718	.29228	.28750	.20283
69	.34432	.33854	.33290	.32741	.32204	.31681	.31170	.30672	.30185	.29710
70	.35972	.35389	.34820	.34264	.33721	.33190	.32673	.32167	.31672	.31189
71	.37565	.36977	.36403	.35842	.35294	.34758	.34234	.33721	.33220	.32731
72	.39210	.38619	.38042	.37477	.36924	.36384	.35855	.35337	.34831	.34335
73	.40900	.40308	.39728	.39161	.38605	.38061	.37529	.37007	.36496	.35996
74	.42618	.42025	.41444	.40876	.40318	.39772	.39237	.38713	.38199	.37695
75	.44345	.43753	.43173	.42604	.42046	.41499	.40962	.40436	.39920	.39413
76	.46073	.45483	.44904	.44336	.43779	.43232	.42695	.42168	.41650	.41142
77	.47799	.47212	.46635	.46069	.45513	.44967	.44431	.43905	.43386	.42878
78	.49524	.48941	.48368	.47805	.47252	.46708	.46173	.45647	.45130	.44622
79	.51256	.50678	.50110	.49551	.49001	.48460	.47928	.47405	.46890	.46383
80	.53001	.52429	.51867	.51313	.50769	.50232	.49705	.49185	.48673	.48169
81	.54745	.54181	.53626	.53079	.52541	.52010	.51487	.50973	.50465	.49965
82	.56476	.55921	.55374	.54835	.54303	.53779	.53263	.52754	.52252	.51757
83	.58193	.57648	.57110	.56579	.56056	.55540	.55031	.54529	.54033	.53544
84	.55907	.59373	.58845	.58325	.57811	.57304	.56804	.56309	.55822	.55340
85	.61624	.61102	.60586	.60077	.59574	.59077	.58586	.58102	.57623	.57150
86	.63300	.62791	.62289	.61791	.61300	.60815	.60335	.59860	.59392	.58928
87	.64883	.64387	.63896	.63411	.62932	.62458	.61989	.61525	.61066	.60613
88	.66363	.65880	.65402	.64929	.64461	.63998	.63540	.63086	.62638	.62194
89	.67775	.67304	.66838	.66377	.65921	.65469	.65022	.64579	.64141	.63707
90	.69160	.68703	.68250	.67802	.67357	.66918	.66482	.66050	.65623	.65199
91	.70509	.70066	.69626	.69191	.68760	.68332	.67909	.67489	.67073	.66661
92	.71775	.71345	.70919	.70496	.70078	.69662	.69251	.68843	.68439	.68038
93	.72929	.72512	.72099	.71689	.71282	.70879	.70479	.70082	.69689	.69299
94	.73964	.73559	.63157	.72758	.72362	.71970	.71581	.71195	.70812	.70432
95	.74867	.74472	.74081	.73692	.73306	.72924	.72544	.72167	.71793	.71422
96	.75625	.75239	.74856	.74476	.74099	.73724	.73353	.72984	.72618	.72254
97	.76303	.75925	.75550	.75177	.74807	.74440	.74076	.73714	.73354	.72998
98	.76892	.76521	.76152	.75786	.75422	.75061	.74703	.74347	.73994	.73643
99	.77443	.77078	.76715	.76355	.75998	.75642	.75290	.74939	.74591	.74245
100	.77990	.77631	.77275	.76921	.76569	.76219	.75872	.75527	.75184	.74844
101	.78463	.78109	.77757	.77407	.77060	.76715	.76372	.76031	.75692	.65356
102	.78971	.78622	.78275	.77930	.77587	.77246	.76908	.76571	.76236	.75904
103	.79629	.79287	.78947	.78608	.78272	.77937	.77605	.77274	.76945	.76618
104	.80244	.79907	.79572	.79239	.78907	.78577	.78249	.77923	.77598	.77275
105	.81198	.80871	.80546	.80222	.79900	.79579	.79259	.78941	.78625	.78310
106	.82792	.82485	.82180	.81876	.81572	.81270	.80969	.80670	.80371	.80073
107	.85057	.84783	.84509	.84237	.83964	.83693	.83422	.83152	.82883	.82614
108	.88740	.88526	.88312	.88098	.87885	.87672	.87459	.87246	.87034	.86822
109	.94900	.94800	.94700	.94600	.94500	.94400	.94300	.94200	.94100	.94000

Table E—Continued (10) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
0.....	.02396	.02380	.02366	.02352	.02338	.02325	.02313	.02301	.02290	.02279
1.....	.00600	.00585	.00572	.00559	.00547	.00536	.00525	.00514	.00505	.00495
2.....	.00550	.00535	.00521	.00508	.00495	.00484	.00472	.00462	.00451	.00442
3.....	.00536	.00520	.00505	.00491	.00478	.00465	.00453	.00442	.00431	.00421
4.....	.00536	.00519	.00504	.00489	.00475	.00461	.00449	.00437	.00426	.00415
5.....	.00549	.00532	.00515	.00499	.00484	.00470	.00457	.00444	.00432	.00421
6.....	.00572	.00554	.00536	.00519	.00503	.00488	.00474	.00460	.00447	.00435
7.....	.00602	.00582	.00563	.00545	.00528	.00512	.00496	.00482	.00468	.00455
8.....	.00640	.00618	.00598	.00579	.00561	.00543	.00527	.00512	.00497	.00483
9.....	.00688	.00665	.00644	.00623	.00604	.00585	.00568	.00551	.00536	.00521
10.....	.00747	.00723	.00699	.00678	.00657	.00637	.00619	.00601	.00584	.00568
11.....	.00818	.00792	.00767	.00744	.00722	.00701	.00681	.00662	.00644	.00627
12.....	.00900	.00873	.00846	.00822	.00798	.00776	.00755	.00735	.00716	.00697
13.....	.00988	.00959	.00931	.00905	.00880	.00857	.00834	.00813	.00793	.00773
14.....	.01077	.01046	.01017	.00989	.00963	.00938	.00914	.00892	.00870	.00850
15.....	.01160	.01127	.01097	.01067	.01040	.01014	.00989	.00965	.00942	.00921
16.....	.01234	.01200	.01167	.01137	.01108	.01080	.01054	.01029	.01005	.00983
17.....	.01299	.01263	.01229	.01197	.01166	.01137	.01109	.01083	.01058	.01035
18.....	.01357	.01319	.01283	.01249	.01217	.01186	.01157	.01130	.01103	.01078
19.....	.01410	.01370	.01332	.01297	.01263	.01230	.01200	.01171	.01143	.01117
20.....	.01465	.01422	.01382	.01345	.01309	.01275	.01243	.01212	.01183	.01155
21.....	.01520	.01475	.01433	.01393	.01355	.01319	.01285	.01253	.01222	.01193
22.....	.01576	.01529	.01484	.01442	.01402	.01364	.01328	.01293	.01261	.01230
23.....	.01636	.01586	.01538	.01493	.01450	.01410	.01372	.01336	.01301	.01268
24.....	.01703	.01649	.01599	.01551	.01505	.01463	.01422	.01383	.01347	.01312
25.....	.01781	.01724	.01670	.01619	.01571	.01525	.01482	.01441	.01401	.01364
26.....	.01874	.01813	.01756	.01701	.01650	.01601	.01555	.01511	.01469	.01430
27.....	.01983	.01918	.01857	.01799	.01744	.01692	.01643	.01596	.01551	.01509
28.....	.02111	.02042	.01976	.01915	.01856	.01800	.01748	.01697	.01650	.01604
29.....	.02253	.02179	.02110	.02044	.01981	.01922	.01865	.01812	.01760	.01712
30.....	.02411	.02333	.02259	.02188	.02121	.02058	.01998	.01940	.01886	.01833
31.....	.02583	.02500	.02421	.02345	.02274	.02206	.02142	.02080	.02022	.01966
32.....	.02772	.02683	.02599	.02519	.02443	.02370	.02301	.02236	.02173	.02113
33.....	.02979	.02885	.02795	.02709	.02628	.02550	.02477	.02407	.02340	.02276
34.....	.03203	.03102	.03006	.02915	.02829	.02746	.02667	.02592	.02521	.02452
35.....	.03447	.03340	.03238	.03141	.03048	.02960	.02876	.02796	.02719	.02646
36.....	.03710	.03597	.03488	.03385	.03286	.03193	.03103	.03017	.02936	.02858
37.....	.03995	.03874	.03758	.03649	.03544	.03444	.03348	.03257	.03170	.03087
38.....	.04299	.04170	.04048	.03931	.03820	.03714	.03612	.03515	.03422	.03333
39.....	.04623	.04487	.04358	.04234	.04115	.04002	.03894	.03791	.03692	.03597
40.....	.04970	.04826	.04689	.04558	.04432	.04312	.04197	.04087	.03981	.03880
41.....	.05341	.05189	.05043	.04904	.04771	.04643	.04521	.04404	.04292	.04185
42.....	.05739	.05578	.05424	.05277	.05136	.05001	.04871	.04747	.04628	.04514
43.....	.06163	.05993	.05830	.05674	.05525	.05382	.05245	.05113	.04987	.04865
44.....	.06614	.06435	.06263	.06099	.05941	.05789	.05644	.05505	.05371	.05242
45.....	.07090	.06901	.06720	.06547	.06380	.06220	.06067	.05919	.05777	.05641
46.....	.07595	.07396	.07206	.07023	.06847	.06678	.06516	.06360	.06210	.06065
47.....	.08128	.07919	.07718	.07525	.07340	.07162	.06991	.06826	.06668	.06514
48.....	.08693	.08474	.08263	.08061	.07866	.07678	.07498	.07324	.07157	.06999
49.....	.09291	.09061	.08840	.08627	.08423	.08225	.08035	.07852	.07676	.07506
50.....	.09925	.09684	.09452	.09229	.09014	.08807	.08607	.08415	.08229	.08050
51.....	.10593	.10341	.10098	.09864	.09638	.09421	.09211	.09009	.08814	.08625
52.....	.11296	.11032	.10778	.10534	.10297	.10070	.09850	.09637	.09432	.09234
53.....	.12034	.11759	.11494	.11238	.10991	.10753	.10523	.10300	.10085	.09877
54.....	.12805	.12519	.12243	.11976	.11718	.11468	.11227	.10994	.10769	.10551

Table E—Continued (11) Table, Single Life, Unisex, Showing the Present Worth of the Reminder Interest in Property Transferred to a Unitrust Having the Adjusted Payout Rate Shown

(1)	(2) Adjusted Payout Rate									
Age	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
55	.13611	.13313	.13025	.12747	.12478	.12218	.11966	.11722	.11487	.11258
56	.14451	.14141	.13841	.13551	.13271	.12999	.12737	.12483	.12236	.11998
57	.15327	.15005	.14694	.14393	.14101	.13818	.13545	.13279	.13022	.12773
58	.16240	.15906	.15583	.15270	.14967	.14673	.14388	.14112	.13844	.13584
59	.17194	.16848	.16513	.16189	.15874	.15568	.15272	.14985	.14706	.14435
60	.18189	.17831	.17485	.17148	.16822	.16505	.16198	.15899	.15609	.15327
61	.19230	.18860	.18502	.18154	.17816	.17488	.17169	.16859	.16558	.16265
62	.20317	.19936	.19566	.19207	.18857	.18518	.18187	.17866	.17554	.17251
63	.21453	.21060	.20679	.20308	.19947	.19596	.19255	.18923	.18600	.18285
64	.22635	.22231	.21839	.21457	.21085	.20723	.20371	.20028	.19694	.19368
65	.23864	.23450	.23046	.22653	.22271	.21893	.21535	.21181	.20836	.20500
66	.25140	.24715	.24301	.23898	.23505	.23121	.22748	.22383	.22028	.21681
67	.26461	.26026	.25602	.25188	.24785	.24392	.24008	.23633	.23267	.22910
68	.27828	.27384	.26950	.26527	.26114	.25711	.25317	.24932	.24556	.24189
69	.29246	.28793	.28350	.27918	.27496	.27083	.26680	.26285	.25900	.25523
70	.30718	.30256	.29805	.29364	.28933	.28512	.28100	.27697	.27302	.26916
71	.32251	.31783	.31324	.30876	.30437	.30007	.29587	.29176	.28773	.28378
72	.33850	.33375	.32910	.32455	.32009	.31572	.31145	.30726	.30315	.29913
73	.35506	.35026	.34555	.34094	.33642	.33199	.32765	.32340	.31923	.31514
74	.37201	.36716	.36241	.35776	.35319	.34871	.34431	.34000	.33577	.33162
75	.38916	.38429	.37950	.37481	.37020	.36568	.36124	.35688	.35260	.34840
76	.40644	.40154	.39673	.39200	.38737	.38281	.37833	.37393	.36961	.36537
77	.42378	.41887	.41404	.40930	.40464	.40006	.39555	.39113	.38677	.38249
78	.44123	.43631	.43148	.42673	.42205	.41745	.41293	.40848	.40410	.39980
79	.45885	.45394	.44911	.44436	.43969	.43508	.43055	.42609	.42170	.41737
80	.47673	.47184	.46703	.46229	.45763	.45303	.44850	.44404	.43964	.43531
81	.49473	.48987	.48509	.48037	.47573	.47115	.46663	.46218	.45779	.45347
82	.51269	.50787	.50313	.49845	.49383	.48928	.48479	.48036	.47599	.47168
83	.53062	.52586	.52116	.51653	.51195	.50744	.50298	.49858	.49424	.48995
84	.54864	.54395	.53931	.53473	.53021	.52575	.52134	.51698	.51268	.50843
85	.56683	.56221	.55765	.55314	.54869	.54429	.53994	.53564	.53139	.52720
86	.58470	.58017	.57570	.57127	.56689	.56257	.55829	.55406	.54988	.54574
87	.60164	.59720	.59281	.58847	.58417	.57993	.57572	.57156	.56745	.56338
88	.61754	.61320	.60889	.60464	.60042	.59625	.59212	.58804	.58399	.57999
89	.63277	.62851	.62430	.62013	.61600	.61191	.60786	.60384	.59987	.59594
90	.64780	.64364	.63953	.63545	.63141	.62741	.62344	.61952	.61562	.61177
91	.66252	.65848	.65446	.65049	.64655	.64264	.63877	.63493	.63113	.62736
92	.67640	.67246	.66856	.66468	.66084	.65703	.65326	.64951	.64580	.64212
93	.68912	.68528	.68148	.67770	.67396	.67024	.66656	.66291	.65928	.65568
94	.70055	.69680	.69309	.68941	.68576	.68213	.67854	.67497	.67142	.66791
95	.71054	.70689	.70326	.69966	.69609	.69255	.68903	.68554	.68207	.67863
96	.71893	.71535	.71180	.70827	.70476	.70128	.69783	.69440	.69100	.68762
97	.72643	.62292	.71943	.71596	.71252	.70910	.70570	.70233	.69899	.69566
98	.73294	.72948	.72604	.72263	.71924	.71587	.71252	.70920	.70590	.70263
99	.73902	.73561	.73222	.72886	.72551	.72219	.71889	.71562	.71236	.70913
100	.74506	.74170	.73836	.73504	.73174	.72847	.72522	.72198	.71877	.71558
101	.75021	.74689	.74359	.74030	.73704	.73380	.73058	.72738	.72420	.72104
102	.75573	.75244	.74918	.74593	.74270	.73949	.73630	.73313	.72998	.72685
103	.76293	.75970	.75649	.75329	.75011	.74695	.74381	.74068	.73758	.73449
104	.76954	.76634	.76316	.76000	.75685	.75372	.75060	.74751	.74442	.74136
105	.77996	.77684	.77373	.77064	.76756	.76449	.76144	.75840	.75538	.75237
106	.79777	.79481	.79187	.78894	.78602	.78311	.78021	.77732	.77444	.77157
107	.82346	.82078	.81812	.81546	.81281	.81016	.80752	.80489	.80227	.79965
108	.86610	.86398	.86187	.85976	.85765	.85554	.85344	.85134	.84924	.84715
109	.93900	.93800	.93700	.93600	.93500	.93400	.93300	.93200	.93100	.93000

Table F(1)—Table, 10 Percent, Showing Factors for Computation of the Adjusted Payout Rate for Certain Valuations and Payout Sequences

1		2			
Number of Months by Which the Valuation Date Precedes the First Payout		Factors for Payout at the End of Each.			
At least	But Less than	Annual Period	Semiannual Period	Quarterly Period	Monthly Period
. .	1		.976731	.965232	.957616
1	2	.992089	.969004	.957596	.950041
2	3	.984240	.961338	.950021	
3	4	.976454	.953733	.942505	
4	5	.968729	.946188		
5	6	.961066	.938703		
6	7	.953463	.931277		
7	8	.945920			
8	9	.938436			
9	10	.931012			
10	11	.923647			
11	12	.916340			
12	. .	.909091			

(c) *Valuation of charitable remainder unitrusts having certain payout sequences; for testamentary transfers made after November 30, 1983, and before August 9, 1984.* For purposes of section 2055 or 2106, if —

(1) the testamentary transfer occurred after November 30, 1983, and before August 9, 1984, or

(2) on December 1, 1983, a decedent was under a mental disability such that the disposition of the property could not be changed, and the testamentary transfer occurs any time on or after December 1, 1983 without such decedent ever having regained competency to dispose of such decedent's property, or having died within 90 days of the date on which such decedent first regains competency,

the present value determined under this section of a remainder interest shall be determined in accordance with paragraphs (b)(1) through (5) or (d)(1) through (5) of this section, whichever is most beneficial to the taxpayer.

(d) *Valuation of charitable remainder unitrusts having certain payout sequences; for transfer made before December 1, 1983*—(1) *In general.* For transfers made before December 1, 1983, the present value determined under this section of a remainder interest which is dependent on a term of years or the termination of the life of one individual shall be determined under paragraphs (d)(1) through (5) of this section provided that the amount of the payout as of any payout date during any taxable year of the trust is not larger than the amount which the trust could distribute on such date under paragraph (a)(1)(v) of §1.644-3 if the taxable year of the trust were to end on such date. ***For transfers made after November 30, 1983, see paragraphs (b)(1) through (5) and (c) of this section.

* * * * *

§11.414(c)-2 [Amended]

Par. 10. The last sentence of paragraph (b)(2)(ii) of §11.414(c)-2 is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, which is appropriate.".

§11.414(c)-4 [Amended]

Par. 11. The last sentence of paragraph (b)(3)(i) of §11.414(c)-4 is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate.".

Par. 12. Section 20.2031-7 is revised to read as set forth below.

§20.2031-7 Valuation of annuities, life estates, terms for years, remainders, and reversions for estates of decedents dying after November 30, 1983.

(a) *In general.* (1) Except as otherwise provided in this paragraph (a)(1), for estates of decedents dying after November 30, 1983, the fair market value of annuities, life estates, terms for years, remainders, and reversions is their present value determined under this section. If a decedent dies after November 30, 1983, and before August 9, 1984, or if on December 1, 1983, a decedent was under a mental disability such that the disposition of the decedent's property could not be changed, and such decedent dies any time on or after December 1, 1983 without such decedent ever having regained competency to dispose of such decedent's property, or dies within 90 days of the date on which such decedent first regains competency, the fair market value of annuities, life estates, terms for years, remainders, and reversions included in the estate of such decedent is their present value determined under this section or §20.2031-10, whichever is most beneficial to the taxpayer. The value of annuities issued by companies regularly engaged in their sale, and of insurance policies on the lives of persons other than the decedent is determined under §20.2031-8. The fair market value of a remainder interest in a charitable remainder unitrust as defined in §1.664-3 is its present value determined under §1.664-4. The fair market value of a life interest or term

for years in a charitable remainder unitrust is the fair market value of the property as of the date of valuation less the fair market value of the remainder interest on such date determined under §1.664-4. The fair market value of interests in a pooled income fund, as defined in §1.642(c)-5, is their value determined under §1.642(c)-6. (See §20.2031-10 with respect to the valuation of annuities, life estates, terms for years, remainders, and reversions includable in estates of decedents dying after December 31, 1970, and before December 1, 1983; §20.2042-1 with respect to insurance policies on the decedent's life.) With respect to the valuation of annuities, life estates, terms for years, remainders and reversions includible in estates of decedents dying before January 1, 1971, see T.D. 6296, 23 FR 4529, June 24, 1958 [1958-2 C.B. 432], as amended by T.D. 7077, 35 FR 18461, December 4, 1970 [1970-2 C.B. 183].

(2) The present value of an annuity, life estate, remainder, or reversion determined under this section which is dependent on the continuation or termination of the life of one person is computed by the use of Table A in paragraph (f) of this section. The present value of an annuity, term for years, remainder, or reversion dependent on a term certain is computed by the use of Table B in paragraph (f) of this section. If the interest to be valued is dependent upon more than one life or there is a term certain concurrent with one or more lives, see paragraph (e) of this section. For purposes of the computations described in this section, the age of a person is to be taken as the age of that person at his or her nearest birthday.

(3) In all examples set forth in this section, the decedent is assumed to have died on or after August 9, 1984 and to have been competent to change the disposition of the property on December 1, 1983.

(b) *Annuities.* (1) If an annuity is payable annually at the end of each year during the life of an individual (as for example if the first payment is due one year after the decedent's death), the amount payable annually is multiplied by the figure in column 2 of Table A opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. If the annuity is payable annually at the end of each of year for a definite number of years, the amount payable annually is multiplied by the figure in column 2 of Table B opposite the number of years in column 1 representing the duration of the annuity. The application of this paragraph (b)(1) may be illustrated by the following examples:

Example (1). The decedent received, under the terms of the decedent's father's will an annuity of $10,000 a year payable annually for the life of the decedent's elder brother. At the time the decedent died, an annual payment had just been made. The brother at the decedent's death was 40 years eight months old. By reference to Table A, the figure in column 2 opposite 41 years, the number nearest to the brother's actual age, is found to be 9.1030. The present value of the annuity at the date of the decedent's death is, therefore, $91,030 ($10,000 × 9.1030).

Example (2). The decedent was entitled to receive an annuity of $10,000 a year payable annually throughout a term certain. At the time the decedent died, the annual payment had just been made and five more annual payments were still to be made. By reference to Table B, it is found that the figure in column 2 opposite five years is 3.7908. The present value of the annuity is, therefore, $37,908 ($10,000 × 3.7808).

(2) If an annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods during the life of an individual (as for example if the first payment is due one month after the decedent's death), the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table A opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. The product so obtained is then multiplied by whichever of the following factors is appropriate:

1.0244 for semiannual payments,
1.0368 for quarterly payments,
1.0450 for monthly payments,
1.0482 for weekly payments.

If the annuity is payable at the end of the semiannual, quarterly, monthly, or weekly periods for a definite number of years, the aggregate amount to be paid within a year is first multiplied by the figure in column 2 o Table B opposite the number of year in column 1 representing the duratio of the annuity. The product so ob tained is then multiplied by whicheve of the above factors is appropriate The application of this paragrap (b)(2) may be illustrated by the fol lowing example:

Example. The facts are the same as thos contained in example (1) set forth in paragrap (b)(1) of this section, except that the annuity i payable semiannually. The aggregate annual amount, $10,000, is multiplied by the factor 9.1030 and the product multiplied by 1.0244. The present value of the annuity at the date of the decedent's death is, therefore, $93,251.13 ($10,000 × 9.1030 × 1.0244).

(3)(i) If the first payment of an annuity for the life of an individual is due at the beginning of the annual or other payment period rather than at the end (as for example if the first payment is to be made immediately after the decedent's death), the value of the annuity is the sum of (A) the first payment plus (B) the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in paragraphs (b)(1) or (2) of this section. The application of this paragraph (b)(3)(i) may be illustrated by the following example:

Example. The decedent was entitled to receive an annuity of $50 a month during the life of another person. The decedent died on the date the payment was due. At the date of the decedent's death, the person whose life measures the duration of the annuity was 50 years of age. The value of the annuity at the date of the decedent's death is $50 plus the product of $50 × 12 × 8.4743 (see Table A) × 1.0450 (See paragraph (b)(2) of this section). That is $50 plus $5,313.39, or $5,363.39.

(ii) If the first payment of an annuity for a definite number of years is due at the beginning of the annual or other payment period, the applicable factor is the product of the factor shown in Table B multiplied by whichever of the following factors is appropriate:

1.1000 for annual payments,
1.0744 for semiannual payments,
1.0618 for quarterly payments,
1.0534 for monthly payments,
1.0502 for weekly payments.

The application of this paragraph (b)(3)(ii) may be illustrated by the following example:

Example. The decedent was the beneficiary of an annuity of $50 a month. On the day a payment was due, the decedent died. There were 300 payments to be made, including the payment due. The value of the annuity as of the date of decedent's death is the product of $50 × 12 × 9.0770 (see Table B) × 1.0534, or $5,737.03.

(c) *Life estates and terms for years.* If the interest to be valued is the right of a person for his or her life, or for the life of another person, to receive the income of certain property or to use nonincome-producing property, the value of the interest is the value of the property multiplied by the figure in column 3 of Table A opposite the number of years nearest to the actual age of the measuring life. If the interest to be valued is the right to receive income of property or to use nonincome-producing property for a term of years, column 3 of Table B is used. The application of this paragraph (c) may be illustrated by the following example:

Example. The decedent or the decedent's estate was entitled to receive the income from a fund of $50,000 during the life of the decedent's elder brother. Upon the brother's death, the remainder is to go to B. The brother was 31 years, five months old at the time of decedent's death. By reference to Table A the figure in column 3 opposite 31 years is found to be 0.95254. The present value of the decedent's interest is, therefore, $47,627 ($50,000 × 0.95254).

(d) *Remainders or reversionary interests.* If a decedent had, at the time of the decedent's death, a remainder or a reversionary interest in property to take effect after an estate for the life of another, the present value of the decedent's interest is obtained by multiplying the value of the property by the figure in column 4 of Table 4 opposite the number of years nearest to the actual age of the person whose life measures the preceding estate. If the remainder or reversion is to take effect at the end of the term for years, column 4 of Table B is used. The application of this paragraph (d) may be illustrated by the following example:

Example. The decedent was entitled to receive certain property worth $50,000 upon the death of the decedent's elder sister, to whom the income was bequeathed for life. At the time of the decedent's death, the elder sister was 31 years five months old. By reference to Table A the figure in column 4 opposite 31 years is found to be .04746. The present value of the remainder interest at the date of the decedent's death is, therefore, $2,373 ($50,000 × .04746).

(e) *Actuarial computations by the Internal Revenue Service.* If the valuation of the interest involved is dependent upon the continuation or the termination of more than one life or upon a term certain concurrent with one or more lives a special factor must be used. The factor is to be computed on the basis of interest at the rate of 10 percent a year, compounded annually, and life contingencies determined, as to each person involved, from the values of lx that are set forth in column 2 of Table LN of paragraph (f). Table LN contains values of lx taken from the life table for the total population appearing as Table 1 of United States Life Tables: 1969-71, published by the Department of Health, Education, and Welfare, Public health service. A copy of the publication containing many such special factors, may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, D.C. 20404. However, if a special factor is required in the case of an actual decedent, the Commissioner will furnish the factor to the executor upon request. The request must be accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the interest, and by copies of the relevant instruments. Special factors are not furnished for prospective transfers.

(f) *Tables.* The following tables shall be used in the application of the provisions of this section:

Table A—Single Life, Unisex, 10 Percent Showing the Present Worth of an Annuity, of a Life Interest, and of a Remainder Interest

Age	Annuity	Life Estate	Remainder	Age	Annuity	Life Estate	Remainder
(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
0	9.7188	.97188	.02812	20	9.7365	.97365	.02635
1	9.8988	.98988	.01012	21	9.7245	.97245	.02755
2	9.9017	.99017	.00983	22	9.7120	.97120	.02880
3	9.9008	.99008	.00992	23	9.6986	.96986	.03014
4	9.8981	.98981	.01019	24	9.6841	.96841	.03159
5	9.8938	.98938	.01062	25	9.6678	.96678	.03322
6	9.8884	.98884	.01116	26	9.6495	.96495	.03505
7	9.8822	.98822	.01178	27	9.6290	.96290	.03710
8	9.8748	.98748	.01252	28	9.6062	.96062	.03938
9	9.8663	.98663	.01337	29	9.5813	.95813	.04187
10	9.8565	.98565	.01435	30	9.5543	.95543	.04457
11	9.8453	.98453	.01547	31	9.5254	.95254	.04746
12	9.8329	.98329	.01671	32	9.4942	.94942	.05058
13	9.8198	.98198	.01802	33	9.4608	.94608	.05392
14	9.8066	.98066	.01934	34	9.4250	.94250	.05750
15	9.7937	.97937	.02063	35	9.3868	.93868	.06132
16	9.7815	.97815	.02185	36	9.3460	.93460	.06540
17	9.7700	.97700	.02300	37	9.3026	.93026	.06974
18	9.7590	.97590	.02410	38	9.2567	.92567	.07433
19	9.7480	.97480	.02520	39	9.2083	.92083	.07917

Table A—Continued (1)

Age (1)	Annuity (2)	Life Estate (3)	Remainder (4)
40	9.1571	.91571	.08429
41	9.1030	.91030	.08970
42	9.0457	.90457	.09543
43	8.9855	.89855	.10145
44	8.9221	.89221	.10779
45	8.8558	.88558	.11442
46	8.7863	.87863	.12137
47	8.7137	.87137	.12863
48	8.6374	.86374	.13626
49	8.5578	.85578	.14422
50	8.4743	.84743	.15257
51	8.3874	.83874	.16126
52	8.2969	.82969	.17031
53	8.2028	.82028	.17972
54	8.1054	.81054	.18946
60	7.4491	.74491	.25509
61	7.3267	.73267	.26733
62	7.2002	.72002	.27998
63	7.0696	.70696	.29304
64	6.9352	.69352	.30648
65	6.7970	.67970	.32030
66	6.6551	.66551	.33449
67	6.5098	.65098	.34902
68	6.3610	.63610	.36390
69	6.2086	.62086	.37914
70	6.0522	.60522	.39478
71	5.8914	.58914	.41086
72	5.7261	.57261	.42739
73	5.5571	.55571	.44429
74	5.3862	.53862	.46138
75	5.2149	.52149	.47851
76	5.0441	.50441	.49559
77	4.8742	.48742	.51258
78	4.7049	.47049	.52951
79	4.5357	.45357	.54643
80	4.3659	.43659	.56341
81	4.1967	.41967	.58033
82	4.0295	.40295	.59705
83	3.8642	.38642	.61358
84	3.6998	.36998	.63002
85	3.5359	.35359	.64641
86	3.3764	.33764	.66236
87	3.2262	.32262	.67738
88	3.0859	.30859	.69141
89	2.9526	.29526	.70474
90	2.8221	.28221	.71779
91	2.6955	.26955	.73045
92	2.5771	.25771	.74229
93	2.4692	.24692	.75308
94	2.3728	.23728	.76272
95	2.2887	.22887	.77113
96	2.2181	.22181	.77819
97	2.1550	.21550	.78450
98	2.1000	.21000	.79000
99	2.0486	.20486	.79514
100	1.9975	.19975	.80025
101	1.9532	.19532	.80468
102	1.9054	.19054	.80946
103	1.8437	.18437	.81563
104	1.7856	.17856	.82144
105	1.6962	.16962	.83038
106	1.5488	.15488	.84512
107	1.3409	.13409	.86591
108	1.0068	.10068	.89932
109	.4545	.04545	.95455

Table B—Table Showing the Present Worth at 10 Percent of an Annuity for a Term Certain, of an Income Interest for a Term Certain and of a Remainder Interest Postponed for a Term Certain

(1) Number of Years	(2) Annuity	(3) Term Certain	(4) Remainder
1	.9091	.090909	.909091
2	1.7355	.173554	.826446
3	2.4869	.248685	.751315
4	3.1699	.316987	.683013
5	3.7908	.379079	.620921
6	4.3553	.435526	.564474
7	4.8684	.486842	.513158
8	5.3349	.533493	.466507
9	5.7590	.575902	.424098
10	6.1446	.614457	.385543
11	6.4951	.649506	.350494
12	6.8137	.681369	.318631
13	7.1034	.710336	.289664
14	7.3667	.736669	.263331
15	7.6061	.760608	.239392
16	7.8237	.782371	.217629
17	8.0216	.802155	.197845
18	8.2014	.820141	.179859
19	8.3649	.836492	.163508
20	8.5136	.851356	.148644
21	8.6487	.864869	.135131
22	8.7715	.877154	.122846
23	8.8832	.888322	.111678
24	8.9847	.898474	.101526
25	9.0770	.907704	.092296
26	9.1609	.916095	.083905
27	9.2372	.923722	.076278
28	9.3066	.930657	.069343
29	9.3696	.936961	.063039
30	9.4269	.942691	.057309

Table B—Continued

(1) Number of Years	(2) Annuity	(3) Term Certain	(4) Remainder	(1) Number of Years	(2) Annuity	(3) Term Certain	(4) Remainder
31	9.4790	.947901	.052099	46	9.8753	.987528	.012472
32	9.5264	.952638	.047362	47	9.8866	.988662	.011338
33	9.5694	.956943	.043057	48	9.8969	.989693	.010307
34	9.6086	.960857	.039143	49	9.9063	.990630	.009370
35	9.6442	.964416	.035584	50	9.9148	.991481	.008519
36	9.6765	.967651	.032349	51	9.9226	.992256	.007744
37	9.7059	.970592	.029408	52	9.9296	.992960	.007040
38	9.7327	.973265	.026735	53	9.9360	.993600	.006400
39	9.7570	.975686	.024304	54	9.9418	.994182	.005818
40	9.7791	.977905	.022095	55	9.9471	.994711	.005289
41	9.7991	.979914	.020096	56	9.9519	.995191	.004809
42	9.8174	.981740	.018260	57	9.9563	.995629	.004371
43	9.8340	.983400	.016600	58	9.9603	.996026	.003974
44	9.8491	.984909	.015091	59	9.9639	.996387	.003613
45	9.8628	.986281	.013718	60	9.9672	.996716	.003284

Table LN

Age X (1)	lx (2)	Age X (1)	lx (2)	Age X (1)	lx (2)	Age X (1)	lx (2)	Age X (1)	lx (2)	Age X (1)	lx (2)
0	100000	19	96846	37	94073	55	85110	74	52363	93	4773
1	97998			38	93843	56	84142	75	49705	94	3682
2	97876	20	96716	39	93593	57	83103	76	46946	95	2786
3	97792	21	96580			58	81988	77	44101		
4	97724	22	96438	40	93322	59	80798	78	41192	96	2068
		23	96292	41	93028	60	79529	79	38245	97	1511
5	97668	24	96145	42	92712			80	35285	98	1087
6	97619			43	92368	61	78181			99	772
7	97573	25	96000	44	91995	62	76751	81	32323	100	542
8	97531	26	95859			63	75236	82	29375		
9	97494	27	95721	45	91587	64	73631	83	26469	101	375
		28	95586	46	91144	65	71933	84	23638	102	257
10	97460	29	95448	47	90662			85	20908	103	175
11	97430			48	90142	66	70139			104	117
12	97401	30	95307	49	89579	67	68246	86	18282	105	78
13	97367	31	95158			68	66254	87	15769		
14	97322	32	95003	50	88972	69	64166	88	13407	106	52
		33	94840	51	88315	70	61984	89	11240	107	34
15	97261	34	94666	52	87605	71	59715	90	9297	108	22
16	97181			53	86838	72	57360	91	7577	109	14
17	97083	35	94482	54	86007	73	54913	92	6070	110	0
18	96970	36	94285								

§20.2031-10 [Amended]

Par. 13. Section 20.2031-10 is amended as follows:

a. The topic heading of §20.2031-10 is amended by adding ", and before December 1, 1983" immediately following "December 31, 1970".

b. The first sentence of paragraph (a)(1) is amended by adding "and before December 1, 1983," immediately following "December 31, 1970,".

c. The last sentence of paragraph (a)(1) is amended by removing "on or before December 31, 1970" and inserting in lieu thereof "after November 30, 1983".

d. Paragraph (a)(3) is amended by adding ", and before December 1, 1983" immediately following "December 31, 1970".

Par. 14. The last two sentences of paragraph (f)(1) of §20.2032-1 are revised to read as set forth below.

§20.2032-1 Alternate valuation.

* * * * *

(f) *Mere lapse of time.****

(l) *Life estates, remainders, and similar interests.**** The value of the decedent's remainder interest at the date of the decedent's death would, as explained in paragraph (d) of §20.2031-7, by $2,373 ($50,000 × .04746). If, because of economic conditions, the property declined in value and was worth only $40,000 6 months after the date of the

decedent's death, the value of the remainder interest would be $1,898.40 ($40,000 × .04746), even though the elder brother may be 32 years old on the alternate date.

* * * * *

§20.2055-2 [Amended]

Par. 15. Section 20.2055-2 is amended as follows:

a. The first sentence of paragraph (f)(2)(iv) is amended by removing "§20.2031-10" and inserting in lieu thereof "§20.2031-7 or 20.2031-10, whichever is appropriate,"

b. Paragraph (f)(4) is revised to read as set forth below.

§20.2055-2 Transfers not exclusively for charitable purposes.

* * * * *

(f) *Valuation of charitable interests*—***

(4) *Other decedents.* The present value of an interest not described in paragraph (f)(2) of this section is to be determined under §20.2031-7 in the case of decedents dying after November 30, 1983, or under §20.2031-10 in the case of decedents dying after December 31, 1970, and before December 1, 1983.

* * * * *

Par. 16. Section 25.2512-5 is revised to read as set forth below.

§25.2512-5 Valuation of annuities, life estates, terms for years, remainders, and reversions transferred after November 30, 1983.

(a) *In General.* (1)(i) Except as otherwise provided in this paragraph (a)(1)(i), the fair market value of annuities, life estates, terms for years, remainders, and reversions transferred after November 30, 1983, is their present value determined under this section. The value of annuities issued by companies regularly engaged in their sale and of insurance policies issued by companies regularly engaged in their sale is determined under §25.2512-6. The fair market value of a remainder interest in a charitable remainder unitrust, as defined in §1.664-3, is its present value determined under §1.664-4. The fair market value of a life interest or term for years in a charitable remainder unitrust is the fair market value of the property as of the date of transfer less the fair market value of the remainder interest on such date determined under §1.664-4. The fair market value of interests in a pooled income fund, as defined in §1.642(c)-5, is their value determined under §1.642(c)-5, is their value determined under §1.642(c)-6. Where the donor transfers property in trust or otherwise and retains an interest therein, the value of the gift is the value of the property transferred less the value of the donor's retained interest. If the donor assigns or relinquishes an annuity, life estate, remainder, or reversion which the donor holds by virtue of a transfer previously made by the donor or another, the value of the gift is the value of the interest transferred. See §25.2512-9 with respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred after December 31, 1970, and before December 1, 1983. With respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred before January 1, 1971, see T.D. 6334,23 FR 8904, November 15, 1958 [1958-2 C.B. 627], as amended by T.D. 7077, 35 FR 18464, December 4, 1970 [1970-2 C.B. 183].

(ii) If the donor transfers in December of 1983, either—

(A) A remainder or a reversion subject to a life interest or a term for years where the life interest or term for years was transferred by the donor after December 31, 1982, and before December 1, 1983, or

(B) A life interest or term for years, the remainder interest of which was transferred by the donor after December 31, 1982, and before December 1, 1983, the donor shall make an election. The donor may elect to value both interests transferred in 1983 under §25.2512-9 as if such section applied to all transfers made before January 1, 1984, or the donor may elect to have both transfers valued under this section. The donor shall indicate the election being made in a statement attached to the donor's gift tax return for 1983.

(iii) If the donor transfers in calendar year 1984, either—

(A) A remainder on a reversion subject to a life interest or a term for years where the life interest or term for years was transferred by the donor in the first eleven months of 1983, or

(B) A life interest or term for years, the remainder interest of which was transferred by the donor in the first eleven months of 1983, the donor shall make an election. The donor may elect to value the interest transferred in 1984 under §25.2512-9 as if such section applied to all transfers made before January 1, 1985, or the donor may elect to have the transfer valued under this section. If the donor elects to value the interest transferred in 1984 under §25.2512-9, the donor shall indicate the election being made by a statement attached to the donor's gift tax return for 1984. If the donor elects to value the interest transferred in 1984 under this section the election shall not be effective unless the donor declares, in a statement attached to the donor's gift tax return for 1984, that the donor has filed an amended gift tax return for 1983, in which the donor has revalued the transfers made in the first eleven months of 1983 under this section as if this section applied to transfers made after December 31, 1982.

(2) The present value of an annuity, life estate, remainder, or reversion determined under this section which is dependent on the continuation or termination of the life of one person is computed by the use of Table A in paragraph (f) of this section. The present value of an annuity, term for years, remainder, or reversion dependent on a term certain is computed by the use of Table B in paragraph (f) of this section. If the interest to be valued is dependent upon more than one life or there is a term certain concurrent with one or more lives, see paragraph (e) of this section. For purposes of the computations described in this section, the age of the person is to be taken at his or her nearest birthday.

(3) In all examples set forth in this section, the interest is assumed to have been transferred after November 30, 1983.

(b) *Annuities.* (1) If an annuity is payable annually at the end of each year during the life of an individual (as for example if the first payment is due one year after the date of the gift), the amount payable annually is multiplied by the figure in column 2 of Table A opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. If the annuity is payable annually at the end of each year for a definite number of years, the amount payable annually is multiplied by the figure in column 2 of Table B opposite the number of years in column 1 representing the duration of the annuity.

The application of this paragraph (b)(1) may be illustrated by the following examples:

Example (1). The donor assigns an annuity of $10,000 a year payable annually during the donor's life immediately after an annual payment has been made. The age of the donor on the date of assignment is 40 years and eight months. By reference to Table A, it is found that the figure in column 2 opposite 41 years is 9.1030. The value of the gift is, therefore, $91,030 ($10,000 multiplied by 9.1030).

Example (2). The donor was entitled to receive an annuity of $10,000 a year payable annually at the end of annual periods throughout a term of 20 years. The donor, when 15 years have elapsed, makes a gift thereof to the donor's son. By reference to Table B, it is found that the figure in column 2 opposite five years, the unexpired portion of the 20-year period, is 3.7908. The present value of the annuity is, therefore, $37,908 (10,000 multiplied by 3.7908).

(2) If an annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods during the life of an individual (as for example if the first payment is due one month after the date of the gift), the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table A opposite the number of years in column 1 nearest the age of the individual whose life measures the duration of the annuity. The product so obtained is then multiplied by whichever of the following factors is appropriate:

1.0244 for semiannual payments,
1.0368 for quarterly payments,
1.0450 for monthly payments,
1.0482 for weekly payments.

If the annuity is payable at the end of the semiannual, quarterly, monthly, or weekly periods for a definite number of years the aggregate amount to be paid within a year is first multiplied by the figure in column 2 of Table B opposite the number of years in column 1 representing the duration of the annuity. The product so obtained is then multiplied by whichever of the above factors is appropriate. The application of this paragraph (b)(2) may be illustrated by the following example:

Example. The facts are the same as those contained in example (1) set forth in paragraph (b)(1) above except that the annuity is payable semiannually. The aggregate annual amount, $10,000 is multiplied by the factor 9.1030, and the product multiplied by 1.0244. The value of the gift is, therefore, $93,251.13 ($10,000 × 9.1030 × 1.0244).

(3)(i) If the first payment of an annuity for the life of an individual is due at the beginning of the annual or other payment period rather than at the end (as for example if the first payment is to be made immediately after the date of the gift), the value of the annuity is the sum of (A) the first payment plus (B) the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in paragraphs (b)(1) or (2) of this section. The application of this paragraph (b)(3)(i) may be illustrated by the following example:

Example. The donee is made the beneficiary for life of an annuity of $50 a month from the income of a trust, subject to the right reserved by the donor to cause the annuity to be paid for the donor's own benefit or for the benefit of another. On the day a payment is due, the donor relinquishes the reserved power. The donee is then 50 years of age. The value of the gift is $50 plus the product of $50 × 12 × 8.4743 (see Table A) × 1.0450. That is $50 plus $5,313.39, or 5,363.39.

(ii) If the first payment of an annuity for a definite number of years is due at the beginning of the annual or other payment period, the applicable factor is the product of the factor shown in Table B multiplied by whichever of the following factors is appropriate:

1.1000 for annual payments,
1.0744 for semiannual payments,
1.0618 for quarterly payments,
1.0534 for monthly payments, or
1.0502 for weekly payments.

The application of this paragraph (b)(3)(ii) may be illustrated by the following example:

Example. The donee is the beneficiary of an annuity of $50 a month, subject to a reserved right in the donor to cause the annuity or the cash value thereof to be paid for the donor's own benefit or the benefit of another. On the day a payment is due, the donor relinquishes the power. There are 300 payments to be made covering a period of 25 years, including the payment due. The value of the gift is the product of $50 × 12 × 9.0770 (factor for 25 years Table B) × 1.0534, or $5,737.03.

(c) *Life estates and terms for years.* If the interest to be valued is the right of a person for his or her life, or for the life of another person, to receive the income of certain property or to use non-income-producing property, the value of the interest is the value of the property multiplied by the figure in column 3 of Table A opposite the number of years nearest to the actual age of the measuring life. If the interest to be valued is the right to receive income of property or to use nonincome-producing property for a term of years, column 3 of Table B is used. The application of this paragraph (c) may be illustrated by the following example:

Example. The donor who during the donor's life is entitled to receive the income from property worth $50,000, makes a gift of such interest. The donor is 31 years old on the date of the gift. The value of the gift is $47,627 ($50,000 × .95254).

(d) *Remainders or reversionary interests.* If the interest to be valued is a remainder or reversionary interest subject to a life estate, the value of the interest should be obtained by multiplying the value of the property at the date of the gift by the figure in column 4 of Table A opposite the number of years nearest the age of the life tenant. If the remainder or reversion is to take effect at the end of a term for years, column 4 of Table B should be used. The application of this paragraph (d) may be illustrated by the following example:

Example. The donor transfers by gift a remainder interest in property worth $50,000, subject to the donor's sister's right to receive the income therefrom for her life. The sister at the date of the gift is 31 years of age. By reference to Table A it is found that the figure in

column 4 opposite age 31 is .04746. The value of the gift is, therefore, $2,373 ($50,000 × .04746).

(e) *Actuarial computations by the Internal Revenue Service.* If the interest to be valued is dependent upon the continuation or termination of more than one life, or there is a term certain concurrent with one or more lives, or if the retained interest of the donor is conditioned upon survivorship, a special factor is necessary. The factor is to be computed on the basis of interest at the rate of 10 percent a year, compounded annually, and life contingencies is determined, as to each person involved, from the values of 1x that are set forth in column 2 of Table LN of paragraph (f) of §20.2031-7. Table LN contains values of 1x taken from the life table for the total population appearing as Table 1 in United States Life Tables: 1969-71, published by the Department of Health, Education, and Welfare, Public Health Service. A copy of the publication containing many such special factors, may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington, D.C 20402. However, if a special factor i required in the case of an actual gift the Commissioner will furnish th factor to the donor upon request. Th request must be accompanied by statement of the date of birth of eac person the duration of whose life ma affect the value of the interest, and b copies of the relevant instruments Special factors are not furnished fo prospective transfers.

(f) *Tables.* The following table shall be used in the application of th provisions of this section:

Table A—Single Life, Unisex, 10 Percent Showing the Present Worth of an Annuity, of a Life Interest, and of a Remainder Interest

Age (1)	Annuity (2)	Life Estate (3)	Remainder (4)	Age (1)	Annuity (2)	Life Estate (3)	Remainde (4)
0	9.7188	.97188	.02812	38	9.2567	.92567	.07433
1	9.8988	.98988	.01012	39	9.2083	.92083	.07917
2	9.9017	.99017	.00983	40	9.1571	.91571	.08429
3	9.9008	.99008	.00992	41	9.1030	.91030	.08970
4	9.8981	.98981	.01019	42	9.0457	.90457	.09543
5	9.8938	.98938	.01062	43	8.9855	.89855	.10145
6	9.8884	.98884	.01116	44	8.9221	.89221	.10779
7	9.8822	.98822	.01178	45	8.8558	.88558	.11442
8	9.8748	.98748	.01252	46	8.7863	.87863	.12137
9	9.8663	.98663	.01337	47	8.7137	.87137	.12863
10	9.8565	.98565	.01435	48	8.6374	.86374	.13626
11	9.8453	.98453	.01547	49	8.5578	.85578	.14422
12	9.8329	.98329	.01671	50	8.4743	.84743	.15257
13	9.8198	.98198	.01802	51	8.3874	.83874	.16126
14	9.8066	.98066	.01934	52	8.2969	.82969	.17031
15	9.7937	.97937	.02063	53	8.2028	.82028	.17972
16	9.7815	.97815	.02185	54	8.1054	.81054	.18946
17	9.7700	.97700	.02300	55	8.0046	.80046	.19954
18	9.7590	.97590	.02410	56	7.9006	.79006	.20994
19	9.7480	.97480	.02520	57	7.7931	.77931	.22069
20	9.7365	.97365	.02635	58	7.6822	.76822	.23178
21	9.7245	.97245	.02755	59	7.5675	.75675	.24325
22	9.7120	.97120	.02880	60	7.4491	.74491	.25509
23	9.6986	.96986	.03014	61	7.3267	.73267	.26733
24	9.6841	.96841	.03159	62	7.2002	.72002	.27998
25	9.6678	.96678	.03322	63	7.0696	.70696	.29304
26	9.6495	.96495	.03505	64	6.9352	.69352	.30648
27	9.6290	.96290	.03710	65	6.7970	.67970	.32030
28	9.6062	.96062	.03938	66	6.6551	.66551	.33449
29	9.5813	.95813	.04187	67	6.5098	.65098	.34902
30	9.5543	.95543	.04457	68	6.3610	.63610	.36390
31	9.5254	.95254	.04746	69	6.2086	.62086	.37914
32	9.4942	.94942	.05058	70	6.0522	.60522	.39478
33	9.4608	.94608	.05392	71	5.8914	.58914	.41086
34	9.4250	.94250	.05750	72	5.7261	.57261	.42739
35	9.3868	.93868	.06132	73	5.5571	.55571	.44429
36	9.3460	.93460	.06540	74	5.3862	.53862	.46138
37	9.3026	.93026	.06974				

Table A—Continued (1)

Age (1)	Annuity (1)	Life Estate (3)	Remainder (4)
75	5.2149	.52149	.47851
76	5.0441	.50441	.49559
77	4.8742	.48742	.51258
78	4.7049	.47049	.52951
79	4.5357	.45357	.54643
80	4.3659	.43659	.56341
81	4.1967	.41967	.58033
82	4.0295	.40295	.59705
83	3.8642	.38642	.61358
84	3.6998	.36998	.63002
85	3.5359	.35359	.64641
86	3.3764	.33764	.66236
87	3.2262	.32262	.67738
88	3.0859	.30859	.69141
89	2.9526	.29526	.70474
90	2.8221	.28221	.71779
91	2.6955	.26955	.73045
92	2.5771	.25771	.74229
93	2.4692	.24692	.75308
94	2.3728	.23728	.76272
95	2.2887	.22887	.77113
96	2.2181	.22181	.77819
97	2.1550	.21550	.78450
98	2.1000	.21000	.79000
99	2.0486	.20486	.79514
100	1.9975	.19975	.80025
101	1.9532	.19532	.80468
102	1.9054	.19054	.80946
103	1.8437	.18437	.81563
104	1.7856	.17856	.82144
105	1.6962	.16962	.83038
106	1.5488	.15488	.84512
107	1.3409	.13409	.86591
108	1.0068	.10068	.89932
109	.4545	.04545	.95455

Table B—Table Showing the Present Worth at 10 Percent of an Annuity for a Term Certain, of an Income Interest for a Term Certain and of a Remainder Interest Postponed for a Term Certain

(1) Number of Years	(2) Annuity	(3) Term Certain	(4) Remainder
1	.9091	.090909	.909091
2	1.7355	.173554	.826446
3	2.4869	.248685	.751315
4	3.1699	.316987	.683013
5	3.7908	.379079	.620921
6	4.3553	.435526	.564474
7	4.8684	.486842	.513158
8	5.3349	.533493	.466507
9	5.7590	.575902	.424098
10	6.1446	.614457	.385543
11	6.4951	.649506	.350494
12	6.8137	.681369	.318631
13	7.1034	.710336	.289664
14	7.3667	.736669	.263331
15	7.6061	.760608	.239392
16	7.8237	.782371	.217629
17	8.0216	.802155	.197845
18	8.2014	.820141	.179859
19	8.3649	.836492	.163508
20	8.5136	.851356	.148644
21	8.6487	.864869	.135131
22	8.7715	.877154	.122846
23	8.8832	.888322	.111678
24	8.9847	.898474	.101526
25	9.0770	.907704	.092296
26	9.1609	.916095	.083905
27	9.2372	.923722	.076278
28	9.3066	.930657	.069343
29	9.3696	.936961	.063039
30	9.4269	.942691	.057309
31	9.4790	.947901	.052099
32	9.5264	.952638	.047362
33	9.5694	.956943	.043057
34	9.6086	.960857	.039143
35	9.6442	.964416	.035584
36	9.6765	.967651	.032349
37	9.7059	.970592	.029408
38	9.7327	.973265	.026735
39	9.7570	.975686	.024304
40	9.7791	.977905	.022095
41	9.7991	.979914	.020096
42	9.8174	.981740	.018260
43	9.8340	.983400	.016600
44	9.8491	.984909	.015091
45	9.8628	.986281	.013718
46	9.8753	.987528	.012472
47	9.8866	.988662	.011338
48	9.8969	.989693	.010307
49	9.9063	.990630	.009370
50	9.9148	.991481	.008519
51	9.9226	.992256	.007744
52	9.9296	.992960	.007040
53	9.9360	.993600	.006400
54	9.9418	.994182	.005818
55	9.9471	.994711	.005289
56	9.9519	.995191	.004809
57	9.9563	.995629	.004371
58	9.9603	.996026	.003974
59	9.9639	.996387	.003613
60	9.9672	.996716	.003284

§25.2512-9 [Amended]

Par. 17. Section 25.2512-9 is amended as follows:

a. The topic heading of §25.2512-9 is amended by adding ", and before December 1, 1983" immediately following "December 31, 1970".

b. The first sentence of paragraph (a)(1)(i) is amended by adding "and before December 1, 1983" immediately following "December 31, 1970,".

c. The last sentence of paragraph (a)(1)(i) is amended by removing "on or before December 31, 1970" and inserting in lieu thereof "after November 30, 1983".

d. Paragraph (a)(3) is amended by adding", and before December 1, 1983" immediately following "December 31, 1970".

Par. 18. Section 25.2522(c)-3 is amended as follows:

a. The first sentence of paragraph (d)(2)(iv) is amended by removing " §25.2512-9" and inserting in lieu thereof "§25.2512-5 or 25.2512-9, whichever is appropriate,".

b. Paragraph (d)(3) is revised to read as set forth below.

§25.2522(c)-3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(d) *Valuation of charitable interest—****

(3) *Other transfers.* The present value of an interest not described in paragraph (d)(2) of this section is to be determined under §25.2512-5 in the case of transfers after November 30, 1983 (§25.2512-9 for transfers before December 1, 1983).

* * * * *

§25.2523(a)-1 [Amended]

Par. 19. Paragraph (d) of §25.2523(a)-1 is amended as follows:

a. The second and third sentences are amended by removing "§25.2512-9 (§25.2512-5 in the case of a remainder transferred before January 1, 1971)" wherever it appears and inserting in lieu thereof "§25.2512-5 or 25.2512-9, whichever is appropriate".

b. The fourth and last sentences are amended by removing "§25.2512-9(e)" wherever it appears and inserting in lieu thereof "§25.2512-5(e) or 25.2512-9(e)" whichever is appropriate".

This Treasury decision is issued under the authority contained in sections 170(f)(4), 642(c)(5), and 7805 of the Internal Revenue Code of 1954 (83 Stat. 544, 26 U.S.C. 170(f)(4); 83 Stat. 560, 26 U.S.C. 642(c)(5); 68A Stat. 917, 26 U.S.C. 7805).

Approved by the Office of Management and Budget under control number 1545-0020.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved April 23, 1984.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 10, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 11, 1984, 49 F.R. 19973)

Section 171.—Amortizable Bond Premium

26 CFR 1.171-1: Amortizable bond premium.

Whether premiums paid by a mortgage pool to acquire mortgages are amortizable bond premiums. See Rev. Rul. 84-10, page 155.

Section 194.—Amortization of Reforestation Expenditures

26 CFR 1.194-1: Amortization of reforestation expenditures.

Whether reforestation costs reimbursed by the Federal government under the forestry incentives program are eligible for amortization. See Rev. Rul. 84-67, page 28.

Part VII.—Additional Itemized Deductions for Individuals

Section 212.—Expenses for Production of Income

26 CFR 1.212-1: Nontrade or nonbusiness expenses.

Whether certificate holders in a mortgage pool may deduct service fees as a nontrade or nonbusiness expense. See Rev. Rul. 84-10 pa 155.

Section 219.—Retirement Savings

26 CFR 1.219-1: Deduction for retirement sa ings.
(Also Section 6653; 301.6653-1.)

Individual Retirement Arrange ments; time for making contribu tion. An individual may deduct a cor tribution to an individual retiremer account (IRA) in accordance wit section 219 of the Code, eve though the contribution was mad after the individual's tax return wa filed but was made before the du date of the return. Rev. Rul. 66-14 amplified.

Rev. Rul. 84-18 [1]

ISSUES

1) Whether an individual may de duct a contribution to an individua retirement account (IRA), in accord ance with section 219 of the Interna Revenue Code, when the contributio to the IRA was made after the indi vidual's income tax return was file but was made by the due date of th return.

2) Whether a taxpayer claimin such a deduction may be subject t the penalty provisions of section 665 of the Code, where the IRA contribu tion of the individual was not mad by the due date of the return.

FACTS

A and *B* are cash basis taxpayer who file income tax returns on calendar year basis. *A* and *B* bot timely filed their income tax return claiming deductions for contribution to their respective IRAs for the pre vious taxable year. Such contribu tions had not been made at the tim of filing. Subsequently, but withi the time prescribed for filing for th previous year, *A* made the contribu tion to *A*'s IRA. *B* did not make th contribution to *B*'s IRA by the tim prescribed for the filing of *B*'s ta return. Further, *B* did not timely fi

[1] Also released as News Release IR-84- dated January 13, 1984.

an amended tax return to eliminate the IRA deduction.

LAW AND ANALYSIS

Section 219(f)(3) of the Code provides that for purposes of deducting contributions to an IRA, a taxpayer shall be deemed to have made a contribution to an IRA on the last day of the preceding taxable year if the contribution is made on account of that taxable year and is made not later than the time prescribed by law for filing the return for that taxable year, including extensions thereof (the "due date").

In Rev. Rul. 66-144, 1966-1 C.B. 91, a calendar year corporation obtained an extension of time for filing its income tax return for a taxable year in accordance with section 6081 of the Code. The corporation then filed its income tax return and paid all taxes due. Subsequently, within the time prescribed for filing the return, the corporation made a contribution to a previously established qualified employees' trust. Rev. Rul. 66-144 held that under section 404(a)(6), the contribution was deductible for that taxable year because it was made within the extended period of time for filing and was therefore deemed to have been made on the last day of the taxable year for which the return was filed. The Service interprets Rev. Rul. 66-144 as permitting the deduction to be taken on the return originally filed even though the contribution has not been made at that time. Although the holding of Rev. Rul. 66-144 is limited to an accrual basis taxpayer, section 1013(c)(2) of the Employee Retirement Income Security Act of 1974 ("ERISA"), Pub. L. No. 93-406, 1974-3 C.B. 1, extended the grace period of section 404(a)(6) to cash basis taxpayers.

Section 6653 of the Code provides penalties for the failure to pay taxes. Section 6653(a)(1) provides that an amount equal to 5 percent of an underpayment shall be added to the tax if any part of an underpayment is due to negligence or intentional disregard of rules and regulations. Section 6653(b)(1) provides that if any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment.

Section 6653(c) provides that for purposes of section 6653, in the case of an income tax the term "underpayment" means a deficiency as defined in section 6211. Section 6211 defines a "deficiency" as the amount of tax imposed by subtitle A which exceeds the excess of the sum of the amount shown as the tax by the taxpayer on its return plus the amounts previously assessed as a deficiency over the amount of rebates made.

The language in section 219(f)(3) of the Code which extends the time for making deductible contributions to an IRA is identical to the operative language of section 404(a)(6). Accordingly, consistent with Rev. Rul. 66-144 and section 1013(c)(2) of ERISA, a contribution made to an IRA within the extended period of time for filing the individual's tax return may be claimed as a deduction under section 219 for the preceding taxable year if it is made on account of that year.

A made the IRA contribution that was included as a deduction on *A*'s tax return within the time prescribed for filing the return (including any extensions of time for filing obtained before the return was filed), and the contribution is deemed to have been made on the last day of the preceding taxable year even though *A*'s return was filed before the due date. *A* is not subject to the penalty provisions of section 6653 of the Code with respect to the IRA contribution because the contribution was deducted in accordance with section 219 of the Code, and, therefore, there is no underpayment of tax.

B did not make an IRA contribution on or before the due date of the tax return and *B*'s tax return included a deduction for a contribution to an IRA which does not satisfy the requirements of section 219 of the Code. *B* has underpayed taxes owed and, therefore, may be subject to the penalties prescribed in section 6653 of the Code.

HOLDINGS

A may deduct a contribution to *A*'s IRA, in accordance with section 219 of the Code, where the contribution to the IRA was made after *A*'s income tax return was filed but was made by the due date of the return.

B may be subject to the penalty provisions of section 6653 of the Code where *B*'s IRA contribution was not made by the due date of the return.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 66-144 is amplified.

Part IX.—Items Not Deductible

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

When a railroad company uses the retirement-replacement-betterment method, the cost of replacing wood cross ties with concrete ties is to be expensed as a replacement. See Rev. Rul. 84-22, page 35.

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26 CFR 1.263(a)-1: Capital expenditures; in general.

Whether amounts expended by a limited partnership are maintenance expenses for cattle already owned by the partnership which are currently deductible or expenses connected with the cattles' purchase price which are capital expenditures. See Rev. Rul. 84-35, page 31.

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26 CFR 1.263(a)-2: Examples of capital expenditures.
(Also Sections 162, 168; 1.162-1.)

Capital expenditures; inside wiring account; public telephone company. The cost charged to the inside wiring account of a public telephone company is a capital expenditure under section 263 of the Code and must be recovered under section 168.

Rev. Rul. 84-24

ISSUE

Are the costs charged to the inside wiring account of a public telephone company to be currently expensed

under section 162(a) of the Internal Revenue Code or, alternatively, capitalized under section 263(a) and recovered under section 168?

FACTS

On March 31, 1981, the Federal Communications Commission (FCC) issued its First Report and Order (effective October 1, 1981), which amended the Uniform System of Accounts to change the accounting treatment of certain station connection costs previously capitalized and included in Account 232, Station Connections. As a result of these changes, certain future station connection costs associated with inside wiring that had been included in Account 232 will no longer be capitalized but will be charged to Account 605, Installation and Repairs of Station Equipment, and expensed in the year incurred.

In 1981, the taxpayer, a telephone company that is a public utility subject to the FCC and the State *A* Public Service Commission (PSC), timely filed an Application For Change in Accounting Method (Form 3115). The taxpayer requested permission to change its method of accounting, for federal income tax purposes, for costs associated with "inside wiring," previously capitalized and included in Account 232, to a method of expensing such costs which will be charged to Account 605.

The taxpayer incurs certain costs in the installation of inside wiring. Such costs include the cost of labor and the costs of materials. In addition, taxpayer will maintain and repair the inside wiring. The taxpayer has title to the inside wiring and on request from the subscriber the taxpayer may sell the inside wiring to a subscriber.

The FCC decision to change the accounting treatment of inside wiring was primarily based on its belief that the costs of inside wiring primarily benefitted the current subscriber and therefore the cost should be placed on the causative subscriber rather than on current and future subscribers as under the prior system.

State *A* PSC pursuant to the FCC procedure has issued an order requiring public utility telephone companies to expense the cost of inside wiring.

The decision by the taxpayer to change its accounting method is based on FCC rules and regulations which were amended and which were adopted by the State *A* PSC, requiring telephone companies to expense, in the year incurred for book purposes, the costs associated with inside wiring which had been included in Account 232.

LAW AND ANALYSIS

Section 263(a) of the Code provides that as a general rule no deduction shall be allowed for any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-2 of the regulations sets forth examples of capital expenditures including the cost of acquisition, construction or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

In Rev. Rul. 82-12, 1982-1 C.B. 52, the FCC rules and regulations required the replacement cost of telephone wires to be expensed. However, that Revenue Ruling holds that the costs of replacing telephone wires with buried cable is in the nature of a replacement or permanent improvement and is to be capitalized under section 263(a) of the Code and depreciated over the useful life of the cable under section 167(a).

The facts in this case indicate that the taxpayer installs, maintains and repairs the inside wiring. In addition, the taxpayer retains title to the inside wiring and has the right to sell the inside wiring to a subscriber. The taxpayer has an identifiable asset used in its business, which is an integral part of the system of delivering service to the subscriber. The inside wiring has a useful life that extends beyond the current year. Its installation is therefore in the nature of a permanent improvement. The fact that it may be required for regulatory purposes to recoup expenditures currently does not negate its having a capital expenditure for Federal income tax purposes. See *Old Colony Railroad Co. v. Commissioner*, 284 U.S. 552 (1932) X1-1 C.B. 274 AT 277 (1932) and Rev. Rul. 70-118, 1970-1 C.B. 34.

HOLDING

The cost of inside wiring is a capital expenditure under section 263 of the Code and such cost must be recovered under section 168.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-5: Substantiation requirements. (Also Section 162; 1.162-17.)

Travel expenses; reimbursement; mileage allowances. With respect to expenses paid or incurred after 1982, mileage allowances not exceeding 20.5 cents per mile for transportation paid by employers to employees will satisfy the substantiation and adequate accounting requirements of sections 1.162-17(b) and 1.274-5 of the regulations. Rev. Rul. 80-62, as modified by Rev. Rul. 80-203, is further modified.

Rev. Rul. 84-51

This revenue ruling modifies Rev. Rul. 80-62, 1980-1 C.B. 63, as modified by Rev. Rul. 80-203, 1980-2 C.B. 101, with respect to the mileage allowance for transportation paid by employers to employees.

The sixth paragraph of Rev. Rul. 80-62, which paragraph was modified by Rev. Rul. 80-203, is further modified as follows:

If a fixed mileage allowance not exceeding 20.5 cents per mile is used by an employer in payment of an employee's ordinary and necessary expenses of transportation while traveling away from home, and the elements of time, place, and business purpose of the travel are substantiated in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(a) thereof) of section

1.274-5 of the regulations, such an allowance shall be deemed as satisfying with respect to such travel amounts, the substantiation requirements of section 1.274-5(c) and the adequate accounting requirements of section 1.274-5(e). Also, if an employer grants an allowance not exceeding 20.5 cents per mile to an employee for ordinary and necessary transportation expenses not involving travel away from home, such an arrangement shall be considered to be an accounting to the employer within the meaning of section 1.162-17(b). However, an employer may grant an additional allowance for parking fees and tolls attributable to the traveling and transportation expenses as separate items.

This modification is effective with respect to expenses paid or incurred after December 31, 1982.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-62, as modified by Rev. Rul. 80-203, is further modified.

Subchapter C.—Corporate Distributions and Adjustments
Part I.—Distributions by Corporations
Subpart A.—Effects on Recipients

Section 303.—Distributions in Redemption of Stock to Pay Death Taxes

26 CFR 1.303-2: Requirements.

Redemption of stock to pay death tax. A redemption of stock not actually owned by a decedent at death does not qualify under section 303 of the Code even though such stock is included in the decedent's gross estate by reason of section 2035(a) and (d)(3)(A). However, such stock included in a decedent's gross estate is taken into account in determining satisfaction of the percentage requirements of section 303(b).

Rev. Rul. 84-76

ISSUE

Whether, in the situations described below, a distribution in redemption of stock of a corporation qualifies as a distribution in full payment in exchange for the stock redeemed under section 303 of the Internal Revenue Code.

FACTS

Situation 1:

Decedent died on January 1, 1982. During 1979, 1980, and 1981, Decedent made various gifts of Corporation *X* stock to *A*, the sole beneficiary of Decedent's estate. Decedent was required by section 6019 of the Code to file a gift tax return with respect to each gift of *X* stock to *A*. At death, Decedent did not own any *X* stock. However, if the *X* stock gifted by Decedent to *A* since 1979 were included in Decedent's gross estate for federal estate tax purposes, such stock would have constituted 40 percent of Decedent's adjusted gross estate.

The federal estate tax return for Decedent's estate was filed on July 1, 1982. The amount of the federal estate tax, state inheritance taxes, and funeral and administrative expenses incurred by Decendent's estate totalled 450*x* dollars. On July 15, 1982, *X* redeemed from *A* 10*x* shares of its stock that Decedent had gifted to *A* for a total redemption price of 450*x* dollars.

Situation 2:

The facts are the same as in *Situation 1* except that the *X* stock surrendered by *A* for redemption had actually been owned by Decedent at death. If the *X* stock gifted by Decedent to *A* were included in Decedent's gross estate for federal estate tax purposes, such stock, when combined with the *X* stock actually owned by Decedent at death, would have constituted 40 percent of Decedent's adjusted gross estate. The *X* stock actually owned by Decedent at death constituted only 15 percent of Decedent's adjusted gross estate.

LAW AND ANALYSIS

Section 303(a) of the Code provides that a distribution of property to a shareholder by a corporation in redemption of its stock, the value of which is included in determining the gross estate of a decedent for federal estate tax purposes, will be treated as a distribution in full payment in exchange for the stock redeemed, to the extent that the amount of the distribution does not exceed the total of (1) all death taxes plus (2) funeral and administration expenses allowable as deductions to the estate under sections 2053 or 2106.

Section 303(b)(1)(A) of the Code provides, in part, that the provisions of section 303(a) apply only to amounts distributed after the death of the decedent and within the period of limitations provided in section 6501(a) for the assessment of the federal estate tax, or within 90 days after the expiration of such period. The general rule provided by section 6501(a) is that the amount of tax imposed shall be assessed within 3 years after the return is filed.

Section 303(b)(2)(A) of the Code provides that in order to qualify for the redemption treatment described in section 303(a), the value (for federal estate tax purposes) of all the stock of the corporation that is included in determining the value of the decedent's gross estate must exceed 35 percent of the excess of (i) the value of the gross estate of the decedent, over (ii) the sum of the amounts allowable as a deduction under section 2053 or 2054.

Section 303(b)(3) of the Code provides that the stock that can qualify for treatment under section 303(a) is limited to stock that is redeemed from a shareholder whose interest is reduced (either directly or through a binding obligation to contribute) by the payment of an amount described in section 303(a)(1) or (2).

Section 2035(a) of the Code provides, generally, that the value of all property transferred by a decedent within 3 years of death is included in the decedent's gross estate.

Section 2035(b)(2) of the Code provides, in part, that section 2035(a) shall not apply to any gift to a donee made during a calendar year if the decedent was not required by section 6019 to file any gift tax return for

such year with respect to gifts to such donee.

Section 2035(d)(1) of the Code provides that, except as otherwise provided, section 2035(a) is not applicable to the estates of decedents dying after December 31, 1981. However, section 2035(d)(3)(A) provides that section 2035(d)(1) will not apply for purposes of section 303(b).

The purpose of section 2035(d)(3)(A) of the Code, as reflected in the legislative history, is to preclude deathbed transfers designed to qualify estates for favorable treatment under section 303. H.R. Rep. 97-201, 97th Cong., 1st Sess. 187 (1981), 1981-2 C.B. 352, 390. Thus, section 2035(d)(3)(A) retains the 3-year rule of section 2035(a) solely for purposes of making the section 303(b)(2)(A) percentage determinations. Section 2035(d)(3) does not, however, function to include gifted amounts in the value of a decedent's gross estate for purposes of determining the amount of the federal estate tax liability and, therefore, has no effect on whether the requirements of section 303(a) are satisfied.

In both *Situation 1* and *Situation 2*, each transfer of *X* stock by Decedent required the filing of a gift tax return pursuant to section 6019 of the Code. Accordingly, in both situations, the value of all the *x* stock gifted by Decedent to *A* was included in Decedent's gross estate pursuant to section 2035(a) and (d)(3)(A) for the purpose of determining whether the estate satisfies the section 303(b)(2)(A) percentage requirements. However, in *Situation 1*, since the *X* stock surrendered by *A* in the redemption was not included in Decedent's gross estate except by operation of section 2035(d)(3)(A), section 303 does not apply to the redemption since the threshold requirements of section 303(a) were not satisfied. There is no indication that Congress intended section 2035(d)(3) to provide favorable income tax treatment under section 303 with respect to the redemption of stock that is not otherwise included in the Decedent's gross estate.

In *Situation 2*, as a result of the operation of section 2035(a) and (d)(3)(A) of the Code, since the value of the *X* stock gifted by Decedent to *A* was combined with the value of the *X* stock actually owned by Decedent at death, the percentage requirements of section 303(b)(2)(A) were thereby satisfied. In addition, the requirements of section 303(b)(3) are satisfied since, as sole beneficiary, *A*'s interest in the estate was directly reduced by the payment of the death taxes and funeral and administration expenses. Furthermore, the redemption of *X* stock from *A* satisfied the time limitations of section 303(b)(1). Accordingly, since the amount distributed to *A* was in redemption of *X* stock actually owned by Decedent at death and included in Decedent's gross estate and did not exceed the limitations of section 303(a), the distribution will be treated as a distribution in full payment in exchange for the stock redeemed.

HOLDINGS

Situation 1:

The redemption of 10*x* shares of *X* stock from *A* for 450*x* dollars does not qualify as a distribution in full payment in exchange for the stock redeemed under section 303 of the Code because *A*'s *X* stock was not includible in Decedent's gross estate for purposes of section 303(a).

Situation 2:

The redemption from *A* of 10*x* shares of the *X* stock owned by Decedent at death for 450*x* dollars qualifies as a distribution in full payment in exchange for the stock redeemed under section 303 of the Code.

Part II.—Corporate Liquidations
Subpart A.—Effects on Recipients

Section 332.—Complete Liquidations of Subsidiaries

26 CFR 1.332-2: Requirements for nonrecognition of gain or loss.

Liquidation of subsidiary; nominal assets transferred to new subsidiary. A transaction in which a parent corporation receives the assets of a subsidiary may qualify as a complete liquidation of the subsidiary within the meaning of section 332 of the Code even though the parent transfers a portion of these assets to a new subsidiary, provided the assets transferred to the new subsidiary are nominal in amount and are only for the purpose of protecting the corporate name of the liquidated subsidiary.

Rev. Rul. 84-2

ISSUE

Under the circumstances described below, will the statutory merger of a wholly owned subsidiary corporation with and into its parent corporation immediately followed by the transfer by the parent corporation of a nominal amount of the subsidiary's cash to a newly formed wholly owned subsidiary of the parent prevent the transaction from qualifying as a complete liquidation of the former subsidiary within the meaning of section 332 of the Internal Revenue Code?

FACTS

P corporation owned all the stock of a subsidiary corporation, *S-1*, for several years, and both *P* and *S-1* were engaged in manufacturing. Pursuant to a plan of complete liquidation adopted by *P* and *S-1*, *S-1* merged with and into *P* under applicable state ("short form") merger laws. Immediately thereafter, *P*, solely to protect *S-1*'s name, transferred a nominal amount of cash of *S-1* to *S-2*, a newly formed subsidiary organized in the same state as *S-1* and with the same name as *S-1*. No other assets were transferred to *S-2*, *S-2* will conduct no business, and *P* does not intend to sell or otherwise dispose of the stock of *S-2*. The form of the transaction was chosen because the managements of *P* and *S-1* concluded that the liquidation of *S-1* could most efficiently be effected through the use of the "short form" merger laws.

LAW AND ANALYSIS

Section 332(a) of the Code provides that no gain or loss is recognized on

the receipt by a corporation of property distributed in complete liquidation of another corporation. Section 1.332-2(c) of the Income Tax Regulations provides that the retention of a nominal amount of assets for the sole purpose of preserving the liquidating corporation's legal existence will not disqualify the transaction as a distribution in a complete liquidation. See also Rev. Rul. 54-518, 1954-2 C.B. 142, which holds that the retention of a charter by a liquidating corporation to protect its corporate name does not prevent the liquidation of a corporation from coming under the provisions of section 112(b)(7) of the Internal Revenue Code of 1939 (now section 333 of the Internal Revenue Code).

On the other hand, Rev. Rul. 76-525, 1976-2 C.B. 98, holds that the retention by a subsidiary corporation of any property, no matter how small in amount, for the purpose of continuing the operation of its present business or for the purpose of engaging in a new business, will prevent the distribution of property that is actually distributed to its parent from qualifying as a distribution in complete liquidation within the meaning of section 332 of the Code.

In the present situation, only a nominal amount of cash was transferred to S-2 for the sole purpose of protecting *S-1*'s name, and not to continue *S-1*'s manufacturing business or to enable *S-1* to enter a new business. If *S-1* had not dissolved under state law and had retained its corporate charter and a nominal amount of cash, solely to preserve its legal existence, the retention would not disqualify the transaction as a complete liquidation of *S-1* within the meaning of section 1.332-2(c) of the regulations. Since both the substance and effect of the present transaction is the same as if *S-1* had merely preserved its legal existence, similar treatment under section 1.332-2(c) of the regulations will be accorded this transaction.

HOLDING

The transfer by *P* of a nominal amount of *S-1* cash to *S-2*, immediately after the statutory merger of *S-1* with and into *P*, will not prevent the transaction from qualifying as a complete liquidation of *S-1* within the meaning of section 332 of the Code.

Subpart B.—Effects on Corporation

Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

26 CFR 5f.338-1: Elections under section 338(g) of the Internal Revenue Code of 1954).

T.D. 7942

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 5f.—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

Income tax—Elections and miscellaneous matters under section 224 of the Tax Equity and Fiscal Responsibility Act of 1982, as amended by the Technical Corrections Act of 1982.

AGENCY: Internal Revenue Service, Treasury

ACTION: Temporary regulations.

SUMMARY: This document contains rules relating to elections and miscellaneous matters under section 224 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. 97-248, 1982-2 C.B. 462, 501], as amended by the Technical Corrections Act of 1982 (TCA) [Pub. L. 97-448, 1983-1C.B. 451]. The temporary regulations provide guidance to taxpayers subject to section 224. The text of §5f.338-1 of the temporary regulations set forth in this document also serves as the test of the proposed regulations cross-referenced in the notice of proposed rulemaking ***[page 772, this Bulletin].

DATE: These temporary regulations are effective as of February 7, 1984, and apply, with two exceptions, to stock acquisitions made after August 31, 1982. The transitional election rule applies to acquisitions after August 31, 1980, and before September 1, 1982. A LIFO recapture rule applies to acquisitions subject to section 338 that occur before 1983.

FOR FURTHER INFORMATION CONTACT: Duane H. Pellervo of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to elections under section 338 of the Internal Revenue Code of 1954 (the "Code), as added by section 224 of TEFRA (Pub. L. No. 97-248; 96 Stat. 324) [1982-2 C.B. 462, 501], and as amended by section 306 of the Technical Corrections Act of 1982 (Pub. L. No. 97-448; 96 Stat. 2365) [1983-1 C.B. 451, 470]. The temporary regulations also contain a special rule coordinating section 224 of TEFRA with section 101 of the Miscellaneous Revenue Act of 1982 (Pub. L. No. 97-362, 96 Stat. 1726) [1983-1 C.B. 367], which provides a transitional rule for the application of the LIFO recapture provisions of section 403 of the Crude Oil Windfall Profit Tax Act of 1980 (Pub. L. No. 96-223, 94 Stat. 229) [1980-3 C.B. 1, 73]. A special rule exempting the acquisition of certain financial institutions from the provisions of section 224 of TEFRA is also provided. These temporary regulations will remain in effect until superseded by later temporary or final regulations relating to these matters. These temporary regulations, which amend other temporary regulations published in the FEDERAL REGISTER on November 22, 1982 (47 F.R. 52433) [T.D. 7855, 1982-2 C.B. 79], are contained in 26 CFR Part 5f, Temporary Income Tax Regulations under TEFRA. Certain provisions of these temporary regulations were announced in a news release. IR-83-36 (Feb. 25, 1983).

SECTION 338 OF THE CODE

Section 224 of TEFRA adds a new section 338 to the Code and repeals the rules under section 334(b)(2). New section 338 generally applies if a corporation makes a qualified purchase of stock in another corporation (target). In general, under section 338(d)(3), a qualified stock purchase is the purchase of 80% control of the target over a 12-month period. At the election (or "deemed election") of the purchasing corporation, the target is deemed to have sold its assets in a single transaction under section 337 at the end of the first day on which there is a qualified stock purchase (the "acquisition date"). The target is subsequently treated as a new corporation ("new target") which purchased those assets at the beginning of the following day. The target is deemed to have sold (and purchased) those assets for an amount equal to the purchasing corporation's basis in target's stock on the acquisition date, with certain adjustments. The rules of section 338 apply if the acquisition date of a target occurs after August 31, 1982. The rules also apply, with certain limitations, to a target for which the acquisition date occurs after August 31, 1980, and before September 1, 1982, if a transitional rule election under section 338 is made within a specified period of time.

The taxable year of "old" target ends immediately after its deemed asset sale. Thus, any tax liability triggered by the deemed sale is reported in the final income tax return of old target. As a general rule, the target's deemed sale cannot be reported in a consolidated return of the purchasing corporation since old target generally cannot be a member of the purchaser's affiliated group. H.R. Rep. No. 97-760, 97th Cong., 2d Sess. 539 (1982) (Conference Report) [1982-2 C.B. 600, 633].

Section 306(a)(8) of the Technical Corrections Act of 1982 (TCA) amended section 224 of TEFRA to clarify that, with certain exceptions, tax liability resulting from the target's deemed sale of assets is excluded from the selling corporation's consolidated return (if any). For acquisitions occurring after August 31, 1982, this result is achieved by treating a target as disaffiliated from all affiliated groups with respect to its deemed sale of assets. (For acquisitions occurring during the transitional rule period, the TCA mechanism for excluding deemed sale tax liability from the selling corporation's consolidated return also permits inclusion of such liability in the purchasing corporation's consolidated return. Transitional rule elections are discussed under a separate heading below.) In the case of a post-August 31, 1982 acquisition, a separate final return of old target must be filed to report tax liability arising from the deemed sale of assets if target is included in the seller's consolidated return for the acquisition date. (Target is included in that consolidated return for the acquisition date, and thus must file a separate return for the deemed sale, if target is affiliated with the group including the selling corporation (selling group) at the beginning of the acquisition date. See §5f.338-1(f)(3).) The temporary regulations provide that target is disaffiliated immediately before the deemed sale, which occurs at the close of the acquisition date and is considered the last transaction of old target. The deemed sale is considered to occur in a separate taxable year, and target's attributes carry over to that year from the consolidated return of the selling group (and, similarly, carry back from that year) under the rules applicable to corporations leaving a consolidated return group. The separate taxable year rule is subject to one exception: Solely for purposes of determining the number of years in a carryover or carryback period, the deemed sale is considered to occur in the same taxable year of target as is represented by the seller's consolidated return for the period including the acquisition date.

Because the "deemed sale return" is considered the final return of old target, any tax attributes that cannot be used in that return (or carried back to a prior return) are extinguished. Except for carryover items, target's deemed sale return includes only items resulting from the deemed sale. Although target, for the deemed sale, may not be included in any consolidated return filed by the purchasing corporation, target generally will be considered a component member of the purchaser's controlled group for purposes of determining, among other items, the taxable income bracket amounts available in calculating tax liability on the deemed sale return.

These temporary regulations provide that a target is not subject to the disaffiliation rule if it is the common parent of a group of corporations filing consolidated returns or a subsidiary in a consolidated return group the common parent of which is also a target. In such cases, a final consolidated return for the taxable year which ends at the close of the acquisition date must be filed by the common parent target, and the deemed sale of such common parent is reported in that final consolidated return. If a subsidiary of that common parent is also a target with a deemed sale occurring on the same acquisition date, that deemed sale also is reported in the final consolidated return of the group. As a further exception to the disaffiliation rule, items resulting from the deemed sale may be included in a selling group's consolidated return under a binding contract rule discussed below.

Under regulations to be prescribed at a later date pursuant to section 338(h)(9), as added by the TCA, an election may be made for the target to recognize gain or loss on its deemed sale as if it were an actual sale of assets, with any resulting tax included in the selling group's consolidated return. To the extent provided by regulations, the selling corporation would recognize no gain or loss on the actual sale of target's stock. An election under this provision may be made only when regulations are issued, and only as provided in such regulations.

ELECTIONS FOR ACQUISITIONS OCCURRING AFTER AUGUST 31, 1982

In general

Rules for making elections under section 338(g) for post-August 31, 1982, acquisitions are provided in §5f.338-1 of these temporary regulations. As published in the Federal Register on November 22, 1982, §5f.338-1 provided generally that no election would be due before 30 days after publication of regulations specifying the rules for making an election. As revised by this document, §5f.338-1(c) provides that no election will be due before 60 days after the date of publication of the next set of temporary regulations under section 338. It is contemplated that such regulations will be issued within 60 days. Additional time is provided in §5f.338-1(j) and (k) for foreign and certain other corporations. A special rule for foreign corporations under which a section 338 election is not required until relevant for United States tax purposes applies when the purchasing corporation, the target, and certain related corporations have minimal or no contacts with the United States tax system during the acquisition period of target. In such cases, a section 338 election is not due until a specified time after significant U.S. contacts are established. See §5f.338-1(k)(2).

The next set of temporary regulations, which will be in the form of questions and answers, will include substantive guidance as to some of the major consequences of a section 338 election in a domestic context. In light of section 338(g)(3), which provides that section 338 elections, once made, are irrevocable, taxpayers should be aware that any elections made prior to the issuance of those questions and answers will be binding and subject to the rules set forth in those temporary regulations and any future regulations.

Pursuant to an amendment made by section 306(a)(8)(B) of the TCA, these temporary regulations also provide that an election made before March 1, 1983, may be revoked before March 1, 1983. (A procedure for revoking an election, in §5f.338-1(g), was previously announced in a news release issued on February 25, 1983 (IR-83-36).)

Suspension of time to elect under section 338

Under §5f.338(j)(1) of the temporary regulations, the last day for making a section 338 election is suspended in certain cases until the date specified in regulations to be published in section 338(h)(6)(B). This suspension is necessary because of the absence of regulations explaining the provisions of section 338(h)(6)(B). Under section 338(h)(6)(B), the consistency rules of section 338(e) and (f) (which operates to force, or prohibit, a section 338 election in certain cases) are applicable to foreign and certain other types of corporations to the extent and subject to the conditions provided in regulations. Thus, for example, if an election were required prior to the issuance of regulations under section 338(h)(6)(B) for a target that had a foreign target affiliate for which a qualified stock purchase was also made, the purchasing corporation would be required to make a decision regarding a section 338 election for target without knowledge of the consequences of that election to its foreign target affiliate under section 338(f)(1). The purchasing corporation could find itself in a similar position if the qualified stock purchase of a foreign target was followed, several months later, by the qualified stock purchase of its domestic target affiliate sister corporation. Until regulations under section 338(h)(6)(B) are published, the purchasing corporation will not know whether failure to elect for the foreign target will bar a later election for the domestic target by reason of section 338(f)(2). Because it would be unfair to place purchasing corporations in such a position, the time requirement for elections is suspended for acquisitions that could be affected by regulations under section 338(h)(6)(B). Subject to a special procedural requirement, a purchasing corporation is permitted to make an election notwithstanding the suspension. Such an election will be subject to all of the provisions of section 338 as well as the provisions of regulations issued or to be issued thereunder, including regulations under section 338(h)(6). The suspension is not available if one of the principal purposes for the acquisition of stock in a corporation is to qualify for the suspension.

Time for filing final return of old target; taxable year and method of accounting of new target

The temporary regulations clarify that old target's final return reflecting the deeemed sale generally is due on the 15th day of the third calendar month following the month in which the acquisition date occurs. Special rules are provided for DISCs and certain foreign corporations. New target is not presumed to follow old target's annual accounting period and may choose any taxable year that is consistent with section 441 and any other applicable provisions of the Code and regulations. Similarly, new target may adopt any method of accounting that is consistent with section 446 and any other applicable provisions of the Code and regulations. In neither case is the prior consent of the Commissioner required.

Waiver of additions to tax; certain elections considered timely

Certain additions to tax or additional amounts ("additions") may arise by reason of a section 338 election. For example, an election may be made for a target which, by reason of that election, has a final return retroactively due before that election is filed, resulting, technically, in additions to tax for failure to file a return and for failure to pay tax shown on a return. The temporary regulations waive certain additions, arising on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, which would not exist but for a section 338 election. This waiver is conditioned on corrective action being taken on or before such day. Only additions that are excusable upon a showing of reasonable cause are waived under this rule. Interest on

any underpayment of tax will run from the due date of the particular return.

The temporary regulations provide that any election or other action that must be specified in a timely filed return for the taxable period covered by a late-filed return to which the waiver rule applies will be considered timely if specified in the late-filed return. A special rule is provided for a new target included in the purchaser's consolidated return.

Selling group tax liability: The binding contract rule

As an exception to the general rule that old target's deemed sale may not be included in a consolidated return filed by the selling group, the binding contract rule in section 306(a)(8)(A)(ii) of the TCA permits the deemed sale to be included in that consolidated return. The deemed sale will be reported in such a return if the purchasing corporation acquired stock of a target (which was counted as part of a qualified stock purchase) pursuant to a binding stock purchase contract entered into after September 2, 1982, and before January 13, 1983, and if the purchasing corporation is able to establish by clear and convincing evidence that the contract was negotiated on the contemplation that any tax liability of target resulting from its deemed sale of assets would be reported in the selling group's consolidated return. The regulations explain how the binding contract rule is asserted, and provide standards for determining whether the clear and convincing evidence test has been satisfied.

The regulations specify that the clear and convincing evidence requirement is not considered satisfied if the purchasing corporation is contractually obligated to indemnify the selling group in the event that the selling group is legally obligated to pay any tax resulting from the deemed sale. Such an indemnification provision presupposes that the stock sale price was calculated on the assumption that the purchasing corporation was liable for any deemed sale tax.

The binding contract rule does not apply if the purchasing corporation fails to notify the selling group, within the time and in the manner prescribed by these regulations, of its intent to assert the rule. Even though the selling group agrees to a contract that qualifies under the binding contract rule, it cannot be forced to file a consolidated return unless the consolidated return regulations impose that obligation. If a consolidated return is not filed, the binding contract rule is inapplicable and the selling group is not statutorily liable for tax on the deemed sale. Under these circumstances, tax liability for the deemed sale must be reported in the final separate return of old target for its taxable year ending at the close of the acquisition date.

TRANSITIONAL RULE ELECTIONS

In general

A purchasing corporation may elect to apply section 338 to an acquisition occurring in the two-year period ending on August 31, 1982, by making a transitional rule election under section 338 in the manner prescribed in §5f.338-2 of these temporary regulations. The consistency rules of section 338(e), (f), and (i) and the provisions of section 338(h)(4), (6), (8), and (9) do not apply to transitional rule elections. These regulations amend §5f.338-2, as published in the Federal Register on November 22, 1982, in several ways, such as by adding a new procedure for selecting the deemed sale date and by providing generally that a copy of the statement of election must be attached to the first income tax return of new target as well as the last return of old target. (If both of these taxable periods are included in a single consolidated return of the purchasing corporation, the statement of election is simply attached to that consolidated return.) Elections filed on or before February 28, 1983, in accord with §5f.338-2 as originally promulgated, are valid and need not be amended. If the purchasing corporation or the target is a foreign corporation, a statement of transitional rule election that constitutes a reasonable attempt to comply with the requirements of these regulations will be valid.

Selected deemed sale date

The temporary regulations provide procedures for selecting the date of the deemed section 338 asset sale, which under section 306(a)(8)(B)(i) of the TCA can be no earlier than the day after the acquisition date. (These procedures codify rules announced in a new release issued on February 25, 1983. IR-83-36.) Two important consequences flow from the separation of the deemed sale date from the actual stock acquisition date. First, while old target cannot be included in the seller's consolidated return for the deemed sale date, old target may be included in the purchasing corporation's consolidated return for that date, with the result that tax triggered by the deemed sale is reported in the purchaser's return. Second, the basis of target's assets after the election is made must be adjusted for operations of target between the acquisition date and the deemed sale date in a manner similar to the adjustment prescribed in regulations under the last sentence of section 334(b)(2), as in effect on August 31, 1982. (Such adjustments are not required with respect to acquisitions after August 31, 1982, since in such cases the deemed sale date is always the acquisition date.)

Time for filing return; waiver of additions to tax

The final return of old target generally is due on the 15th day of the third calendar month following the month in which the deemed sale occurs. (Special rules are provided for DISCs and certain foreign corporations.) The rule summarized above for waiver of additions to tax (and additional amounts) also applies to transitional rule elections.

DATE OF SECTION 338 ELECTION FOR PURPOSES OF SPECIAL LIFO RECAPTURE RULE

The Miscellaneous Revenue Act of 1982 (MRA) [Pub. L. 97-362, 1983-1 C.B. 367] amended the LIFO recap-

ture provisions of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1] to provide generally that, for a plan of liquidation adopted in 1982, the LIFO recapture amount is reduced by $1 million. The MRA specifically provided that the $1 million exemption applies to a section 338 election if the election is made during 1982. Because no guidance on making elections for post-August 31, 1982, acquisitions was available to taxpayers in 1982, §5f.338-3(a) of these temporary regulations provides that any election (including a transitional rule election) that could have been made in 1982 will be treated as if made in 1982 for purposes of the LIFO recapture rule if a timely election under section 338 is actually made. For transitional rule section 338 elections, this special rule will apply only if a 1982 deemed sale date is selected.

ELECTION OUT FOR FINANCIAL INSTITUTIONS

Under section 224(d)(3) of TEFRA, the purchasing corporation may elect not to have section 224 of TEFRA apply to the acquisition of a financial institution even though the acquisition date occurs after August 31, 1982, if certain requirements are satisfied. The principal effect of such an election is that section 334(b)(2), as in effect on August 31, 1982, rather than section 338 will apply to the determination of the basis of the assets of the acquired financial institution. The procedure for electing out of section 224 is provided in §5f.338-3(b).

REGULATORY FLEXIBILITY ACT; EXECUTIVE ORDER 12291; AND PAPERWORK REDUCTION ACT OF 1980

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule. The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. The reporting requirements added by this document have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. The reporting requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these temporary regulations is Duane H. Pellervo of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, Part 5f of Title 26 of the Code of Federal Regulations is amended as follows:

Paragraph 1. Section 5f.338-1 is revised to read as follows:

§5f.338-1 Elections under section 338(g) of the Internal Revenue Code of 1954.

(a) *Scope.* This section prescribes rules relating to elections under section 338, as added by TEFRA and as amended by the Technical Corrections Act of 1982. This section also prescribes rules under certain related provisions not included in the Internal Revenue Code. This section only applies with respect to acquisitions for which the acquisition date (determined without section 224(d)(5) of TEFRA) occurs after August 31, 1982.

(b) *Definitions*—(1) *TEFRA.* "TEFRA" is the Tax Equity and Fiscal Responsibility Act of 1982.

(2) *Acquisition date.* The "acquisition date" of a corporation is the first day on which there is a qualified stock purchase of such corporation. Thus, in the event of a series of stock purchases over a period of time, the acquisition date is the first day on which the aggregate of the stock purchases satisfies the requirements of section 338(d)(3).

(3) *Common parent.* The term "common parent" has the same meaning as in section 1504.

(4) *Purchasing corporation.* The term "purchasing corporation" has the same meaning as in section 338(d)(1).

(5) *Qualified stock purchase.* The term "qualified stock purchase" has the same meaning as in section 338(d)(3).

(6) *Selling group; purchasing group.* The "selling group" is the affiliated group (as defined in section 1504) that is eligible to file a consolidated return that includes the target for the acquisition date and that does not have a target as common parent for the taxable year including the acquisition date. See §5f.338-1(f)(3)(i) and (ii). The "purchasing group" is the affiliated group that includes the purchasing corporation.

(7) *Old target; new target.* The "target" is the target corporation as defined in section 338(d)(2). "Old target" refers to the target for periods ending as of the close of the date of the target's deemed sale of assets. "New target" refers to the target for subsequent periods.

(8) *Old target's final return.* "Old target's final return" is the income tax return of old target that includes the deemed sale of assets under section 338. If the definition rule of paragraph (f)(3)(i) of this section applies, target's "deemed sale return" is considered old target's final return.

(c) *Time and manner of making election.* The purchasing corporation makes an election under section 338(g) only by filing, not later than 75 days after the acquisition date (or, if later, the 60th day after the date of publication of the next set of temporary regulations under section 338), a statement of election with the Internal Revenue Service Center with which it files its annual income tax return. If the purchasing corporation is considered to have made a qualified stock purchase of more than one cor-

poration by reason of section 338 (h)(3)(B), then a statement of election is required only for the corporation the stock of which is directly purchased. For a special suspension of time to elect under section 338, see paragraph (j) of this section. For special rules applicable to certain foreign corporations and DISCs, see paragraph (k) of this section.

(d) *Statement of election.* The statement of election under section 338 must be made by the purchasing corporation on Form 8023. If the form is not yet available, a statement prepared by the purchasing corporation will be satisfactory. The heading of the statement should prominently identify the statement as an election under section 338. Except as provided in paragraphs (j)(2) and (k)(4) and (5) of this section, the statement must—

(1) Contain the name, address, and employer identification number of the purchasing corporation and the target,

(2) Identify the election as an election under section 338(g) of the Code,

(3) For elections filed after May 8, 1984, specify the acquisition date, and

(4) Be signed by a person who states under penalties of perjury that he or she is authorized to make the election on behalf of the purchasing corporation.

(e) *Schedule of corporations; copy of statement attached to returns of target*—(1) *Schedule of corporations subject to election.* A schedule must be attached to the statement of election providing the name, address, and employer identification number of each corporation subject to the election by reason of section 338 (h)(3)(B). Failure to attach the schedule will not invalidate the election.

(2) *Copy of statement of election attached to returns of target.* A copy of the statement of election under section 338 must be attached to old target's final return and to the first return of new target. Alternatively, if the target is a foreign corporation not subject to United States tax (as defined in paragraph (k)(3)(iii) of this section), a copy of the statement of election must be attached to the return(s) specified in paragraph (k)(6) of this section. Failure to attach the statement to these returns will not invalidate the election.

(f) *Certain consequences of section 338 election*—(1) *Exclusion of old target's deemed sale from purchasing group's consolidated return.* Notwithstanding the provisions of §1.1502-76(b)(5)(i) (relating to elective inclusion in an affiliated group), old target is not includible in a consolidated return of the purchasing group with respect to its deemed sale of assets under section 338.

(2) *Old target's final taxable year not otherwise included in consolidated return of selling group*—(i) *General rule.* If a valid election under section 338 is made for a target that is not includible in any consolidated return for a period that includes the acquisition date, then a final return must be filed for old target's taxable year that ends at the close of the acquisition date by reason of the section 338 election. Any tax liability resulting from the deemed sale of assets under section 338 is reported in that final return and may not be included in any consolidated return of the purchasing group.

(ii) *Old target the common parent of affiliated group or a subsidiary in a group with a common parent target.* If a valid election under section 338 is made for a target that is the common parent of an affiliated group, the final return specified in paragraph (f)(2)(i) of this section may be a consolidated return of that group. If such a final consolidated return is filed, any tax liability resulting from the deemed sale of such target, as well as from any deemed sales occurring on the same date of subsidiaries in target's group, is reported in that consolidated return (along with any tax liability on other income of the group for the taxable year ending at the close of the acquisition date) and may not be included in any consolidated return of the purchasing group. Thus, the final consolidated return of the common parent target is also the final return for each subsidiary of such target that is also a target with the same acquisition date.

(3) *Old target's final taxable year otherwise included in consolidated return of selling group*—(i) *General rule.* If a valid election under section 338 is made for a target that is includible in a consolidated return filed by the selling group for a period that includes the acquisition date, then old target is disaffiliated from that group immediately before its deemed sale of assets under section 338 and must file a final return including only the items resulting from the deemed sale and the carryover items specified in paragraph (f)(3)(iv) of this section ("deemed sale return"). The deemed sale occurs at the close of the acquisition date and is the last transaction of old target. If a "deemed sale return" must be filed, then any transactions of old target occurring on the acquisition date prior to the deemed sale are reported in the selling group's consolidated return.

(ii) *Old target includible in selling group's consolidated return.* Old target is considered to be includible in a consolidated return filed by the selling group for a period that includes the acquisition date if target is an includible corporation (within the meaning of section 1504) with respect to that group at the beginning of the acquisition date and if the 30-day rule option in § 1.1502-76(b)(5)(ii) (relating to elective exclusion from an affiliated group) is not exercised. For the definition of "selling group," see paragraph (b)(6) of this section.

(iii) *Separate taxable year.* The deemed sale of old target reported in the "deemed sale return" under this subparagraph (3) occurs in a separate taxable year, except that such sale is treated as occurring in the same taxable year of target as is represented by the selling group's consolidated return (for the period including the acquisition date) for purposes of determining the number of years in a carryover or carryback period.

(iv) *Carryover and carryback of tax attributes.* Target's attributes may be carried over to, and carried back from, the "deemed sale return" un-

der the rules applicable to a corporation that ceases to be a member of an affiliated group during a consolidated return year. See generally §§1.1502-21 and 1.1502-79.

(v) *Old target is a component member of purchasing corporation's controlled group.* For purposes of its deemed sale return, target is a component member of the controlled group of corporations including the purchasing corporation unless target is treated as an excluded member under section 1563(b)(2).

(vi) *Exception.* This subparagraph (3) does not apply if the binding contract rule of paragraph (l) of this section applies.

(4) *EIN not affected.* New target shall use the same employer identification number old target used.

(5) *Liquidating target before election.* Liquidating target on or after the acquisition date and before the filing on of an election under section 338 has no effect on the validity of the election. If target liquidates on the acquisition date, the liquidation will be considered to occur on the following day and immediately after new target's deemed purchase of assets.

(6) *Due date for old target's final return*—(i) *General rule.* Old target's final return (as defined in paragraph (b)(8) of this section) is due on the 15th day of the third calendar month following the month in which the acquisition date occurs. If old target is sold by a selling group, §1.1502-76(c) may be applicable to old target's final return.

(ii) *Exceptions.* If the final period of old target is includible in the consolidated return of the selling group by reason of the binding contract rule of paragraph (l) of this section, the due date of that consolidated return controls. For special rules applicable to certain foreign corporations and DISCs, see paragraph (k)(7) of this section.

(7) *New target's taxable year and method of accounting*—(i) *Selection.* Except as otherwise provided in the Code and the Income Tax Regulations, new target may adopt, without obtaining prior approval from the Commissioner, any taxable year that meets the requirements of section 441 and any method of accounting that meets the requirements of section 446.

(ii) *First return due on or before the 60th day after the date of publication of the next set of temporary regulations under section 338.* Notwithstanding §1.441-1(b)(3), a new target may adopt a taxable year for which the first return is due on or before the 60th day after the date of publication of the next set of temporary regulations under section 338 (not including extensions of time) by filing its first return as new target for the desired taxable year on or before the 60th day after the date of publication of the next set of temporary regulations under section 338.

(8) *Example.* The provisions of this paragraph (f) may be illustrated by the following example. A capital letter refers to a domestic corporation.

Example. S is the common parent of an affiliated group that includes T. The S Group files calendar year consolidated returns. At the close of June 30, 1983, P purchases all of the T stock from S. P makes a timely election under section 338(g), and the tax resulting from T's deemed sale of assets is triggered to T as of the close of the acquisition date (June 30). T is considered disaffiliated for purposes of reporting the deemed sale. Accordingly, T is included in the consolidated return of the selling group for the acquisition date except that the tax liability resulting from the deemed sale of assets will be reported in a separate "deemed sale return" of T. The result would be the same if P purchased the T stock at 10 a.m. on June 30, 1983. See paragraph (f)(3)(i) and (ii) of this section. Provided that T is not treated as an excluded member under section 1563(b)(2), T is a component member of P's controlled group for the taxable year represented by the deemed sale, and the taxable income bracket amounts available in calculating tax on the deemed sale return must be limited accordingly. If the S group does not file consolidated returns and if old T filed on the calendar year, a separate return must be filed for old T for its short taxable year beginning on January 1, 1983, and ending on June 30, 1983, which would include the deemed sale.

(g) *Revoking election made before March 1, 1983*—(l) *In general.* An election under section 338(g) made before March 1, 1983, that meets all the requirements of paragraphs (c) and (d) of this section may be revoked by filing a statement of revocation before March 1, 1983, with the Internal Revenue Service Center with which the statement of election was filed. Technical Corrections Act of 1982, §306(a)(8)(B)(i) (Pub. L. No. 97-448; 96 Stat. 2365). (A statement filed with the Internal Revenue Service that does not meet all the requirements of paragraphs (c) and (d) of this section is not a valid election and need not be revoked.) The revocation of an election does not bar a later, timely election under section 338 with respect to the same acquisition. The heading of the statement of revocation should prominently identify the statement as a revocation of section 338 election, and a copy of the statement of election previously filed must be attached. The statement of revocation must—

(i) Identify the purchasing corporation and the target by name, address, and employer identification number,

(ii) Indicate that the previously filed election under section 338 is revoked, and

(iii) Be signed by a person who states under penalties of perjury that he or she is authorized to revoke the election on behalf of the purchasing corporation.

(2) *Perfection of revocation.* A statement of revocation filed before March 1, 1983, that sufficiently identifies the prior election and is signed by a person authorized to revoke the election but does not meet all of the requirements of paragraph (g)(1) of this section will nonetheless be considered valid if a statement of perfection is filed with the appropriate Internal Revenue Service Center not later than May 8, 1984. The statement of perfection must contain the information omitted from the original statement of revocation and be signed in the manner required for a statement of revocation. A copy of the previously filed statement of revocation must be attached to the statement of perfection.

(h) *Waiver: certain additions to tax and times to act, etc.*—(1) *Waiver of certain additions to tax arising on or before the 60th day after the date of publication of the next set of tem-*

porary regulations under section 338. An addition to tax or additional amount (addition) under Subchapter A of Chapter 68 arising on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, by reason of circumstances that would not exist but for an election under section 338, is waived if (i) under the particular statute the addition is excusable upon a showing of reasonable cause and (ii) corrective action is taken on or before the 60th day after the date of publication of the next set of temporary regulations under section 338. The Service should be notified at the time of correction (*e.g.*, by attaching a statement to a return that constitutes corrective action) that the waiver rule of this paragraph (h) is being asserted.

(2) *Elections or other actions required to be specified on a timely filed return*—(i) *In general.* If the addition to tax for failure to file a return is waived under paragraph (h)(1) of this section, then any election or other action that must be specified on a timely filed return for the taxable period covered by the late filed return descirbed in that paragraph (h)(1) will be considered timely if specified on that late-filed return.

(ii) *New target in purchasing group's consolidated return.* If new target is includible for its first taxable year in a consolidated return filed by the purchasing group on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, then any election or other action that must be specified in a timely filed return for new target's first taxable year (but which is not specified in the consolidated return) will be considered timely if specified in an amended return (or, if the contents of the return itself are not affected by the election or other action, a separate statement), filed on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, with the Internal Revenue Service Center with which the consolidated return was filed. If the election is made on a separate statement, such statement must cite this provision and must include the name, address, and EIN of the parent corporation of the purchasing group.

(3) *Moot return not required.* If a timely election under section 338 is made, then an income tax return need not be filed for the taxable year of old target which, had an election not been made, would have included any day after the acquisition date.

(4) *Examples.* The provisions of this paragraph (h) may be illustrated by the following examples. A capital letter refers to a domestic corporation.

Example (1). T is an unaffiliated corporation filing income tax returns on the basis of a fiscal year ending October 31. At the close of September 20, 1982, T is acquired by P. P does not file consolidated returns. P files an election under section 338 on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, which causes T's taxable year to end as of the close of September 20, 1982. An income tax return for T's taxable period ending on September 20, 1982, was due on December 15, 1982. Additions to tax for failure to file a return and to pay tax shown on a return will not be imposed if T's return is filed and the tax paid on or before the 60th day after the date of publication of the next set of temporary regulations under section 338. (This waiver applies even if the acquisition date coincides with the last day of T's former taxable year, *i.e.*, October 31, 1982.) Interest on any underpayment of tax for old T's short taxable year ending September 20, 1982, will run from December 15, 1982. A statement indicating that the waiver rule of §5f.338-1(h) is being asserted should be attached to T's return.

Example (2). Assume the same facts as in Example (1). Assume further that new T adopts the calendar year. Under paragraph (f)(7)(ii) of this section, a calendar year will be properly adopted if new T files its first return on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, indicating that a calendar year is adopted for new T (including the period beginning on September 21, 1982, and ending on December 31, 1982). Any additions to tax or additional amounts described in this paragraph (h) which arise by reason of the late filing of a return for the period ending on December 31, 1982, are waived, since they are based on circumstances that would not exist but for the section 338 election. Notwithstanding this waiver, however, the return is still considered due on March 15, 1983, and interest on any underpayment runs from that date. Although prior to the election old T had a return due on January 15, 1983, that return need not be filed since a timely election under section 338 was made. See paragraph (h)(3) of this section.

(i) [Reserved]

(j) *Suspension of time to elect under section 338 in certain cases*—(1) *In general.* The last day for making an election under this section is suspended until the date specified in a Treasury decision setting forth regulations under section 338(h)(6)(B) if—

(i) the target (A) is a foreign corporation, a DISC, a corporation described in section 934(b), or a corporation to which section 936 applies, and (B) has a target affiliate or

(ii) the target has a target affiliate that either (A) is a foreign corporation, a DISC, a corporation described in section 934(b), or a corporation to which section 936 applies, or (B) owns stock in a foreign corporation or a domestic corporation that is a DISC or described in section 1248(e).

(2) *Option to make election notwithstanding suspension.* A purchasing corporation may opt to make an election notwithstanding the suspension by filing a statement of election within the latest time prescribed in paragraph (c) or (k) of this section. such statement of election must include, in addition to the other requirements specified in this section, a declaration that the election is made pursuant to the option in "§5f.338-1(j)(2)" to make the section 338 notwithstanding the suspension. A statement of election that does not contain this declaration is invalid unless the purchasing corporation files a perfecting declaration on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, with the Internal Revenue Service Center with which it filed the statement of election. The perfecting declaration must be signed by a person who states under penalties of perjury that he or she is authorized to make the declaration on behalf of the purchasing corporation, and a copy of the previously filed statement of election must be attached. An election made pursuant to this paragraph (j)(2) is subject to all of the provisions of section 338 as well as the provisions of regulations issued or to be issued thereunder, including regulations under section 338(h)(6).

(3) *Exception.* The suspension will not apply to a target if one of the

principal purposes for the acquisition of stock is to qualify for the suspension.

(4) *Target affiliate.* For the definition of target affiliate, see paragraph (k)(3)(ii) of this section.

(k) *Special rules for foreign corporations or DISCs*—(1) *Election by foreign purchasing corporation not subject to U.S. tax.* Except as otherwise provided in this paragraph (k) or in paragraph (j) of this section, a foreign purchasing corporation not subject to United States tax for its taxable year that includes the acquisition date is required to file a statement of election under section 338 on or before the 15th day of the sixth calendar month following the month in which the acquisition date occurs (or, if later, the 60th day after the date of publication of the next set of temporary regulations under section 338). The statement of election must be filed with the Philadelphia Service Center, Philadelphia, Pennsylvania 19255.

(2) *Election not required until relevant*—(i) *General rule.* A qualifying foreign purchasing corporation is not required to file a statement of election for a qualifying foreign target before the 180th day after the close of the purchasing corporation's taxable year within which a triggering event occurs.

(ii) *Qualifying foreign purchasing corporation.* A purchasing corporation is a "qualifying foreign purchasing corporation" only if, during the acquisition period of a qualifying foreign target, all the corporations in the purchasing corporation's affiliated group (as defined in section 338(h)(5)) are foreign corporations that are not subject to United States tax.

(iii) *Qualifying foreign target.* A target is a "qualifying foreign target" only if the target and its target affiliates are foreign corporations that, during the acquisition period of target, are not subject to United States tax (and will not become subject to United States tax during such period by reason of a section 338 election). A target affiliate is taken into account for purposes of the preceding sentence only if, during the acquisition period of target, it is or becomes a member of the affiliated group (as defined in section 338(h)(5)) that includes the purchasing corporation of target.

(iv) *Triggering event.* A triggering event occurs in the taxable year of the qualifying purchasing corporation in which either that corporation or any corporation in which either that corporation or any corporation in its affiliated group (as defined in section 338(h)(5)) becomes subject to United States tax.

(v) *Special rule.* For purposes of this paragraph (k)(2), a corporation is considered "subject to United States tax" if it is subject to a tax described in paragraph (k)(3)(iii) of this section or if it is a controlled foreign corporation, a foreign investment company, or a foreign corporation the stock ownership of which is described in section 552(a)(2).

(3) *Definitions.* For purposes of this paragraph (k)—

(i) *Acquisition period.* The "acquisition period" is the period beginning at the end of the day before the first day of the "12-month acquisition period" (as defined in section 338(h)(1)) and ending at the beginning of the day following the acquisition date.

(ii) *Target affiliate.* The term, "target affiliate," has the same meaning as in section 338(h)(6) (applied without section 338(h)(6)(B)(i)).

(iii) *United States tax.* "United States tax" is a tax under Subtitle A of the Internal Revenue Code of 1954 (other than a tax under section 881 thereof). Subtitle A relates to income taxes.

(4) *Statement of election may be filed by United States shareholders in certain cases.* The United States shareholders (as defined in section 951(b)) may file a statement of election on behalf of a foreign purchasing corporation described in paragraph (k)(1) of this section if such corporation is also a controlled foreign corporation (as defined in section 957(a)). The statement of election must include the name, address, taxpayer identification number, and stock interest of each United States shareholder. In lieu of the requirement of paragraph (d)(4) of this section, the statement must be jointly signed by each United States shareholder, with each such shareholder stating under penalties of perjury that he or she holds the stock interest specified for such shareholder in the statement of election. (As an alternative to a jointly signed statement of election, the shareholder signatures may be contained in separate statements attached to the statement of election.) If a United States shareholder is not an individual or has delegated authority to sign the statement of election, the statement must be signed by a person who states under penalties of perjury that he or she is authorized to execute the statement on behalf of the United States shareholder. A copy of the statement of election must be attached to the Form 5471 (information return with respect to a foreign corporation) filed with respect to the purchasing corporation by each United States shareholder for the purchasing corporation's taxable year that includes the acquisition date (or, if paragraph (k)(2) of this section applies to the election, for the purchasing corporation's taxable year within which it becomes a controlled foreign corporation). The provisions of §1.964-1(c) (including §1.964-1(c)(7)) do not apply to an election made by the United States shareholders.

(5) *EIN not required for certain corporations.* Paragraph (d)(1) of this section requires that the employer identification numbers (EINs) of the purchasing corporation and target be specified in the statement of election. This requirement does not apply for a corporation that does not have, and is not otherwise required to have, an EIN.

(6) *Copy of statement of election for certain foreign target corporations attached to return.* If a valid election under section 338 is made for a foreign target corporation not subject to United States tax, a copy of the statement of election must be attached to the first United States in-

come tax return of such target or the first Form 5471 each United States person files with respect to such target subsequent to the acquisition date. Failure to attach the statement to these returns will not invalidate the election.

(7) *Special rules for due date of old target's final return*—(i) *Old target a foreign corporation subject to United States tax.* The final return of old target is due on the 15th day of the sixth calendar month following the month in which the acquisition date occurs if old target is subject to United States tax for its taxable year that includes the acquisition date but does not have an office or fixed place of business in the United States during such period.

(ii) *Old target a foreign corporation not subject to United States tax.* A final return of old target is not required if old target is not subject to United States tax for its taxable year including the acquisition date.

(iii) *Old target a DISC.* The final return of old target is due on the 15th day of the ninth calendar month following the month in which the acquisition date occurs if old target is a DISC for its taxable year that includes the acquisition date.

(l) *Binding contracts entered into after September 2, 1982, and before January 13, 1983*—(1) *In general.* This paragraph (l) is prescribed under section 306(a)(8)(A)(ii) of the Technical Corrections Act of 1982. Notwithstanding the disaffiliation rule of paragraph (f)(3)(i) of this section, the target's deemed sale of assets is reported in the selling group's consolidated return for a period including the acquisition date if—

(i) Any portion of the stock of target that is part of the qualified stock purchase is acquired by the purchasing corporation pursuant to a binding contract (the "contract") entered into after September 2, 1982, and before January 13, 1983, and

(ii) The purchasing corporation establishes by clear and convincing evidence that the contract was negotiated on the contemplation that any tax liability resulting from the target's deemed section 338 sale would be reported in the selling group's consolidated return.

(2) *Clear and convincing evidence*—(i) *Requirement considered satisfied.* The purchasing corporation is considered to have satisfied the clear and convincing evidence requirement of paragraph (l)(1)(ii) of this section if, in the absence of contradictory evidence—

(A) Language in the contract plainly and unequivocally provides that the Federal income tax liability resulting from the deemed section 338 sale will be reported in the selling group's consolidated return;

(B) Documents contemporaneous with the negotiation of the contract plainly and unequivocally provide that the Federal income tax liability resulting from the deemed section 338 sale will be reported in the selling group's consolidated return, provided that the provisions of such documents relating to the selling group's liability were relied upon by both the buyer and seller in computing the contract selling price; or

(C) A statement, signed under penalties of perjury by a person authorized to act on behalf of the common parent of the selling group that files a consolidated return for a period including the acquisition date, plainly and unequivocally provides that the contract was negotiated on the contemplation that the Federal income tax liability resulting from the deemed section 338 sale would be reported in the selling group's consolidated return.

(ii) *Requirement not considered satisfied.* In no event will the purchasing corporation be considered to have satisfied the clear and convincing evidence requirement if the stock sale contract (or collateral documents) requires the purchasing corporation to indemnify the selling group for any Federal income tax liability resulting from the deemed section 338 sale in the event that applicable law or regulations impose that liability on the selling group.

(3) *Manner of asserting binding contract rule*—(i) *In general.* The purchasing corporation asserts the binding contract rule of this paragraph (l) by filing a "binding contract statement" with the statement of election under section 338 (or with a copy of a previously filed statement of election, provided that the binding contract statement and such copy are filed with the appropriate Internal Revenue Service Center on or before the due date for making the section 338 election).

(ii) *Contents of binding contract statement.* The binding contract statement must—

(A) Contain the name, address, and employer identification number of the common parent of the selling group;

(B) State that the binding contract rule is asserted;

(C) Indicate the date of entry into the binding contract;

(D) Set forth the facts which demonstrate that the parties contemplated selling group liability for target's deemed sale of assets; and

(E) Be signed by a person who states under penalties of perjury that he or she is authorized to make the binding contract statement on behalf of the purchasing corporation.

(iii) *Notice to common parent or selling corporations.* The binding contract rule does not apply unless, on or before the due date for filing a statement of election, a copy of the bonding contract statement and the statement of election are provided the common parent of the selling group or each selling corporation.

(4) *Binding contract rule inapplicable if no consolidated return.* If a consolidated return including the target for a period including the acquisition date is not filed by the selling group (or if such return is filed but is properly withdrawn), then old target's final return is a separate return for its year ending on the acquisition date.

(The reporting requirements of this section have been assigned OMB Control Number 1545-0702.)

Par. 2. Section 5f.338-2 is revised to read as follows:

§5f.338-2 Transitional rule elections.

(a) *In general*—(1) *Scope.* This section prescribes rules relating to section 338 "transitional rule" elections permitted by reason of section 224(d)(2) of TEFRA, as amended by section 306(a)(8)(B) of the Technical Corrections Act of 1982. See also section 224(d)(4) and (5) of TEFRA as added by such section 306(a)(8)(B). In general, a transitional rule election may be made for a corporation for which the acquisition date occurs after August 31, 1980, and before September 1, 1982.

(2) *Definitions.* The definitions contained in §5f.338-1(b) also apply to this section.

(b) *Manner of making election.* The purchasing corporation makes a transitional rule election only by filing a statement of election not later than February 28, 1983, with the Internal Revenue Service Center with which it files its annual income tax return.

(c) *Statement of election*—(1) *General rule.* The heading of the statement of election should prominently identify the statement as a transitional rule election under section 338. Form 8023 is not used for this purpose. The statement must—

(i) Contain the name, address, and employer identification number of the purchasing corporation and the target,

(ii) Identify the election as an election under section 338(g) of the Code that is permitted by section 224(d)(2) of TEFRA, and

(iii) Be signed by a person who states under penalties of perjury that he or she is authorized to make the election on behalf of the purchasing corporation.

(2) *Purchasing corporation or target a foreign corporation.* If the purchasing corporation or the target is a foreign corporation, then a statement of transitional rule election filed not later than February 28, 1983, that constitutes a reasonable attempt to comply with the rules of paragraphs (b) and (c)(1) of this section will be valid.

(d) *Copy of statement of election attached to returns of target.* A copy of the statement of transitional rule election must be attached to old target's final return and to the first return of new target. Alternatively, if the target is a foreign corporation not subject to United States tax (as defined in §5f.338-1(k)(3)(iii)), a copy of the statement of election must be attached to the return(s) specified in §5f.338-1(k)(6). Failure to attach the statement to these returns will not invalidate the election.

(e) *Certain consequences of transitional rule election*—(1) *Taxable year ends at close of selected deemed sale date.* Old target's taxable year ends at the close of the deemed sale date selected under paragraph (f) of this section. Because that date is never earlier than the day after the acquisition date, old target's tax liability resulting from its deemed sale of assets may not be included in the consolidated return of a selling group but may be included in the consolidated return of the purchasing group.

(2) *EIN not affected.* New target shall use the same employer identification number as old target used.

(3) *Rules similar to old section 334(b)(2); certain provisions of section 338 inapplicable.* If a transitional rule election is made, then—

(i) A rule similar to the last sentence of section 334(b)(2) (as in effect on August 31, 1982) applies, and

(ii) Subsections (e), (f), and (i) of section 338 and paragraphs (4), (6), (8), and (9) of section 338(h) do not apply.

(4) *Liquidating target before election.* Liquidating target on or after the deemed sale date (or after August 31, 1982, if later) and before the filing of a transitional rule election under section 338 has no effect on the validity of the election. If target liquidates on the deemed sale date, the liquidation will be considered to occur on the following day and immediately after new target's deemed purchase of assets.

(5) *Due date for old target's final return*—

(i) *General rule.* Old target's final return is due on the 15th day of the third calendar month following the month in which the deemed sale date occurs. If old target is sold by a selling group, §1.1502-76(c) may be applicable to old target's final return.

(ii) *Exceptions.* If the final taxable period of old target is includible in the consolidated return of the purchasing group, the due date of that consolidated return controls. For special rules applicable to DISCs and certain foreign corporations, see §5f.338-1(k)(7) (applied by replacing the phrase, "acquisition date," wherever it occurs, with the phrase, "deemed sale date").

(6) *New target's taxable year and method of accounting.* The rules of §5f.338-1(f)(7) also apply to transitional rule elections.

(f) *Selection of deemed sale date by purchasing corporation*—(1) *In general.* The date of the target's deemed sale of assets under section 338(a) is the date selected by the purchasing corporation in the statement of transitional rule election or in a deemed sale date statement, rather than the acquisition date specified in section 338(h)(2). For purposes of determining whether the transitional election rules apply to the particular acquisition and for purposes of determining when target can be included in the consolidated return filed by the affiliated group that includes the purchasing corporation, the acquisition date rather than the selected deemed sale date controls.

(2) *Date selected as deemed sale date*—(i) *In general.* The purchasing corporation may select any deemed sale date in the statement of transitional rule election or deemed sale date statement, so long as such date—

(A) Is after the later of the acquisition date or June 30, 1982, and

(B) Is no later than (*1*) the date the statement of transitional rule election specifying a deemed sale date is filed or (*2*) if a deemed sale date is selected in a deemed sale date statement filed subsequent to the filing of a statement of transitional rule election (whether or not that election specified a deemed sale date), no later than the earlier of the date the deemed sale date statement is filed or February 28,

1983.

(ii) *Unspecified deemed sale date.* If a timely filed statement of transitional rule election does not specify a deemed sale date and a deemed sale date statement is not filed, the date of filing the election is considered the selected deemed sale date.

(iii) *Filing date.* For purposes of determining the date on which the deemed sale occurs, the date of mailing a statement, as evidenced by the postmark date, is considered the date of filing.

(3) *Selecting deemed sale date after filing transitional rule election—* (i) *Deemed sale date statement.* A purchasing corporation may select a deemed sale date after timely filing a valid statement of transitional rule election, whether or not that election specifies a deemed sale date, by filing a deemed sale date statement on or before May 8, 1984, with the Internal Revenue Service Center with which it filed the election. A copy of the statement of transitional rule election must be attached. The deemed sale date statement should contain the name, address, and employer identification number of the purchasing corporation and the target, identify the deemed sale date, and be signed by a person who states under penalties of perjury that he or she is authorized to select a deemed sale date on behalf of the purchasing corporation. The EIN requirement does not apply for a corporation that does not have, and is not otherwise required to have, an EIN.

(ii) *Revoking and filing new election.* As an alternative to the deemed sale date statement procedure, the purchasing corporation may revoke the previously filed election in accordance with paragraph (g) of this section and file a new election which specifies the desired deemed sale date. The prior election must be revoked and the new election filed before March 1, 1983.

(g) *Revoking election made before March 1, 1983.* A timely filed transitional rule election that meets all the requirements of paragraphs (b) and (c) of this section may be revoked only in the manner prescribed in §5f.338-1(g).

(h) *Waiver: certain additions to tax and times to act, etc.* The rules of §5f.338-1(h) also apply to transitional rule elections, except that §5f.338-1(h)(3) is applied by substituting the phrase "deemed sale date" for the phrase "acquisition date."

(i) [Reserved]

(j) *Examples.* The provisions of this section may be illustrated by the following examples. In each example, a capital letter refers to a domestic corporation.

Example (1). (i) S is the common parent of an affiliated group that includes T. The S group files calendar year consolidated returns. At the close of May 31, 1982, S sells all of the stock of T to P, a calendar year corporation, and on November 10, 1982, P files a statement of transitional rule election with respect to T. The statement of election meets all the requirements of this section but does not specify the deemed sale date. P will file a separate return for the 1982 calendar year. Unless P takes action to specify a different date, the date of filing the statement of transitional rule election will be considered the selected deemed sale date. Thus, T's deemed sale occurs and its taxable year ends at the close of November 10, 1982. T's income from January 1, 1982, through May 31, 1982, is included in the consolidated return of the S group. Any income tax liability resulting from the deemed sale under section 338 is reported in old T's return for its final taxable period which begins on June 1, 1982, and ends on November 10, 1982. Under paragraph (e)(5)(i) of this section, this return is due on February 15, 1983. Assuming new T adopts the calendar year, another return will be required for the period from November 11, 1982, through December 31, 1982, which is T's first taxable period as "new target." Under paragraph (e)(6) of this section, new T may adopt the calendar year on its first income tax return if that return is filed on or before the 60th day after the date of publication of the next set of temporary regulations under section 338.

(ii) Because a return would not be due on February 15, 1983, but for the transitional rule election under section 338, additions to tax under section 6651(a)(1) and (2) are waived if that return is filed and the tax shown thereon paid on or before the 60th day after the date of publication of the next set of temporary regulations under section 338. See paragraph (h) of this section. These additions to tax are also waived with respect to the return of new T due on March 15, 1983, if that return is filed and the tax shown thereon paid on or before the 60th day after the date of publication of the next set of temporary regulations under section 338. Interest on any underpayment of tax, however, runs from the due date of these returns.

(iii) If P files a consolidated return for the 1982 calendar year, T's income for its final taxable period as old target and for its first taxable period as new target will be included in P's consolidated return, to which a copy of the statement of transitional rule election must be attached. See paragraph (d) of this section. The waiver rule applies only to additions that would not arise but for the section 338 election.

Example (2). Assume the same facts as in Example (1)(i), except that P wishes to select a deemed sale date other than November 10, 1982. If P files a proper deemed sale date statement under paragraph (f) of this section after February 28, 1983, and on or before May 8, 1984, P may select as the deemed sale date any date after June 30, 1982, and before March 1, 1983. If July 1, 1982, is selected as the deemed sale date and P does not join with T in filing a consolidated return for 1982, any income tax liability resulting from the deemed sale of assets (occurring at the close of July 1, 1982) is reported in old T's final return for its taxable period beginning on July 1, 1982, and ending on July 1, 1982. Under paragraph (e)(5)(i) of this section, that return is due on October 15, 1982. Assuming that new T adopts the calendar year as its taxable year, another return will be required for the period beginning on July 2, 1982, and ending on December 31, 1982, which is new T's first taxable period as new target. If these returns are filed on or before the 60th day after the date of publication of the next set of temporary regulations under section 338, additions to tax for failure to file a return and to pay tax shown on a return will be waived. The return of old T which, had an election not been made, would have been due on March 15, 1983 (for the period from June 1, 1982, to December 31, 1982) need not be filed. See paragraph (h) of this section. If P acquired all of the stock of T at the close of June 30, 1982, and selected July 1, 1982, as the deemed sale date, old T's final return would consist of July 1, 1982 (*i.e.*, only one day).

(The reporting requirements of this section have been assigned OMB Control Number 1545-0702.)

Par. 3. A new section §5f.338-3 is added to read as follows:

§5f.338-3 Miscellaneous rules under section 224 of TEFRA.

(a) *Date of section 338 election for purposes of the LIFO recapture rule of the Miscellaneous Revenue Act of 1982*—(1) *In general.* Solely for purposes of section 403(b)(4)(D) of the Crude Oil Windfall Profit Tax Act of 1980, as added by section 101 of the Miscellaneous Revenue Act of 1982, an election under section 338(g) that could have been made during 1982 is considered to have been made during 1982 if an election under section 338(g) is actually made before the expiration of the time for making such an election.

(2) *Election that could have been made during 1982*—(i) *In general.* Except as provided in paragraph (a)(2)(ii) of this section, an election is considered one that could have been made during 1982 if the qualified

stock purchase as defined in section 338(d)(3) occurred before January 1, 1983.

(ii) *Transitional rule elections.* For transitional rule elections, an election is not considered made in 1982 unless the deemed sale date occurs in 1982. For selection of deemed sale date, see §5f.338-2(f).

(b) *Certain acquisitions of financial institutions*—(1) *In general.* The amendments made by section 224 of TEFRA do not apply to the acquisition of control (within the meaning of section 368(c)) of a financial institution in certain cases if the purchasing corporation elects out under section 224(d)(3) of TEFRA.

(2) *Manner of electing out.* A purchasing corporation is considered to elect out only if the requirements of section 224(d)(3) of TEFRA are satisfied and the purchasing corporation files a statement of election-out within 30 days after adoption of the plan of complete liquidation of the financial institution specified in section 224(d)(3)(C) (or by May 8, 1984, if later) with the Internal Revenue Service Center with which it files its annual income tax return.

(3) *Statement of election-out.* The heading of the statement of election-out should prominently identify the statement as an election-out under section 224(d)(3) of TEFRA. The statement must—

(i) Contain the name, address, and employer identification number of the purchasing corporation and financial institution,

(ii) Identify the election as an election-out under section 224(d)(3) of TEFRA,

(iii) Specify the date of entry into the binding contract to acquire control of the financial institution,

(iv) Specify the date of final approval of the last regulatory authority granting final approval of the acquisition,

(v) Specify the date of adoption of the plan of complete liquidation of the financial institution, and

(vi) Be signed by a person who states under penalties of perjury that he or she is authorized to make the election on behalf of the purchasing corporation.

(4) *Copy of statement of election-out attached to return of purchasing corporation.* A copy of the statement of election-out should be attached to the income tax return of the purchasing corporation for its taxable year in which the liquidation begins. Failure to attach the statement to that return will not invalidate the election-out.

(5) *Financial institution.* For purposes of this section, a financial institution is an entity described in section 585 or 593 or a bank holding company within the meaning of section 2(a) of the Bank Holding Company Act of 1956.

(6) *Adoption of plan of complete liquidation; date of final approval.* The statement of election-out is valid only if a plan of complete liquidation of the financial institution is adopted within 90 days after the date of final approval of the acquisition by the last regulatory authority granting approval. The date of final approval by the last regulatory authority includes, where applicable, the expiration date of the period under 12 U.S.C. §1849 within which the Attorney General is authorized to commence an action under the antitrust laws with respect to the acquisition (provided that no such action is commenced).

(7) *Election-out invalidates prior section 338 election.* A valid election-out invalidates a prior section 338 election made for the target financial institution. If a prior section 338 election has been made, the statement of election-out should indicate that such prior election is invalidated by the election-out.

(The reporting requirements of this section have been assigned OMB Control Number 1545-0702.)

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 338 and 7805 of the Internal Revenue Code of 1954 (96 Stat. 324, 26 U.S.C. 338; 68A Stat. 917, 26 U.S.C. 7805, respectively).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 25, 1984.

John E. Chapoton,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 7, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 8, 1984, 49 F.R. 4722)

Part III.—Corporate Organizations and Reorganizations
Subpart A.—Corporate Organizations

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Transfer to corporation controlled by transferor. Stock of a parent corporation, received by shareholders of a target corporation in a merger under sections 368(a)(1)(A) and 368(a)(2)(D) of the Code, will not be aggregated with stock of the parent received by a transferor of property to the parent in determining whether the control requirement of section 351 is met. Rev. Ruls. 68-357 and 76-123 distinguished.

Rev. Rul. 84-44

ISSUE

Under the facts described below, does section 351 of the Internal Revenue Code apply to the transfer of assets from *Y* to *P* in exchange for *P* stock?

FACTS

X, *Y* and *P* were unrelated corporations. In a transaction qualifying as a reorganization under sections 368(a)(1)(A) and (a)(2)(D) of the Code, *X* was merged into *S*, a wholly owned subsidiary of *P*. In the trans-

action, the shareholders of *X* received shares of *P* stock in exchange for their shares of *X* stock. At the same time, as part of an overall plan, *Y* transferred part (but less than substantially all) of its assets to *P* in exchange for *P* stock. While *Y* did not have the requisite control of *P* to qualify its transfer of assets within the provisions of section 351, *Y* together with the former shareholders of *X* were in control of *P* within the meaning of section 368(c) of the Code.

LAW AND ANALYSIS

Section 368(a)(2)(D) of the Code provides that the acquisition by one corporation, in exchange for stock of a corporation which is in control of the acquiring corporation, of substantially all of the properties of another corporation shall not disqualify the transaction under section 368(a)(1)(A) if no stock of the acquiring corporation is used in the transaction and the transaction would have qualified as a reorganization under section 368(a)(1)(A) had the merger been into the controlling corporation.

Section 351(a) of the Code provides that no gain or loss will be recognized if property is transferred to a corporation solely in exchange for its stock and immediately after the exchange the transferors are in control of the corporation (as defined in section 368(c)).

Although *P* stock was used as the consideration in the merger of *X* into *S*, the shareholders of *X* did not transfer any property to *P*. Therefore, since *P* is not the transferee of the stock of *X*, the *P* stock received by the shareholders of *X* is not taken into account with the *P* stock received by *Y* in determining whether the requirements of section 351 of the Code have been met. The only assets received by *P* were transferred by *Y*, and since *Y* was not in control of *P* immediately after the transfer, the transaction does not qualify under section 351. Additionally, since *P* is not the transferee of the *X* assets, the receipt of *P* stock by *X* upon the transfer of its assets to *S* cannot be aggregated with the *P* stock received by *Y* in determining whether the 80 percent control requirement of section 351 could be met by *X* and *Y*.

The instant case should be compared with Rev. Rul. 68-357, 1968-2 C.B. 144, and Rev. Rul. 76-123, 1976-1 C.B. 94. In those rulings, stock received by individual transferors was aggregated with stock received in reorganizations for purposes of the control requirement of section 351 of the Code when the transfers were to the same corporation.

HOLDING

Since the control requirement of section 351 of the Code was not met by *Y*, any gain or loss realized by *Y* on the exchange will be recognized as provided by section 1001 of the Code. No gain or loss is recognized to *P* under section 1032(a) upon the exchange with *Y* of *P* stock for assets of *Y*.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 68-357 and Rev. Rul. 76-123 are distinguished.

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26 CFR 1.351-1: Transfer to corporation controlled by transferors.
(Also Section 7805; 301.7805-1.)

Transfer to corporation controlled by transferors; continuity of interest. Upon reconsideration, the Service has concluded that the fact that "larger acquisitive transactions," such as those described in Rev. Ruls. 80-284 and 80-285, fail to meet the requirements for tax-free treatment under the reorganization provisions of the Code does not preclude the applicability of section 351(a) of the Code to transfers that may be described as part of such larger transactions. Rev. Ruls. 80-284 and 80-285 revoked.

Rev. Rul. 84-71

The Internal Revenue Service has reconsidered Rev. Rul. 80-284, 1980-2 C.B. 117, and Rev. Rul. 80-285, 1980-2 C.B. 119, in which transfers that satisfied the technical requirements of section 351(a) of the Internal Revenue Code were nevertheless held to constitute taxable exchanges because they were part of larger acquisitive transactions that did not meet the continuity of interest test generally applicable to acquisitive reorganizations.

In Rev. Rul. 80-284, fourteen percent of *T* corporation's stock was held by *A*, president and chairman of the board, and eighty-six percent by the public. *P*, an unrelated, publicly held corporation wished to purchase the stock of *T*. All the *T* stockholders except *A* were willing to sell the *T* stock for cash. *A* wished to avoid recognition of gain.

In order to accommodate these wishes, the following transactions were carried out as part of an overall plan. First, *P* and *A* formed a new corporation, *S*. *P* transferred cash and other property to *S* in exchange solely for all of *S*'s common stock; *A* transferred *T* stock to *S* solely in exchange for all of *S*'s preferred stock. These transfers were intended to be tax-free under section 351 of the Code. Second, *S* organized a new corporation, *D*, and transferred to *D* the cash it had received from *P* in exchange for all the *D* common stock. Third, *D* was merged into *T* under state law. As a result of the merger, each share of *T* stock, except those shares held by *S*, were surrendered for cash equal to the stock's fair market value and each share of *D* stock was converted into *T* stock.

Rev. Rul. 80-284 concluded that if a purported section 351 exchange is an integral part of a larger transaction that fits a pattern common to acquisitive reorganizations, and if the continuity of shareholder interest requirement of section 1.368-1(b) of the Income Tax Regulations is not satisfied with respect to the larger transaction, then the transaction as a whole resembles a sale and the exchange cannot qualify under section 351 because that section is not intended to apply to sales. Rev. Rul. 80-285 reached a similar conclusion with re-

spect to an asset, rather than stock, acquisition in which a purported section 351 exchange was also part of a larger acquisitive transaction.

Upon reconsideration, the Service has concluded that the fact that "larger acquisitive transactions," such as those described in Rev. Rul, 80-284 and Rev. Rul. 80-285, fail to meet the requirements for tax-free treatment under the reorganization provisions of the Code does not preclude the applicability of section 351(a) to transfers that may be described as part of such larger transactions, but also, either alone or in conjunction with other transfers, me the requirements of section 351(a).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-284 and Rev. Rul. 80-285 are revoked.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the conclusion of this revenue ruling will not be applied adversely to taxpayers who want to treat their transactions in accord with the position set forth in Rev. Rul. 80-284 or Rev. Rul. 80-285 and who either have consummated transactions before May 7, 1984, the date of publication of this revenue ruling in the Internal Revenue Bulletin, or consummate transactions after that date pursuant to terms of a binding written contract entered into before that date when such terms remain in effect on that date.

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26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Whether contingent or escrowed stock may be issued in a transaction described in section 351 of the Code. See Rev. Proc. 84-42, page 521.

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26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Whether the transfer of assets under section 351 of the Code, previously purchased by the taxpayer in accordance with the involuntary conversion provisions of sections 1033 and 1071, to its newly organized subsidiary disqualify the assets as eligible replacement property. See Rev. Rul. 84-29, page 181.

Subpart D.—Special Rules; Definitions

Section 367.—Foreign Corporations

26 CFR 1.367(a)-1: Ruling requests under section 367(a)(1) relating to certain transfers to a foreign corporation.
(Also Section 7477; 301.7477-1)

T.D. 7954

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 7—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976; PART 301—PROCEDURE AND ADMINISTRATION

Ruling Requests Relating To Certain Transfers By United States Persons To Foreign Corporations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the requirement that a ruling be obtained in order for a foreign corporation to be treated as a corporation for purposes of determining the amount of gain to be recognized on certain transfers by United States persons to foreign corporations. This Treasury decision conforms the present regulations under sections 367(a)(1) and 7477 to section 1042 of the Tax Reform Act of 1976 [1976-3 C.B. (Vol. 1) 1, 110]. The regulations provide the public with the guidance needed to obtain a ruling and affect United States persons transferring property to foreign corporations in exchanges, reorganizations, and certain liquidations and distributions. These final regulations supersede a portion of the temporary regulations published on December 30, 1977 (42 FR 65152) [T.D. 7530, 1978-1 C.B. 92].

DATES: This document is effective June 7, 1984 and applies to transfers of property made after June 7, 1984.

FOR FURTHER INFORMATION CONTACT: Mary Elizabeth Dean of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) and the Temporary Income Tax Regulations under the Tax Reform Act of 1976 (26 CFR Part 7) under section 367(a)(1), and the Regulations on Procedure and Administration (26 CFR Part 301) under section 7477, both of the Internal Revenue Code of 1954. These amendments conform the regulations to section 1042 of the Tax Reform Act of 1976 (90 Stat. 1634) and are issued under the authority contained in sections 367(a)(1) (90 Stat. 1634; 26 U.S.C. 367(a)(1)) and 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

A notice of proposed rulemaking on these matters was published in the FEDERAL REGISTER on December 27, 1982 (47 FR 57503) [LR-24-81, 1983-1 C.B. 977]. The comments received have been considered and taken into account as appropriate in the preparation of the final regulations contained in this document.

The portions of the temporary regulations published on December 30, 1977, relating to section 367(a)(1) are deleted on the date these final regulations become effective.

DISCUSSION

STATUTORY PROVISIONS

Section 367(a)(1), as added by section 1042 of the Tax Reform Act of 1976, relates to transfers of property by United States persons to foreign corporations in connection with an exchange described in section 332, 351, 354, 355, 356 or 361. The foreign corporation will not be considered to be a corporation for purposes of determining the amount of gain to be recognized on such a transfer unless it

is established to the satisfaction of the Secretary or his delegate that the exchange is not pursuant to a plan having the avoidance of Federal income taxes as one of its principal purposes. A determination is made pursuant to a ruling request filed not later than the close of the 183rd day after the beginning of the transfer. Transfers by a United States person of stock in a foreign corporation that is a party to the exchange or a party to the reorganization are subject to section 367(b) and the regulations issued pursuant to that section. To the extent exchanges and transfers are exempt from the section 367(a)(1) ruling requirement by regulations that may be issued under section 367(a)(2), the ruling requirement will not apply.

COMMENTS ON PROPOSED REGULATIONS

These final regulations reflect the significant comments received with respect to the proposed regulations.

Three comments concerned the definition of transfers described in section 367(a)(1). One comment requested clarification of the effect of paragraph (b)(2) of §1.367(a)-1, relating to certain triangular reorganizations involving indirect outbound transfers. The final regulations include language indicating the special rules in paragraph (b)(2) do not limit the application of the general rule in paragraph (b)(1). Thus, a direct transfer of property by a United States person to a foreign corporation in connection with a reorganization is a transfer described in section 367 (a)(1).

Paragraph (c)(3) of §1.367(a)-1 describes the minimum standards that must be satisfied in order for a ruling request to be filed. In response to the comment that some of the minimum standards appeared to be more stringent than current practice, the final regulations state that a general description of the types of property exchanged is sufficient and that the submission must satisfy the requirements in any revenue procedures applicable to the type of ruling requested.

A comment suggested that a request for a ruling under section 1492(2) should be treated as a request for a section 367(a)(1) ruling if the IRS subsequently determines that the transferee is an association taxable as a corportion. Paragraph (c)(3)(i) of the final regulations contains the rule that, if a taxpayer requests a ruling that a transfer to a foreign partnership is not pursuant to a plan having as one of its principal purposes the avoidance of Federal income taxes under section 1492 (2) and subsequently the IRS determines that the transferee is an association taxable as a corporation, then a later request for a section 367(a)(1) ruling may be filed and will be considered timely if filed before the close of the 60th day after the final administrative determination of the Internal Revenue Service that the entity is an association taxable as a corporation.

Two issues were raised concerning the time a transfer is considered to begin. Paragraph (c)(4)(ii) of the proposed regulations stated that a section 367(a)(1) transfer by an alien individual electing to be treated as a resident under section 6013(g) or (h) begins on the later of the date a timely section 6013(g) or (h) election is filed or the date the transfer is otherwise considered to begin. The final regulations clarify that this rule applies only for purposes of determining the timeliness of a request for a section 367(a)(1) ruling and does not affect the time the transfer is considered to occur under other income tax provisions. A comment pointed out that the rule in paragraph (c)(4)(v) for determining the date a conditional transfer begins would be clarified if the description of the relevant condition did not incorporate a special definition of a "favorable ruling" but instead referred to a ruling satisfactory to the parties to the transfer. The final regulations adopt this suggestion.

Paragraph (d)(3) of §1.367(a)-1 contains requirements regarding information to be attached to the transferor's income tax return. In response to a comment, the final regulations do not apply the penalty of voiding a favorable ruling for a failure to satisfy the requirements of paragraph (d)(3). However, the Internal Revenue Service intends to initiate a procedure whereby the district office having jurisdiction over the return of the taxpayer will be notified of any pending section 367 ruling request of the taxpayer and will be notified of the ultimate disposition of such request.

Paragraph (g)(1) of §1.367(a)-1 contains a definition of the term "United States person" for purposes of section 367(a)(1). The proposed regulations stated that a nonresident alien individual or a foreign corporation would not be considered a United States person merely because it carried on a U.S. trade or business. One comment questioned whether the use of the word "merely" implied that the IRS could consider a nonresident alien individual or foreign corporation to be a United States person for section 367(a)(1) purposes in some other circumstances. The word "merely" has been omitted in the final regulations to clarify that, other than in the case of an election under section 6013(g) or (h) or under section 1504(d), a nonresident alien individual or foreign corporation will never be considered a United States person under section 367(a)(1).

Certain comments received were considered but rejected. For example, one comment requested additional examples of specific variances that would be material. Paragraph (e)(3) contains a description of a material variance from the facts included in the ruling request. However, the facts and circumstances surrounding section 367(a)(1) transfers are so diverse that more specific examples could be misleading. Therefore, no examples were added.

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that these regulations do not have a significant impact on a substantial number of small entities. Accordingly, these regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The Commissioner of Internal Revenue has determined that the regulations are not subject to Executive Order 12291.

DRAFTING INFORMATION

The principal author of these regulations is Mary Elizabeth Dean of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

The following amendments to 26 CFR Part 1, 7, and 301 are hereby adopted as set forth below.

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. A new §1.367(a)-1 is added, immediately after §1.362-2, to read as follows:

§1.367(a)-1 Ruling requests under section 367(a)(1) relating to certain transfers to a foreign corporation.

(a) *Introduction*—(1) *General rule.* For purposes of determining the amount of gain to be recognized on a transfer of property by a United States person to a foreign corporation in connection with an exchange described in section 332, 351, 354, 355, 356, or 361, the foreign corporation shall not be considered a corporation unless, pursuant to a request for a ruling filed not later than 183 days after the beginning of the transfer, it is established to the satisfaction of the Commissioner that the exchange is not pursuant to a plan having the avoidance of Federal income taxes as one of its principal purposes. Transfers subject to this section are described in paragraph (b) of this section. The time and manner for filing ruling requests is set forth in paragraph (c) of this section. Persons who are to request rulings are described in paragraph (d) of this section. The consequences of failure to comply with this section are described in paragraph (e) of this section. The procedure for the protest and appeal of a ruling is described in paragraph (f) of this section. Terms used in this section are defined in paragraph (g) of this section.

(2) *Section 367(a)(2) exception.* This section shall not apply to exchanges and transfers described in regulations that may be issued under section 367(a)(2) to the extent such regulations except the exchanges and transfers from the requirements of this section.

(b) *Transfers described in section 367(a)(1)*—(1) *General rule.* A transfer described in section 367(a)(1) is a transfer of property, other than stock or securities of a foreign corporation that is a party to the exchange or a party to the reorganization (as defined in section 368(b)), made directly, indirectly, or constructively by a United States person (as defined in paragraph (g)(1) of this section) to a foreign corporation in connection with an exchange described in section 332, 351, 354, 355, 356, or 361. Thus, a transfer of stock of a foreign corporation by a United States person to another foreign corporation pursuant to a reorganization described in section 368(a)(1)(B) is not a transfer described in section 367(a)(1) because the foreign corporation whose stock is transferred is a party to the reorganization, even though that foreign corporation may not be a party to other types of reorganizations or exchanges for which the transaction also qualifies. Such transfer is subject to the rules of §7.367(b)-4(b). The following special rules apply in determining whether certain transfers of property are transfers described in section 367(a)(1).

(2) *Reorganizations involving indirect transfers*—(i) *Mergers.* A transfer in connection with a reorganization described in section 368(a)(1)(A) to which either section 368(a)(2)(D) or (E) applies may be a transfer described in section 367(a)(1) if the reorganization involves the merger of two domestic corporations and if stock of a foreign corporation which controls one of such domestic corporations is exchanged in such reorganization. The transfers in connection with such a reorganization that are described in section 367(a)(1) are as follows—

(A) *Reorganizations described in section 368(a)(1)(A) to which section 368(a)(2)(D) applies.* A domestic corporation is considered to make a transfer of property described in section 367(a)(1) if it transfers substantially all its properties to another domestic corporation in connection with a reorganization described in section 368(a)(1)(A) to which section 368(a)(2)(D) applies and if the controlling corporation (within the meaning of section 368(a)(2)(D)) is a foreign corporation. The rule of this paragraph (b)(2)(i)(A) is illustrated by the following example.

Example. F, a foreign corporation, owns all the stock of S, a domestic corporation. In a reorganization described in section 368(a)(1)(A) to which section 368(a)(2)(D) applies, S acquires substantially all the properties of W, a domestic corporation, in a merger of W into S. The stock of F is used as consideration. The reorganization includes an indirect asset transfer described in section 367(a)(1) by W.

(B) *Reorganizations described in section 368(a)(1)(A) to which section 368(a)(2)(E) applies.* [Reserved].

(ii) *Reorganizations described in section 368(a)(1)(B).* . n exchanging shareholder who is a United States person is considered to make a transfer described in section 367(a)(1) if, in connection with a reorganization described in section 368(a)(1)(B), such shareholder exchanges his stock in a domestic corporation for voting stock of a foreign corporation that is in control (as defined in section 368(c)) of the domestic acquiring corporation. The rule of this paragraph (b)(2)(ii) is illustrated by the following example.

Example. F, a foreign corporation, owns all the stock of S, a domestic corporation. In a reorganization described in section 368(a)(1)(B), S acquires all the stock of domestic corporation Y, and the shareholders of Y receive voting stock of F. The reorganization includes an indirect stock transfer described in section 367(a)(1) by those shareholders of Y who are United States persons.

(iii) *Reorganizations described in section 368(a)(1)(C).* A domestic corporation is considered to make a transfer described in section 367(a)(1) if it transfers substantially all of its properties to another domestic corporation in connection with a reorganization described in section 368(a)(1)(C) and if it receives voting stock in a foreign corporation that is in control (as defined in section 368(c)) of the acquiring corporation. The rule of this paragraph (b)(2)(iii) is illustrated by the following example.

Example. F, a foreign corporation, owns all the stock of S, a domestic corporation. In a reorganization described in section 368(a)(1)(C), S acquires substantially all the properties of Z, a domestic corporation, and Z receives voting stock of F. The reorganization includes an indirect asset transfer described in section 367(a)(1) by Z, whether Z retains the stock of F or distributes the stocks to its shareholders and whether the shareholders of Z are United States persons or foreign persons.

(3) *Transfers by partnerships.* A transfer of property by a United States person indirectly to a foreign corporation results from a transfer of property by a partnership (whether foreign or domestic) to a foreign corporation in an exchange described in section 367(a)(1), to the extent that the partnership property transferred to the foreign corporation is attributable to partnership interests held by one or more United States persons. Attribution of partnership assets to interests held by United States persons shall be determined under the rules and principles of sections 701 through 761 of the Internal Revenue Code and the regulations thereunder. The rule of this paragraph (b)(3) is illustrated by the following example.

Example. P is a partnership having five equal general partners, two of whom are United States persons. P transfers property to F, a foreign corporation, in connection with an exchange described in section 351. The exchange includes an indirect transfer of property by the partners to F. The transfers of property attributable to those partners who are United States persons, that is, 40 percent of each asset transferred to F, are transfers described in section 367(a)(1). The gain (if any) recognized on the transfer of 40 percent of each asset to F is attributable to the two partners who are United States persons.

(4) *Transfers by trusts and estates.* Except as otherwise provided in paragraph (b)(5) of this section, a transfer of property by a trust or an estate to a foreign corporation in an exchange described in section 367(a)(1) is considered a direct, indirect, or constructive transfer by a United States person only if the trust or estate is a domestic trust or a domestic estate. Except as otherwise provided in paragraph (b)(5) of this section, a transfer by a foreign trust or foreign estate (as defined in section 7701(a)(31)) is not a transfer described in section 367(a)(1). These rules apply irrespective of whether the beneficiaries of the trust or estate are United States persons or foreign persons.

(5) *Transfers by grantor trusts.* A transfer of a portion or all of the assets of a foreign or domestic trust to a foreign corporation in an exchange described in section 367(a)(1) is considered a transfer by any United States person who is treated as the owner of any such portion or all of the assets of the trust under section 671 through 679.

(6) *Termination of election under section 1504(d).* The termination of an election under section 1504(d), relating to treatment of certain contiguous country corporations as domestic corporations, shall be considered to be a transfer of property by a domestic corporation to a foreign corporation. The characterization of the transfer for purposes of section 367(a)(1) depends on the facts and circumstances. The rule of this paragraph (b)(6) is illustrated by the following examples.

Example 1. Domestic corporation Y previously made a valid election under section 1504(d) to have its wholly owned Canadian subsidiary, C, treated as a domestic corporation. On July 1, 1983, C fails to continue to qualify for the election under section 1504(d). A constructive reorganization described in section 368(a)(1)(D) occurs, and the constructive transfer of assets by "domestic" corporation C to Canadian corporation C included in that reorganization is a transfer described in section 367(a)(1).

Example 2. Domestic corporation Z previously made a valid election under section 1504(d) to have its wholly owned Canadian subsidiary, S, treated as a domestic corporation. On August 1, 1983, Z sells all the stock of S to an unrelated United States person. Because S is no longer directly or indirectly wholly owned or controlled by Z, it is no longer subject to the section 1504(d) election. No direct, indirect, or constructive transfer described in section 367(a)(1) has occurred.

(7) *Changes in classification of an entity.* If a foreign entity is classified as an entity other than an association taxable as a corporation for United States tax purposes, and subsequently a change is made in the governing documents, articles, or agreements of the entity so that the entity is thereafter classified as an association taxable as a corporation, the change in classification is considered a transfer of property to a foreign corporation in connection with an exchange described in section 351. For purposes of section 367(a)(1), the transfer of property is considered as made by the persons determined under the rules set forth in paragraph (b)(3) of this section, with respect to partnerships, and paragraph (b)(4) or (5), with respect to trusts and estates, and the rules of such paragraphs apply in determining whether a transfer described in section 367(a)(1) has been made.

(8) *Contributions to capital.* For rules with respect to treating a contribution to the capital of a foreign corporation as a transfer described in section 367(a)(1), see section 367(c)(2) and the regulations thereunder.

(c) *Time and manner of filing a request for a section 367(a)(1) ruling—* (1) *In general.* A request for a ruling that a transfer of property in connection with an exchange described in section 367(a)(1) is not a transfer pursuant to a plan (as defined in paragraph (c)(5) of this section) having the avoidance of Federal income taxes as one of its principal purposes must be filed no later than the close of the 183d day after the beginning of the transfer (as defined in paragraph (c)(4) of this section). A favorable ruling (as defined in paragraph (g)(2) of this section) will not be issued with respect to a ruling request that does not meet the requirements of this paragraph (c).

(2) *Delivery and filing.* A request for a ruling under this section shall be delivered during regular business hours to the Commissioner of Internal Revenue. Attn: CC:IND:S, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. If the ruling request is delivered by United States mail, the provisions of section 7502 and the regulations thereunder shall apply in determining the date of delivery. A request for a ruling under this section is considered to be filed on the date that the documents which satisfy the minimum standards described in paragraph (c)(3) of this section are delivered to the Commissioner.

(3) *Minimum standards*—(i) *Requirements.* A request for a ruling under section 367(a)(1) must—

(A) Set forth all the facts and circumstances relating to the plan in sufficient detail to apprise the Commissioner of the nature of the plan and the purpose for which the request is submitted.

(B) Set forth a general description of all types of property (other than U.S. currency if its transfer does not affect the type of exchange or reorganization that occurs) to be transferred,

(C) Be accompanied by a written copy (if any) of the plan of reorganization or exchange.

(D) Be submitted in accordance with the procedural rules set forth in 26 CFR 601.201(e) (Statement of Procedural Rules) and in substantial compliance with each revenue procedure relating to one or more of the requests in the ruling request submitted, and

(E) Be executed by the person filing the request or the corporation or partnership described in paragraph (d) of this section, under penalties of perjury. If, however, the classification of an entity which is a transferee is determined to be an association taxable as a corporation and the transferor first learns of this determination after filing an otherwise timely and proper request for a ruling under section 1492(2), then a later request for a ruling under section 367(a)(1), supplementing or amending the earlier request under section 1492(2), will be considered timely if filed no later than the close of the 60th day after the administrative determination of the Internal Revenue Service that the entity is an association taxable as a corporation has become final (without regard to the pendency or likely pendency of this determination before a court). The later request must satisfy the minimum standards of paragraph (c)(3)(i). The filing of a later request will not be considered an admission of association status.

(ii) *Failure to satisfy minimum standards.* A request for a ruling that (*A*) does meet substantially, but not fully, the minimum standards of paragraph (c)(3)(i)(A) and (B) of this section (without regard to whether the standards of paragraph (c)(3)(i)(C), (D) and (E) are met), or (*B*) fully meets the minimum standards of paragraph (c)(3)(i)(A) and (B) but does not meet the minimum standards of paragraph (c)(3)(i)(C), (D), or (E) of this section will be acknowledged and the person submitting the request will be notified in writing of the minimum standards that have not been satisfied. If the information or materials necessary to satisfy the minimum standards are then delivered to the Internal Revenue Service within 60 days of the date of the letter notifying the taxpayer of the failure, that information or materials will be treated as if received with the original submission of the request for a ruling. If the information or materials necessary to satisfy the minimum standards are not delivered within the 60-day period, the ruling request will not be treated as filed on the date the original ruling was delivered. Such additional information or materials delivered after the 60-day period will instead be treated (together with the original submission) as a new request for a ruling delivered and filed on the date the additional information or materials are received, but only if the minimum standards of paragraph (c)(3)(i) of this section are satisfied by all the information and materials submitted. The date on which the additional information or materials required by this paragraph (c)(3)(ii) are considered to be delivered shall be determined by the same rules as those set forth in paragraph (c)(2) of this section, which apply to the delivery and filing of ruling requests.

(iii) *Requests for additional information.* If the minimum standards described in paragraph (c)(3)(i) of this section are satisfied but additional information or materials are required to make a determination under this section, the Internal Revenue Service will request the additional information or materials. The person requesting the ruling shall deliver the information or materials to the Internal Revenue Service within 30 days of the date of the request for such information or materials, or shall deliver within such 30-day period a written statement explaining why the information or materials are unavailable. The request for additional information or materials will not alter the date the ruling request is considered as filed. However, unless the taxpayer establishes reasonable cause for not timely providing the information or materials, the Commissioner may decline to make a determination until the requested information or materials are provided or, as in any case, may issue an unfavorable ruling under the ruling guidelines. In determining whether reasonable cause exists for failure to provide the additional information or materials, the significance of such information or materials to the determination of the Commissioner as to whether a favorable ruling should be issued shall be taken into account. The date on which the additional information or materials or statement required by this paragraph (c)(3)(iii) are considered to be delivered shall be determined pursuant to the same rules as those set forth in paragraph (c)(2) of this section, which apply to the delivery and filing of ruling requests.

(4) *Beginning of a transfer*—(i) *In general.* A transfer described in section 367(a)(1) will be considered to begin on the earliest date on which title, possession of, or right to the use

of stock, securities, or other property passes pursuant to the plan for purposes of subtitle A of the Internal Revenue Code. A transfer will not be considered to begin with a decision of a board of directors or similar action unless the transaction otherwise takes effect for purposes of subtitle A of the Internal Revenue Code on that date.

(ii) *U.S. resident under section 6013 (g) or (h).* For purposes of determining the timeliness of a request for a ruling under this section, a transfer made by an alien individual who is considered to be a United States resident by reason of a timely election made under section 6013 (g) or (h) will be considered to begin—

(A) On the date such election under section 6013 (g) or (h) is made, if such date is later than the date the transfer otherwise would be considered to begin under this section, or

(B) On the date the transfer otherwise would be considered to begin under this section, if such date is later than the date the election under section 6013 (g) or (h) is made.

The rule of this paragraph (c)(4)(ii) is illustrated by the following example.

Example. D is a nonresident alien individual who is married to a United States citizen. On March 1, 1983, D transfers property to a foreign corporation in an exchange described in section 351. On April 15, 1984, D and the spouse timely file an election under section 6013(g) with their tax return for the taxable year ended December 31, 1983, for D to be treated as a United States resident. The election is effective on January 1, 1983. For purposes of determining the timeliness of a request for a ruling, the transfer described in section 367(a)(1) made by D in connection with the section 351 exchange is considered to begin on April 15, 1984, the date on which the timely election was made under section 6013(g).

(iii) *Termination of section 1504(d) election.* A transfer deemed to occur as a result of the termination of an election under section 1504(d) will be considered to begin on the date the contiguous country corporation first fails to continue to qualify for the election under section 1504(d). The rule of this paragraph (c)(4)(iii) is illustrated by the following example.

Example. Domestic corporation W previously made a valid election under section 1504(d) to have its Mexican subsidiary, S, treated as a domestic corporation. On August 1, 1984, W disposes of its right, title, and interest in 10 percent of the stock of S by selling such stock to an unrelated United States person who is not a director of S. S first fails to continue to qualify for the election under section 1504(d) on August 1, 1984, since on such date it ceases to be directly or indirectly wholly owned or controlled by W. The constructive transfer of assets from "domestic" corporation S to Mexican corporation S is considered to begin on that date.

(iv) *Change in classification.* A transfer deemed to occur as a result of a change in classification of an entity caused by a change in the governing documents, articles, or agreements of the entity (as described in paragraph (b)(7) of this section) will be considered to begin on the date such changes take effect for purposes of subtitle A of the Internal Revenue Code.

(v) *Conditional transfers.* A transfer will be considered to begin on the date otherwise determined under paragraph (c)(4)(f) through (iv) of this section even though it is made subject to a condition that if there is a failure to obtain a ruling from the Commissioner that is satisfactory to the parties to the transaction, the transaction will not be consummated and to the extent possible the assets transferred will be returned. The rule of this paragraph (c)(4)(v) relates only to determining the date on which a transfer is considered to begin for purposes of section 367(a)(1) and does not have any substantive effect on the tax consequences arising from the rescission of or failure to consummate a transaction.

(5) *Transfers pursuant to a plan.* For purposes of this section, transfers pursuant to a plan are direct, indirect, and constructive transfers of property in connection with an exchange described in section 332, 351, 354, 355, 356, or 361. A transfer may be pursuant to a plan even though it is not described in any document relating to the plan, and a transfer described in a document relating to a plan is not necessarily made pursuant to the plan. The rule of this paragraph (c)(5) is illustrated by the following example.

Example. X, a domestic corporation, exchanges stock of Y corporation for voting stock of F, a foreign corporation, in a reorganization described in section 368(a)(1)(B). The documents describing the exchange also describe a lease of Blackacre by X to F for a five-year term at a fair market rental value. The exchange of Y stock for F voting stock is pursuant to the plan of reorganization. The transfer of the leasehold interest in Blackacre to F is not pursuant to the plan of reorganization.

(d) *Persons who must request rulings*—(1) *In general.* Any United States person who makes a direct, indirect, or constructive transfer of property to which this section applies must request a ruling as provided in paragraph (c) of this section, receive a favorable ruling, and comply with paragraph (d)(3) of this section for the foreign corporation to be considered to be a corporation, within the meaning of sections 332, 351, 354, 355, 356, or 361, for purposes of determining the amount of gain to be recognized by the United States person.

(2) *Special rules for shareholders and partners*—(i) *Shareholders.* A corporation may request a ruling on behalf of its shareholders who are transferors of its stock with respect to a single plan and for whom the tax consequences of the transfers will be determined in the same manner. Each such shareholder who satisfies the requirements of paragraph (d)(3) of this section will be considered to be a person who requested the ruling, except that any shareholder who requested a separate ruling cannot be so considered. The rule of this subdivision (i) is illustrated by the following example.

Example. All the shareholders of domestic corporation X transfer their stock of X to foreign corporation F solely in exchange for voting stock of F in a reorganization described in section 368(a)(1)(B). X may request a ruling with respect to the plan on behalf of all of its shareholders who are United States persons, since the gain or loss realized by each such shareholder on the exchange of stock and the basis in the stock of F received is determined in the same manner, even though each such shareholder may have a different basis and holding period with respect to stock of X. Each such shareholder who satisfies the requirements of paragraph (d)(3) of this section will be treated as a person who requested the ruling. Each such shareholder also has the opportunity to request a separate ruling that will have effect only for that shareholder, but if a separate request is made, the shareholder cannot be treated as requesting the ruling obtained by the corporation on behalf of its shareholders. If neither a shareholder nor the corporation on behalf of the shareholder timely requests a rul-

ing and receives a favorable ruling, the shareholder will not be entitled to nonrecognition of gain under section 354.

(ii) *Partners.* A partnership may request a ruling on behalf of its partners who are considered transferors either of property of the partnership or of interests in the partnership pursuant to a single plan and for whom the tax consequences of the transfers will be determined in the same manner. Each such partner who satisfies the requirements of paragraph (d)(3) of this section will be considered to be a person who requested the ruling, except that any partner who requested a separate ruling cannot be so considered.

(3) *Attachments to tax return.* Any taxpayer to whom this section applies shall file with its income tax return for any period during which one or more transfers subject to section 367(a)(1) and this section begins either—

(i) A copy of any ruling relating to the transfer that is received by or on behalf of the taxpayer prior to filing the return,

(ii) If a ruling has been requested but has not been received prior to filing the return, a written summary of any ruling request relating to the transfer that has been filed by or on behalf of the taxpayer, indicating the date it was filed, or

(iii) If no ruling request relating to the transfer has been filed, a written statement disclosing—

(A) That the transfer is subject to section 367(a)(1),

(B) That no ruling relating to the transfer has been requested by or on behalf of the taxpayer,

(C) The date of the beginning of the transfer (as defined in paragraph (c)(4) of this section), and

(D) Whether the taxpayer intends to file a request for a ruling relating to the transfer within the time limit specified in paragraph (c)(1) of this section.

A copy of any ruling received after the return is filed or a statement that the ruling request has been withdrawn shall be forwarded by the person who requested the ruling to the district director or the service center where the return was filed within 60 days of the receipt or withdrawal, together with an identification of the return to which the ruling or statement relates. Any amended return that is required due to the ruling or the withdrawal of the ruling request must also be submitted with the ruling or statement.

(e) *Failure to comply with section 367(a)(1)*—(1) *Action or inaction constituting a failure to comply.* A taxpayer fails to comply with section 367(a)(1) and this section if, with respect to a transfer described in section 367(a)(1) to which this section applies, either—

(i) The taxpayer fails to obtain a favorable ruling (as defined in paragraph (g)(2) of this section) with respect to the transfer,

(ii) The taxpayer fails to comply with all of the terms and conditions imposed as part of a favorable ruling, or

(iii) The plan is carried out in a manner that constitutes a material variance (as defined in paragraph (e)(3) of this section) from the plan as described in the ruling request.

(2) *Consequences of failure to comply.* Except as provided in paragraph (e)(4) of this section, if a taxpayer fails to comply with section 367(a)(1) and this section with respect to a transfer described in section 367(a)(1) a foreign corporation shall not be considered to be a corporation for purposes of determining the amount of gain to be recognized on the transfer and of determining the basis of property transferred or received. For all other purposes, including the determination of whether a loss shall be recognized and whether corporate attributes shall be carried over pursuant to section 381, the foreign corporation shall be considered to be a corporation. Any loss realized but not recognized on a transfer described in section 367(a)(1) does not reduce the amount of gain realized or recognized on any other transfer described in section 367(a)(1), regardless of whether both transfers are made pursuant to the same plan.

(3) *Material variance*—(i) *In general.* Whether a variance is a material variance is a determination within the discretion of the Commissioner and will be made on a case-by-case basis. In general, a material variance is a variance to which the Commissioner would reasonably attach importance in determining whether the transfer was pursuant to a plan having the avoidance of Federal income taxes as one of its principal purposes. A variance is material if, had it been known by the Commissioner, it would have had an influence or bearing on his determination. The variance need not directly control the determination contained in the ruling to be material. Examples of a variance that is not material may include a relatively insignificant overstatement or understatement of the value of assets transferred if such overstatement or understatement does not affect the type of exchange or reorganization that occurs.

(ii) *Taxable transfers disclosed in a ruling request.* If a transfer is disclosed in a ruling request that is filed more than 183 days after the transfer began, such transfer (although taxable) will not constitute a variance from the plan as described in the ruling request. A favorable ruling may be issued with respect to other transfers pursuant to the same plan which begin no more than 183 days before the ruling request is filed.

(iii) *Transfers covered by separate or amended ruling request.* If a material variance would result from the execution of a particular transfer pursuant to a plan, which transfer is not described in a ruling request that is filed timely with respect to other transfers pursuant to the same plan, a favorable ruling may nevertheless be obtained with respect to all transfers pursuant to the plan—

(A) If a separate ruling request is timely filed with respect to the omitted transfer and if all other transfers described in the initial ruling request are also described in such separate ruling request, or

(B) If the initial ruling request is still pending, an amendment to the initial ruling request describing the

omitted transfer is filed timely with respect to such transfer.

The rules of this subdivision (iii) apply only if the omitted transfer is described in accordance with the minimum standards set forth in paragraph (c)(3) of this section.

(iv) *Cash transfers.* No ruling under section 367(a)(1) is required with respect to the transfer of solely U.S. currency to a foreign corporation. The undisclosed transfer of U.S. currency to a foreign corporation in connection with an exchange described in section 367(a)(1) generally will not constitute a material variance from the plan as described in the ruling request unless such transfer affects the type of exchange or reorganization that occurs.

(4) *Exception.* The failure to comply with section 367(a)(1) and this section may not be used by the taxpayer to its advantage. In those situations the Commissioner deems appropriate, a foreign corporation will be treated as a corporation even if the taxpayer fails to comply with section 367(a)(1).

(f) *Protests and appeals*—(1) *Administrative remedies.* A person requesting a ruling under this section (including the corporation or partnership that requests a ruling on behalf of its shareholders or partners under paragraph (d) of this section) may file an administrative protest of a ruling not later than the 45th day after the date of the ruling letter. The protest must include a copy of the ruling letter, the reason for the protest (including the grounds of the protest and arguments in support thereof), a statement as to whether a conference is requested, and the names of the persons expected to attend the conference if one is requested. A protest that meets the requirements of this paragraph (f)(1) is considered to be filed upon delivery to the Commissioner pursuant to the rules of paragraph (c)(2) of this section, which apply to the delivery and filing of ruling requests.

(2) *Judicial appeals.* Provisions for petitioning the United States Tax Court with respect to a transfer subject to section 367(a)(1) and this section are set forth in section 7477 and the regulations thereunder. Such a proceeding is the exclusive means for obtaining judicial review of the determination of the Commissioner.

(g) *Definitions.* The following definitions apply for purposes of this section.

(1) *United States person.* The term "United States person" includes those persons described in section 7701(a)(30). Such term includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and any estate or trust other than an estate or trust described in section 7701(a)(31) as a foreign estate or foreign trust. For purposes of this section, an individual with respect to whom an election has been made under section 6013 (g) or (h) is considered to be a resident of the United States while such election is in effect. A nonresident alien or a foreign corporation will not be considered a United States person because of its actual or deemed conduct of a trade or business within the United States during a taxable year. Nor will a nonresident alien individual be considered to be a United States person solely on the basis that such individual has been present in the United States for 183 days or more during the taxable year.

(2) *Favorable ruling.* A favorable ruling is a ruling that a transfer described in section 367(a)(1) is not in connection with an exchange pursuant to a plan having the avoidance of Federal income taxes as one of its principal purposes, including such a ruling that is subject to terms and conditions.

PART 7—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

§§7.367(a)-1 and 7.367-2 [Removed]

Par. 2. Sections 7.367(a)-1 and 7.367-2 are removed.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. Section 301.7477-1 is amended by revising paragraph (a)(3) and the last sentence of paragraph (b)(2) to read as follows:

§301.7477-1 Declaratory judgments relating to transfers of property from the United States.

(a) *Petition*—***

(3) *Beginning of exchange.* An exchange generally shall be considered to begin upon the beginning of the first transfer of property pursuant to the plan under which the exchange is to be made. For rules determining the beginning of a transfer see §1.367(a)-1(c)(4).

*****

(b) Judgment—***

(2) *Exhaustion of administrative remedies.* *** In no event shall the Internal Revenue Service be deemed to have had a reasonable time to act if a failure to act has occurred because the petitioner did not proceed with due diligence or because the petitioner has not provided all available information or materials reasonably requested by the Internal Revenue Service.

* * * * *

This Treasury decision is issued under the authority contained in sections 367(a)(1) (90 Stat. 1634, 26 U.S.C. 367(a)(1)) and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Internal Revenue Code of 1954. Approved by the Office of Management and Budget under control number 1545-0719.

ROSCOE L. EGGER, Jr.,
Commissioner of Internal Revenue.

Approved April 20, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury

(Filed by the Office of the Federal Register on May 7, 1984, 8:45 p.m., and published in the issue of the Federal Register for May 8, 1984, 49 F.R. 19460)

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Reorganizations; continuity of

proprietary interest. The continuity of proprietary interest requirement of section 1.368-1(b) of the regulations is satisfied when the stock of the acquiring corporation, given in exchange for the acquired corporation, is distributed through the acquired corporation's 100 percent corporate shareholder, to its 100 percent corporate shareholder.

Rev. Rul. 84-30

ISSUE

Whether the continuity of proprietary interest requirement of section 1.368-1(b) of the Income Tax Regulations is satisfied in the following situation.

FACTS

Corporation *X* owns all the stock of corporations, *Y* and *Z*. *Z* in turn, owns all the stock of corporation *N*. This relationship has existed for many years, during which each corporation has been engaged in the active conduct of a separate trade or business.

Pursuant to an integrated plan of acquisition adopted for good business reasons, *Y* acquired substantially all of the assets of *N* solely in exchange for shares of *Y* voting stock and the assumption by *Y* of the liabilities of *N*. *N* was liquidated and the *Y* stock received by *N* was distributed to *Z* and then immediately by *Z* to *X*.

LAW AND ANALYSIS

Section 368(a)(1)(C) of the Internal Revenue Code defines the term "reorganization" to include an acquisition by one corporation, in exchange solely for all or part of its voting stock (or voting stock of its parent), of substantially all of the properties of another corporation.

Section 1.368-1(b) of the regulations provides that requisite to a reorganization under the Code is a continuity of interest in the business enterprise under modified corporate form on the part of those persons who, "directly or indirectly", were the owners of the enterprise prior to the reorganization. This section further explains that the purpose of this requirement is to insure that the exceptions to the general rule of taxability are limited to readjustments of corporate structures that are required by business exigencies and that effect only a readjustment of continuing interest in property under modified corporate forms.

The "directly or indirectly" phrase in section 1.368-1(b) of the regulations clearly encompasses the transferor corporation (*N* in this case) as the direct owner of the business enterprise prior to the reorganization and the shareholders of the transferor corporation (*Z* in this case), who through their ownership of the corporation are the indirect owners of the enterprise. See Rev. Rul. 66-23, 1966-1 C.B. 67. The question presented is if the transferor corporation is a wholly owned subsidiary of another corporation does such corporation's sole shareholder (*X* in this case) also qualify as an indirect owner of the business enterprise.

In Rev. Rul. 62-138, 1962-2 C.B. 95, a realty corporation (Realty) engaged in two active businesses transferred one of them, which represented less than "substantially all" of its assets, to a newly created corporation (Newco) in exchange for all of its stock and distributed that stock to its sole shareholder, a banking corporation (Banking), also in the active conduct of a business. Banking, in turn, distributed the stock of Newco to its shareholders. Rev. Rul. 62-138 holds that the successive distributions of stock qualify for nonrecognition pursuant to section 355. The ruling concludes that the overall transaction satisfies the continuity of interest requirement under section 1.355-2(c) of the regulations. Although Banking, the immediate shareholder of Realty, did not retain the Newco stock, the shareholders of Banking qualified as indirect owners of Realty within the meaning of section 1.355-2(c) inasmuch as Banking owned 100 percent of Realty. As Rev. Rul. 62-138 states:

> In the instant case, there is no change in the aggregate interests held by the banking corporation's shareholders, no new parties in interest were added as a result of the transaction and none were eliminated. The shareholders after the transaction held the same enterprises in modified corporate form as before the transaction and the corporate enterprises were continued as such.

As in Rev. Rul. 62-138, the distribution by *Z* of the *Y* stock to *X* does not result in a change in *X's* aggregate interests, because *X* was the 100 percent parent of *Z*, which, in turn, owned all of *N*. Accordingly, the distribution of *Y* stock by *Z* to *X* did not violate the continuity of proprietary interest requirement because *X* was an indirect owner of *N* within the meaning of such phrase in section 1.368-1(b) of the regulations.

HOLDING

The continuity of proprietary interest requirement of section 1.368-1(b) of the regulations is satisfied when the stock of the acquiring corporation given in exchange for the acquired corporation is distributed through its 100 percent parent corporation to such corporation's 100 percent parent.

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26 CFR 1.368-2: Definitions of terms.

Whether contingent or escrowed stock may be issued in transactions described in sections 368(a)(1)(A), 368(a)(1)(B), 368(a)(1)(C), 368(a)(1)(D), and 368(a)(1)(E) of the Code. See Rev. Proc. 84-42, page 521.

Subchapter D.—Deferred Compensation, etc.
Part I.—Pension, Profit-Sharing, Stock Bonus Plans, etc.
Subpart A.—General Rule

Section 401.—Qualified Pension, Profit-Sharing and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.

Procedures for employers to obtain determination letters on certain Service-issued Model Plans. See Rev. Proc. 84-7, page 373.

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26 CFR 1.401-3: Requirements as to coverage. (Also Section 411; 1.411(a)-4.)

Estimated primary insurance amount in offset plans. A defined benefit offset plan that uses estimated wages for an employee in de-

termining that employee's old-age insurance benefit provided under the Social Security Act fails to satisfy the nondiscriminatory requirements of sections 401(a)(4) and (5) of the Code and the minimum vesting requirements of section 411 unless certain conditions are satisfied. Rev. Rul. 71-446 clarified and modified.

Rev. Rul. 84-45

ISSUE

Whether a defined benefit offset plan that uses estimated wages for an employee in determining that employee's old-age insurance benefit provided under the Social Security Act fails to satisfy the nondiscrimination requirements of sections 401(a)(4) and (5) of the Internal Revenue Code and the minimum vesting requirements of section 411.

FACTS

A defined benefit plan is integrated with old-age, survivors, and disability insurance benefits by offsetting the retirement benefit otherwise payable to a participant by 83⅓ percent of the old-age insurance benefit payable to such participant under the Social Security Act. The plan's retirement benefit is an annuity payable at age 65 for the life of a participant. The plan does not provide benefits upon death, disability or early retirement. All optional forms of benefit (including a qualified joint and survivor annuity) are the actuarial equivalent of the life annuity.

In determining the actual benefits to be paid under the plan, a participant's old-age insurance benefits under the Social Security Act are calculated by estimating the participant's compensation (rather than using actual compensation) for years before the year of the participant's separation from service on or before retirement. Further, in the case of a participant who separates from service before age 65, the social security old-age insurance benefit is determined under the plan on the assumption that the participant continues to receive compensation until age 65 at the same rate as the participant was receiving compensation at the time of his or her separation from the service of the employer.

LAW AND ANALYSIS

Section 401(a)(4) of the Code provides that a plan will not satisfy the qualification requirements of section 401(a) if the contributions and benefits provided under the plan discriminate in favor of employees who are officers, shareholders, or highly compensated.

Section 401(a)(5) of the Code provides that a plan shall not be considered discriminatory within the meaning of section 401(a)(4) merely because the contributions or benefits based on that part of an employee's remuneration which is excluded from "wages" by section 3121(a)(1) (relating to the Federal Insurance Contributions Act) differ from the contributions or benefits based on an employee's remuneration not so excluded.

Section 1.401-3(e) of the Income Tax Regulations establishes the general basis for the integration of pension, annuity, profit-sharing and stock bonus plans with old-age, survivors, and disability insurance benefits provided under the Social Security Act (OASDI benefits).

Rev. Rul. 71-446, 1971-2 C.B. 187, provides additional rules for the integration of plans with old-age, survivors and disability insurance benefits provided under the Social Security Act. Section 2.07 of Rev. Rul. 71-446 defines, in part, an "offset plan" as a plan under which all the provisions including the benefit rates apply uniformly to all covered employees regardless of compensation, except that an employee's benefit otherwise computed under the plan formula is reduced or offset by a stated percentage of such employee's old-age insurance benefit under the Social Security Act. Section 7 of Rev. Rul. 71-446 provides, in general, that an offset plan is integrated if the rate at which the offset to any employee's benefit is computed does not exceed 83⅓ percent. Because the amount of such old-age insurance benefit under the Social Security Act is determined based on the actual wage history of the employee, the old-age insurance benefit under the Social Security Act used to offset an employee's benefit must also be computed based on the actual wage history of the employee. Section 11 of Rev. Rul. 71-466 requires that, in the event of retirement or severance of employment by an employee before age 65, the permissible offset must be calculated on the basis of the employee's actual wage history for the period before retirement or severance and an assumed compensation determined under one of the alternatives provided in that section for the period thereafter.

In this case, because the offset specified in the plan is based upon an estimated or assumed wage history for all years of employment, such offset may exceed the maximum offset permitted by Rev. Rul. 71-446. Thus, the plan fails to satisfy the integration requirements of Rev. Rul. 71-446.

Furthermore, aside from the specific integration requirements of Rev. Rul. 71-446, the plan may fail to satisfy the nondiscrimination requirements of section 401(a)(4) of the Code. The use of an assumed wage history may effectively result in an offset that varies from participant to participant as a percentage of the old-age benefit based upon the actual wage history of each participant. If employees who are officers, shareholders, or highly compensated receive, in effect, offsets that are lower than the offsets (as a percentage of actual old-age benefits) for other employees, the plan will not satisfy the requirements of section 401(a)(4).

Section 411(a) of the Code provides rules under which certain rights of employees to benefits accrued under a qualified plan must be nonforfeitable.

Section 1.411(a)-4(a) of the regulations states that "nonforfeitable rights are not considered to be forfeitable by reason of the fact that they may be reduced to take into account benefits which *are provided* under the Social Security Act or under any

other Federal or State law and which are taken into account in determining plan benefits." (emphasis added). That section does not consider a forfeiture to occur when the accrued benefit decreases, because the participant has not lost a benefit when social security is taken into account with other plan benefits in accordance with section 401(a)(5) of the Code. Consequently, in the case of an offset plan where social security offsets are calculated based on actual compensation history, a forfeiture will not occur merely because a participant, who has not separated from service, suffers a dollar reduction in the actual annual benefit provided under the plan because the offset portion of the benefit formula, over some interval, increases more rapidly than the positive portion of the benefit formula.

In the case of an offset plan where offsets are calculated based on estimated compensation, the mere offset of social security benefits based on estimated previous compensation will not constitute an impermissible forfeiture to the extent that the offset limits the accrued benefit without causing a reduction in the accrued benefit previously nonforfeitable. If a plan calculates offsets on the basis of estimated compensation, it is possible for a participant to suffer an impermissible forfeiture under section 411 of the Code. For example, it is possible, from one year to the next, for the estimated offset to increase more rapidly than the actual offset and more rapidly than the positive portion of the benefit formula. In such a case, a participant for whom the estimated offset is greater than the actual offset will suffer an impermissible forfeiture because the dollar reduction in the accrued benefit under the plan is not matched by actual benefits under social security or any other Federal or State law. Similarly, it also is possible for social security benefits to increase by a percentage (such as by a cost-of-living adjustment) that causes the estimated offset with respect to a participant to increase more rapidly than the actual offset. In this case, a participant for whom the estimated offset is greater than the actual offset will suffer an impermissible forfeiture because such participant's accrued benefit under the plan is decreased as a result of such increase in social security.

In *Alessi v. Raybestos Manhattan, Inc.*, 451 U.S. 504 (1981), 1981-1 C.B. 219, the Supreme Court held that certain pension plan provisions for offsets based on workers' compensation awards do not contravene the nonforfeiture provisions of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1. However, the Supreme Court acknowledged that the right of the parties to create a plan providing for offsets is not absolute. The Supreme Court, citing Rev. Rul. 78-178, 1978-1 C.B. 118, noted that the Internal Revenue Service does not permit qualified plans to offset pension benefits by reimbursement of medical expenses, fixed sums made for bodily impairment, or unemployment compensation because such payments do not match up with any benefits available under a pension plan qualified under the Internal Revenue Code or ERISA. The court pointed out that "Without speaking directly of its own rationale, Congress embraced such IRS rulings." *Id.* at 521. See H.R. Conf. Rept. No. 93-1280, 93d Cong., 2d Sess. 277 (1974). In the facts in *Alessi* the benefits that were offset were actual benefits provided not estimated benefits.

HOLDING

The defined benefit plan in this case fails to satisfy the requirements of section 411 of the Code and may fail to satisfy the requirements of sections 401(a)(4) and (5).

GENERAL RULES FOR USE OF ESTIMATED EARNINGS HISTORY

However, under this revenue ruling, a defined benefit plan will not fail to satisfy the requirements of sections 401 and 411 of the Code merely because the maximum offset under the plan is determined using an estimated wage history for some or all years before retirement or separation from employment (and therefore estimated old-age benefits) if and only if all of the following rules are satisfied:

(1) The pre-separation or pre-retirement salary history (or pre-hire salary history) is estimated by applying a salary scale, projected backwards, to the employee's compensation (as defined in section 3.03 of Rev. Rul. 71-446) at separation or retirement (or compensation at hire) and the salary scale is either

(A) the actual change in the average wages from year to year as determined by the Social Security Administration, or

(B) a level percentage per year that is not less than six percent per annum.

(2) A plan gives clear written notice to each employee of the employee's right to supply actual salary history and of the financial consequences of failing to supply such history. The notice must be given each time the summary plan description is provided to the employee and must also be given upon separation from service. The notice must also state that the employee can obtain the actual salary history from the Social Security Administration.

(3) The plan provides that the benefit for a participant will be adjusted to the offset based on an actual salary history for years previously estimated before separation from service (and an assumed post-separation or post-retirement compensation in accordance with section 11.01 of Rev. Rul. 71-446 when applicable) if the participant supplies documentation of that history. A plan may provide that such documentation must be provided no later than a reasonable period of time following the later of the date of separation from service (by retirement or otherwise) and the time when the participant is notified of the benefit to which he or she is entitled.

The estimated wages may be used either only for years before employment with the employer or for all years before retirement or separation

from employment.

The use of estimated wage histories subject to the above rules will not, in and of itself, cause the plan to fail to satisfy sections 401 and 411 of the Code.

This revenue ruling does not preclude an employer from basing the social security offset upon the actual wage history of the participants. Also, the offset may be determined by assuming that a participant earned no compensation for periods before the participant was employed by the employer and using actual compensation paid by the employer for periods of service with the employer. In determining an offset using this latter approach, such years of zero compensation are averaged together with the compensation for subsequent years to compute average indexed earnings.

For purposes of this revenue ruling, the term "employer" includes all entities that are treated as a single employer under sections 414(b), 414(c), or 414(m) of the Code, relating respectively to controlled corporations, controlled trades or business, and affiliated service groups.

PROSPECTIVE APPLICATION

Inasmuch as employers may have plans that provide for an offset based upon an estimated wage history but fail to satisfy the requirements set forth above, pursuant to the authority contained in section 7805(b) of the Code, this revenue ruling is effective only with respect to any employee who has any service during a plan year beginning after December 31, 1983.

Offset plans using estimated wages in determining old-age insurance benefits must be amended to comply with the requirements of this revenue ruling in order to satisfy the requirements of Rev. Rul. 71-446, as modified by this revenue ruling. The amendment must be adopted by the end of the first plan year beginning after December 31, 1983, and made effective as of the beginning of such plan year.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 71-446 is clarified and is modified to allow the use of an estimated wage history as specified in this revenue ruling.

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26 CFR 1.401-4: Discrimination as to contributions or benefits.

Discrimination; elective contributions as basis for pension benefit computation. Inclusion or exclusion of elective contributions under a tax sheltered annuity described in section 403(b) of the Code, as compensation in a money purchase pension plan, does not cause the pension plan to be discriminatory within the meaning of section 401(a)(4); however, inclusion of nonelective contributions may cause the plan to be discriminatory. Rev. Rul. 69-296 modified.

Rev. Rul. 84-74

PURPOSE

The purpose of this revenue ruling is to give further consideration to Rev. Rul. 69-296, 1969-1 C.B. 127.

ISSUE

Whether the inclusion of elective contributions to a tax sheltered annuity described in section 403(b) of the Internal Revenue Code as compensation in the employer's money purchase pension plan may cause the pension plan to be discriminatory within the meaning of section 401(a)(4).

FACTS

In Rev. Rul. 69-296, an organization which is exempt from federal income tax under section 501(c)(3) of the Code established a money purchase pension plan for its employees. Under the provisions of the plan, the term "compensation" of an employee is defined to include all current compensation paid to the employee, plus any amounts paid by the employer toward the purchase of nonforfeitable annuities under an arrangement referred to in section 403(b). The money purchase pension plan otherwise meets the requirements of section 401(a).

LAW

Section 401(a)(4) of the Code provides that the contributions or benefits under a qualified plan must not discriminate in favor of employees who are officers, shareholders or highly compensated.

Section 401(a)(5) of the Code provides that a plan shall not be considered discriminatory merely because the contributions or benefits of or on behalf of employee-participants bear a uniform relationship to the total compensation or the basic or regular rate of compensation of the employees.

Rev. Rul. 83-89, 1983-1 C.B. 88, provides that the inclusion of elective contributions under a qualified cash or deferred arrangement as compensation in a defined benefit pension plan does not cause the pension plan to be discriminatory under section 401(a)(4). However, nonelective contributions under the cash or deferred arrangement may be used to compute employees' benefits under the pension plan only if they do not result in prohibited discrimination under section 401(a)(4). Rev. Rul. 59-13, 1959-1 C.B. 83.

Rev. Rul. 69-296, 1969-1 C.B. 127, holds that any amounts contributed by an employer toward the purchase of a nonforfeitable section 403(b) annuity are to be considered compensation under section 401(a)(5) of the Code. That revenue ruling does not specifically indicate whether the contributions to purchase the section 403(b) annuity are subject to the election of the employee under a salary reduction or similar agreement; nor does it in any way distinguish between elective and nonelective employer contributions.

ANALYSIS

Nonforfeitable contributions made by the employer under a tax sheltered annuity arrangement described in section 403(b) of the Code may be made at the election of the employee under

a salary reduction or similar arrangement or may be nonelective contributions. Despite their characterization as employer contributions, elective contributions differ fundamentally from nonelective contributions. If an individual employee does not make an election to have elective contributions deferred, they will be received as current compensation and will clearly be compensation for purposes of section 401(a)(5). Thus, in Rev. Rul. 69-296, any contributions to the annuity contract that were deferred as a result of the employee's individual election may be treated as compensation for purposes of section 401(a)(5) of the Code. Therefore, such deferred amounts may be used to determine whether the money purchase pension plan satisfies the requirements of section 401(a)(4). However, in accordance with Rev. Rul. 83-89, any nonelective contributions to the annuity contract may be used to compute the employer contributions under the money purchase pension plan only if they do not result in prohibited discrimination in the pension plan. See also Rev. Rul. 80-359, 1980-2 C.B. 136.

HOLDING

The inclusion of elective contributions under the tax sheltered annuity arrangement described in section 403(b) of the Code as compensation in the money purchase pension plan does not cause the pension plan to be discriminatory within the meaning of section 401(a)(4) of the Code. Further, the exclusion of elective employer contributions under the tax sheltered arrangement from compensation also would not cause the plan to be discriminatory. However, inclusion of nonelective employer contributions under a tax sheltered annuity arrangement as compensation used to determine contributions or benefits to a pension plan may cause the pension plan to be discriminatory within the meaning of section 401(a)(4).

Pursuant to the authority contained in section 7805(b) of the Code, this revenue ruling will not be applied to treat a plan as discriminatory under section 401(a)(4) merely because that plan used nonelective contributions under a tax sheltered annuity arrangement to determine plan benefit accruals or plan contributions for any plan year beginning on or before May 21, 1984, the date of publication of this revenue ruling in the Internal Revenue Bulletin.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 69-296 is modified to remove therefrom the implication that contributions under a section 403(b) arrangement may be treated as compensation for purposes of section 401(a)(4) of the Code, regardless of whether they are elective or nonelective contributions.

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26 CFR 1.401-4: Discrimination as to contributions or benefits.

T.D. 7934 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Early termination of qualified plans

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the limitation on benefits in the event of the early termination of certain tax qualified retirement plans providing defined benefits for employees. Changes in the applicable law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1]. The regulations would provide the public with additional guidance needed to comply with that Act and would affect employers maintaining such plans and employees covered by such plans subject to Title IV of that Act.

DATES: The regulations are effective for plan terminations occurring on or after March 12, 1984.

FOR FURTHER INFORMATION CONTACT: Marjorie Hoffman of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On January 26, 1982, the FEDERAL REGISTER published a proposed amendment to the Income Tax Regulations (26 CFR Part 1) under section 401 of the Internal Revenue Code of 1954 (47 FR 3562) [EE-11-78, 1982-1 C.B. 515]. The amendment reflects certain provisions of Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 1003) [Pub. L. 93-406, 1974-3 C.B. 1, 172] related to plan termination insurance. No public hearing was requested or held. After consideration of all comments regarding the proposed amendment, that amendment is adopted as revised by this Treasury decision.

STATUTORY PROVISIONS

Section 401(a)(4) of the Code prescribes certain discrimination standards which are qualification requirements for employee retirement plans (and related trusts) described in sections 401(a), 403(a), and 405 of the Code. Section 411(d)(2) and (d)(3) of the Code prescribe additional vesting-discrimination standards which are also qualification standards for these retirement plans.

SPECIFIC RULES CONCERNING PLAN PROVISIONS

In general, this amendment, which is applicable to certain retirement plans covered by section 4021(a) of

[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

ERISA, raises the limits on the amount of employer contributions to such plans which can be used for the benefit of each of the 25 highest paid employees without violating the provisions of section 401(a)(4) of the Code. As a result of the interaction of sections 401(a) and 411, these new limits for plans, allowing additional employee benefits attributable to employer contributions, must be used where applicable in order for the plan to remain qualified. The limits on the use of employer contributions for the benefit of the 25 highest paid employees are an exception to the requirements of section 411(a) which prohibit the forfeiture of vested benefits. Section 411(d)(2) provides that section 411(a) does not apply to benefits which may not be provided for designated employees in the event of early termination of the plan under provisions of the plan adopted pursuant to regulations prescribed by the Secretary to preclude the discrimination prohibited by section 401(a)(4). This amendment is such a regulation. By implication, any vested benefits that may be provided based on this amendment must be nonforfeitable in accordance with section 411(a).

The increased amount available to substantial owners from plans covered by section 4021(a) of ERISA is equal to the present value of the benefit guaranteed for substantial owners under section 4022 of ERISA upon termination of the plan or, if the plan has not terminated, the present value of the benefit that would be guaranteed if the plan terminated on the date the benefit commenced. The increased amount available to employees of such plans other than substantial owners is equal to the present value of the maximum benefit described in section 4022(b)(3)(B) of ERISA. These new limits are only to be used when they produce an amount higher than the old limit in §1.401-4(c)(2)(iii) of the regulations.

In response to the comments received, certain revisions have been made to the amendment proposed. First, the effective date has been clarified. These new limits are effective for plans terminating on or after March 12, 1984. Plan amendments would be required for these terminating plans. For plans not terminating, plan amendments incorporating these new limits must be adopted that are effective for plan years beginning after December 31, 1983. However, in the interim these new limits may be elected without a plan amendment on or after January 10, 1984. No formal election need be filed with the Service. An election will be deemed to have been made if the new limits are used in an applicable distribution.

Also, the regulation is clarified to specify that the present value of the maximum benefit described in section 4022(b)(3)(B) of ERISA [Pub. L. 93-406, 1974-3 C.B. 1, 185] is to be determined in accordance with the regulations of the Pension Benefit Guaranty Corporation (PBGC).

Some commentators inquired as to the effect of the regulation on Rev. Rul. 80-229, 1980-2 C.B. 133, regarding distribution upon termination of assets in a plan in which the value of plan assets as of the date of termination is not less than the present value of all accrued benefits (whether or not forfeitable). Those guidelines may still be applied as indicated in that revenue ruling, whether or not the termination would otherwise invoke the early termination restrictions of this amendment.

It should also be noted that nonforfeitable benefits for purposes of Title IV of ERISA are determined under the definition of that term in Title IV and implementing PBGC regulations.

DRAFTING INFORMATION

The principal author of these final regulations was Marjorie Hoffman of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for interpretative regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply and no Regulatory Flexibility Analysis is required for this rule.

* * * * *

Adoption of amendments to the regulations

Accordingly, the following amendment to 26 CFR Part 1 is hereby adopted:

Section 1.401-4 is amended by adding three new sentences at the end of paragraph (c)(1) and by adding a new paragraph (c)(7). These added provisions read as follows:

§1.401-4 Discrimination as to contributions or benefits.

* * * * *

(c)(1) *** Any pension plan containing a provision described in this paragraph shall not fail to satisfy section 411(a), (d)(2) and (d)(3) merely by reason of such a plan provision. Paragraph (c)(7) sets forth special early termination rules applicable to certain qualified defined benefit plans for plan years affected by the Employee Retirement Income Security Act of 1974 ("ERISA"). Paragraph (c)(7) does not contain all the rules required by the enactment of ERISA.

* * * * *

(7)(i) A qualified defined benefit plan subject to section 412 (without regard to section 412(h)(2)) shall not be required to contain the restriction described in paragraph (c)(2)(ii)(*c*) applicable to an employee in a plan whose full current costs for the first 10 years have not been funded.

(ii) A qualified defined benefit plan covered by section 4021(a) of ERISA ("qualified Title IV plan") shall satisfy the restrictions in paragraph (c)(2) of this section only if the plan satisfies this paragraph (c)(7). A plan satisfies this paragraph (c)(7) by providing that employer contributions which may be used for the benefit of an employee described in paragraph (c)(2) who is a substantial owner, as defined in section 4022(b)(5) of ERISA, shall not exceed the greater of the dollar amount described in paragraph (c)(2)(iii) or a dollar amount which equals the present value of the benefit guaranteed for such employee under section 4022 of ERISA, or if the plan has not terminated, the present value of the benefit that would be guaranteed if the plan terminated on the date the benefit commences, determined in accordance with regulations of the Pension Benefit Guaranty Corporation ("PBGC").

(iii) A plan satisfies this paragraph (c)(7) by providing that employer contributions which may be used for the benefit of all employees described in paragraph (c)(2) (other than an employee who is a substantial owner as defined in section 4022(b)(5) of ERISA) shall not exceed the greater of the dollar amount described in paragraph (c)(2)(iii) or a dollar amount which equals the present value of the maximum benefit described in section 4022(b)(3)(B) of ERISA (determined on the date the plan terminates or on the date benefits commence, whichever is earlier, and determined in accordance with regulations of PBGC) without regard to any other limitations in section 4022 of ERISA.

* * * * *

(iv) A plan provision satisfying this paragraph (c)(7) may be adopted by amendment or by incorporation at the time of establishment. Any allocation of assets attributable to employer contributions to an employee which exceeds the dollar limitation in this paragraph (c)(7) may be reallocated to prevent prohibited discrimination.

(v) The early termination rules in the preceding subparagraphs (1) through (6) apply to a qualified Title IV plan except where such rules are determined by the Commissioner to be inconsistent with the rules of this paragraph (c)(7), §1.411(d)-2, and section 4044(b)(4) of ERISA. The early termination rules of this paragraph (c)(7) contain some of the rules under section 401(a)(4) and (a)(7), as in effect on September 2, 1974, and section 411(d)(2) and (3). Section 1.411(d)-2 also contains certain discrimination and vesting rules which are applicable to plan terminations.

(vi) Paragraph (c)(7) of this section applies to plan terminations occurring on or after March 12, 1984. For distributions not on account of plan terminations, paragraph (c)(7) applies to distributions in plan years beginning after December 31, 1983. However, a plan may elect to apply that paragraph to distributions not on account of plan termination on or after January 10, 1984.

This Treasury decision is issued under the authority contained in sections 411(d)(2) and (3) and 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 88 Stat. 912; 26 U.S.C. 411(d)(2) and (3) and 7805).

PHILIP E. COATES,
Acting Commissioner of Internal Revenue.

Approved December 19, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 9, 1984, 8:45 p.m., and published in the issue of the Federal Register for January 10, 1984, 49 F.R. 1182)

Section 404.—Deduction for Contributions of an Employer to an Employee's Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

26 CFR 1.404(a)-14: Special rules in connection with the Employee Retirement Income Security Act of 1974.

Pension plan; contributions; deductible limit determination. Examples are provided on how the deductible limit under section 404 (a)(1)(A) of the Code for a defined benefit plan is determined within the meaning of section 1.404(a)-14 of the regulations. Rev. Ruls. 55-411, 57-89, and 70-30 obsoleted.

Rev. Rul. 84-62

ISSUE

How are the deductible limits under section 404(a)(1)(A)(iii) of the Internal Revenue Code determined for a defined benefit plan under the circumstances described below?

FACTS

An employer whose taxable year is the calendar year maintains a defined benefit plan with a calendar plan year. The plan was in existence on January 1, 1974, and became subject to section 404(a) of the Code on January 1, 1976. For the 1976 plan year, the funding method is the entry age normal cost method and the valuation rate is 5 percent.

The results of the valuations as of January 1 of 1976, and 1977 are summarized below.

	January 1, 1976 Valuation	
(1)	Accrued liability	$750,000
(2)	Actuarial value of total assets	170,000
(3)	Unfunded liability for the purpose of section 412 of the Code [(1)-(2)]	580,000
(4)	Expected unfunded liability	600,000
(5)	Experience gain [(4)-(3)]	20,000
(6)	Normal cost due 1/1/76	60,000
(7)	Deduction carry-over, 1/1/76	10,000
(8)	10 percent base if section 404 were not amended by ERISA (original balance)	800,000

For the 1976 plan year the employer contributed $110,000 on January 1, 1976, and $20,000 on June 1, 1977. The latter contribution was not made during the period described in section 404(a)(6) of the Code and therefore was not deductible in the 1976 tax year. However, both contri-

butions were credited in 1976 for purposes of section 412.

As of January 1, 1977, the actuarial assumptions were changed. Included in that change was an increase in valuation rate from 5% to 6%.

January 1, 1977 Valuation

(1)(a)	Accrued liability (old assumptions)	$850,000
(b)	Accrued liability (new assumptions)	950,000
(2)	Actuarial value of total assets	350,000
(3)	Unfunded liability for the purpose of section 412 of the Code [(1)-(2)]	
(a)	old assumptions	500,000
(b)	new assumptions	600,000
(4)	Expected unfunded liability (old assumptions)	$536,500
(5)	Experience gain [(4)-(3a)]	36,500
(6)	Increase in liability due to change in assumption [(3b)-(3a)]	100,000
(7)	Normal cost due 1/1/77 (new assumptions)	70,000

LAW, ANALYSIS, AND HOLDING

Section 1.404(a)-14 of the Income Tax Regulations provides rules for determining the deductible limits for any defined benefit plan under section 404(a)(1)(A) of the Code.

Section 1.404(a)-14(c) of the regulations states that if the employer's taxable year coincides with the plan year, the deductible limit for the taxable year is the deductible limit for the plan year coinciding with the taxable year.

Section 1.404(a)-14(f) of the regulations states that subject to the full funding limitation, the deductible limit under section 404(a)(1)(A)(iii) of the Code is the normal cost of the plan, decreased by the limit adjustments of the negative amortization bases (such as a base for an experience gain) and increased by the limit adjustments of the positive bases (such as a base for an initial unfunded liability).

A. 1976 Deductible Limit

For 1976, the normal cost as of the first day of the plan year is $60,000. However, this amount must be adjusted by the limit adjustments of any 10-year amortization base.

(1) *Determination of 10-Year Amortization Bases*

For a plan in existence prior to the effective date of section 404(a) of the Code, section 1.404(a)-14(j) of the regulations provides special rules for the determination of the amount of the initial 10-year amortization base.

Section 1.404(a)-14(j)(1) of the regulations states that the 10-year amortization base on the effective date of section 404(a) of the Code is the sum of all 10 percent bases existing immediately before section 404(a) became effective for the plan, determined under the rules of old section 404(a).

Section 1.404(a)-14(j)(3) of the regulations allows an employer to establish either a single initial base reflecting all prior 10 percent bases and the experience gain or loss for the immediately preceding period, or a separate base for the prior 10 percent bases and another for the experience gain and loss for the immediately preceding period. If a separate base for the experience gain or loss is established, the unamortized amount of the initial base is equal to the unfunded liability increased by the net experience gain or decreased by the net experience loss.

Section 1.404(a)-14(d)(2) of the regulations states that, in computing the unfunded liability of a plan for purposes of section 404 of the Code, contributions for a plan year that have not been previously deducted must be excluded from the plan assets.

In this case, assume the employer chose to establish two bases as of January 1, 1976: (1) a base with an original balance and an unamortized amount of $20,000 for the experience gain determined as of January 1, 1976, and (2) a separate base with an original balance of $800,000.

In the absence of the deduction carryover the unamortized amount of this latter base would have been equal to $600,000 (the $580,000 unfunded liability as of January 1, 1976, plus the $20,000 experience gain which has been taken into account in the separate base). However, because of the $10,000 carryover, the assets must be reduced by such carryover so that the unfunded liability, for purposes of section 404 of the Code, was $590,000. Therefore, the separate base for the prior 10 percent bases had an unamortized amount of $610,000 ($590,000 plus the $20,000 gain). The original amount of this base was $800,000 (the sum of the pre-ERISA 10 percent bases), and was unaffected by the carryover.

[Note the net of the unamortized amounts of the two bases is equal to the unfunded liability of the plan as adjusted for the carryover ($610,000 − $20,000 = $580,000 + $10,000).]

(2) *Determination of Limit Adjustments for Bases*

Section 1.404(a)-14(b)(3) of the regulations defines the limit adjustment with respect to any 10-year amortization base as the lesser of (i) the level annual amount necessary to amortize the base over 10 years using the valuation rate, or (ii) the unamortized balance of the base.

Section 1.404(a)-14(j)(2) of the regulations states that in the case of a plan in existence before the effective date of section 404(a) of the Code, the level annual amortization of the initial base is calculated using the original balance of the remaining bases (under old section 404(a) rules).

In accordance with the above regulations the limit adjustment for each base must be calculated as the amount necessary to amortize the base over 10 years at the valuation rate (unless such amount is more than the unamortized amount of the base). The level annual amortization amounts, assuming payments due at the end of each year, are $2,590 for the gain base and $103,604 for the initial base. The calculations yielding these figures may be expressed as ($20,000 ÷ a $\overline{10}|5\%$) and ($800,000 ÷ a $\overline{10}|5\%$), respectively, where a $\overline{10}|5\%$ is the present value of an annuity of $1 per year payable at the

end of each year for 10 years, assuming 5 percent interest. For the initial base, the $800,000 amount amortized equals the original balance of the remaining 10 percent bases under the rules of old section 404(a) of the Code.

(3) *Determination of 1976 Deductible Limit*

Section 1.404(a)-14(f)(3) of the regulations states that, regardless of the actual time when contributions are made, the normal cost and the limit adjustments used in calculating the deductible limit shall be computed as of the earlier of (i) the last day of the plan year used to compute the deductible limit for the taxable year, or (ii) the last day of that taxable year.

In this case the plan year and the tax year coincide with the calendar year. The deductible limit was calculated as of the end of the plan year as the normal cost with interest to the end of the plan year ($60,000 × 1.05 or $63,000), plus the level annual amortization of the initial base ($103,604), minus the level annual amortization of the experience gain base ($2,590), or $164,014. Therefore, the $110,000 contribution made on January 1, 1976, and the $10,000 carryover existing on January 1, 1976, were deductible in the 1976 tax year.

B. 1977 Deductible Limit

For 1977, the normal cost as of the first day of the plan year is $70,000. However, as was the case for the 1976 normal cost this amount must be adjusted by the limit adjustments of any 10-year amortization base to determine the deductible limit for the year.

(1) *Determination of 10-Year Amortization Bases*

As of January 1, 1977, the two bases in existence for 1976 continue to exist. Furthermore, two new bases must be established.

Section 1.404(a)-14(g)(1) of the regulations states that in the case of a plan valued by the use of an immediate gain type of funding method, a 10-year amortization base must be established in any plan year equal to the net experience gain and loss required under section 412 of the Code to be determined with respect to that plan year. Section 4 of Rev. Rul. 81-213, 1981-2 C.B. 101, requires that an experience gain base be established for purposes of section 412 of the Code in this situation. Therefore, for computing the deductible limit, a new experience gain base of $36,500 is established as of January 1, 1977.

Section 1.404(a)-14(g)(2) of the regulations states that if an amortization base is required to be established under section 412 of the Code for a change in unfunded liabilities due to a change in actuarial assumptions, then a 10-year amortization base must also be established for purposes of section 404. Assuming that such a base would be required under section 412 because of the change in assumptions as of January 1, 1977, an additional $100,000 10-year amortization base would be established.

(2) *Determination of the Unamortized Amounts of the Prior Bases*

Section 1.404(a)-14(h)(3) of the regulations defines the unamortized amount of a base as of any valuation date as the unamortized amount of the base as of the prior valuation date plus interest at the valuation rate from the prior valuation date to the current valuation date, minus the contribution allocated to the base. Section 1.404(a)-14(h)(4) defines the contribution allocated to a base as the total contribution for all bases multiplied by a ratio. The numerator of the ratio is the level annual amortization for that base and the denominator is the sum of such amounts for all bases. Section 1.404(a)-14(h)(6) defines the contribution for all bases as the total deduction (including a carryover deduction) for the prior year, plus interest on the actual contribution for the prior year (whether or not deductible) at the valuation rate for the period between the date as of which the contributions were credited under section 412 of the Code and the current valuation date, plus interest on the carryover (if available at the beginning of the year) at the valuation rate for the period between the current the prior valuation dates, minus the normal cost with interest at the valuation rate from the date as of which the normal cost is calculated to the current valuation date.

The calculation of the unamortized portion of the bases as of 1/1/77 is as follows:

A deduction carryover of $10,000 existed as of January 1, 1976. Two contributions were made for the 1976 plan year, $110,000 paid on January 1, 1976, (bearing interest from that date), and $20,000 paid on June 1, 1977, but deemed paid on December 31, 1976, for the purpose of section 412 of the Code. As stated in the facts, the latter contribution was not deductible in 1976. Therefore $120,000 was considered available for possible deduction in 1976 ($110,000 contribution + $10,000 carryover). That amount was less than the 1976 deductible limit of $164,014, and the deduction taken was $120,000.

The contributions for all bases were computed, in accordance with section 1.404(a)-14(h)(6) of the regulations, as follows:

(1) Total 1976 deduction	$120,000
(2) Interest on 1976 contributions: ($110,000 × .05)	5,500
(3) Interest on deduction carryover existing on 1/1/76: (10,000 × .05)	500
(4) 1976 normal cost	60,000
(5) Interest on normal cost (60,000 × .05)	3,000
(6) Contribution towards amortization bases: (1) + (2) + (3) − (4) − (5)	63,000

The unamortized amounts as of January 1, 1977, of the two bases existing on January 1, 1976, were calculated in accordance with section 1.404(a)-14(h)(3) and (4) of the regulations as follows:

	Initial Base	*Experience Gain Base*	*Total*
(1) Unamortized amount as of 1/1/76	$610,000	($20,000)	$590,000
(2) Level annual amortization	103,604	(2,590)	101,014
(3) Contribution with respect to each Base*	64,615	(1,615)	63,000
(4) Unamortized amount as of 1/1/77: (1) × 1.05 − (3)	575,885	(19,385)	556,500

*The $63,000 total contribution is allocated between the two bases in (1) in proportion to the level annual amortization in (2)

[Note that the total unamortized amount of the prior bases as of 1/1/77 ($556,500) equals the expected unfunded liability as of the same date after adjustment for the undeducted $20,000 contribution ($536,500 + $20,000 = $556,500). Also, the total unamortized amount of all the bases as of 1/1/77 ($556,500 − $36,500 + $100,000 = $620,000) equals the unfunded liability of the plan after adjustment for the undeducted $20,000 contribution ($600,000 + $20,000 = $620,000).]

(3) *Redetermination of Limit Adjustments for Prior Bases*

Section 1.404(a)-14(h)(8) states that when the interest rate is changed a new level annual amortization must be calculated for each base. The annual amortization must be the level amount necessary to amortize the unamortized amount of a base over the remaining amortization period using the new interest rate. The remaining amortization period of a base is the number of years at the end of which the unamortized amount would be zero if the contributions with respect to that base equaled the limit adjustment each year.

The level annual amortizations of the two bases existing on January 1, 1976, are redetermined, in accordance with the above-referenced section of the regulations, as follows:

	Initial Base	*Experience Gain Base*
(1) Unamortized amount as of 1/1/77	$575,885	($19,385)
(2) Level annual amortization @ 5%	$103,604	($2,590)
(3) Present value of each $1 of the level annual amortization (1) ÷ (2)	5.6	7.5
(4) Remaining amortization period (Equal to period certain of the amount in (3) obtained from standard annuity table reflecting end of year payments and 5% interest)	6.7 years	9.6 years
(5) Level annual amortization @ 6% assuming end of year payments of unamortized amounts in (1) over periods in (4)	$106,904	($2,713)

The 1977 limit adjustments for the prior bases are $106,904 for the initial base and (−$2,713) for the 1976 experience gain base, because these level amortizations are less than the unamortized amounts.

(4) *Determination of Limit Adjustments for New Bases*

The limit adjustments for the new bases established in 1977 are (−$4,959) for the $36,500 experience gain base and $13,587 for the $100,000 base established due to a change in assumptions. These limit adjustments are equal to a 10-year amortization at 6 percent interest, assuming payments at the end of the year.

(5) *Determination of 1977 Deductible Limit*

As was the case with 1976, the deductible limit for 1977 is calculated as of the end of the plan year. This limit is the normal cost with interest to the end of the plan year ($70,000 × 1.06 = $74,200), plus the limit adjustments for the positive bases ($106.904 + 13,587 = $120,491), minus the limit adjustments for the negative bases ($2,713 + 4,959 = $7,672), or $187,019.

(6) *Determination of Deductible Limit Using Single combined Amortization Base for 1977*

As an alternative to computing the 1977 deductible limit as described above, the four 10-year amortization bases could have been combined and offset into a single base and the normal cost adjusted by a single limit adjustment attributable to that base.

Section 1.404(a)-14(i) of the regulations describes an acceptable method for combining and offsetting the 10-year amortization bases for the purposes of section 404 of the Code. This method requires that:

(1) the unamortized amount of the single base is the net of the unamortized amounts of the combined bases;

(2) the remaining amortization period of the single base is the average of the remaining amortization periods of the bases weighted by the absolute value of the unamortized portion of the bases; and

(3) the level annual amortization is the amount obtained by dividing the amount in (1) by an annuity certain at the valuation rate for the period defined in (2).

The existing four bases would be combined and offset as of January 1, 1977, in accordance with these rules. The characteristics of the four bases are shown below:

Base	*Unamortized Amount*	*Remaining Amortization Period*	*Absolute value of the unamortized amount*
Initial Base	$575,885	6.7	$575,885
1976 Gain	(19,385)	9.6	19,385
1977 Gain	(36,500)	10.0	36,500
Assumption Change	100,000	10.0	100,000
	$620,000		$731,770

The single base has an unamortized amount of $620,000, equal to the sum of the unamortized amounts of the four bases. The remaining amortization period of the single base is 7.4 which equals (a) divided by (b) where

(a) = (575,885 × 6.7) + (19,385 × 9.6) + (36,500 × 10) + (100,000 × 10) = 5,409,526, and

(b) = 731,770, the sum of the absolute values of the unamortized amounts.

According to standard actuarial tables, the present value of an annuity certain with end-of-year payments for 7.4 years at 6% is 5.84. The level amortization amount with respect to the single base with end-of-year payments is obtained by dividing $620,000 by 5.84, which equals $106,164.

The deductible limit would then be calculated as the normal cost with interest to the end of the plan year ($70,000 × 1.06 = $74,200) plus the limit adjustment for the single base ($106,164), or 180,364.

EFFECT ON OTHER DOCUMENTS

This revenue ruling obsoletes Rev. Ruls. 55-411, 1955-1 C.B. 303; 57-89, 1957-1 C.B. 169; and 70-30, 1970-1 C.B. 109.

Subpart B.—Special Rules

Section 411.—Minimum Vesting Standards

26 CFR 1.411-4: Forfeitures, suspensions, etc.

Whether a defined benefit offset plan that uses estimated wages for an employee in determining that employee's old-age insurance benefit provided under the Social Security Act fails to satisfy the nondiscrimination requirements of section 401(a)(4) and (5) of the Code and the minimum vesting requirements of section 411. See Rev. Rul. 84-45, page 115.

26 CFR 1.411(a)-1: Minimum vesting standards; general rules.

Qualification; effect of plan language on the vested accrued benefit at normal retirement age. A plan that limits an employee's right to nonforfeitable benefits to amounts in which the employee already has a nonforfeitable interest pursuant to the plan's vesting schedule does not satisfy the requirements of section 411(a) of the Code.

Rev. Rul. 84-69

ISSUE

Does the retirement plan described below satisfy the minimum vesting provisions of section 411 of the Internal Revenue Code?

FACTS

An employer maintains a noncontributory retirement plan which includes a vesting schedule under which an employee who has at least 10 years of service has a nonforfeitable right to 100 percent of his accrued benefit. The vesting schedule satisfies the requirements of the section 411 (a)(2)(A) of the Code. In addition, the plan provides that an employee's right to the normal retirement benefit under the plan is nonforfeitable upon attainment of the normal retirement age (which the plan defines as age 65). Other plan language defines the term normal retirement benefit as the portion of the employee's accrued benefit determined under the plan's vesting schedule to be nonforfeitable. As a result, employees hired after age 55 who retire at normal retirement age are not entitled to any retirement benefit.

LAW AND ANALYSIS

Section 401(a)(7) of the Code provides that a plan shall not be a qualified plan under section 401(a) unless it satisfies the requirements of section 411.

Section 411(a)(2)(A), (B), and (C) of the Code provide vesting schedules, one of which must be satisfied in order to satisfy the requirements of section 411. In addition, the introductory language of section 411(a) requires that an employee's right to a normal retirement benefit be nonforfeitable upon attainment of normal retirement age.

Section 411(a)(9) of the Code defines the term normal retirement benefit as the greater of the early retirement benefit or the benefit under the plan commencing at normal retirement age.

Section 411(a)(7) of the Code defines accrued benefit in general as (1) in the case of a defined benefit plan, the benefit determined under the plan expressed as an annual benefit commencing at normal retirement age or (2) in the case of any other plan, the balance of the employee's account.

For purposes of section 411 of the Code, the term normal retirement benefit means the individual's accrued benefit, determined without regard to whether such benefit is vested. Thus, for a plan to satisfy the requirements of section 411, an employee participating in the plan at normal retirement age must have a nonforfeitable right to 100 percent of

the employee's accrued benefit irrespective of whether some portion of such accrued benefit would otherwise be forfeitable under the plan's vesting schedule. See *Caterpillar Tractor Co. v. Commissioner*, 72 T.C. 1088 (1979).

HOLDING

Because the plan in this case limits an employee's right to nonforfeitable benefits to amounts in which the employee already has a nonforfeitable interest pursuant to the plan's vesting schedule, the plan does not satisfy the requirements of section 411(a) of the Code.

Subchapter E.—Accounting Periods and Methods of Accounting
Part I.—Accounting Periods

Section 442.—Change of Annual Accounting Period

26 CFR 1.442-1: Change of annual accounting period.

Whether the Service will recognize as valid certain corporations' elections to be S corporations under section 1362 of the Code under the circumstances described. See Rev. Proc. 84-25, page 468.

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26 CFR 1.442-1: Change of annual accounting period.

A procedure is provided whereby certain corporations may expeditiously obtain approval of a change of their annual accounting periods, even though all of the conditions of section 1.442-1(c)(2) of the regulations can not be satisfied. See Rev. Proc. 84-35, page 509.

Part II.—Methods of Accounting
Subpart A.—Methods of Accounting in General

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.
(Also Sections 451, 481; 1.451-3, 1.481-5.)

Accounting methods; change; long-term contracts. A taxpayer who uses the completed contract method of accounting, and wishes to change from reporting income when each contract is substantially completed to reporting income when each contract is finally completed in order to comply with the regulations, must apply for the Commissioner's consent to a change in method of accounting.

Rev. Rul. 84-27

ISSUE

Is a change in reporting income under the completed contract method of accounting from reporting income when each long-term contract is substantially completed to reporting income when each contract is finally completed a change in method of accounting?

FACTS

The taxpayer, a domestic corporation, elected the completed contract method of accounting under section 1.451-3(d) of the Income Tax Regulations to report its gross income for federal income tax purposes. It had been the consistent practice of the taxpayer for several years to report gross income when each contract was substantially completed but not finally completed and accepted. In 1981, the taxpayer began reporting income from each contract when it was finally completed and accepted by the customer. This was done without applying for a change in method of accounting on Form 3115, Application for Change in Accounting Method, with the Internal Revenue Service. This change resulted in reporting income in a different taxable year than under the method used in the preceding taxable year.

LAW AND ANALYSIS

Section 1.446-1(e)(2)(i) of the regulations provides that, except as otherwise expressly provided in the Internal Revenue Code and regulations thereunder, a taxpayer must secure the Commissioner's consent before changing its method of accounting. Consent is required even if the taxpayer's current method is improper.

Section 1.446-1(e)(2)(ii)(*a*) of the regulations provides that a change in the method of accounting includes a change in the treatment of any material item in an overall plan of accounting. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of a deduction. Section 1.446-1(e)(2)(ii)(*b*) provides that a change in accounting method does not include correction of mathematical or posting errors.

Section 1.446-1(e)(3)(i) of the regulations provides that the taxpayer, in order to secure the Commissioner's consent to change a method of accounting, must file an application on Form 3115, with the Commissioner of Internal Revenue, Attn: CC:C:C:1, Washington, D.C. 20224, within 180 days after the beginning of the taxable year in which it is desired to make the change.

Section 1.451-3(b)(2) of the regulations provides that a long-term contract will not be considered "completed" until final completion and acceptance have occurred.

Section 1.451-3(d)(1) of the regulations provides that under the completed contract method of accounting, gross income derived from long-term contracts must be reported by including the gross contract price of each contract in gross income for the taxable year in which the contract is completed.

Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustments required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

In *H. F. Campbell Company v. Commissioner*, 53 T.C. 439 (1969), *as supplemented by*, 54 T.C. 1021 (1970), *aff'd*, 443 F.2d 965 (6th Cir. 1971), the taxpayer elected to use the completed contract method of accounting. The taxpayer reported income from each contract when the following criteria were met (1) physi-

cal completion, (2) customer acceptance, (3) recordation of all costs, and (4) computation of the final bill. Following an examination by the Service, the taxpayer changed to a method of reporting income under the completed contract method by using only the first two criteria. This change was made without the Commissioner's permission and was not dictated by the Service. The Tax Court held that this was a change in method of accounting since the taxable income shown in *Campbell's* income tax return for 1962 was computed under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed.

Under the regulations a change in method of accounting includes adjustments to any item of income or deduction that involves the proper time for the inclusion of the item in income or the taking of a deduction. In this case, prior to 1981 the taxpayer reported income from each long-term contract in a year preceding the year in which each contract was finally completed and accepted. The change in 1981 to reporting of income from each long-term contract in the year each contract was finally completed and accepted under section 1.451-3(b)(2) of the regulations resulted in the shifting of income or loss from one taxable year to another. This change is similar to the change in *H. F. Campbell*, which was held to be a change in method of accounting.

HOLDING

A change in reporting income under the completed contract method of accounting from when each contract is substantially completed to the reporting of income when each contract is finally completed to comply with section 1.451-3(b)(2) of the regulations is a change in method of accounting and is subject to the provisions of sections 446 and 481 of the Code and regulations thereunder.

This ruling is identified as a designated ruling pursuant to section 5.12(2) of the Rev. Proc. 80-51, 1980-2 C.B. 818.

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26 CFR 1.446-1: General rule for methods of accounting.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed using the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-27, page 469.

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26 CFR 1.446-1: General rule for methods of accounting.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed under the Rule of 78's exceeds the loan payments made during any year of the term of the loan. See Rev. Proc. 84-28, page 475.

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26 CFR 1.446-1: General rule for methods of accounting.

A simplified procedure for individual borrowers to compute current and future years' interest deductions, with respect to certain loans, when they have been reporting interest deductions in accordance with the Rule of 78's computation. See Rev. Proc. 84-29, page 480.

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26 CFR 1.446-1: General rule for methods of accounting.

A procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to short-term consumer loans that are covered by the administrative exception of Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-30, page 482.

Subpart B.—Taxable Year for Which Items of Gross Income Included

Section 451.—General Rule for Taxable Year Of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.

Taxable year of inclusion; "deficiency takings" under "take or pay" gas purchase contracts. The deficiency taking amount in a "take or pay" gas purchase contract determined at December 31, the last day of the contract year, must be included in the taxpayer's gross income for its tax year ended June 30, the tax year in which the amount of the deficiency taking became fixed and determinable.

Rev. Rul. 84-31

ISSUE

In what tax year must "deficiency taking" amounts be included in gross income under the circumstances described below?

FACTS

Corporation *X*, whose tax year is a fiscal year ending June 30 and who uses an accrual method of accounting, is a natural gas producer. *X* sells gas under a "take or pay" gas purchase contract (the "contact") entered into with Corporation *Y*, a pipline company. Under the terms of the contract, which became effective January 1, 1982, *Y* agrees to purchase a quantity of gas equal to 70 percent of *X's* delivery capacity during each calendar year accounting period (referred to in the contract as "aggregate daily contract quantities"). *Y* agrees to pay *X* by the end of each month for gas delivered to *Y* during the preceding month. However, if *Y* fails to take delivery of a quantity of gas equal to the aggregate daily contract quantities during the calendar year accounting period, *Y* is nevertheless required to pay *X*, within 30 days after the end of the calendar year accounting period, for the quantity of gas equal to the difference between the aggregate daily contract quantities and the quantities of gas actually purchased and taken (the "deficiency taking"). Under the terms of the contract, *Y* is entitled to receive the quantity of gas paid for but not taken in installments during the next succeeding four calendar year accounting periods (the "make-up" period), by applying the previously paid deficiency taking amounts as payment for gas taken in excess of the aggregate daily contract quantities during the make-

up period. The contract life is 20 years.

Although *X* is on a fiscal year ending June 30 for federal income tax purposes, deficiency takings are calculated on a calendar year basis; that is, "deficiency takes" (a calculation for any period less than the contract year) occurring in the first six months of the calendar year accounting period may be offset by "overtakes" occurring in the last six months of the calendar year accounting period. Under the terms of the contract, payments for overtakes on one gas well may offset the amount due for deficiency takes on another gas well. Moreover, *Y* may reduce deficiency takes occurring during the calendar year to the extent *Y* requests delivery of a quantity of gas and *X* fails to deliver such quantity of gas.

Although deficiency takes occurred during the period January 1, 1982 through June 30, 1982, the first six months of the calendar year accounting period ending December 31, 1982, *X* did not include the amount of the deficiency takes in gross income for its tax year ended June 30, 1982. Since the existence and amount of the deficiency taking was not fixed and determinable until December 31, 1982, the last day of the contract year, *X* did not include the amount of the deficiency taking in gross income until its tax year ended June 30, 1983.

LAW AND ANALYSIS

Section 451(a) of the Internal Revenue Code provides that the amount of any item of gross income shall be included in the gross income for the tax year in which received by the taxpayer, unless under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the regulations provides that under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

The terms of the take or pay contract provide that *Y* is liable for payment to *X* for a minimum amount of gas even though *Y* does not take the required minimum amount in any given contract (calendar) year. All the events that fix the right to receive income under an accrual method of accounting occur when (1) the required performance occurs, (2) payment therefor is due, or (3) payment therefor is made, whichever happens first. See. Rev. Rul. 74-607, 1974-2 C.B. 149.

In the instant situation, the required performance occurs during the contract year that *X* makes available to *Y* a quantity of gas. Under the terms of the contract, payment for deficiency takings, if any, is not due until 30 days after the end of the contract (calendar) year. Moreover, under the terms of the contract the amount of the deficiency taking, if any, is not determinable until the end of the contract (calendar) year. That is, "deficiency takes" occurring from January 1 through June 30 of any given year (the first six months of the contract year) may be offset (1) by "overtakes" occurring during the last six months of the contract year and (2) to the extent *Y* requests delivery of a quantity of gas during the last six months of the contract year and *X* fails to deliver such quantity of gas. To the extent there is a deficiency taking at the end of the contract year, *X's* right to receive the deficiency taking amount becomes fixed as of the last day of the contract (calendar) year. "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount of gross income." *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182, 184, XIII-1 C.B. 281 (1934). While there were in fact deficiency takings for the period January 1, 1982 through June 30, 1982, the amount thereof was not fixed and determinable at June 30, 1982. Therefore, *X* is not required under the all events test of section 451 of the Code and the regulations thereunder to include the deficiency taking amounts in gross income for its tax year ended June 30, 1982.

HOLDING

The deficiency taking amount determined at December 31, 1982, the last day of the contract year, must be included in *X's* gross income for its tax year ended June 30, 1983, the tax year in which the amount of the deficiency taking became fixed and determinable.

Any change in the taxpayer's present method of accounting for take or pay deficiency amounts to the method described in this revenue ruling is a change in method of accounting to which the provisions of sections 446 and 481 of the Code apply.

This ruling is identified as a designated ruling pursuant to section 5.12 2 of Rev. Proc. 80-51, 1980-2 C.B. 818.

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26 CFR 1.451-1: General rule for taxable year of inclusion.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with Rule of 78's computation. This procedure applies to loans for which the interest computed using the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-27, page 469.

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26 CFR 1.451-1: General rule for taxable year of inclusion.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed under the Rule of 78's exceeds the loan payments made during any year of the term of the loan. See Rev. Proc. 84-28, page 475.

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26 CFR 1.451-1: General rule for taxable year of inclusion.

A procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to short-term consumer loans that are covered by the administrative exception of

Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-30, page 482.

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26 CFR 1.451-3: Long-term contracts.

Accounting methods; long-term contracts; painting contractor. A painting contractor who paints industrial and commercial buildings, highways and railroad bridges, and industrial plants is not entitled to use the completed contract method of accounting.

Rev. Rul. 84-32

ISSUE

Is a taxpayer who, by contract, furnishes industrial and commercial painting services qualified to use the long-term contract method of accounting under section 1.451-3(b)(1) of the Income Tax Regulations?

FACTS

The taxpayer, a domestic corporation, is engaged in the business of providing industrial and commercial painting services. The business consists principally of sandblasting and painting commercial and industrial buildings, highway and railroad bridges, and industrial manufacturing facilities.

In 1982, the taxpayer entered into contracts for painting that would not be completed until the subsequent tax year. The taxpayer elected to report its income and deductions under the long-term contract method as provided under section 1.451-3 of the regulations.

LAW AND ANALYSIS

Section 1.451-3(a)(1) of the regulations provides that income from a long-term contract may be included in gross income in accordance with one of the two long-term contract methods, namely, the percentage of completion method or the completed contract method, or any other method if the method chosen clearly reflects income.

Section 1.451-3(b)(1)(i) of the regulations provides that the term "long-term contract" means a building, installation, construction or manufacturing contract that is not completed within the taxable year in which it is entered into.

The long-term contract method of accounting is only available to all taxpayers who have long-term contracts, as defined in section 1.451-3(b)(1) of the regulations. The Internal Revenue Service has published several revenue rulings holding that an architect, an engineer, and a taxpayer providing engineering and construction management services cannot use the completed contract method of accounting. See Rev. Rul. 70-67, 1970-1 C.B. 117, Rev. Rul. 80-18, 1980-1 C.B. 103, and Rev. Rul. 82-134, 1982-2 C.B. 88 respectively. In each of these rulings the taxpayers were not required to actually construct, build or install anything, even though their services are functionally related to activities that may be the subject of long-term contracts as defined in section 1.453(b)(1)(i) of the regulations.

In this case the taxpayer's business activity does not require the taxpayer to construct, build, or install anything. Rather the taxpayer only provides painting services. In the rulings cited above, the taxpayer provided architectual, engineering, and management services. Thus, the taxpayer in this case does not have a long-term contract as described in section 1.451-3(b)(1)(i) of the regulations. Its contracts are not building, installation, construction or manufacturing contracts.

HOLDING

The taxpayer is not entitled to use the completed contract method of accounting under section 1.451-3(b)(1) of the regulations because the contract does not qualify as a long-term contract as defined in section 1.451-3(b)(1)(i).

The discontinuance of the use of the long-term contract method of accounting as a result of the application of this ruling constitutes a change in method of accounting to which sections 446 and 481 of the Internal Revenue Code and the related regulations will apply.

The use of the long-term contract method under the facts in this case constitutes the use of a Category A method of accounting as defined in section 6.02 of Rev. Proc. 80-51, 1980-2 C.B. 818, 825.

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26 CFR 1.451-3: Long-term contracts.

Whether a change in reporting income under the completed contract method of accounting from reporting income when each long-term contract is substantially completed to reporting income when each contract is finally completed is a change in method of accounting. See Rev. Rul. 84-27, page 126.

Subpart C.—Taxable Year for Which Deductions Taken

Section 461.—General Rule For Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with Rule of 78's computation. This procedure applies to loans for which the interest computed using the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-27, page 469.

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26 CFR 1.461-1: General rule for taxable year of deduction.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed under the Rule of 78's exceeds the loan payments made during any year of the term of the loan. See Rev. Proc. 84-28, page 475.

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26 CFR 1.461-1: General rule for taxable year of deduction.

A simplified procedure for individual borrowers to compute current and future years' interest deductions, with respect to certain loans, when they have been reporting interest deductions in accordance with the Rule of 78's computation. See Rev. Proc. 84-29, page 480.

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26 CFR 1.461-1: General rule for taxable year of deduction

A procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance

with the Rule of 78's computation. This procedure applies to short-term consumer loans that are covered by the administrative exception of Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-30, page 482.

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26 CFR 1.461-1: General rule for taxable year of deduction.

Whether a partnership that purchases timeshare units in a vacation home can deduct interest with respect to a nonrecourse obligation. See Rev. Rul. 84-5, page 32.

Subpart D.—Inventories

Section 471.—General Rule for Inventories

26 CFR 1.471-3: Inventories at cost. (Also Section 1012; 1.1012-1.)

General rule for inventories; inventories at cost; manufacturer's rebate by automobile dealer. An automobile dealer must record the cost of new automobiles in inventory reduced by the amount of a manufacturer's rebate which represents a trade discount.

Rev. Rul. 84-41

ISSUE

Is it proper for an automobile dealer to record the cost of new automobiles in inventory (and cost of goods sold) without reduction of a manufacturer's rebate under the circumstances described below?

FACTS

X, an automobile dealer, uses an accrual method of accounting and files its federal income tax returns on a calendar year basis. *X* is entitled to a 2 percent rebate (the "rebate") from the automobile manufacturer, which is based on the cost to *X* of new automobiles purchased during the taxable year. The rebate is based solely on the total cost of dealer purchases, and does not relate to sales volume, length of time that the dealer holds the automobile in inventory, or other incentives that the manufacturer may offer. Pursuant to the agreement with the manufacturer, *X* is entitled to the rebate in the taxable year of purchase; however, the rebate is actually received by *X* in the taxable year subsequent to the year of purchase.

Under *X*'s method of accounting, at the time new vehicles are purchased from the manufacturer the purchases are recorded in inventory at *X*'s cost with no reduction for the 2 percent rebate. As vehicles are sold, the inventory is reduced by the cost of the vehicles (which becomes the cost of goods sold), without any recognition of the 2 percent rebate that will be received. With respect to automobiles on hand at the end of *X*'s taxable year, such automobiles are valued at cost with no reduction for the rebate. When *X* actually receives its 2 percent rebate on new vehicle purchases in the following year, the cost of goods sold for that year is reduced by an amount equal to the rebate received. That is, the 2 percent rebate is recorded on a cash basis in the year of receipt, even though it relates to and is derived from new vehicle purchases made in the prior taxable year.

LAW AND ANALYSIS

Section 1012 of the Internal Revenue Code provides, generally, that the basis of property shall be its cost. Section 1.1012-1(a) of the Income Tax Regulations provides that cost is the amount paid for such property in cash or other property.

Section 471 of the Code provides that whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income.

Section 1.471-3(b) of the regulations provides that cost means, in the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed.

Generally, there are two types of discounts available: trade (or quantity) discounts and cash discounts. Trade discounts represent adjustments to the purchase price granted by a vendor. The discount may vary depending upon volume or quantity purchases, or other factors established by the vendor. If a discount is always allowed irrespective of time of payment, it is considered to be a trade discount. *See Thomas Shoe Co.*, 1 B.T.A. 124 (1924), *acq.*, IV-1 C.B. 3 (1925). The amount that a dealer will pay for an item is the net price after the trade discount. Cash discounts, on the other hand, represent a reduction in the invoice or purchase price attributable to payment within a prescribed time period. The discount is only available if the purchaser makes payment within such time period.

Rev. Rul. 76-96, 1976-1 C.B. 23, concerns the federal income tax treatment of rebates paid by an automobile manufacturer to qualifying retail customers who purchased its automobiles. Rev. Rul. 76-96 holds that the receipt of the rebate by a qualifying retail customer does not result in the receipt of gross income. However, Rev. Rul. 76-96 holds that the rebate represents a reduction in the purchase price of the automobile, requiring a downward adjustment to the basis of the automobiles in the hands of the purchasers under section 1012 of the Code.

Although the present case involves rebates to an automobile dealer rather than to retail purchasers, the rationale expressed in Rev. Rul. 76-96 is applicable to the instant case. It supports a conclusion that a cash rebate paid to an automobile dealer should be treated as a reduction in the cost of the automobile purchased, and not as an item of gross income. This result is consistent with section 1.471-3(b) of the regulations.

In the present situation, *X* has a fixed right to reimbursement in the taxable year of purchase with respect to the amount of the rebate. Income is distorted in cases in which the rebate is not subtracted in calculating cost of goods sold. That is, under *X*'s

present method of reporting rebates, cost of goods sold is overstated and income is understated where *X* sells an automobile in the same taxable year in which it is purchased. *X* cannot deduct the rebate in a later year (through an adjustment to cost of goods sold) when it has fixed right to reimbursement from the manufacturer in the year a car is purchased. See *Wolfers v. Commissioner*, 69 T.C. 975, 983-985 (1978). That is, *X*'s cost of new automobiles is the amount paid to the manufacturer, less the amount of the rebate for which it has a fixed right to reimbursement.

HOLDING

It is not proper for an automobile dealer to record the cost of new automobiles in inventory (and cost of goods sold) without reduction of a manufacturer's rebate. In this case, the manufacturer's rebate received by an automobile dealer represents a trade discount and, therefore, must be treated as a reduction in the cost of the automobile in the year of purchase.

Any change in a taxpayer's method of accounting, from recording the cost of new vehicles in inventory at cost with no reduction for the 2 percent manufacturer's rebate, to the method described in this revenue ruling is a change in method of accounting to which the provisions of sections 446 and 481 of the Code apply.

This ruling is identified as a designated ruling pursuant to section 5.12 of Rev. Proc. 80-51, 1980-2 C.B. 818.

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The January 1984 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods of valuing inventories for tax years ended on, or with reference to, December 31, 1983, and January 31, 1984.

Rev. Rul. 84-77

Price indexes for February 1984 were issued by the Bureau of Labor Statistics on March 26, 1984, for use by department stores and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, December 31, 1983, and January 31, 1984.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR-STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

	January 1983	January 1984	Percentage Change from January 1983 to January 1984 [1]
I. Piece Goods	392.9	384.3	−2.2
II. Domestics and Draperies	504.2	515.9	−2.3
III. Women's and Children's Shoes	539.2	538.0	−0.2
IV. Men's and Boy's Shoes	669.6	685.8	2.4
V. Infants' Wear	464.9	470.1	1.1
VI. Women's Underwear	388.6	410.2	5.6
VII. Women's and Girls' Hosiery	221.9	230.9	4.1
VIII. Women's and Girls' Accessories	412.6	419.4	1.6
IX. Women's Outerwear and Girls' Wear	315.1	324.7	3.0
X. Men's Clothing	441.3	451.7	2.4
XI. Men's Furnishings	451.1	458.4	1.6
XII. Boys' Clothing and Furnishings	407.5	426.0	4.5
XIII. Jewelry	678.4	694.8	2.4
XIV. Notions	464.1	466.4	0.5
XV. Toilet Articles and Drugs	566.9	610.6	7.7
XVI. Furniture and Bedding	502.6	514.4	2.3
XVII. Floor Coverings	427.1	454.8	6.5
XVIII. Housewares	719.0	731.7	1.8
XIX. Major Appliances	238.3	238.7	0.2

BUREAU OF LABOR-STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS—Continued
(January 1941 = 100)

	January 1983	January 1984	Percentage Change from January 1983 to January 1984 [1]
XX. Radio and Television	115.8	114.0	−1.6
Groups I - XV: Soft Goods	442.5	456.2	3.1
Groups XVI - XX: Durable Goods	437.2	445.6	1.9
Store Total	440.9	453.0	2.7

[1] Absence of a minus sign before percentage change in this column signfies price increase.

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The February 1984 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods of valuing inventories for tax years ended on, or with reference to, February 29, 1984.

Rev. Rul. 84-90

In the past, the Internal Revenue Service accepted and republished the department store inventory price indexes that were published semiannually by the Bureau of Labor Statistics for January and July. The indexes were accepted as appropriate for use by department stores employing the retail inventory and last-in, first-out (LIFO) inventory method, but only for tax years ending on December 31 or January 31 with respect to the January index, or June 30 or July 31 with respect to the July index. However the Bureau of Labor Statistics now issues the department store inventory price indexes monthly. Therefore, the department store inventory indexes will be available to all department stores employing the retail inventory and LIFO inventory method regardless of when their tax years end.

Price indexes for February 1984 were issued by the Bureau of Labor Statistics on March 26, 1984, for use by department stores and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories of department stores employing the retail inventory and LIFO inventory methods for tax years ended on, or with reference to, February 29, 1984.

Indexes are prepared on a national basis for the store total, for 20 major groups of departments, and for two special combinations - soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, food, liquor, tobacco, paints, and wallpaper, as well as contract departments.

A department store using the retail inventory and LIFO inventory methods may not change to the department store inventory price indexes prepared by the Bureau of Labor Statistics and accepted by the Service, without first securing the consent of the Commissioner. The change constitues a change in method of accounting to which section 446 of the Internal Revenue Code and the related regulations will apply.

BUREAU OF LABOR-STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

	February 1983	February 1984	Percentage Change from February 1983 to February 1984 [1]
I Piece Goods	394.6	399.2	1.2
II. Domestics and Draperies	527.9	532.0	0.8
III. Women's and Children's Shoes	543.0	537.5	−1.0
IV. Men's and Boy's Shoes	672.4	688.6	2.4
V. Infants' Wear	471.1	475.6	1.0
VI. Women's Underwear	395.1	413.1	4.6
VII. Women's and Girls' Hosiery	225.2	231.7	2.9
VIII. Women's and Girls' Accessories	411.7	423.5	2.9
IX. Women's Outerwear and Girls' Wear	320.3	324.3	1.2
X. Men's Clothing	441.9	445.8	0.9

BUREAU OF LABOR-STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS—Continued
(January 1941 = 100)

	February 1983	February 1984	Percentage Change from February 1983 to February 1984
XI. Men's Furnishings	447.7	455.8	1.8
XII. Boys' Clothing and Furnishings	406.5	422.3	3.9
XIII. Jewelry	690.3	689.7	−0.1
XIV. Notions	461.4	470.7	2.0
XV. Toilet Articles and Drugs	571.4	612.2	7.1
XVI. Furniture and Bedding	502.5	509.5	1.4
XVII. Floor Coverings	423.3	445.7	5.3
XVIII. Housewares	719.7	727.0	1.0
XIX. Major Appliances	238.4	239.7	0.5
XX. Radio and Television	116.1	113.4	−2.3
Groups I - SV: Soft Goods	448.9	458.5	2.1
Groups XVI - XX: Durable Goods	437.2	442.1	1.1
Store Total	445.4	453.9	1.9

[1] Absence of a minus sign before percentage change in this column signifies price increases.

Part III.—Adjustments

Section 481.—Adjustments Required By Changes In Method Of Accounting

26 CFR 1.481-1: Adjustments in general.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed using the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-27, page 469.

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26 CFR 1.481-1: Adjustments in general.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deduction in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed under the Rule of 78's exceeds the loan payments made during any year of the term of the loan. See Rev. Proc. 84-28, page 475.

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26 CFR 1.481-1: Adjustments in general.

A procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to short-term consumer loans that are covered by the administrative exception of Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-30, page 480.

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26 CFR 1.481-5: Adjustment taken into account with consent.

Whether a change from reporting income when each long-term contract is substantially completed to reporting income when each contract is finally completed to comply with section 1.451-3(b)(2) of the regulations is a change in method of accounting subject to the provisions of section 481 of the Code. See Rev. Rul. 84-27, page 126.

Subpart F.—Exempt Organizations
Part I.—General Rule

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(a)-1: Exemption from taxation.

Procedures for employers to obtain determination letters on certain Service-issued Model Plans. See Rev. Proc. 84-7, page 373.

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26 CFR 1.501(a)-1: Exemption from taxation.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Situations are described that involve the computation of the 15-month period for notification under section 1.508-1(a)(2)(i) of the regulations where an organization makes nonsubstantive amendments to its governing instrument. See Rev. Proc. 84-47, page 545.

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26 CFR 1.501(c)(8)-1: Fraternal beneficiary societies.

Fraternal beneficiary society; legal defense fund for law enforcement officers. A fraternal beneficiary society, composed of law enforcement officers and operating under the lodge system, that provides legal expenses to defend members accused of criminal, civil, or administrative misconduct arising in the course of their employment, provides "other benefits" within the meaning of section 501(c)(8) of the Code.

Rev. Rul. 84-48

ISSUE

Under the circumstances described below, does the maintenance of a legal defense fund by a fraternal beneficiary society, otherwise qualified for exemption from federal in-

come tax under section 501(c)(8) of the Internal Revenue Code, constitute the provision of "other benefits" within the meaning of that section?

FACTS

Local Lodge *E* is a subordinate of national fraternal beneficiary society *P*. *E* is included in *P*'s group exemption letter under section 501(c)(8) of the Code. *E* is composed of law enforcement officers in a particular community.

E maintains a legal defense fund that pays legal counsel reasonable fees to defend members of *E* who have been accused of criminal, civil, or administrative misconduct arising out of the course of their employment. The fund is supported by members' dues.

LAW AND ANALYSIS

Section 501(c)(8) of the Code provides for the exemption from federal income tax of fraternal beneficiary societies, orders, or associations that operate under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and that provide for the payment of life, sick, accident, or other benefits to the members of such societies or their dependents.

The term "other benefits" as used in section 501(c)(8) of the Code, is limited by the type of benefit specified in that section. It is applicable only to those benefits which are of a like kind and nature to those enumerated.

Historically, sick benefits have been understood to include benefits designed to compensate for loss of income during a period of illness, and accident benefits have been understood to encompass benefits payable due to a loss of earning power resulting from an injury. See section 1.501(c)(9)-3(c) of the Income Tax Regulations. For a benefit to be of a like kind and nature to sick or accident benefits and, therefore, to be included within the term "other benefits" under section 501(c)(8) of the Code, the benefit must be similar in nature to protection designed to compensate for expenses resulting from bodily injury or loss of earning power. See section 1.501(c)(9)-3(d) of the regulations.

E's payment of fees to legal counsel for defending members against criminal, civil, and administrative misconduct charges offers protection against the type of financial loss directly related to the loss of earning power.

In the case of *E*'s members, the imposition of penalties on those found guilty of misconduct arising out of acts performed during the course of their employment could include disciplinary action such as dismissal or suspension without pay. Penalties could, therefore, result in loss of earning power to members.

HOLDING

Under the circumstances described above, the maintenance of a legal defense fund by a fraternal beneficiary society, otherwise qualified for exemption from federal income tax under section 501(c)(8) of the Internal Revenue Code, constitutes the provision of "other benefits" within the meaning of that section.

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26 CFR 1.501(c)(8)-1: Fraternal beneficiary societies.

Fraternal beneficiary society; orphanage for deceased members' dependent children. A fraternal beneficiary society that operates an orphanage for surviving children of deceased members provides "other benefits" within the meaning of section 501(c)(8) of the Code.

Rev. Rul. 84-49

ISSUE

Under the circumstances described below, does a fraternal beneficiary society provide "other benefits" within the meaning of section 501(c)(8) of the Internal Revenue Code if it provides an orphanage for the surviving dependent children of deceased members?

FACTS

National fraternal beneficiary society *M*, which otherwise qualifies for exemption from federal income tax under section 501(c)(8) of the Code, operates an orphanage open to the surviving dependent children of any deceased member. All expenses of the orphanage are paid from a separate fund maintained by *M*. The separate fund is supported by members' dues. Each of *M*'s subordinate lodges contributes a portion of its dues income to the fund.

LAW AND ANALYSIS

Section 501(c)(8) of the Code provides for the exemption from federal income tax of fraternal beneficiary societies, orders, or associations that operate under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and that provide for the payment of life, sick, accident, or other benefits to the members of such societies or their dependents.

The term "other benefits," as used in section 501(c)(8) of the Code, is limited by the type of benefit specified in that section. It is applicable only to those benefits that are of a like kind and nature to those enumerated. Providing an orphanage for members' surviving dependent children is providing a benefit of a like kind and nature to life insurance benefits. Although it differs from life insurance benefits because it is a noncash benefit, *M*'s orphanage serves the same purpose that life insurance serves. Life insurance provides a measure of financial security to the insured's survivors if the insured dies. Similarly, *M*'s orphanage provides its members' children security against becoming wards of the state if their parents die. Both benefits provide *M*'s members a way to protect their families.

Also, *M* operates the orphanage in a manner similar to a life insurance program. The members' contributions, made through their subordinate lodges, to *M*'s separately maintained orphanage fund are similar to insurance premium payments to typical life insurance funds.

HOLDING

Under the circumstances described above, a fraternal beneficiary society provides "other benefits" within the meaning of section 501(c)(8) of the Code, if it provides an orphanage for the surviving dependent children of deceased members.

Part II.—Private Foundations

Section 508.—Special Rules With Respect to Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.

Situations are described that involve the computation of the 15-month period for notification under section 1.508-1(a)(2)(i) of the regulations where an organization makes nonsubstantive amendments to its governing instrument. See Rev. Proc. 84-47, page 545.

Section 509.—Private Foundation Defined

26 CFR 1.509(a)-1: Definition of private foundation.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

Part IV.—Farmers' Cooperatives

Section 521.—Exemption Of Farmers' Cooperatives From Tax

26 CFR 1.521-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Cooperative marketing forest products; definition of "farming". A federated cooperative marketing newsprint, and its member cooperatives growing pulpwood, are not engaged in the business of farming and do not qualify for the exemption from federal income tax as farmers' cooperatives within the meaning of section 521 of the Code.

Rev. Rul. 84-81

ISSUE

Do a federated cooperative marketing newsprint and its member cooperatives supplying pulpwood cut from timber grown by the cooperatives' patron members qualify for exemption from federal income tax as farmers' cooperatives within the meaning of section 521 of the Internal Revenue Code?

FACTS

Three taxpayers were organized as agricultural associations and qualify as cooperative organizations (COOPS) under subchapter T, sections 1381-1385 of the Code. Their purpose is to engage in the business of marketing the forest products of their member patrons. The COOPS' producer-members are engaged in the business of growing pine trees for timber and cutting it into pulpwood that is marketed by the COOPS. In connection with the marketing, the COOPS cut or contract to cut the members' pine timber. The COOPS also provide forest management services to improve yields.

In order to consolidate their marketing activities, the COOPS formed a federated cooperative in which the COOPS are members. The federated cooperative buys pulpwood from the COOPS. In order to provide a steady market for the pulpwood, the federated cooperative formed a partnership with other investors to construct and operate a newsprint papermill. The federated cooperative provided its shares of the necessary capital by assessing the COOPS and their members. The partnership buys pulpwood from the federated cooperative and processes it into newsprint and subsequently sells it to newsprint users. The profits of the partnership are derived from selling newsprint and are distributed equally to the partners.

LAW AND ANALYSIS

Section 521(a) of the Code provides that a farmers' cooperative organization shall be exempt from the federal income tax except as provided in subchapter T.

Section 521(b) of the Code defines farmers' cooperatives that are exempt from federal income tax under sections 521(a). Included are farmers', fruit growers' or like associations organized and operated on a cooperative basis for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary marketing expenses.

Section 1.521-1(a)(1) of the Income Tax Regulations includes in the definition of exempt farmers' cooperatives cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, and dairymen, and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of either the quantity or value of the products furnished by them.

Neither sections 521 of the Code nor 1.521-1 of the regulations defines the terms "farm", "business of farming", or "land used in farming." However, other sections of the Code and their related regulations do define these or similar terms.

Section 61 of the Code is an income defining section. Under section 1.61-4(d) of the regulations, a farm is defined in the ordinarily accepted sense and cited as examples are stock, dairy, poultry, fruit, and truck farms, as well as plantations and ranches. A reference is made to section 1.175-3 of the regulations for more detailed rules to apply in determining whether farming is being carried on.

Section 175 of the Code provides for the deduction of soil and water conservation expenditures by a taxpayer engaged in the business of farming. Section 1.175-3 of the regulations states that a taxpayer engaged in the growing of timber is not engaged in the business of farming.

Section 180 of the Code provides for the deduction of expenditures by farmers for fertilizer. The regulations underlying section 180 require that the principles of section 1.175-3 and 1.175-4 apply to determine if a taxpayer is engaged in the business of farming.

Section 182 of the Code applies to expenditures by farmers for clearing land. For purposes of defining the term "land suitable for farming",

section 1.182-2 of the regulations provides that a taxpayer is engaged in the business of farming if he operates or manages a farm for profit. Section 1.182-2 specifically provides that forestry or the growing of timber is not a farming activity.

Section 464(e)(1) of the Code provides that for purposes of section 464, the term "farming" means the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. For purposes of the preceding sentence, trees (other than trees bearing fruit or nuts) shall not be treated as an agricultural or horticultural commodity.

Rev. Rul. 73-570, 1973-2 C.B. 194, holds that an incorporated organization marketing lumber for independent lumber producing companies controlling the organization does not qualify for exemption under section 521 of the Code. Rev. Rul. 73-570 relied on sections 1.61-4(d) and 1.175-3 of the regulations as supporting the exclusion of lumbering from the generally accepted definition of farming. Lumbering is the business of cutting timber and converting the cut timber by the forest industry into lumber.

In the present situation, the grown timber is cut and the cut timber converted by a forest industry into pulpwood, which is then pulped and made into newsprint. Lumbering and the production of pulpwood are similiar in that timber is cut and the products cut from the timber are sent to a forest industry mill for conversion into another product. The primary distinction between lumbering and the production of pulpwood is the kind of forest industry mill that is used in the conversion of the timber into an end product. This distinction does not affect the classification of the activity as forestry for purposes of the Code.

The terms "farmers" and "farming" as used in sections 61, 175, 180, and 182 of the Code and regulations do not apply to forestry. Consequently, the cutting of timber for its end use as either lumber or newsprint is excluded from the definition of farming or fruit growing within the meaning of section 521. See also section 1.175-3 of the regulations.

HOLDING

A federated cooperative marketing newsprint and its member cooperatives supplying pulpwood cut from timber grown by patron members do not qualify for exemption from federal income tax as farmers' cooperatives within the meaning of section 521 of the Code.

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26 CFR 1.521-1: Farmer's cooperative marketing and purchasing associations; requirements for exemption under section 521.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under section 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

Subchapter H.—Banking Institutions
Part I.—Rules of General Application to Banking Institutions

Section 584.—Common Trust Funds

26 CFR 1.584-1: Common trust funds. (Also Section 6032; 1.6032-1.)

T.D. 7935

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Common trust funds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to common trust funds. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], by the Act of September 17, 1976 [Pub. L. 94-414, 1976-2 C.B. 535], by the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2], by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], and by the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. These regulations provide the public with guidance necessary to comply with those Acts and with other rules affecting common trust funds. The regulations affect common trust funds and their participants.

EFFECTIVE DATES: The amendments conforming to sections of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] are effective for taxable years as follows: section 1402(b)(1) for taxable years beginning in 1977; section 1402(b)(2) for taxable years beginning after December 31, 1977; section 1901(b)(1)(G) for taxable years beginning after December 31, 1976; and sections 2131(d) and 2138(a) for taxable years ending after April 7, 1976, and October 3, 1976, respectively. The amendments conforming to the Act of September 17, 1976 [Pub. L. 94-414, 1976-2 C.B. 535], are effective for taxable years beginning after December 31, 1975. The amendment conforming to the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2] (as amended by section 302(b)(1) of the Economic Recovery Tax Act of 1981) [Pub. L. 96-223, 1980-3 C.B. 2] (as amended by section 302(b)(1) of the Economic Recovery Tax Act of 1981) [Pub. L. 97-34, 1981-2 C.B. 256, 309] is effective with respect to taxable years beginning after December 31, 1980, and before January 1, 1982. The clarifying amendment under §1.584-2(c)(3), relating to the pass-through of unrelated business income to participants in the common trust fund, is effective for taxable years of participants beginning on or after September 22, 1980.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention:

CC:LR:T (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 22, 1980, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 584 and 6032 of the Internal Revenue Code of 1954 (45 FR 62848). The amendments were proposed to make certain clarifying changes and to conform the regulations to the following statutory changes:

Section 1402(b)(1) and (2) of the Tax Reform Act of 1976 (90 Stat. 1732) amended section 584 to reflect the new holding period provisions for determining long-term and short-term capital gains and losses under section 1222.

Section 1901(b)(1)(G) of the Tax Reform Act of 1976 (90 Stat. 1790) amended section 584 to delete references to sections 35, 242, and 171.

Section 2131(d) of the Tax Reform Act of 1976 (90 Stat. 1924) amended section 584 to provide that the admission of a participant shall be treated as a purchase of, or exchange for, the participating interest.

Section 2138(a) of the Tax Reform Act of 1976 (90 Stat. 1932) amended section 584 to provide for the allowance of accounts established under the Uniform Gifts to Minors Act or similar state law.

Section 1 and 2 of the Act of September 17, 1976 (90 Stat. 1273) [Pub. L. 94-414, 1976-2 C.B. 535], amended Code section 584 to provide that when banks become members of the same affiliated group (within the meaning of Code section 1504) they are, for purposes of section 584, to be treated as one bank for the period of their affiliation.

A public hearing was held on February 19, 1981. All comments and testimony regarding the proposed amendments were considered. Those proposed amendments are adopted as revised by this Treasury decision. The following three technical changes to those regulations have been made.

EXEMPTION OF CERTAIN INTEREST INCOME

The Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2] (as amended by section 302(b)(1) of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 309]) amended section 116 of the Code to provide for the exemption of certain interest income from tax. Section 404(b)(3) of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2, 78] amended Code section 584(c)(2) to conform this exemption to interest income earned by a common trust fund. Section 128 of the Code provides that gross income does not include any amount received by an individual during the taxable year as interest on a depository institution tax-exempt savings certificate. Section 103(a)(2) of the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451, 456] amended Code section 584(c)(2) to conform this exemption to interest earned by a common trust fund. This final regulation makes corresponding changes to §1.584-2(b)(1).

TREATMENT OF AMOUNTS IN HANDS OF PARTICIPANTS

The proposed regulations, in §1.584-2(c)(3), provided that, for purposes of determining the character in the hands of a participant of any item of income or deduction, each participant is treated as if it made directly the investment by the common trust fund from which the item was derived. In response to comments that section 584 does not specifically provide for the flow-through of all items from a common trust fund, §1.584-2(c)(3) has been modified. The modified regulation provides that any amount of income or loss of the common trust fund that is included in the computation of a participant's taxable income is to be treated as income or loss from an unrelated trade or business to the extent that such amount would have been income or loss from an unrelated trade or business if the participant had made directly the investment in the common trust fund. Thus, any amounts of income or loss to be included in a participant's computation of taxable income will be computed as specifically provided in section 584, while the treatment in the hands of the participant as income or loss from an unrelated trade or business of amounts so computed will be determined as if the participant had made directly the investments of the common trust fund. A cross reference in the regulations under section 512 is added.

The proposed regulations did not specify an effective date for §1.584-2(c)(3), relating to the treatment of amounts of income or loss included in the computation of the participant's taxable income. As a result, the amendment would have had retroactive effect. In response to comments received on this subject, the final regulations provide a prospective effective date for this rule, commencing on the date of publication of the notice of proposed rulemaking. Therefore, the portion of the regulations relating to the rule in §1.584-2(c)(3) applies to computation of taxable income for taxable years beginning on or after September 22, 1980.

ADMISSION OR WITHDRAWAL OF PARTICIPANTS

Under §1.584-4 of the proposed regulations the transfer of a participating interest by two or more banks that are members of the same affiliated group as a result of the division of a single common trust fund will not be considered to be an admission or a withdrawal. However, this rule only applies where the dividing and resulting common trust funds have diversified portfolios and each participant's pro rata interest in each of the resulting common trust funds is substantially the same as was the participant's pro rata interest in the dividing fund. If a common trust fund in which several affiliated banks participate is divided because of the termination of the affiliation this rule

would require that each of the participants in the dividing common trust fund become a participant in each of the resulting common trust funds. One commentator has stated that in many situations this will not be possible. In order to allow disaffiliating banks to divide a common trust fund without causing the participants to recognize gain, the final regulations provide that each of the participants in the dividing common trust fund need not become a participant in each of the resulting common trust funds. However, this rule shall only apply where the written plans of operation of the resulting common trust funds are substantially identical to the plan of operation of the dividing common trust fund, each of the assets of the dividing common trust fund are distributed substantially pro rata to each of the resulting common trust funds, and each participant's aggregate interest in the assets of the resulting common trust funds of which he or she is a participant is substantially the same as was the participant's pro rata interest in the assets of the dividing common trust fund. The plan of operation of a resulting common trust fund will not be considered to be substantially identical to that of the dividing common trust fund where, for example, the plan of operation of the resulting common trust fund contains restrictions as to the types of participants that may invest in the common trust fund where such restrictions were not present in the plan of operation of the dividing common trust fund. The requirement that the distribution of the assets of the dividing common trust fund must be "substantially" pro rata is intended to allow distributions in order to eliminate fractional shares.

PROVISIONS APPLICABLE TO PARTICIPANTS

Under §1.584-2(d) of the existing and of the proposed regulations, participants accounted for their proportionate share of income from a common trust fund according to provisions under subchapter J, chapter 1 of the Code. This final regulation clarifies that certain participants may account for such income according to the provisions under subchapter D, F, or H, as the case may be.

EXPLANATION OF PROVISIONS UNCHANGED FROM THE NOTICE

The Act of September 17, 1976, amended Code section 584 to provide that when banks become members of the same affiliated group (within the meaning of Code section 1504) they are, for purposes of section 584, to be treated as one bank for the period of their affiliation. This Treasury decision makes it clear that banks that are members of the same affiliated group may contribute to common trust funds of other member banks without disqualifying the funds as common trust funds.

Rules and regulations promulgated by the Comptroller of the Currency permit the contribution of cash and, in limited circumstances, non-cash property to a fund. The Tax Reform Act of 1976 amended section 584 to make the contribution of non-cash property to a common trust fund a taxable event. In addition, the Act extended common trust fund treatment to custodial accounts established pursuant to a State law that is substantially similar to the Uniform Gifts to Minors Act. The Tax Reform Act also repealed an obsolete portion of section 584 dealing with partially tax-exempt interest and amended the section to reflect the new holding period provisions for determining long-term and short-term capital gains and losses under section 1222. This Treasury decision incorporates these changes as they relate to common trust funds and their participants.

The final regulations adopted by this Treasury decision impose no new reporting or recordkeeping requirements. The principal purpose of the final regulations is to conform existing regulations under sections 584 and 6032 of the Code to changes made by the Act of September 17, 1976 [Pub. L. 94-414, 1976-2 C.B. 535], the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2], the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] and the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. Evaluation of the effectiveness of these regulations after issuance will be based on comments received from offices within Treasury, the Internal Revenue Service, other governmental agencies, and the public.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this proposed regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. §553(b) for interpretative regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal author of this regulation is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulation on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 1.512(a)-1 is amended by adding a new sentence at the end of paragraph (a). The added sentence reads as follows:

§1.512(a)-1 Definition.

(a) *In general.* ***

For the treatment of amounts of income or loss of common trust funds, see §1.584-2(c)(3).

Par. 2. Section 1.584-1 is amended by deleting the third sentence of paragraph (a), by revising paragraph (b), and by adding new paragraph (c). These added and amended provisions read as follows:

§1.584-1 Common trust funds.

* * * * *

(b) *Conditions for qualification.* (1) For a fund to be qualified as a common trust fund it must be maintained by a bank (as defined in section 581) in conformity with the rules and regulations of the Comptroller of the Currency, exclusively for the collective investment and reinvestment of contributions to the fund by the bank. The bank may either act alone or with one or more other fiduciaries, but it must act solely in its capacity as one or a combination of the following: (i) as a trustee of a trust created by will, deed, agreement, declaration of trust, or order of court; (ii) as an executor of a will or as an administrator of an estate; (iii) as a guardian (by whatever name known under local law) of the estate of an infant, of an incompetent individual, or of an absent individual; or (iv) on or after October 3, 1976, as a custodian of a Uniform Gifts to Minors account. A Uniform Gifts to Minors account is an account established pursuant to a State law substantially similar to the Uniform Gifts to Minors Act. (*See* the Uniform Gifts to Minors Act of 1956 or the Uniform Gifts to Minors Act of 1966, as published by the National Conference of Commissioners on Uniform State Laws.) The Commissioner will publish a list of the States whose laws he determines to be substantially similar to such uniform acts. A bank that maintains a Uniform Gifts to Minors Act account must establish, to the satisfaction of the Commissioner or his delegate, that with respect to the account the bank has duties and responsibilities similar to the duties and responsibilities of a trustee or guardian.

(2) A common trust fund may be a participant in another common trust fund.

(c) *Affiliated groups.* For taxable years beginning after December 31, 1975, two or more banks that are members of the same affiliated group (within the meaning of section 1504) are treated, for purposes of section 584, as one bank for the period of their affiliation. A common trust fund may be maintained by one or by more than one member of an affiliated group. Any member of the group may, but need not, contribute to the fund. Further, for purposes of this paragraph, members of an affiliated group may be, but need not be, co-trustees of the common trust fund.

Par. 3. Section 1.584-2 is amended by revising paragraphs (a) and (b) and subparagraphs (1) and (2) of paragraph (c); by redesignating subparagraph (3) of paragraph (c) as subparagraph (4) and adding a new subparagraph (3); by revising the first sentence of paragraph (c)(4) as so redesignated; by redesignating existing subparagraph (4) of paragraph (c) as subdivision (v) of redesignated paragraph (c)(4); by adding a new subdivision (vi) to redesignated paragraph (c)(4); and by revising paragraph (d). These added and amended provisions read as follows:

§1.584-2 Income of participants in common trust fund.

(a) Each participant in a common trust fund is required to include in computing its taxable income for its taxable year within which or with which the taxable year of the fund ends, whether or not distributed and whether or not distributable:

(1) Its proportionate share of short-term capital gains and losses, computed as provided in §1.584-3;

(2) Its proportionate share of long-term capital gains and losses, computed as provided in §1.584-3; and

(3) Its proportionate share of the ordinary taxable income or the ordinary net loss of the common trust fund, computed as provided in §1.584-3.

(b)(1) Each participant's proportionate share of dividends and interest to which section 116 or 128 applies received by the common trust fund shall be deemed to have been received by such participant as such dividends and as such interest.

(2) Any tax withheld at the source from income of the fund (*e.g.*, under section 1441) is deemed to have been withheld proportionately from the participants to whom such income is allocated.

(c)(1) The proportionate share of each participant's short-term capital gains and losses, long-term capital gains and losses, ordinary taxable income or ordinary net loss, dividends and interest received, and tax withheld at the source shall be determined under the method of accounting adopted by the bank in accordance with the written plan by which the common trust fund is established and administered, provided such method clearly reflects the income of each participant.

(2) Items of income and deductions shall be allocated to the periods between valuation dates established by the plan within the taxable year in which they were realized. Ordinary taxable income or ordinary net loss, short-term capital gains and losses, long-term capital gains and losses, and tax withheld at the source shall be computed for each period. The participants' proportionate shares of income and losses for each period shall then be determined.

(3) For taxable years beginning on or after September 22, 1980, any amount of income or loss of the common trust fund which is included in the computation of a participant's taxable income for the taxable year shall be treated as income or loss from an unrelated trade or business to the extent that such amount would have been income or loss from an unrelated trade or business if such participant had made directly the investments of the common trust fund.

(4) The provisions of this paragraph may be illustrated by the following example: ***

(vi) Assume in the above example that participant Trust A qualified as a

trust forming part of a pension, profit sharing, or stock bonus plan under section 401(a). Assume further that 20 percent of the ordinary taxable income of the common trust fund would be unrelated business taxable income (as defined under section 512(a)(1)) if received directly by Trust A. Under paragraph (c)(3), participant Trust A, for purposes of computing its taxable income, must treat its proportionate share of the common trust fund's ordinary taxable income as income from an unrelated trade or business to the extent such amount would have been income from an unrelated trade or business if Trust A had directly made the investments of the common trust fund. Therefore, participant Trust A must take into account 20 percent of its proportionate share of the common trust fund's ordinary taxable income as income from an unrelated trade or business.

(d) The provisions of part I, subchapter J, chapter 1 of the Code, or, as the case may be, the provisions of subchapters D, F, or H of chapter 1 of the Code, are applicable in determining the extent to which each participant's proportionate share of any income or loss of the common trust fund is taxable to the participant, or to a person other than the participant.

Par. 4. Section 1.584-3 is amended by inserting the word "and" at the end of paragraph (b), by deleting the semi-colon and the word "and" and inserting a period in lieu thereof at the end of paragraph (c), and by deleting paragraph (d).

Par. 5. Section 1.584-4 is amended by adding a new sentence after the first sentence of paragraph (a), by adding three new sentences after the last sentence of paragraph (a), and by revising paragraph (c)(4). These added and amended provisions read as follows:

§1.584-4 Admission or withdrawal of participants in the common trust fund.

(a) *Gain or loss.* *** For taxable years of participants ending after April 7, 1976, and for transfers occuring after that date, the transfer of property by a participant to a common trust fund is treated as a sale or exchange of the property transferred. *** When a participating interest is transferred by a bank or by two or more banks that are members of the same affiliated group (within the meaning of section 1504), as a result of the combination of two or more common trust funds or the division of a single common trust fund, the transfer to the surviving or divided common trust fund is not considered to be an admission or a withdrawal if—

(1) The combining, dividing, and resulting common trust funds have diversified portfolios within the meaning of section 368(a)(2)(F)(ii) and the regulations thereunder, and

(2) In the case of a division, each participant's pro rata interest in each of the resulting common trust funds is substantially the same as was the participant's pro rata interest in the dividing fund. However, in the case of the division of a common trust fund maintained by two or more banks that are members of the same affiliated group resulting from the termination of such affiliation, the division will be treated as meeting the requirements of this subparagraph if the written plans of operation of the resulting common trust funds are substantially identical to the plan of operation of the dividing common trust fund, each of the assets of the dividing common trust fund are distributed substantially pro rata to each of the resulting common trust funds, and each participant's aggregate interest in the assets of the resulting common trust funds of which he or she is a participant is substantially the same as was the participant's pro rata interest in the assets of the dividing common trust fund. The plan of operation of a resulting common trust fund will not be considered to be substantially identical to that of the dividing common trust fund where, for example, the plan of operation of the resulting common trust fund contains restrictions as to the types of participants that may invest in the common trust fund where such restrictions were not present in the plan of operation of the dividing common trust fund.

* * * * *

(c) *Addition to basis.* ***

(4) The excess of the gains over the losses recognized to the common trust fund upon sales or exchanges of capital assets held (i) for more than 18 months for taxable years beginning after December 31, 1937, and before January 1, 1942, (ii) for more than 6 months for taxable years beginning after December 31, 1941, and before January 1, 1977, (iii) for more than 9 months for taxable years beginning in 1977, and (iv) for more than 1 year for taxable years beginning after December 31, 1977, and ***

Par. 6. Section 1.6032-1 is amended by adding new sentences immediately following the first and sixth sentences. The added provisions read as follows:

§1.6032-1 Returns of banks with respect to common trust funds.

***Member banks of an affiliated group that serve as co-trustees with respect to a common trust fund must act jointly in making a return for the fund. *** If the common trust fund is maintained by two or more banks that are members of the same affiliated group, the return must also identify the member bank in the group that has contributed each participant's property or money to the fund. ***

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 22, 1983,

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 12, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 13, 1984, 49 F.R. 1692)

26 CFR 1.584-1: Common trust funds.

Guidelines for the determination of the fair market value of participating interests in common trust funds between bank valuation dates. See Rev. Proc. 84-17, page 432.

Section 585.—Reserves for Losses on Loans of Banks

26 CFR 1.585-2: Addition to reserve.

Whether the portion of an international loan that is either charged to the allocated transfer risk reserve or against the allowance for possible loan losses is excluded from a bank's loans or eligible loans outstanding for purposes of determining the reasonable addition to the reserve for bad debts under section 585 of the Code. See Rev. Rul. 84-94, page 34.

Part II.—Mutual Savings Banks, etc.

Section 593.—Reserves for Losses on Loans

26 CFR 1.593-11: Qualifying real property loan and nonqualifying loan defined.

Whether an interest in a mortgage "pool" comes within the definition of the term "qualifying real property loans". See Rev. Rul. 84-10, page 155.

Subchapter I.—Natural Resources
Part I.—Deductions

Section 611.—Allowance of Deduction for Depletion

26 CFR 1.611-1: Allowance of deduction for depletion.

Depletion; economic interest. A mining company as operator has an economic interest under an agreement that requires the delivery of all extracted coal to the owner, who applies additional mining processes and shares the proceeds received on the sale of the processed coal at specified percentages. A stated minimum amount payable to the operator did not negate the economic interest under the specific facts of the case.

Rev. Rul. 84-88

ISSUE

Does taxpayer possess an economic interest in coal under section 1.611-1(b)(1) of the Income Tax Regulations under the circumstances described below?

FACTS

The owner of coal properties (X) and a mining company (taxpayer) entered into an agreement by which X granted the taxpayer the exclusive right to mine coal from the specified coal seams until all coal has been mined. The taxpayer is required to deliver all of the coal produced to X who applies only mining processes as defined in section 613(c)(4)(A) of the Internal Revenue Code and sells the processed coal to others.

The agreement provides that the taxpayer mine the coal in return for a 70-percent share of the net proceeds of the processed coal sold. The agreement further provides that the taxpayer will receive a minimum amount of $\$22x$ on each ton of the first $1000y$ tons of coal processed and sold. This minimum amount will be paid to the taxpayer by X on each ton of the first $1000y$ tons that are processed and sold if 70 percent of the net proceeds is less than such minimum amount. However, in no event, will X pay the taxpayer more than the net proceeds of any sale. Furthermore, at the time they entered into the agreement, the coal reserves were $5000y$ tons. The agreement also provides that X will be entitled to recoup, out of the taxpayer's 70 percent share of net proceeds in excess of $\$22x$, any amounts that X previously paid to the taxpayer that exceeded 70 percent of the net proceeds.

LAW AND ANALYSIS

Section 1.611-1(b)(1) of the regulations provides for annual depletion deductions to the owner of an economic interest in mineral deposits. An economic interest is possessed when the taxpayer has acquired by investment an interest in mineral in place and secures, by any form of legal relationship income derived from the extraction of the mineral to which he must look for a return of his capital.

For the taxpayer to have an economic interest in minerals in place, it is essential that the consideration received for the minerals, under the terms of an agreement, represents literally a share of the minerals extracted or proceeds from their sales, and that the taxpayer be dependent upon such consideration for a return of his capital. See *Palmer v. Bender*, 287 U.S. 551 (1933), XII-1 C.B. 235 (1933).

In Rev. Rul. 74-469, 1974-2 C.B. 177, a lessee under various mineral leases, with the right to extract and sell certain minerals, granted to Y the right to mine such minerals to exhaustion. Y had the burden of extracting the minerals from the ground and delivering them to a stockpile. Lessee had the burden of transporting and processing the minerals and of paying all production royalties. Upon severance from the ground all minerals became the property of lessee and Y individually in specified shares, and an independent agent sold the minerals on the open market for the accounts of lessee and Y. Rev. Rul. 74-469 holds that both lessee and Y obtained an economic interest in their respective shares of the minerals in place.

The situation in this ruling differs from that in Rev. Rul. 74-469 in that (1) the taxpayer does not have the right to sell its share of the coal produced because the coal is to be delivered to X who sells the coal after processing, and (2) the taxpayyer receives 70 percent of the net proceeds from the sale of the processed coal, but not less than $\$22x$ per ton (or the net proceeds, if less than $\$22x$) for a specified basic tonnage. Nevertheless, the taxpayer acquired from X separate contractual rights to mine coal to exhaustion and to look to the sale of the coal for the return of its investment. The income to the taxpayer is dependent solely on the eventual sale of the coal. Therefore, the taxpayer has acquired an economic interest in the coal in place under section 1.611-1(b)(1) of the regulations.

HOLDING

The taxpayer possesses an economic interest in coal in place under section 1.611-1(b)(1) of the regulations.

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26 CFR 1.611-3: Rules applicable to timber.

Whether reforestation costs reimbursed by the Federal government under the forestry incentives program are to be capitalized as a cost of timber. See Rev. Rul. 84-67, page 28.

Section 613.—Percentage Depletion

26 CFR 1.613-2: Percentage depletion rates

Depletion; percentage depletion rate; nahcolite. Nahcolite falls under the category of "all other minerals" entitled to a percentage depletion rate of 14 percent under section 613(b)(7) of the Code.

Rev. Rul. 84-87

ISSUE

Whether "nahcolite" comes within the category of "all other minerals" entitled to the percentage depletion rate of 14 percent under section 613(b)(7) of the Internal Revenue Code.

FACTS

Nahcolite is a naturally occurring sodium carbonate mineral with a chemical formula of $NaHCO_3$. It is a soft, colorless, water-soluble substance with a vitreous luster. Nahcolite occurs in association with oil shale and is separated from the oil shale by solution mining methods. The extracted mineral will be marketed for such uses as food and baking, chemicals, pharmaceuticals, soaps and detergents, and others in competition with manufactured bicarbonate of soda or baking soda.

Sections 613(b)(1) through (7) of the Code list various minerals and the percentage depletion rate to which each is entitled. Section 613(b)(7) provides for a percentage depletion rate of 14 percent for "all other minerals, including but not limited to", certain listed ones, subject only to the exceptions specifically set forth.

In considering the classification into which minerals fall, the court pointed out in *United States v. Fannin Investment Co., Inc.*, 322 F.2d 449 (1963), citing S.Rep. No. 781, 82nd Cong., 1st Sess. 37 (1951), 1951-2 C.B. 458, 485, that the "names of all the various enumerated minerals are . . . intended to have their commonly understood commercial meaning."

The term "nahcolite" has a commonly understood commercial meaning as a separately identifiable mineral possessing properties and characteristics that distinguish it from other sodium carbonate bearing minerals as well as other minerals listed under section 613(b).

Nahcolite is not one of the minerals listed in subsection (1) through (6) of section 613(b) of the Code, nor is it one of the exclusions named in subsection (7) of that section. Therefore, nahcolite, a mineral recognized in commercial industry, is included as one of the "all other minerals" in subsection (7) subject to a percentage depletion rate of 14 percent.

HOLDING

Nahcolite falls under the category of "all other minerals" entitled to a percentage depletion rate of 14 percent under section 613(b)(7) of the Code.

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26 CFR 1.613-4: Gross income from the property in the case of minerals other than oil and gas.

Depletion; pipeline transportation of slurry to mining processing plant. In transporting mineral slurry by pipeline from a beneficiation plant to a seaport where additional mining processes are applied before sale, only that portion of the transportation within 50 miles of the mine is considered "mining" under section 613(c)(2) of the Code. Rev. Rul. 73-474 revoked.

Rev. Rul. 84-26

ISSUE

Whether, under the facts and circumstances described below, pipeline transportation of the concentrates to the seaport is "mining" as defined in section 613(c)(2) of the Internal Revenue Code?

FACTS

A corporate taxpayer mines and sells a mineral in which it has an economic interest. The mineral deposit is located 150 miles from a seaport and is mined by conventional open-pit mining methods. The extracted ore is transported by truck, 4 miles from the mine to the taxpayer's beneficiation plant where it is reduced in size and beneficiated by a flotation process. The concentrate product which contains about 60 percent water is then sent to a thickener where a portion of the water added during the flotation process is removed leaving approximately 35 percent water. The resulting concentrate is suitable for transportation by slurry pipeline. The slurry is transported over land by pipeline to the seaport where it is sold. At the seaport, most of the water is removed by filtering and drying the concentrates to about 4 percent water content. The concentrates are then delivered to the purchasers for transportation by ship to their plants.

LAW AND ANALYSIS

Section 613(c)(2) of the Code provides that the term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in section 613(c)(4) as well as the treatment processes necessary or incidental thereto and so much of the transportation of ores or minerals from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles, unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

Section 1.613-4(f)(1)(iii) of the regulations provides that mining includes transportation of ores or minerals from the place of extraction to plants or mills where mining processes are applied. Transportation for a distance greater than 50 miles is mining transportation only to the ex-

tent the Commissioner of the Internal Revenue finds that both the physical and other requirements are such that the ores or minerals must be transported more than 50 miles.

Section 1.613-4(f)(5)(iii) of the regulations provides that drying to remove free water, provided that such drying does not change the physical or chemical identity or composition of the mineral, is recognized as a mining process in addition to the specific processes recognized as mining under section 613(c)(4) of the Code.

Section 1.613-4(g)(2) provides that a process applied subsequent to a nonmining process (other than nonmining transportation) shall also be considered to be a nonmining process.

In the instant case, the taxpayer removed only a portion of the water that was added during the concentration of the valuable mineral product by flotation at its beneficiation plant. The taxpayer's election to retain a portion of the flotation water with the concentrates, after having served its purpose in the concentration processes, and not dry it any further was done solely as an aid to the transportation of the concentrates in the form of slurry.

Section 1.613-4(g)(3) of the regulations is only meant to disallow as mining the transportation that would otherwise be nonmining transportation because no mining process is applied at the end of such transportation, but during which a mining process incidentally results, e.g., transportation during the course of which some extraneous matter is removed from the mineral by the operation of forces of nature.

The filtering and drying of the mineral concentrates at the seaport qualify as mining processes under section 1.613-4(f)(5) of the regulations. Although the transportation in excess of 50 miles is nonmining transportation because the Commissioner did not authorize it as mining, drying cannot be disallowed solely because it follows nonmining transportation. The provisions of section 1.613-4(g)(2) contain an exception in the case of mining processes after nonmining transportation.

Therefore, the processes considered as "mining" under section 613(c) of the Code are the extraction of the ore from the mineral deposit, the four-mile transportation from the mine to the beneficiation plant, crushing, the reduction in size, beneficiation by concentration using a flotation process, dewatering the concentrates from 60 percent water content to 35 percent, an additional transportation of 46 miles to the seaport and the filtering and drying processes at the seaport. The transportation of the concentrates in excess of the first 50 miles (4 miles from the mine to the plant plus 46 miles to the seaport is considered to be nonmining under section 1.613-4(f)(1)(iii) of the regulations.

HOLDING

The first 46 miles of the pipeline transportation to the seaport, in this case, is considered "mining" as defined in section 613(c)(2) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 73-474, 1973-2 C.B. 200, is revoked.

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26 CFR 1.613-4; Gross income from the property in the case of minerals other than oil and gas.

Percentage depletion; proportionate profits method. The cost or value of carbon monoxide gas produced during a nonmining process is not considered a mining cost and a reduction of nonmining costs when that gas is used as fuel in a mining process for purposes of the proportionate profits computation.

Rev. Rul. 84-36

ISSUE

Should the cost or value of carbon monoxide gas produced during a nonmining process be considered a mining cost and a reduction of nonmining costs when that gas is used as fuel in a mining process by an integrated miner-manufacturer who computes gross income from mining under the proportionate profits method as described in section 1.613-4(d)(1) of the Income Tax Regulations.

FACTS

The taxpayer owns and operates a phosphate ore mine and a processing plant to produce elemental phosphorus. The phosphate ore is extracted, hauled to the plant, and stockpiled. The ore is then nodulized in a rotary kiln. The nodulization of phosphate rock is a mining process under section 1.613-4(f)(2)(i)(e)(4) of the regulations. The nodules are blended with silica and coke and fed into an electric furnace where the nodules are reduced to elemental phosphorus. Carbon monoxide gas is generated as a by-product in the electric furnace during the reduction process. The gas is used as a fuel to heat the kiln in the nodulizing process. The taxpayer incurs no additional costs in order to produce and use the carbon monoxide gas. The costs of the electric furnace process will be the same regardless of whether the taxpayer uses the carbon monoxide, vents it into the air, or sells it to a third party.

The taxpayer uses the proportionate profits method to compute gross income from mining for purposes of determining percentage depletion because a representative market or field price for the phosphate nodules cannot be ascertained.

LAW AND ANALYSIS

Section 611(a) of the Code provides that in the case of mines and other natural deposits, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion. The amount of this depletion deduction is set by section 613(a), which provides that in the case of mines and other natural deposits, the allowance for depletion shall be the percentage specified in section 613(b) of the gross income from the property. Section 613(c)(1) defines the term "gross income from

the property," in the case of property other than an oil and gas well or geothermal deposit, as the "gross income from mining."

Section 1.613-4(d)(1)(i) of the Income Tax Regulations provides for the use of the proportionate profits method for computing gross income from mining in cases in which a representative market or field price cannot be determined. It also provides that a method of computing gross income from mining under the provisions of that paragraph shall not be deemed to be a method of accounting for purposes of section 1.446-1(e).

Section 1.613-4(d)(2) of the regulations provides that in determining gross income from mining by use of methods based on the taxpayer's costs, only costs actually paid or incurred shall be taken into consideration.

Section 1.613-4(d)(4) of the regulations states that the objective of the "proportionate profits method" is to ascertain gross income from mining by applying the principle that each dollar of the total costs paid or incurred to produce, sell and transport the first marketable product or group of products earns the same percentage of profit. The first marketable product or group of products means those products produced by application of nonmining processes in the form or condition in which such products are first marketed. The proportionate profits methods involves multiplying the gross sales (actual or constructive) of the first marketable product or group of products by a fraction whose numerator is the sum of mining costs and whose denominator is the total of all mining and nonmining costs.

Section 1.613-4(d)(4)(v)(a) of the regulations specifies that the term "gross sales (actual or constructive)" means the total of the taxpayer's actual competitive sales to others of the first marketable product or group of products, plus the taxpayer's constructive sales of the first marketable product or group of products used or retained for use in its own subsequent operations.

The carbon monixide is a by-product when the elemental phosphorus is produced from the phosphate ore nodules in the electric furnace reduction process. The use of the carbon monoxide gas as a fuel results in a cost savings to the taxpayer in operating the nodulizing kiln. However, this cost savings has no effect upon the allocation of the taxpayer's actually incurred mining and nonmining costs. Since the taxpayer incurs no additional costs in order to produce and use this carbon monoxide gas, neither the value of the gas nor any portion of the cost of the electric furnace process can be considered mining costs or as a reduction in nonmining costs for purposes of the proportionate profits method, regardless of the method of cost accounting used by the taxpayer. Section 1.613-4(d)(2) of the regulations provides that only costs paid or incurred will be taken into consideration.

HOLDING

The cost or value of carbon monoxide gas produced during a nonmining process, where no additional cost is incurred in producing the gas, is not considered a mining cost and is not a reduction of nonmining costs when that gas is used as fuel in a mining process by an integrated miner-manufacturer who computes gross income from mining under the proportionate profits method as described in section 1.613-4(d)(1) of the regulations.

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26 CFR 1.613-4: Gross income from the property in the case of minerals other than oil and gas.

Depletion; percentage; nonmining costs. Costs associated with certain dust collection systems in cement plants are nonmining costs for purposes of computing gross income from mining by the proportionate profits method.

Rev. Rul. 84-70

ISSUE

Whether dust collection systems in the production of cement are mining or nonmining processes in computing gross income from the property by the proportionate profits method.

FACTS

The taxpayer, an integrated miner-manufacturer, owns and operates three cement rock mines, each of which supplies a different cement plant in which the taxpayer produces and sells cement. The taxpayer computes its allowance for depletion for each property in accordance with the proportionate profits method under section 1.613-4(d)(4) of the Income Tax Regulations. In each plant, the taxpayer employs dust collection systems to collect the dust particles that otherwise would escape into the atmosphere. The amount of retrieved dust particles constitutes a small part of the kiln feed mix. The two operations are described below.

Situation 1

The taxpayer employs the wet processing method in producing the kiln feed. In this process, the raw materials, cement rock and additives in correct proportions, are finely ground in a ball mill with water, thereby producing a slurry. The slurry is stored in tanks and continually agitated to maintain a uniform mixture. The slurry is transferred from the storage tanks and fed into a kiln and burned. The hot gases from the kiln's reverse air flow dry the feed and carry dust particles to the kiln dust collection system. The collected dust is transferred to the storage tanks for mixing with the slurry.

Situation 2

In this operation, the taxpayer employs the dry processing method in producing the kiln feed. In this process, the raw materials are finely ground in a grinding mill. The hot gases from the kiln and the kiln dust collection system are used in the grinding mill operation for drying the raw materials. The ground raw material is conveyed to storage silos prior to the burning in the kiln. The raw material is transferred from the

storage silos to a preheater that uses hot gases from the kiln. The raw material in the preheater is heated to temperatures that result in about 40 percent calcination before the feed enters the kiln. The hot gases from the kiln's reverse air flow carry dust particles to the preheater and then to the dust collection system. The collected dust is transferred to the raw material feed.

LAW AND ANALYSIS

Section 613(c)(4)(F) of the Internal Revenue Code and section 1.613-4(f)(2)(ii)(a) of the regulations provide that, in the case of calcium carbonates and other minerals when used in making cement, mining includes all processes (other than preheating the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process.

In *Commissioner v. Portland Cement Company of Utah*, 450 U.S. 156 (1981), 1981-1 C.B. 378, involving an integrated cement miner-manufacturer, the Court upheld the regulations implementing the statute that classifies all processes applied after the introduction of the feed into the kiln as nonmining processes. The facts in *Portland Cement*, as in *Situation 1*, involve the wet processing method in which the taxpayer finely grinds the rock in water, producing a slurry. The slurry is stored in tanks and continually agitated to maintain a uniform mixture. The taxpayer feeds the slurry from the storage tanks into a fired kiln that heats it to prepare a hard, glass-like substance known as clinker. The Court stated that in applying sections 613(c)(2) and 613(c)(4)(F) of the Code, the taxpayer's mining phase ends when the slurry has been produced and is stored in tanks to await introduction into the kiln. In the instant case, dust collection in *Situation 1* is applied after the introduction of the kiln feed into the kiln and operates only to recover dust particles contained in the hot gases escaping from the kiln. Therefore, the dust collection system is to be considered a part of the nonmining processes under section 613(c)(4)(F).

In *Situation 2*, the preparation of the kiln feed is by the dry process method. Here, the dry kiln feed is stored in silos as a dry powder prior to being transferred to the kiln. Preheating of the kiln feed is expressly classified as a nonmining process in the Code and regulations, and since dust collection is applied after the introduction of the kiln feed into the kiln, the dust collection process is considered to be a nonmining process under section 613(c)(4)(F) of the Code. The mining cut-off point in *Situation 2* ends when the dry powder has been produced and is stored in silos to await introduction into the kiln.

HOLDINGS

In the case of the wet process method in *Situation 1*, the cost of the kiln dust collection system is considered a nonmining cost.

In the case of the dry process method in *Situation 2*, the cost of the dust collection system associated with the preheater and kiln operations is considered a nonmining cost.

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26 CFR 1.613-4: Gross income from the property in the case of minerals other than oil and gas.

Percentage depletion; proportionate profits; selling expenses. The selling expenses of an integrated miner-manufacturer of cement are nonmining costs in the proportionate profits method of computing gross income from mining.

Rev. Rul. 84-82

ISSUE

Whether for purposes of computing the allowable deduction for percentage depletion by use of the proportionate profits method, the selling expenses of integrated cement producers are nonmining costs.

FACTS

The taxpayer, an integrated miner-manufacturer, owns a cement rock mine, operates a cement plant, produces and sells bagged and bulk cement, and maintains sales offices in its market areas. The taxpayer does not sell any kiln feed and since there is no field or market price in the area of the taxpayer's plant, computes gross income from mining under the proportionate profits method.

LAW AND ANALYSIS

Section 613(c)(4)(F) of the Internal Revenue Code provides that in the case of calcium carbonates and other minerals when used in making cement, all processes (other than preheating of the kiln feed) applied prior to the introduction of the kiln feed into the kiln, but not including any subsequent process, shall be considered as mining processes.

Section 1.613-4(d)(4)(ii) of the Income Tax Regulations provides that the proportionate profits method of computation is applied by multiplying the taxpayer's gross sales of his first marketable product or group of products by a fraction whose numerator is the sum of all the costs allocable to those mining processes that are applied to produce, sell, and transport the first marketable product or group of products, and whose denominator is the total of all the mining and nonmining costs paid or incurred to produce, sell, and transport the first marketable product or group of products.

Section 1.613-4(d)(4)(iv) of the regulations provides that the term "first marketable product or group of products" means the product (or group of essentially the same products) produced by the taxpayer as a result of the application of non-mining processes, in the form or condition in which such product or products are first marketed in significant quantities by the taxpayer or by others in the taxpayer's marketing area. For this purpose, bulk and packaged products are considered to be essentially the same product.

Section 1.613-4(d)(3)(iii) of the regulations provides that in determining gross income from mining by use of methods based on the taxpayer's costs, the costs of bags and bagging

and similar operations, costs of bulk loading, and the costs of storage and distribution shall be considered as nonmining costs.

Section 1.613-4(d)(3)(iv) of the regulations provides that in computing gross income from mining by the use of methods based on the taxpayer's costs, the principles set forth in section 1.613-5(c) will apply when determining whether selling expenses are to be treated, in whole or in part, as mining costs or as nonmining costs.

Section 1.613-5(c)(4)(ii) of the regulations provides that in computing taxable income from the property, a reasonable portion of the expenses of selling a manufactured product shall be subtracted from the gross income from the property. Such reasonable portion must be equivalent to the typical selling expenses that are incurred by unintegrated miners or producers in the same mineral industry so as to maintain equality in the tax treatment of unintegrated miners or producers in comparison with integrated miner-manufacturers or producer-manufacturers. If unintegrated miners or producers in the same mineral industry do not typically incur any selling expenses, then no portion of the expenses of selling manufactured product may be subtracted from gross income from the property when determining the taxpayer's taxable income from the property.

When read together, sections 1.613-4(d)(3)(iv) and 1.613-5(c)(4)(iv) provide that, for purposes of computing gross income from mining under section 1.613-4(d)(4), integrated miner-manufacturers must treat sales expenses as nonmining costs except to the extent that unintegrated miners, in the same mineral industry, typically incur such expenses in selling their mineral product.

The Supreme Court, in its decision in *Commissioner v. Portland Cement Company of Utah*, 450 U.S. 156 (1981), 1981-1 C.B. 378, dealing with similar facts, interpreted the definition of "mining" under section 613(c)(4)(F) of the Code by classifying all processes subsequent to the cutoff point of the kiln feed as nonmining processes. The Court recognized that sections 1.613-4(d)(3)(iv) and 1.613-5(c)(4)(ii) of the regulations provide that an integrated miner-manufacturer may allocate selling expenses between mining and nonmining with the objective of parity of tax treatment between integrated miner-manufacturers and unintegrated miners. The Court found no unintegrated miners in the cement industry and, therefore, no evidence to show that selling expenses were typically incurred by those unintegrated miners. Therefore, the Court concluded that all the selling expenses were to be treated as nonmining costs.

HOLDING

For purposes of computing the allowable deduction for percentage depletion by use of the proportionate profits method, the selling expenses of integrated cement producers are nonmining costs.

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26 CFR 1.613-5: Taxable income from the property.

Depletion; percentage; taxable income from the property. A payment to a nonqualified compensation plan that is deductible under section 404(a)(5) of the Code for computing the taxpayer-employer's taxable income is also a deductible mining expense in the same tax year for computing the taxable income limitation on the percentage depletion deduction under section 613(a).

Rev. Rul. 84-46

ISSUE

Whether an employer's payment to a nonqualified, deferred compensation plan, covering past service liability of its employees with respect to mineral properties no longer being operated by the employer, is a deductible mining expense in the taxable year of payment for purposes of computing the taxable income limitation on the percentage depletion allowance deduction under section 613(a) of the Internal Revenue Code?

FACTS

The taxpayer is a nonintegrated miner of iron ore. For purposes of computing percentage depletion under section 613(a) of the Code, the taxpayer did not elect to aggregate mineral properties.

In 1976, the taxpayer established a nonqualified, deferred compensation plan to which it made a lump sum payment. The plan was established for the purpose of providing individuals additional compensation for services performed by them on certain mineral properties prior to 1965. None of the mineral properties operated by the taxpayer prior to 1965 was still in operation in 1976.

The entire amount paid to the plan is deductible in computing taxpayer's taxable income in 1976 pursuant to section 404(a)(5) of the Code.

LAW AND ANALYSIS

The percentage depletion allowance under section 613(a) of the Code is computed as a percentage of the gross income from the mineral property and is limited to 50 percent of the taxpayer's taxable income from the mineral property. In determining the 50 percent taxable income limitation on percentage depletion, all allowable deductions that are attributable to the mineral property are to be subtracted from gross income from the mineral property.

Section 1.613-5(a) of the Income Tax Regulations provides that the term "taxable income from the property" means gross income from the property less all allowable deductions which are attributable to mining processes. Where a taxpayer has more than one mineral property, deductions which are not directly attributable to a specific mineral property shall be fairly apportioned among the several properties on a reasonable basis. Section 1.613-5(a) concludes by stating that the amount of any particular item to be taken into account shall be determined in accordance with the principles set forth in paragraph (d)(2) and (3) of section 1.613-4 of the Regulations.

Section 1.613-4(d)(2) states that the amount of any particular item to be taken into account shall be the amount used in determining the taxpayer's taxable income for tax purposes.

In *Montreal Mining Co. v. Commissioner*, 41 B.T.A. 399 (1940), the Board of Tax Appeals considered the relationship of a deduction for payment of workmen's compensation claims to the 50 percent taxable income limitation in a substantially similar predecessor of what is now section 613(a). The claims related to prior years' service by the workers. The taxpayer argued that the deduction for payment of the claims should not enter the depletion allowance limitation computation for the current year of payment because such payment did not relate to the current year's production. The Board, relying on *Helvering v. Wilshire Oil Co.*, 308 U.S. 90 (1939), which involved a similar issue, rejected the taxpayer's position and required inclusion of the deduction for payment of the workmen's compensation claims in the computation of taxable income for the year of payment for purposes of the 50 percent taxable income limitation on the depletion allowance. *See Rialto Mining Corp. v. Commissioner*, 5 T.C.M. (CCH) 519 (1946), involving current year payment of back wages that was held to be deductible in the year of payment for purposes of the 50 percent taxable income limitation on the depletion allowance.

HOLDING

Since the payment to the nonqualified plan is deductible under section 404(a)(5) of the Code for purposes of computing the taxpayer employer's 1976 taxable income, such payment is a deductible mining expense in 1976 for purposes of computing the taxable income limitation on the percentage depletion allowance deduction under section 613(a) of the Code.

Section 613A.—Limitations on Percentage Depletion in Case of Oil and Gas Wells

Percentage depletion; Clifford trust; transfer of proven oil and gas properties. Neither the conveyance of an interest in oil and gas property to a Clifford trust, nor the conveyance of the corpus of the trust to the grantor at the termination of the trust, will be a transfer of proven oil and gas properties that will cause the grantor to become ineligible for percentage depletion.

Rev. Rul. 84-14

ISSUE

Whether the conveyance of interests in oil and gas properties to a Clifford trust, as described below, or the conveyance of the corpus of the trust to the grantor at the termination of the trust will constitute a transfer of proven oil and gas properties that will cause the grantor to become ineligible for percentage depletion.

FACTS

In 1981, *X* executed an agreement creating a Clifford trust (trust), for a period of 121 months. *X*'s spouse is trustee. *X* transferred to the trust certain interests in oil and gas properties in which *X* was eligible to claim allowances for depletion under sections 611 through 613A of the Code.

The trust provides that the trustee shall set aside annually, during the term of the trust, and pay to the grantor when the corpus of the trust reverts to the grantor, that portion of the income of the trust that is attributable to the reserve for depletion. The reserve for depletion is the amount of the depletion deduction allowable for the tax year under the provisions of sections 611 through 613A of the Code. The trustee may pay or apply so much of income of the trust to or for the benefit of the beneficiary, as the trustee in the trustee's sole discretion, may deem necessary or appropriate to provide for said beneficiary's health, maintenance, education and support. The income from the trust shall not be paid or applied to discharge the legal obligations of either the grantor or the trustee to provide support or maintenance for such beneficiary. Amounts not so distributed shall be accumulated in the trust and held, invested and reinvested.

The corpus of the trust will revert to the grantor 121 months after the date the trust was executed. The grantor will not be treated as owner of the trust under sections 673, 674, 675, 676, or 678 of the Code.

LAW AND ANALYSIS

Section 611(a) of the Code provides that there will be allowed as a deduction, in computing taxable income, a reasonable allowance for depletion in the case of oil and gas wells.

Section 611(b)(3) of the Code provides that, in the case of property held in trust, the deduction for depletion will be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

Section 1.611-1(c)(4) of the regulations provides that where the trust instrument or local law requires or permits the trustee to maintain a reserve for depletion in any amount, the deduction is first allocated to the trustee to the extent that income is set aside for a depletion reserve, and any part of the deduction in excess of the income set aside for the reserve will be apportioned between the income beneficiaries and the trustee on the basis of the trust income (in excess of the reserve) allocable to each.

Sections 612 and 613(a) of the Code and the regulations thereunder provide that the annual allowance for depletion is to be computed on the basis of the adjusted depletion basis of the property or on a percentage of the gross income from the property, whichever results in the greater allowance.

Section 613A(a) of the Code provides that, except as provided in sections 613A(b) and 613A(c), the allowance for depletion will be computed without reference to section 613.

Section 613A(c)(1) of the Code provides that, with respect to independent producers and royalty owners, the allowance for depletion will be computed in accordance with section 613 with respect to limited quantities of domestic crude oil and natural gas.

Section 613A(c)(9) of the Code provides that, in the case of a transfer after December 31, 1974 of an interest in any proven oil and gas property, section 613A(c)(1) will not apply to the transferee with respect to production attributable to the transferred interest.

For purposes of section 613A (c)(9)(A) of the Code, a person will not be treated as a transferee of an interest in a proven oil and gas property to the extent that such person was entitled to a percentage depletion allowance on mineral produced with respect to such property immediately before the transfer.

Section 677(a) of the Code provides that the grantor will be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor or held or accumulated for future distribution to the grantor.

Because the trust provides that the corpus of the trust will revert to the grantor upon termination of the trust, the grantor must include in gross income, in the year realized, the income that under the terms of the trust and applicable local law becomes a part of corpus in accordance with sections 671 and 677(a) of the Code. The amount to be included in the grantor's gross income includes the income attributable to the annual reserve for depletion in an amount equal to the depletion deductions allowable under sections 611 through 613A of the Code. Because the trustee is required by the trust to maintain a reserve for depletion, the grantor will be entitled to the deduction for depletion provided that the provisions of sections 611 through 613A are met.

The grantor will not be taxable, pursuant to section 677 of the Code, on any current income of the trust that is not allocated to corpus, provided that such income is not applied or distributed in satisfaction of the grantor's legal obligation to support or maintain the grantor's beneficiary. Because the trust, in accordance with the special provision of section 611 of the Code and regulations thereunder, must apportion the income from the oil and gas royalty interests and the attendant depletion deductions, and because the grantor was entitled to compute an allowance for percentage depletion in respect of such interests prior to their conveyance to the trust, the grantor will not be treated as a transferee of an interest in proven oil and gas property (within the meaning of section 613A(c)(9)(A)) during the term of the trust.

Because the grantor will be entitled to deduct an allowance for percentage depletion in respect of production attributable to the oil and gas interests during the term of the trust by reason of sections 611, 677(a), and 671 of the Code, the grantor will not be treated as a transferee of an interest in proven oil and gas property under section 613A(c)(9)(A) following termination of the trust.

Because the grantor, to the exclusion of all others, will be entitled to the allowance for percentage depletion in respect of the oil and gas interests prior to the conveyance of the interest to the trust, during the term of the trust, and after termination of the trust, section 613A(c)(9)(A) of the Code will not apply to the conveyance of the interests to the trust or the reversion of the interests to the grantor upon termination of the trust.

HOLDING

Under the facts described above, neither the conveyance of interests in oil and gas property to the trustee nor the conveyance of the corpus of the trust to the grantor at the termination of the trust is a transfer of proven oil and gas properties that will cause the grantor to become ineligible for the percentage depletion allowance.

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26 CFR 1.613A-1: Post-1974 limitations on percentage depletion in case of gas and oil wells; general rule.

Ct. D. 2023

SUPREME COURT
OF THE
UNITED STATES
No. 82-599

Commissioner of Internal Revenue
v. Engle et ux.
[464 U.S.]

On Writ of Certiorari
to the United States
Court of Appeals
for the Seventh Circuit
[January 10, 1984]*

Syllabus

In response both to the public outcry concerning the United States' growing dependence on foreign energy and to the alleged excessive profits that major integrated oil companies were earning, the Tax Reduction Act of 1975 [Pub. L. 94-12, 1975-1 C.B. 545] repealed, as applied to the major integrated oil companies, the percentage depletion allowance authorized as a deduction from taxable income, but exempted independent producers and royalty owners from the repeal so as to encourage domestic production of oil and gas. The Act added §613A to the Internal Revenue Code (Code). That section provides that a percentage depletion allowance under §611 for such independent producers and royalty owners shall be computed in accordance with §613 "with respect to. . .so much of the taxpayer's average daily production of domestic crude oil as does not exceed the taxpayer's oil quantity" and "depletable natural gas quantity." During 1975, respondents (husband and wife) in No. 82-599 assigned their oil and gas leases to third parties, while retaining overriding royalties. As partial consideration for these assignments, respondents received $7,600 in advance royalties. This constituted the entire income received from the property in 1975 since there was no oil and gas production that year. On their joint federal income tax return for 1975, respondents claimed a percentage depletion deduction equal to 22% of the advance royalties. The Commissioner of Internal Revenue (Commissioner) disallowed the deduction because the advance royalties were not received "with respect to" any "average daily production" of oil or gas. The Tax Court upheld this determination, but the Court of Appeals reversed. In No. 82-774, petitioner joint owners leased their oil and gas interests in 1975 to various lessees. Under the leases petitioners were to receive both royalties from oil and gas produced and annual cash bonuses even if no oil or gas was produced. In 1976, oil and gas was discovered on the property and was produced in substantial amounts. Petitioners claimed depletion deductions on both the bonuses and the royalties received in that year. The Commissioner disal-

*Together with No. 82-774, *Farmar et al.* v. *United States*, on certiorari to the Court of Claims.

lowed the deduction on the bonuses, again because they were not received "with respect to" any "average daily production." After paying the resulting deficiencies, petitioners filed a suit for refund in the Court of Claims, which held for the Commissioner.

Held: Section 613A was not intended to deny the allowance for percentage depletion on advance royalty or lease bonus income altogether; rather, §§611-613A entitle taxpayers to such an allowance at some time during the productive life of the lease.

(a) Any reasonable interpretation of §613A must harmonize with the section's goal of subsidizing the combined efforts of small producers and royalty owners in the exploration and production of the Nation's oil and gas resources. The Commissioner's interpretation—under which taxpayers would receive percentage depletion on income derived from oil and gas interests only if the payment associated with that income could be attributed directly to specific units of production, and which anomolously suggests that a Congress intent on increasing domestic production by small producers included substantial economic disincentives in the same legislation—does not comport with this goal. By contrast, allowing percentage depletion on all qualified income makes available the maximum public subsidy that Congress was willing to provide.

(b) The legislative history of §613A discloses a clear congressional intent to retain the percentage depletion rules that existed in 1975, and under which taxpayers leasing their interests in mineral deposits were entitled to a percentage depletion on any bonus or advance royalty whether there was production of the underlying mineral or not.

(c) When §613A is considered together with related Code sections and in light of the legislative history, it is clear that Congress did not mean to withdraw the percentage depletion on lease bonuses or advance royalty income arising from oil and gas properties. Section 613A clearly provides that income attributable to production over a certain level will not be eligible for percentage depletion, but nothing in the statute bars such a depletion on income received prior to actual production. To the contrary, so long as the income can be attributed to production below the established ceilings, lease bonuses and royalty income come within the four corners of the percentage depletion provisions.

(d) Since the Commissioner's interpretation is unreasonable, this Court will not defer to it. The Commissioner has not shown any "insurmountable" practical problems that would render his position more tenable. While §613A's various production requirements and limitations make accurate percentage depletion allowances difficult in the absence of production figures, these problems can be resolved in a number or reasonable ways, as, for example, by requiring lessors to defer depletion deductions to years of actual production or to adjust deductions taken with amended returns. The Commissioner cannot resolve the practical problems by eliminating the allowances altogether.

No. 82-599, 677 F.2d 594, affirmed; No. 82-774, 231 Ct. Cl. ____, 689 F.2d 1017, reversed and remanded.

O'CONNOR, J., delivered the opinion of the Court, in which BURGER, C. J., and POWELL, REHNQUIST, and STEVENS, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which BRENNAN, WHITE, and MARSHALL, JJ., joined.

JUSTICE O'CONNOR delivered the opinion of the Court:

These consolidated cases present the question whether §§611-613A of the Internal Revenue Code (Code), 26 U.S.C. §§611-613A, entitle taxpayers to an allowance for percentage depletion on lease bonus or advance royalty income received from lessees of their oil and gas mineral interests.

I

A

Ever since enacting the earliest income tax laws, Congress has subsidized the development of our nation's natural resources. Toward this end, Congress has allowed holders of economic interests in mineral deposits, including oil and gas wells, to deduct from their taxable incomes the larger of two depletion allowances: cost or percentage.[1] Under cost depletion, taxpayers amortize the costs of their wells over their total productive lives.[2] Under percentage depletion, taxpayers deduct a statutorily specified percentage of the "gross income" generated from the property, irrespective of actual costs incurred.[3] Through these depletion provisions, Congress has permitted taxpayers to recover the investments they have made in mineral deposits and to generate additional capital for further exploration and production of the nation's mineral resources.

Taxpayers have historically preferred the allowance for percentage, as opposed to cost, depletion on wells that are good producers because the tax benefits are significantly greater. Prior to 1975, it was well-settled that taxpayers leasing their interests in mineral deposits to others were entitled to percentage depletion on any bonus [4] or advance royalty [5] received, whether there was production of the underlying mineral or not. The bonus was regarded as "payment in advance for oil and gas to be extracted," *Herring* v. *Commissioner*, 293 U.S. 322, 324 (1934), and the advance royalty was considered a "return *pro tanto* of [the lessor's] capital investment in the oil in anticipation of its extraction . . . ." *Palmer* v. *Bender*, 287 U.S. 551, 559 (1933). Though the Commissioner of the Internal Revenue had once argued that the allowance should not apply to such income,[6] this Court determined that both lease bonuses and advance royalties constituted "gross income from property" and accordingly were subject to percentage depletion. See *Herring* v. *Commissioner, supra*, at 327-328. The depletion was based on the in-

[1] Originally, Congress authorized only a cost depletion allowance. See 38 Stat. 172-173 (1913). However, in the Revenue Act of 1918, it amended the Code to allow taxpayers to calculate depletion based on the discovery value of their mineral deposits. See 40 Stat. 1067-1068 (1919). When discovery value depletion proved difficult to administer, Congress eliminated it in favor of the percentage depletion allowance. See 44 Stat. 16 (1926).

For a detailed study of the history of percentage depletion, see Baker, The Nature of Depletable Income, 7 Tax L. Rev. 267 (1952).

[2] See 26 U.S.C. §612. The annual cost depletion deduction generally is calculated by multiplying the cost of the mineral interest by the ratio of the units sold in a taxable year to the total estimated recoverable reserves. See 26 CFR § 1.611-2(a)(1983).

[3] See 26 U.S.C. §613. Section 613(a) provides that "the allowance for depletion . . .shall be the percentage. . .of gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without the allowance for depletion)." 26 U.S.C §613(a).

[4] A lease bonus is "the cash consideration paid by the lessee for the execution of an oil and gas lease by a landowner. . .Bonus is usually figured on a per acre basis." 8 H. Williams and C. Meyers, Manual of Oil and Gas Terms 65 (1982).

[5] An advance royalty is simply a pre-payment of the landowner's share of production, in kind or in value, free of the expenses of production. *Id.*, at 656-657.

[6] The Commissioner interpreted the pertinent section of the 1926 Code, which provided an allowance for percentage depletion only "in the case of. . .oil and gas wells," see 44 Stat. 16, not to entitle taxpayers to percentage depletion in situations where no such well existed. Since a well does not technically exist prior to actual production, the Commissioner contended that the percentage depletion provision did not apply to lease bonus or advance royalty income, which by definition precedes production. The Commissioner would have allowed percentage depletion only if future production were practically assured, or in fact obtained, during the taxable year. See G. C. M., XII-1 Cum. Bull. 64 (1933), revoked by G.C.M. 14448, XIV-1 Cum. Bull. 98 (1935).

come received from the property, and not, at least in the short run, on the production of the substance itself. 293 U.S., at 327-328.

Even under pre-1975 law, however, depletion deductions eventually had to be attributed to actual production. Lessors receiving bonus or advance royalty income without oil or gas being produced during the life of the lease have been required to recapture their depletion deductions and restore the previously deducted amounts to income. See *Douglas* v. *Commissioner*, 322 U.S. 275, 285 (1944). Furthermore, since only one percentage depletion allowance is statutorily authorized for each dollar of oil and gas income, lessees have always been required to reduce their allowances by any bonuses or advance royalties paid to lessors. See *Helvering* vs. *Twin Bell Oil Syndicate*, 293 U.S. 312 (1934). Thus, prior to 1975, those who held economic interests in mineral deposits, large or small, were entitled to a single percentage depletion deduction for *all* income from the property, including lease bonus and advance royalty income, so long as oil or gas was eventually extracted from the land.

The 1970s, however, brought about an abrupt redirection in the nation's energy policy. Escalating energy prices and the Arab oil embargo awakened the public to the nation's growing reliance on foreign energy sources. Some thought the major integrated oil companies were reaping excessive oil and gas profits at the public's expense, while reinvesting little of their concomitant tax depletion subsidies in domestic energy production.[7] Congress responded to this public outcry by repealing the percentage depletion allowance as applied to the major integrated oil companies. See Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26, 47-53 [Pub. L. 94-12, 1975-1 C.B. 545, 558]. At the same time, however, it exempted independent producers and royalty owners from the repeal to encourage domestic production. In new §613A, Congress provided that:

"[T]he allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to—

(A) so much of the taxpayer's average daily production of domestic crude oil as does not exceed the taxpayer's depletable oil quantity; and

(B) so much of the taxpayer's average daily production of domestic natural gas as does not exceed the taxpayer's depletable natural gas quantity; and the applicable percentage (determined in accordance with the table contained in paragraph (5)) shall be deemed to be specified in subsection (b) of section 613 for purposes of subsection (a) of that section." 26 U.S.C. §613A(c)(1).[8]

Thus, beginning with tax year 1975, only taxpayers who met the terms of this new provision were eligible for the percentage depletion allowance.[9]

B

During 1975, Fred Engle and his wife assigned their two Wyoming oil and gas leases to third parties, retaining overriding royalties in each lease. As partial consideration for these assignments, the Engles received a total of $7600 in advance royalties. This $7600 constituted the entire income the Engles received from the property in 1975 since there was no oil and gas production that year. On their joint federal income tax return for 1975, the Engles claimed a percentage depletion deduction equal to 22% of the advance royalties received. The Commissioner disallowed the deduction because the advance royalties were not received "with respect to" any "average daily production" of oil or gas as, in his view, was required by the 1975 amendments to the Code.

The Tax Court, with one judge dissenting, upheld the Commissioner's determination. See 76 T.C. 915 (1981). It agreed that new §613A tied the oil and gas percentage depletion allowance to actual production and that the Engle's advance royalty receipts were not attributable to such production.[10] But the Court of Appeals for the Seventh Circuit reversed. See 677 F.2d 594 (CA7 1982). It found that Congress' motivation in retaining the percentage depletion allowance for "small producers"—namely, to subsidize domestic energy development—was equally applicable to advance royalties received by lessors. *Id.*, at 600. The Court of Appeals therefore held that, in light of this motivation and the Code's long-standing treatment of advance royalties, new §613A should be interpreted to authorize a percentage depletion allowance on advance royalties received, so long as there eventually was production from the property. *Id.*, at 601-602.

Also during 1975, the families of Philip D. Farmar and A. A. Sugg, joint owners of 46,515 acres of land in Irion County, Texas, leased their oil and gas interests to various lessees. Under the leases, the Farmars and Suggs were to receive as royalties 20% of all oil and gas produced and sold from the property or 20% of the value of all oil and gas produced from the leases. The leases also provided that the Farmars and Suggs were to receive annual cash bonuses, beginning with a small sum in 1975 and continuing with large sums through 1979, over the life of the lease. These bonuses were payable even if no oil or gas was produced from the property. In 1976, oil and gas was discovered on the Irion property and was produced in substantial amounts. The

[7] See, *e.g.*, 121 Cong. Rec. 7239-7244 (1975)(statement of Sen. Hollings); *id.*, at 7244-7248 (statement of Sen. Ribicoff); *id.*, at 7267 (statement of Sen. Cranston); see generally Landis, The Impact of the Income Tax on the Energy Crisis: Oil and Congress Don't Mix, 64 Calif. L. Rev. 1040, 1042-1048 (1976).

[8] Congress defined the taxpayer's "average daily production" of oil or gas to be the aggregate production from the property during the taxable year divided by the number of days in the taxable year. See 26 U.S.C. §613A(c)(2)(A).

[9] In other paragraphs of new §613A, Congress designated certain gradually decreasing rates and depletable quantities that independent producers and royalty owners are to use in calculating their allowances. See 26 U.S.C. §§613A(c)(3),(5).

[10] In a separate determination, the Tax Court held that lease bonuses, like advance royalties, were not subject to the allowance for percentage depletion. See *Glass* v. *Commissioner*, 76 T.C. 949 (1981).

Farmars and Suggs claimed percentage depletion deductions on both the bonuses and royalties received in that year. The Commissioner disallowed the percentage depletion deductions on the lease bonuses, again because income of this type was not received "with respect to" any "average daily production."

After paying the resulting deficiencies, the Farmars and Suggs filed a consolidated suit for refund in the Court of Claims. The Court of Claims held for the Commissioner. It concluded that "[t]his statutory language regularly linking depletion directly to production during a taxable year indicates to us that Congress wanted depletion allowable only 'with respect to' income derived from, or connected with, actual extraction during the taxable year." App. to Pet. for Cert. in No. 82-774, p. 8a. Since lease bonus income was not so attributable, the Court determined that the Farmars and Suggs were not entitled to a percentage depletion allowance on it. See *id.*, at 16a.

The Commissioner sought a writ of certiorari from the adverse decision of the Court of Appeals for the Seventh Circuit, and the Farmars and Suggs sought a writ of certiorari from the adverse decision of the Court of Claims. We granted both writs and consolidated the cases so that we could decide the effect the Tax Reduction Act of 1975 had on percentage depletion of oil and gas income.

II

The 1975 amendments to the Code did not repeal any of the provisions that previously entitled taxpayers to an allowance for percentage depletion on lease bonus or advance royalty income arising from oil and gas mineral interests. Rather, the 1975 amendments added new §613A, which, as its title indicates, is a "Limitation on Percentage Depletion in Case of Oil or Gas Wells." See 26 U.S.C. §613A. Our sole task in this case is to determine whether Congress, in enacting the §613A "limitation," intended to deny the allowance for percentage depletion on advance royalty or lease bonus income altogether.

A

Our starting point, of course, is the language of the statute itself. That language authorizes any independent producer or royalty owner not otherwise disqualified, see 26 U.S.C. §613A(d), to compute "the allowance for percentage depletion under section 611. . .in accordance with" §613's "gross income from property" concept. 26 U.S.C. §613A(c)(1). That language also stipulates that the allowance "be with respect to. . .so much of the taxpayer's average daily production. . .as does not exceed the taxpayer's depletable. . .quantity. . . ." *Ibid.* The Commissioner and the taxpayers take different positions as to what this language means.

The Commissioner contends that new §613A finally adopts the position he took a half century ago in the *Herring* case—namely, that taxpayers are not entitled to percentage depletion on any income not attributable to specific units of production during the taxable year.[11] He points to §613A(c)(1)'s requirement that "the allowance. . .be computed. . .with respect to. . .the taxpayer's average daily production" and to §613A(c)(2) through (10)'s repeated references to "aggregate production," "production during the taxable year," and "production during the calendar year." From these statutory reference points, the Commissioner contends that §613A redefines depletable "gross income from property" to be that income attributable to specific units of production during the taxable year.[12] Since lease bonuses and advance royalties are not attributable to *specific* production during any taxable year, the Commissioner concludes that Congress did not intend such receipts to be eligible for percentage, as opposed to cost, depletion. See Brief for Commissioner 18-24.

The taxpayers, by contrast, suggest that Congress did not intend, by enacting new §613A, to change the tax treatment of lease bonus or advance royalty income at all. Rather, they contend that the percentage depletion allowance is available regardless of whether physical extraction occurred during the year for which the deduction is claimed. Under their view, the reference to "average daily production" in §613A constitutes a limitation on the amount of, rather than a prerequisite to, the deduction a taxpayer may claim. Furthermore, the requirement that the allowance be "with respect to" production is simply the pre-1975 recapture requirement reenacted: depletion deductions must always "be with respect to" actual or prospective extraction. Since lease bonus and advance royalty receipts are income arising from the property, the taxpayers conclude that they are eligible for percentage depletion so long as they do not exceed the §613A limitation and production eventually occurs on the property. See Brief for Respondents in No. 82-599, pp. 5-9; Brief for Petitioners in No. 82-774, pp. 7-16.

The Commissioner's and taxpayers' interpretations do not exhaust the possible readings of this linguistic maze. For example, §613A could also be read to change the *timing*, though not the availability, of the percentage depletion allowance.[13] Under this view, all income arising from the property would potentially be subject

[11] The Commissioner's view is embodied in proposed regulations. See 42 Fed. Reg. 24279 *et. seq.* (1977).

[12] Interestingly enough, the Commissioner does not believe that the language should be literally interpreted in all circumstances. Although he interprets the statute to deny the allowance for percentage depletion on income received prior to production, see 42 Fed. Reg., at 24287 (proposed 26 CFR §1.613A-7(f)(1)), he interprets it to permit the allowance when the situation is reversed—when extraction occurs in a taxable year prior to the year in which income is received. *Id.*, at 24281 (proposed 26 CFR § 1.613A-3(a)(4)(7)).

[13] See Jones, Analysis of CA-7 *Engle* Decision Allowing Percentage Depletion Absent Abstraction, 57 J. Taxation 230, 233 (1982); Bravenec, Significance of Percentage Depletion on Oil and Gas, 23 Oil and Gas Tax Q. 193, 211-214 (1975); Note, Percentage Depletion on Oil and Gas Lease Bonuses and Advance Royalties; Engle v. Commissioner, Glass v. Commissioner, and Farmar v. United States Reviewed, 35 Baylor L. Rev. 97, 120-121 (1983).

to an eventual allowance for depletion, but the actual deduction would be deferred to a year in which it could be attributed, by some allocation method, to actual production. Since lease bonus and advance royalty income always precede production, they would be included in taxable income during the year of receipt. The depletion allowance attributable to such receipts, however, would be capitalized and amortized against income in years of actual extraction, subject to the rates and depletable quantities limitations applicable in those subsequent years.[14]

Each of these possible interpretations of new §613A can be reconciled with the language of the statute itself. Congress' repeated references to "production" during the "taxable year" could not have been completely inadvertent, but each of the possible interpretations gives meaning to those references. Our duty then is "to find that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being most harmonious with its scheme and with the general purposes that Congress manifested." *NLRB* v. *Lion Oil Co.*, 352 U.S. 282, 297 (1957) (Frankfurter, J., concurring in part and dissenting in part). The circumstances of the enactment of particular legislation may be particularly relevant to this inquiry, *Watt* v. *Alaska*, 451 U.S. 259, 266 (1981), and it is to those circumstances that we now turn.

B

The 1975 amendments to the Code responded both to the public outcry concerning the country's growing dependence on foreign energy and to the alleged excessive profits that major integrated oil companies were earning. Congress wanted to encourage domestic production [15] and to improve the competitive position of "small producers"—the independents and the royalty owners—vis-á-vis the major integrated ones.[16] Section 613A's goal, more simply put, was to subsidize the combined efforts of small producers and royalty owners in the exploration and production of the nation's oil and gas resources. Any reasonable interpretation of the statute, therefore, must harmonize with this goal.

If the Commissioner's interpretation were adopted, taxpayers would receive percentage depletion on income derived from oil and gas interests only if the payment associated with that income could be attributed directly to specific units of production. On that view, lessors and lessees interested in favorable tax benefits will not use financing arrangements that provide for pre-payments on production, that spread income to non-production periods or, more importantly, that shift the risks of non-production to the parties better able to bear them.[17] Lessors naturally will begin demanding larger production royalties to offset the increased expense resulting from delayed receipt of payments, income bunching, and risk bearing. Lessees who are forced to pay the increased royalties will, in turn, have less money with which to purchase leases or to extract minerals therefrom. Thus, solely for tax reasons, lessors and lessees will choose less preferred forms of financing their exploration and production efforts and, in the long run, devote fewer dollars to development of the nation's energy reserves. In short, the Commissioner's interpretation anomolously suggests that a Congress intent on increasing domestic production by small producers included substantial economic disincentives in the same enabling legislation. Such an interpretation does not comport with Congress' effort to increase production by the independent producers and royalty owners. By contrast, allowing percentage depletion on all qualified income arising from the property makes available the maximum public subsidy that Congress was willing to provide.

Ironically, the Commissioner defends his interpretation by reference to the oil and gas crisis that existed in 1975. See Reply Brief for Commissioner 6. He argues that if lessors are allowed percentage depletion only on income directly attributable to production, they will have strong incentives to encourage lessees to produce oil and gas immediately from the property. No one disputes this premise. Requiring lessors to *defer* percentage depletion deductions to years of actual production of the property. But the Commissioner has not sug-

[14] See n. 13, *supra*.

[15] The House and Senate debates of the 1975 Congress are replete with references to the nation's domestic oil and gas shortage. See, *e.g.*, 121 Cong. REc. 4606 (1975)(remarks of Rep. Rhodes)("I think we should all recall that one of the reasons for this bill being brought here with some haste is the fact that we have a shortage of domestic petroleum"); *id.*, at 7807 (remarks of Sen. Curtis)("Our first objective should be the production of more gas and oil"); *ibid.* (remarks of Sen. Bartlett)("I think it is important that we face up to the American people and say that this body has done next to nothing to increase the production of natural sources of energy in this country. . . ."); *id.*, at 8128 (remarks of Sen. Dole)("The 2,000 barrel. . .exemption from the depletion allowance repeal is vitally important to maintaining a high level of energy exploration and production."); *id.*, at 8944 (remarks of Rep. Pickle)("In this time of national energy crisis, what we need—desperately—is more production.").

[16] Members of Congress repeatedly emphasized that their efforts were aimed at the major integrated oil companies, and not the small producers. See, *e.g.*, 121 Cong. Rec. 4610 (1975)(remarks of Rep. Cotter)("[I]t will serve notice on the major oil companies that this new Congress will not be subservient to their unreasonable demands. . . ."); *id.*, at 8879 (remarks of Sen. Long)("Although as much as 85 percent of the oil production is not ineligible for the depletion allowance. . .as many as 98 percent of the oil producers in this country will still retain [percentage] depletion.").

[17] Lease bonuses generally are not refundable to lessees even if no oil or gas is produced from the property. See *Shamrock Oil & Gas Corp.* v. *Commissioner*, 35 T.C. 979, 1057 (1961). Smaller risk averse lessors, therefore, are likely to prefer these sums certain to uncertain sums, like advance royalties or royalty streams, that either may not materialize or may have to be returned. Cf. 121 Cong. Rec. 4641 (1975)(remarks of Rep. de la Garza)("We are only hurting the little people" by repealing the percentage depletion deduction for royalty owners). Conversely, lessees prefer to condition their advance payments on eventual production. See H. Williams, Oil and Gas Law §666, 793-795 (1982). But since lessees can spread their risks over many leased properties, they predictably will be willing to pay nonrefundable lease bonuses in exchange for reduced prices on the overall lease arrangements. By pooling risks in this fashion, lessors and lessees, like insurers and their insureds, optimize the allocation of resources in the production of oil and gas from the property. See generally K. Arrow, Essays on the Theory of Risk Bearing 134-143 (1971).

gested that the percentage depletion deductions on advance royalties and lease bonuses be *deferred* to years of actual production; he argues that they be *eliminated* altogether. Eliminating the percentage depletion deductions, rather than deferring them, will reduce the total amount of "gross income" subject to the percentage depletion allowance and thereby shrink the public subsidy of domestic oil and gas production. Smaller public subsidies, in turn, mean reduced exploration and production incentives and smaller absolute quantities of domestic production. Thus, the Commissioner's initial premise—that Congress wanted to encourage domestic exploration and production—is against the general position he has taken with respect to lease bonus and advance royalty income.

C

The reasonableness of each possible interpretation of the statute can also be measured against the legislative process by which §613A was enacted. When the 1975 amendments were introduced, neither the bill, H.R. 2166, 94th Cong., 1st Sess. (1975), nor the accompanying Ways and Means Committee report, see H. Rep. No. 19, 94th Cong., 1st Sess. (1975) [1975-1 C.B. 569], provided for repeal of the percentage depletion allowance on oil and gas wells. Rather, the provision repealing the percentage depletion allowance was introduced only during debate on the House floor. See 121 Cong. Rec. 4651-4652 (1975). This floor amendment did not contain any of the exemptions ultimately enacted as part of §613A, including the exemption for independent producers and royalty owners. It was only when H.R. 2166 reached the Senate floor that the exemption for independent producers and royalty owners was added. See *id.*, at 7813 (1975). The Congress then enacted H.R. 2166, with slight alteration by the Conference Committee, as it was amended on the Senate Floor.

At no time during either the Senate's or the Conference Committee's consideration of H.R. 2166 was a repeal of the percentage depletion allowance on lease bonus or advance royalty income suggested. Rather, both the Senate and the conferees agreed to maintain the percentage depletion allowance, in its entirety, for those small producers and royalty owners whose income from the property did not exceed that associated with the yearly depletable quantities.[18] As explained by the Conference Report, the proposed legislation:

". . .*retains* percentage depletion at 22 percent for the small independent producer to the extent this his average daily production *does not exceed* 2,000 barrels a day, or his average daily production of gas *does not exceed* 12,000,000 cubic feet. Where the independent producer has both oil and natural gas production, the *exemption* must be allocated between two types of production.

* * * * *

The conference substitute follows the Senate amendment in providing a small producer *exemption* from the repeal of percentage depletion for oil and gas." H. Conf. Rep. No. 120, 94th Cong., 1st Sess., 67-68 (1975) [1975-1 C. B. 624, 629-630] (emphasis added).

Thus, in exempting independent producers and royalty owners from the repeal, the Senate and the Conference Committee expressed a clear intent to *retain* the percentage depletion rules as they then existed. Again, the congressional intent is more in harmony with interpretations of the statute that retain percentage depletion on all forms of income than with the Commissioner's interpretation.

The Commissioner attempts to find legislative support for his interpretation not in the history of the enacting Congress, but in the history of a previous Congress. In H.R. 17488, 93d Cong., 2d Sess. (1974), the House proposed to repeal the percentage depletion allowance for oil and gas production and, at the same time, to exempt certain independent producers from the repeal. The House Ways and Means Committee report on H.R. 17488 emphasized that "a lease bonus paid to the lessor of mineral lands in a lump sum or in installments is independent of any actual production from the lease and thus would not be within any of the exemptions." H.R. Rep. No. 1502, 93d Cong., 2d Sess., 46 (1974). The Commissioner suggests that " '[t]he idea of a special exemption for small entities, expressly involving production, was very much in the air of the 94th Congress, and it is not unlikely that the prior report was known to several, if not many, of the members who considered §613A,' and almost certainly to those who proposed that Section 613A be added to the tax reduction bill." Reply Brief for Commissioner 6 (quoting App. to Pet. for Cert. 70a).

In the 94th Congress, however, the House Ways and Means Committee reported out another bill, H.R. 2166, in lieu of H.R. 17488. This bill retained the percentage depletion allowance and differed from H.R. 17488 in many other respects. See 121 Cong. Rec. 4651-4652 (1975). Thus, it cannot be said that a subsequent Congress, or even the House Ways and Means Committee itself,[19] retained

[18] Thus, Senator Bentsen, who introduced one of the amendments to H.R. 2166, see 121 Cong. Rec. 7277 (1975), stated that the depletable figures were chosen "as a definition of a small producer. . .." Hearings on H.R. 2166 Before the Subcomm. on Energy of the Senate Comm. on Finance, 93rd Cong., 2d Sess., 2 (1975); see also 121 Cong. Rec. 7777 (1975). Similarly, Senator Dole stated that the 2000-barrel figure "identif[ied] the particular importance of independent producers." *Id.*, at 8128. Senator Dole believed that the "exemption from the depletion allowance [would] permit most of these small producers to remain in production, giving us the additional oil and gas that we so greatly need. . .It will also encourage most of the independents who do the vast bulk of exploration in this country to continue their drilling programs." *Ibid.*

[19] In the 93d Congress, 25 Representatives, including Chairman Wilbur Mills, served on the Ways and Means Committee. 95th Congress Legislative Record of the Committee on Ways and Means, 95th Cong., 2d Sess. 359 (1979) (listing committee membership). In the 94th Congress, the Committee grew to 37 members, was chaired by Representative Al Ullman, and had 18 new members. *Id.*, at 360. Thus, not only is it difficult to believe the Committees of the 93d and 94th Congress' had the same intent, it is hard to characterize them as being the same committee.

the same intent as reflected in H.R. 17488. Moreover, since it was the Senate, and not the House, that added the small producer exemption to H.R. 2166,[20] we must dismiss the Commissioner's reconstruction of the legislative intent as mere wishful thinking. The idea of an exemption for small producers was certainly in the "air" of the 94th Congress, but we find no evidence that a change in the definition of depletable "gross income" was aloft with it.[21]

D

We have noted that "the true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part." *Helvering* v. *Morgan's Inc.*, 293 U.S. 121, 126 (1934). When the Commissioner's, the taxpayers', and the commentators' interpretations of §613A are viewed in these terms, it becomes clear to us that Congress did not mean, as the Commissioner's interpretation suggests, to withdraw the percentage depletion allowance on lease bonus or advance royalty income arising from oil and gas properties.

The 1975 Congress was concerned with shrinking domestic production levels and with assisting smaller producers to compete with the larger ones. Since most depletion deductions are on royalty payments attributable to actual production, Congress,in its haste, not surprisingly defined the class of taxpayers exempted from the percentage depletion repeal in terms of certain production levels. Section 613A clearly provides that income attributable to production *over* a certain level will not be eligible for percentage depletion. But nothing in the statute bars percentage depletion on income received prior to actual production. To the contrary, we agree that so long as the income can, by some allocation method, be attributed to production below the ceilings Congress established, lease bonus and advance royalty income come within the four corners of the percentage depletion provisions. Lease bonuses and advance royalties are payments received in advance for oil and gas to be extracted, see *Herring* v. *Commissioner, supra*, and therefore should be subject to the §613(a) computation of, and §611 allowance for, oil and gas depletion.

III

Unable to find persuasive support for his position in the text, general purpose, or specific history of the Tax Reduction Act of 1975, the Commissioner reminds us both that the "choice among reasonable interpretations is for the Commissioner, not the courts," *National Muffler Dealers Ass'n, Inc.* v. *United States*, 440 U.S. 472, 488 (1979) [1979-1 C.B. 198], and that his choice, if found to "implement the congressional mandate in some reasonable manner," must be upheld. *United States* v. *Correll*, 389 U.S. 299, 307 (1967) [1968-1 C.B. 64]. "But that principle [only sets] the framework for judicial analysis; it does not displace it. We find that the [Commissioner's interpretation] is. . .unreasonable," and we therefore cannot defer to it. *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973) (similarly refusing to defer to unreasonable position of Commissioner).

Holders of economic interests in oil and gas deposits have consistently been entitled to a percentage depletion allowance on *all* income arising from their property, including lease bonuses and advance royalties, for the past 50 years. See *Herring* v. *Commissioner, supra*, 293 U.S. 322. Our cases have taken a long-run view of the relation between income and production, and we have interpreted the Code to allow percentage depletion on all income so long as actual extraction eventually occurs. See *Douglas* v. *Commissioner, supra*, 322 U.S. 275. We usually presume that "Congress is. . .aware of [our long-standing] interpretation of a statute and. . .adopt[s] that interpretation when it re-enacts [the] statute without [explicit] change. . . ." *Lorillard* v. *Pons*, 434 U.S. 575, 581 (1978); see also *Albemarle Paper Co.* v. *Moody*, 422 U.S. 405, 414 n. 8 (1975). Had Congress meant to eliminate the percentage depletion allowance on lease bonus and advance royalty income, we believe it would have addressed our decisions to the contrary more explicitly. See *Mastro Plastics Corp.* v. *NLRB*, 350 U.S. 270, 289 (1956). Since Congress did not, we find the Commissioner's shortrun view of the relation between income and production to be at odds with the amended statutory scheme.

The percentage depletion provisions, as modified in 1975, plainly were intended to encourage independent producers and royalty owners to explore and develop the nation's domestic oil and gas deposits. See *supra*, at 10-11. Yet the Commissioner would discourage these small producers from using the financing arrangements that would optimize their combined efforts to produce oil and gas. See *supra*, at 11-13. Not only would the Commissioner deny lessors percentage depletion on lease bonus and advance royalty income, but he would continue to require lessees to reduce their depletion allowances by the amounts lessors *would* have been allowed, under pre-1975 law, to deplete. See Rev. Rul. 81-266, 1981-2 Cum. Bull. 139 (1981). The Commissioner would allow *no one* to take the single allowance that the statute clear-

[20] The Senate amendment differed from the exemption contained in H.R. 17488 in still other respects. For example, the Senate amendment allowed percentage depletion at a rate of 22% and with respect to 2000 barrels of average daily production. H.R. 17488, by contrast, provided for percentage depletion at the rate of 15% with respect to the first 3,000 barrels of production per day.

[21] The Commissioner also points to deliberations in subsequent sessions of Congress, that never culminated in legislation, to support his position. See Brief for Commissioner 30-32. We find this particular history to be ambiguous at best: Post-enactment interpretive material of this type is a "hazardous basis for inferring the meaning of a congressional enactment." *Consumer Product Safety Comm'n GTE Sylvania, Inc.*, 447 U.S. 102, 118, and n. 13 (1980); see also *Southeastern Community College v. Davis*, 442 U.S. 397, 411, and n. 11 (1979).

ly contemplates *some one* should take. See 26 U.S.C. §§611(b)(1), 613(a). Thus, the Commissioner not only skews the industry's preferred means of financing oil and gas exploration, but he unreasonably denies that industry a subsidy Congress expressly contemplated it should receive.[22] Such an interpretation is "unrealistic and unreasonable," and therefore is not entitled to deference. *United States* v. *Cartwright, supra*, 411 U.S., at 550.

Finally, the Commissioner has not persuaded us of any "insurmountable" practical problems that would render his position more tenable. We do not doubt that §613A's various production requirements and limitations make accurate calculation of the percentage depletion allowance difficult in the absence of actual production figures. See App. to Pet. for Cert. in No. 82-599, p. 30a. But we believe the Commissioner can resolve these problems in a number of reasonable ways, for example, by requiring lessors to defer depletion deductions to years of actual production or by requiring lessors to adjust deductions taken with amended returns filed in later tax years.[23] The Commissioner has broad authority to prescribe all "needful rules and regulations" for the enforcement of the tax laws, see 26 U.S.C. §7805(a), and it is up to him to choose the method that best implements the statutory mandate. See *United States* v. *Correll, supra*, 389 U.S., at 306-307. What the Commissioner cannot do—because it is an "unreasonable" interpretation of the statutory language in light of its history and purpose—is to resolve the practical problems by eliminating the allowance altogether. Eliminating the allowance might make the statute "simpler to administer," Reply Brief for Commissioner 9, and n. 8, but it does so by ignoring the language of the statute, the views of those who sought its enactment, and the purpose they articulated.

IV

In a case such as this, where the effective and expeditious enforcement of our nation tax's laws is at issue, what we do not decide is as important as what we do decide. This case does not concern whether taxpayers must include bonuses and advance royalties in their income in the year of receipt. No one questions that taxpayers must do that. See *North American Oil Consul.* v. *Burnet*, 286 U.S. 417 (1932). Nor does this case concern the appropriate tax period in which the percentage depletion deduction should be used to offset taxable income. That issue is a significant one, but none of the parties has directly raised it for our review. Cf. 26 CFR §1.461-1 (assets having useful life beyond close of year not necessarily deductible in year expenditure made). Rather, our decision holds only that §§611-613A of the Code entitle taxpayers to an allowance for percentage depletion on lease bonus or advance royalty income at some time during the productive life of the lease.

Accordingly, since the Commissioner has never contested the tax period in which the Engles claimed their percentage depletion deduction, the judgment of the Court of Appeals for the Seventh Circuit in No. 82-599 is affirmed.[24] The judgment of the Court of Claims in No. 82-744 denying the Farmars and Suggs any percentage depletion on their lease bonus income is reversed, and the case is remanded for further proceedings in conformity with this opinion.

It is so ordered.

[22] In *Helvering v. Twin Bell Oil Syndicate*, U.S. 312 (1934), this Court interpreted §613(a) to allow the Commissioner to require lessees, for purposes of computing percentage depletion, to reduce their gross incomes by the advance payments made to lessors. Congress later codified this rule in §611(b), 26 U.S.C. §611(b), which requires that the deduction for depletion be equitably apportioned between lessor and lessee. The Commissioner has implemented §611(b) by requiring lessees to capitalize the lease bonus or advance royalty payments made and to amortize those capitalized costs over the productive life of the well. See 26 CFR §1.1613-2(c)(5) (1983). The very fact that §§611(b) and 613(a) were left intact by the 1975 amendments is itself some indication that Congress did not intend to deny the depletion benefit on advance payments to lessors. See Note, 35 Baylor L. Rev., at 120-121.

[23] See Jones, 57 J. Taxation at 233 (1982); Note, 35 Baylor L. Rev., at 122. The Commissioner currently requires much the same treatment from lessees. See n. 22, *supra*.

[24] We express no opinion concerning whether the Commissioner is precluded from raising this issue in another proceeding.

Subchapter J.—Estates, Trusts, Beneficiaries, and Decedents
Part I.—Estates, Trusts, and Beneficiaries
Subpart A.—General Rules for Taxation of Estates and Trust

Section 642.—Special Rules for Credits and Deductions

26 CFR 1.642(c)-6: Valuation of a remainder interest in property transferred to a pooled income fund.

Revised actuarial tables and interest factors are provided for valuing contributions to pooled income funds in existence for less than three years. See T.D. 7955, page 40.

Subpart C.—Estates and Trusts Which May Accumulate Income or Which Distribute Corpus

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-4: Calculation of the fair market value of the remainder interest in a charitable remainder unitrust.

Revised actuarial tables and interest factors are provided for valuing the remainder interest in a charitable remainder unitrust. See T.D. 7955, page 40.

Subpart E.—Grantors and Others Treated as Substantial Owners

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-1: Grantors and others treated as substantial owners.
(Also Sections 61, 162, 171, 212, 593, 856, 1232, 1232A, 7701; 1.61-1, 1.162-1, 1.171-1, 1.212-1, 1.593-11, 1.856-2, 1.1232-1, 301.7701-4, 301.7701-13A.)

Mortgage-backed certificates; residential mortgage "pool". Tax consequences associated with "straight pass-through" mortgage-backed certificates, representing undivided interests in a "pool" of residential mortgage loans created by the Federal National Mortgage Association and sold to investors are explained. Rev. Ruls. 70-544 and 70-545 clarified.

Rev. Rul. 84-10

ISSUE

What are the federal income tax consequences associated with the mortgage pool trusts described below?

FACTS

The Federal National Mortgage Association (*FNMA*) is a publicly held corporation established to provide assistance to the secondary market for home mortgage loans. *FNMA* has initiated a guaranteed mortgage pass-through securities program under Federal National Mortgage Association Charter Act §304(d), 12 U.S.C.A. §1719(d) (West 1980). Pursuant to a trust agreement, *FNMA* creates home mortgage pools and serves as trustee of each pool. Each pool consists of residential mortgages transferred to it by a single mortgage lender, *X*, in exchange for trust certificates. The trust certificates generally will be sold by *X* to investors. *FNMA* charges *X* a processing fee when it pools mortgages acquired from *X*.

In the capacity of pool trustee, *FNMA* collects principal and interest payments on each mortgage and makes monthly distributions to the certificate holders. *FNMA* receives a fee for its services as trustee consisting of a monthly service charge retained from the interest collected on the mortgages and other compensation including all late payment charges, assumption fees and prepayment penalties collected by *FNMA*. Pool proceeds are held in noninterest bearing accounts and cannot be reinvested. Neither the trustee nor *X* has the power to substitute a new mortgage for an original mortgage in the pool, except that within 120 days of the date the pool is established *FNMA* may require *X* to replace defective mortgages in the pool. Each of the pools will terminate when all mortgages are liquidated and all proceeds are distributed. *FNMA* may terminate a pool by purchasing all trust certificates with respect to the pool when the aggregate outstanding principal amount of mortgages in the pool is 10 percent or less of the initial pool principal balance.

FNMA guarantees that the certificate holders will receive timely payment of interest and collection of principal. If a mortgage is in default or if there is a foreclosure on mortgaged property, *FNMA* has the right to withdraw the mortgage from the pool and deem the mortgage prepaid.

The trust certificates, which are in registered form, state that they represent fractional undivided interests in the mortgage loans, pool proceeds, mortgaged property acquired by foreclosure that has not been withdrawn from the pool, and *FNMA*'s obligation to supplement the pool proceeds to the extent necessary to make distributions.

LAW

The Service has discussed the federal income tax consequences of similar pooling arrangements in Rev. Rul. 71-399, 1971-2 C.B. 433, amplified by Rev. Rul. 81-203, 1981-2 C.B. 137, Rev. Rul. 80-96, 1980-1 C.B. 317, Rev. Rul. 74-300, 1974-1 C.B. 169, Rev. Rul. 74-221, 1974-1 C.B. 365, and Rev. Rul. 72-376, 1972-2 C.B. 647 (concerning mortgage pools established by the Federal Home Loan Mortgage Corporation); Rev. Rul. 70-544, 1970-2 C.B. 6, and Rev. Rul. 70-545, 1970-2 C.B. 7, both modified by Rev. Rul. 74-169, 1974-1 C.B. 147 (concerning mortgage pools guaranteed by the Government National Mortgage Association); and Rev. Rul. 77-349, 1977-2 C.B. 20 (concerning a mortgage pool created by a commercial bank).

HOLDINGS

(1) Each pool will not be considered an association taxable as a corporation, but is classified as a trust of which the certificate holders are the owners under Subpart E of Subchapter J of the Internal Revenue Code.

(2) *FNMA* is the trustee of each trust and will be required to file Form 1041. See section 1.671-4 of the Income Tax Regulations.

(3) *FNMA* will recognize ordinary income in the amount of the processing fees charged *X* for pooling mortgages.

(4) Each certificate holder is treated as the owner of an undivided interest in the entire trust (corpus as well as ordinary income). See section 1.671-3(a)(1) of the regulations.

(5) The sale of a trust certificate transfers to the certificate holder a proportionate share of equitable ownership in each of the mortgages in the pool.

(6) *X* will recognize ordinary income or loss on the sale of its interest in each of the mortgages in the pool (evidenced by the trust certificates) measured by the difference between the proportionate amount of the proceeds realized with respect to the sale of each of the mortgages and its adjusted basis in each of such mortgages.

(7) Certificate holders shall take into account their proportionate share of the mortgage interest and other items of income, including prepayment penalties, assumption fees, and late payment charges, consistent with their methods of accounting.

(8) The certificate holders must also report their proportionate share of the discount income realized on the purchase of each of the mortgages as ordinary income, consistent with their methods of accounting. The special rules of section 1232 of the Code will be applicable to the certificate holders' proportionate shares of the discount on any mortgages in the pool that are obligations of corporations, or of governments or their political subdivisions, if and to the extent that the other conditions for the application of that section are met. Similarly, the rules of section 1232A(a)(1) will apply to the certificate holders' proportionate shares of obligations in the pool that are not obligations described in section 1232A(a)(2)(A) of the Code (relating to any obligation issued by a natural person).

(9) Certificate holders may amortize their proportionate shares of any premium paid to acquire mortgages to the extent allowed by section 171

of the Code. The provisions of section 171 will be applicable to the premium on mortgages in the pool that are issued by a corporation as described in section 171(d) of the Code.

(10) Certificate holders may deduct their proportionate share of *FNMA*'s fee for servicing the mortgages comprised of the monthly service charge, late payment charges, assumption fees, and prepayment penalties under section 162 or section 212 of the Code, consistent with their method of accounting.

(11) A certificate owned by a real estate investment trust is considered as representing "real estate assets" within the meaning of section 856(c)(5)(A) of the Code, and the interest income is considered "interest on obligations secured by mortgages on real property" within the meaning of section 856(c)(3)(B).

(12) A certificate owned by a domestic building and loan association is considered as representing "loans secured by an interest in real property" within the meaning of section 7701(a)(19)(C)(v) of the Code, provided the real property is (or from the proceeds of the loan will become) the type of real property described in that section of the Code.

(13) A certificate owned by a domestic building and loan association, within the meaning of section 7701(a)(19) of the Code, is considered as representing "qualifying real property loans" within the meaning of section 593(d) provided the real property underlying the mortgages is (or, from the proceeds of the loan, will become) the type of real property described in that section.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-544, 1970-2 C.B. 6, and Rev. Rul. 70-545, 1970-2 C.B. 7, are clarified with respect to the reporting of service fees, assumption fees, prepayment penalties and late charges by the certificate holders.

Subchapter K.—Partners and Partnerships
Part I. Determination of Tax Liability

Section 705.—Determination of Basis of Partner's Interest

26 CFR 1.705-1: Determination of basis of partner's interest.

Whether the basis of a contributing partner's interest is increased as a result of gain recognized upon his contribution of encumbered property. See Rev. Rul. 84-15, page 158.

Section 708.—Continuation of Partnership

26 CFR 1.708-1: Continuation of partnership.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, below.

Part II.—Contributions, Distributions, and Transfers
Subpart A.—Contributions to a Partnership

Section 721.—Nonrecognition of Gain or Loss on Contribution

26 CFR 1.721-1: Nonrecognition of gain or loss on contribution
(Also Sections 708, 722, 731, 733, 741, 752, 1001, 1223; 1.708-1, 1.722-1, 1.731-1, 1.733-1, 1.741-1, 1.752-1, 1.1001-1, 1.1223-1.)

Partnerships; conversion of a general partnership interest into a limited partnership interest. The federal income tax consequences of the conversion of a general partnership interest into a limited partnership interest in the same partnership are discussed.

Rev. Rul. 84-52

ISSUE

What are the federal income tax consequences of the conversion of a general partnership interest into a limited partnership interest in the same partnership?

FACTS

In 1975, *X* was formed as a general partnership under the Uniform Partnership Act of state *M*. *X* is engaged in the business of farming. The partners of *X* are *A*, *B*, *C*, and *D*. The partners have equal interest in the partnership.

The partners propose to amend the partnership agreement to convert the general partnership into a limited partnership under the Uniform Limited Partnership Act of State *M*, a statute that corresponds in all material respects to the Uniform Limited Partnership Act. Under the certificate of limited partnership, *A* and *B* will be limited partners, and both *C* and *D* will be general partners and limited partners. Each partner's total percent interest in the partnership's profits, losses, and capital will remain the same when the general partnership is converted into a limited partnership. The business of the general partnership will continue to be carried on after the conversion.

LAW AND ANALYSIS

Section 741 of the Internal Revenue Code provides that in the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized by the transferor partner.

Under section 1001 of the Code, if there is a sale or other disposition of property, the entire amount of the gain or loss realized thereunder will be recognized, unless another section of subtitle A provides for nonrecognition.

Under section 721 of the Code, no gain or loss is recognized by a partnership or any of its partners upon the contribution of property to the partnership in exchange for an interest therein.

Section 708 of the Code provides that a partnership is considered to be continuing if it is not terminated. A partnership is terminated if (1) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or (2) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Section 1.708-1(b)(1)(ii) of the Income Tax Regulations provides that a contribution of property to a partnership does not constitute a sale or exchange for purposes of section 708 of the Code.

Section 722 of the Code generally provides that the basis of an interest in a partnership acquired by a contribution of property equals the trans-

feror partner's adjusted basis in the contributed property.

Section 1223(1) of the Code provides that the holding period of property received in exchange for other property includes the holding period of the property exchanged, if the property received has the same basis (in whole or in part) as the property exchanged.

Under section 731 of the Code, if a partnership distributes money to a partner, then that partner will generally recognize gain only to the extent that the amount of money distributed (or deemed distributed) exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Under section 733 of the Code, if there is a distribution by a partnership to a partner and if there is no liquidation of that partner's interest, then the adjusted basis of that partner's interest in the partnership must be reduced (but not below zero) by the amount of money distributed to the partner.

Section 752(a) of the Code states, in part, that any increase in a partner's share of the partnership's liabilities is considered to be a contribution of money by the partner to the partnership.

Section 752(b) of the Code states in part, that any decrease in a partner's share of a partnership's liabilities is considered to be a distribution of money by the partnership to the partner.

Section 1.752-1(e) of the regulations provides rules for determining a partner's share of partnership liabilities with respect to both limited partnerships and general partnerships.

Under the facts of this revenue ruling, *A*, *B*, *C*, and *D*, will remain partners in *X* after *X* is converted to a limited partnership. Although the partners have exchanged their interests in the general partnership *X* for interests in the limited partnership *X*, under section 721 of the Code, gain or loss will not be recognized by any of the partners of *X* except as provided in section 731 of the Code.

HOLDINGS

(1) Except as provided below, pursuant to section 721 of the Code, no gain or loss will be recognized by *A*, *B*, *C*, or *D* under section 741 or section 1001 of the Code as a result of the conversion of a general partnership interest in *X* into a limited partnership in *X*.

(2) Because the business of *X* will continue after the conversion and because, under section 1.708-1(b)(1)(ii) of the regulations, a transaction governed by section 721 of the Code is not treated as a sale or exchange for purposes of section 708 of the Code, *X* will not be terminated under section 708 of the Code.

(3) If, as a result of the conversion, there is no change in the partners' shares of *X*'s liabilities under section 1.752-1(e) of the regulations, there will be no change to the adjusted basis of any partner's interest in *X*, and *C* and *D* will each have a single adjusted basis with respect to each partner's interest in *X* (both as limited partner and general partner) equal to the adjusted basis of each partner's respective general partner interest in *X* prior to the conversion. *See* Rev. Rul. 84-53, page 159, this Bulletin.

(4) If, as a result of the conversion, there is a change in the partners' shares of *X*'s liabilities under section 1.752-1(e) of the regulations, and such change causes a deemed contribution of money to *X* by a partner under section 752(a) of the Code, then the adjusted basis of that partner's interest shall, under section 722 of the Code, be increased by the amount of such deemed contribution. If the change in the partners' shares of *X*'s liabilities causes a deemed distribution of money by *X* to a partner under section 752(b) of the Code, then the basis of that partner's interest shall, under section 733 of the Code, be reduced (but not below zero) by the amount of such deemed distribution, and gain will be recognized by that partner under section 731 of the Code to the extent the deemed distribution exceeds the adjusted basis of that partner's interest in *X*.

(5) Pursuant to section 1223(1) of the Code, there will be no change to the holding period of any partner's total interest in *X*.

The holdings contained herein would apply with equal force if the conversion had been of a limited partnership to a general partnership.

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26 CFR 1.721-1: Nonrecognition of gain or loss on contribution.

Whether gain is recognized by a partner upon the contribution of property with debt in excess of its adjusted basis. See Rev. Rul. 84-15, below.

Section 722.—Basis of Contributing Partner's Interest

26 CFR 1.722-1: Basis of contributing partner's interest
(Also Sections 705, 721, 723, 731, 752; 1.705-1, 1.721-1, 1.723-1, 1.752-1.)

Partnerships; basis of partner's interest; basis of partnership property; contribution of encumbered property. A partner who recognizes gain upon the contribution of encumbered property to a partnership, does not increase the basis of the partnership interest to reflect the gain and the partnership does not increase the adjusted basis of the contributed property to reflect such gain.

Rev. Rul. 84-15

ISSUE

Is the basis of the partnership interest of a partner increased under section 722 of the Internal Revenue Code and is the basis of partnership property increased under section 723 if the partner contributes encumbered property to the partnership and the partner recognizes gain as a result of sections 731(a) and 752(b) of the Code?

FACTS

A, an individual, acquired a 20 percent interest in *GP*, a general partnership, by contributing land to *GP*. At the time of *A*'s contribution, the property had a fair market value of 100*x* dollars, an adjusted basis to *A* of 40*x* dollars, and was subject to a mort-

gage of 60*x* dollars. Payment of the mortgage was assumed by *GP*, and there were no other outstanding partnership liabilities. *GP* is not a partnership that would be treated as an investment company (within the meaning of section 351 of the Internal Revenue Code) if *GP* were incorporated.

LAW AND ANALYSIS

Section 721(a) of the Code provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(b) of the Code provides that subsection (a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated.

Section 722 of the Code states that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized to the contributing partner at such time.

Section 723 of the Code provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized to the contributing partner at such time.

Section 752(b) of the Code provides that any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities shall be considered as a distribution of money to the partner by the partnership.

Section 731(a) of the Code provides that in the case of a distribution, gain shall not be recognized to a partner except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 705(a)(2) of the Code states that the adjusted basis of a partner's interest shall be decreased (but not below zero) by distributions by the partnership.

Under section 721(a) of the Code, when a person contributes property to a partnership in exchange for an interest therein, gain or loss is generally not recognized on the transfer. However, if the property is encumbered and the encumberance becomes a liability of the partnership, under section 752(b), the contributing partner is deemed to receive a distribution of money from the partnership in an amount equal to the reduction in the share of such liability. As illustrated by example (2) of section 1.722-1 of the Income Tax Regulations, gain is recognized under section 731(a) by the contributing partner on the deemed distribution of money to the extent that such distribution exceeds the adjusted basis of such partner's interest.

Section 721(b) of the Code was added by section 2131(b) of the Tax Reform Act of 1976, 1976-3 (Vol. 1) C.B. 1, 400. It was intended to provide an exception to the general rule of nonrecognition of gain or loss on the contribution of property to a partnership where investors transfer appreciated stock or securities (or other property) to an exchange fund operated as a partnership. S. Rep. No 94-938 (Part 2), 94th Cong., 2d Sess. 43 (1976), 1976-3 (Vol. 3) C.B. 643, 685. Section 2131(c) of the Act made conforming amendments to sections 722 and 723 of the Code providing for the adjustment of the basis of the partner's interest and the basis of the contributed property to the partnership if gain is recognized under section 721(b).

The amendments to sections 722 and 723 of the Code do not apply to the recognition of gain that results under sections 731(a) and 752(b) from the contribution of encumbered property, since such gain arises immediately after the contribution, not ". . .at the time of the contribution." Basis is increased under sections 722 and 723 only by the amount of gain recognized at the time of contribution due to the inapplicability of section 721(a). See S. Rep. No. 94-938 (Part 2) at 43 n.2, 1976-3 (Vol. 3) C.B. at 685.

In this case, section 721(a) of the Code applies to *A*'s contribution of encumbered property to the partnership in exchange for the 20 percent partnership interest. Section 721(b) does not apply to the transaction. However, *A* must recognize a gain of 8*x* dollars under section 731(a), determined as follows:

Portion of mortgage assumed by other partners treated as a distribution under section 752(b) (80% of 60*x* dollars):	48*x* dollars
Less adjusted basis to *A* of property contributed:	40*x* dollars
Gain recognized:	8*x* dollars

The adjusted basis of *A*'s partnership interest is reduced to zero (section 705(a)(2)), and is not increased under section 722 by the 8*x* dollars of gain recognized by A. Similarly, the basis of partnership property is not increased under section 723 by the 8*x* dollars of gain recognized by A.

HOLDING

The adjusted basis of a partnership interest is not increased under section 722 of the Code and the adjusted basis of partnership property is not increased under section 723 if the partner contributes encumbered property to a partnership and the partner recognizes gain under section 731(a) of the Code.

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26 CFR 1.722-1: Basis of contributing partner's interest.
(Also Sections 61, 752, 1001; 1.61-6, 1.752-1, 1.1001-2.)

Partnerships; general and limited partner's basis; sale of partnership interest. Four situations illustrate the basis of a partner's general and limited partnership interest when a portion of the partnership interest is sold or exchanged.

Rev. Rul. 84-53

ISSUE

What are the tax consequences of the sale of a partnership interest in the situations described below?

FACTS

Situation 1

In 1978, *Y* was formed as a limited partnership under the Uniform Limited Partnership Act of State *N* for the purpose of investing and trading in stocks and securities. *Y* has a calendar taxable year. *A* contributed $50x to *Y* in exchange for a general partner interest, entitling *A* to a 50 percent interest in all partnership distributions and in partnership income, gain, loss, and deduction. *B* contributed $50x to *Y* in exchange for a limited partner interest, entitling *B* to a 50 percent interest in all partnership distributions and in partnership income, gain, loss, and deduction.

On January 1, 1980, when the stock and securities of *Y* had decreased in value from $100x to $64x, *B* sold to *A* one-half of *B*'s limited partner interest for $16x, which interest *A* holds as a limited partner.

On January 1, 1982, when the stock and securities of *Y* has risen in value from $64x (its 1980 value) to $120x, *A* sold to *C* one-half of *A*'s general partner interest for $30x. Immediately prior to the sale, *A*'s entire partnership interest had a fair market value of $90x and the transferred portion of the interest had a fair market value of $30x. Since formation, the partnership has made cash distributions in an amount equal to its total income (including tax-exempt income). Assume that all partnership allocations (in all situations) are valid, and that *A*, *B*, and *C* are unrelated parties.

Situation 2

The facts are the same as in *Situation* 1 except that, in 1981, *Y* borrowed $80x recourse which was invested in securities that became worthless on December 31, 1981. Furthermore, immediately prior to *A*'s sale to *C*, *A*'s entire partnership interest had a fair market value of $30x and the transferred portion of *A*'s interest had a fair market value of $10x.

Situation 3

The facts are the same as in *Situation* 2 except that, on January 1, 1982, *A* sold *A*'s entire limited partner interest to *C* for its fair market value of $10x (rather than one-half of *A*'s general partner interest).

Situation 4

The facts are the same as in *Situation* 1 except that, in 1981, *Y* borrowed $96x recourse which is invested in securities that became worthless on December 31, 1981. Furthermore, immediately prior to *A*'s sale to *C*, *A*'s entire partnership interest had a fair market value of $18x and the transferred portion of *A*'s interest had a fair market value of $6x.

LAW and ANALYSIS

Section 705 of the Internal Revenue Code provides rules for determining the adjusted basis of a partner's interest in a partnership.

Section 722 of the Code provides that the basis of an interest in a partnership acquired by a contribution of property equals the transferor partner's adjusted basis in the contributed property.

Section 752(a) of the Code provides that any increase in a partner's share of the partnership's liabilities is considered to be a contribution of money by the partner to the partnership.

Section 752(b) of the Code provides that any decrease in a partner's share of a partnership's liabilities is considered to be a distribution of money by the partnership to the partner.

Section 1.752-1(e) of the Income Tax Regulations provides rules for determining a partner's share of partnership liabilities with respect to both limited partnerships and general partnerships.

Section 752(d) of the Code provides that in the case of a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships.

Section 1.1001-2 of the regulations provides that the amount realized from a sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition.

Section 1.61-6(a) of the regulations provides that when a part of a larger property is sold, the basis of the entire property shall be equitably apportioned among the several parts for purposes of determining gain or loss on the part sold.

Consistent with the provisions of Subchapter K of the Code, a partner has a single basis in a partnership interest, even if such partner is both a general partner and a limited partner of the same partnership. *See* Rev. Rul. 84-52, page 157, this Bulletin. Thus, for example, in applying the limitations of section 704(d) of the Code, losses allocated with respect to a partner's limited partner interest will be allowed so long as they do not exceed the partner's basis in the entire partnership interest.

Under section 1.61-6(a) of the regulations, when a partner makes a taxable disposition of a portion of an interest in a partnership, the basis of the transferred portion of the interest generally equals an amount which bears the same relation to the partner's basis in the partner's entire interest as the fair market value of the transferred portion of the interest bears to the fair market value of the entire interest. However, if such partnership has liabilities, special adjustments must be made to take into account the effect of those liabilities on the basis of the partner's interest.

In cases where the partner's share of all partnership liabilities does not exceed the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the transferor partner shall first exclude from the adjusted basis of such partner's entire interest an amount equal to such partner's share of all partnership liabilities, as determined under section 1.752-1(e) of the regulations. A part of the remaining adjusted basis (if any) shall be allocated to the transferred portion of the interest ac-

cording to the ratio of the fair market value of the transferred portion of the interest to the fair market value of the entire interest. The sum of the amount so allocated plus the amount of the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest (under section 752(d) of the Code and section 1.1001-2 of the regulations) equals the adjusted basis of the transferred portion of the interest.

On the other hand, if the partner's share of all partnership liabilities exceeds the adjusted basis of such partner's entire interest (including basis attributable to liabilities), the adjusted basis of the transferred portion of the interest equals an amount that bears the same relation to the partner's adjusted basis in the entire interest as the partner's share of liabilities that is considered discharged on the disposition of the transferred portion of the interest bears to the partner's share of all partnership liabilities, as determined under section 1.752-1(e).

HOLDINGS

Situation 1

Prior to the sale of one-half of *B*'s limited partner interest to *A*, the adjusted basis of *B*'s entire partnership interest was $50x. Because the fair market value of the transferred portion of *B*'s interest ($16x) is one-half of the fair market value of *B*'s entire partnership interest ($32x), $25x (½ of $50x) of adjusted basis must be allocated to the interest transferred by *B*. *B* sustained a $9 loss ($16x − $25x) on the sale to *A*. The adjusted basis of the remainder of *B*'s partnership interest is $25x.

Prior to the sale of one-half of *A*'s general partner interest to *C*, the adjusted basis of *A*'s entire partnership interest was $66x. Because the fair market value of the transferred portion of *A*'s interest ($30x) is one-third of the fair market value of *A*'s entire partnership interest ($90x), $22x (⅓ of $66x) of the adjusted basis must be allocated to the portion of the interest transferred by *A*. *A* realizes an $8x gain ($30x − $22x) on the sale to *C*. The basis of the remainder of *A*'s partnership interest is $44x. The results would be the same to *A* if *A*, instead, sold to *C* the limited partner interest acquired earlier from *B*.

Situation 2

The tax consequences of *B*'s sale of one-half of *B*'s limited partner interest to *A* are identical to those described in *Situation* 1.

In 1981, *A*'s basis in *A*'s entire partnership interest was increase from $66x to $146x as a result of the $80x recourse borrowing (which increases only the basis of *A*, the sole general partner, under section 1.752-1(e) of the regulations and sections 752(a) and 722 of the Code) and was decreased to $86x as a result of the $60x loss allocated to *A* that year when the securities became worthless. Thus, prior to the sale of one-half of *A*'s general partner interest to *C*, the adjusted basis of *A*'s entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on *A*'s adjusted basis, $80x (*A*'s share of all partnership liabilities) is subtracted from $86x, leaving $6x. Because the fair market value of the transferred portion of *A*'s interest ($10x) is one-third of the fair market value of the entire interest ($30x), $2x (⅓ of $6x) of the remaining adjusted basis must be allocated to the transferred portion of *A*'s general partner interest. The sum of that amount ($2x) plus the amount of partnership liabilities from which *A* is discharged on the disposition of the transferred portion of A's general partner interest ($40), or $42x, equals the adjusted basis of the transferred portion of the interest. *A* realizes an $8x gain ($10x + $40x − $42x) on the sale to *C*. The basis of the remainder of *A*'s partnership interest is $44x ($86x − $42x).

Situation 3

The tax consequences of *B*'s sale of one-half of *B*'s limited partner interest to *A* are identical to those described in *Situation* 1.

As in *Situation* 2, prior to the sale of *A*'s limited partner interest to *C*, the adjusted basis of *A*'s entire partnership interest was $86x. To take into account the effect of the liability sharing rules of section 1.752-1(e) of the regulations on *A*'s adjusted basis, $80x (*A*'s share of all partnership liabilities) is subtracted from $86x, leaving $6x. Because of the fair market value of the transferred portion of *A*'s limited partner interest ($10x) is one-third of the fair market value of *A*'s entire interest ($30x), $2x (⅓ of $6x) of the remaining adjusted basis must be allocated to the transferred limited partner interest. The sum of that amount ($2x) plus the amount of partnership liabilities from which *A* is discharged on the disposition of the transferred limited partner interest ($0x), or $2x, equals the adjusted basis of the transferred portion of the interest. *A* realizes an $8x gain ($10x − $2x) on the sale to *C*. The basis of the remainder of *A*'s partnership interest is $84x ($86x − $2x).

Situation 4

The tax consequences of *B*'s sale of one-half of *B*'s limited partner interest to *A* are identical to those described in *Situation* 1.

In 1981, *A*'s basis in *A*'s entire partnership interest was increased from $66x to $162x as a result of the $96x recourse borrowing and was decreased to $90x as a result of the $72x loss allocated to *A* that year when the securities became worthless. Thus, prior to the sale of one-half of *A*'s general partner interest to *C*, the adjusted basis of *A*'s entire partnership interest was $90x. In this situation, *A*'s share of all partnership liabilities ($96x) exceeds the adjusted basis of *A*'s entire interest ($90x). Thus, the adjusted basis of the transferred portion of *A*'s general partner interest equals $45x, the amount which bears the same relation to A's adjusted basis in the entire interest ($90x) as the amount of partnership liabilities from which *A* is discharged on the disposition of the transferred portion of the general partner interest ($48x) bears to *A*'s share of all partnership liabilities ($96x). *A* realizes a $9x gain ($48x + $6x − $45x) on the sale of *C*. The basis of the remainder of *A*'s

partnership interest is $45x ($90x − $45x).

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26 CFR 1.722-1: Basis of contributing partner's interest.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

Section 723.—Basis of Property Contributed to Partnership

26 CFR 1.723-1: Basis of property contributed to partnership.

Whether the basis of partnership property is increased as a result of gain recognized by the partner who contributed the encumbered property. See Rev. Rul. 84-15, page 158.

Subpart B.—Distributions by a Partnership

Section 731.—Extent of Recognition of Gain or Loss on Distribution

26 CFR 1.731-1: Extent of recognition of gain or loss on distribution.

Whether a new partner is considered to receive a distribution of money in excess of the basis of the partnership interest as a result of the contribution of property with debt greatly in excess of its adjusted basis. See Rev. Rul. 84-15, page 158.

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26 CFR 1.731-1: Extent of recognition of gain or loss on distribution.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

Section 733.—Basis of Distributee Partner's Interest

26 CFR 1.733-1: Basis of distributee partner's basis.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

Subpart C.—Transfers of Interest in a Partnership

Section 741.—Recognition and Character of Gain or Loss on Sale or Exchange

26 CFR 1.741-1: Recognition and character of gain or loss on sale or exchange.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

Subpart D.—Provisions Common to Other Subparts

Section 752.—Treatment of Certain Liabilities

26 CFR 1.752-1: Treatment of certain liabilities.

Whether a partner's share of partnership liabilities is decreased as a result of the contribution of encumbered property. See Rev. Rul. 84-15, page 158.

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26 CFR 1.752-1: Treatment of certain liabilities.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

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26 CFR 1.752-1: Treatment of certain liabilities.

A partner has a single basis in a partnership interest, even if the partner is both a general partner and a limited partner in the same partnership. See Rev. Rul. 84-53, page 159.

Subchapter L.—Insurance Companies
Part I.—Life Insurance Companies
Subpart E.—Miscellaneous Provisions

Section 819.—Foreign Life Insurance Companies

26 CFR 1.819-2: Foreign life insurance companies.

Percentages to be used by Foreign Life Insurance Companies in computing income tax for the taxable year 1983 and estimated tax for the taxable year 1984. See Notice 84-8, page 341.

Subchapter M.—Regulated Investment Companies and Real Estate Investment Trusts
Part I.—Regulated Investment Companies

Section 852.—Taxation of Regulated Investment Companies and Their Shareholders

26 CFR 1.852-4: Method of taxation of shareholders of regulated investment companies.

Definition of capital gain dividend in the case of a regulated investment company. See T.D. 7936, this page.

Part II.—Real Estate Investment Trusts

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856-2: Limitations.

Whether an interest in a mortgage "pool" comes within the definition of the term "real estate assets". See Rev. Rul. 84-10, page 155.

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26 CFR 1.856-9: Election with respect to property held for sale in a taxable year beginning before October 5, 1976.

Treatment of property held for sale to customers by a real estate investment trust. See T.D. 7936, below.

Part III.—Provisions Which Apply to Both Regulated Investment Companies and Real Estate Investment Trusts

Section 860.—Deduction for Deficiency Dividends

26 CFR 1.860-1: Deficiency dividends. (Also Sections 46, 50B, 852, 856; 1.46-4, 1.50B-5, 1.852-4, 1.856-9.)

T.D. 7936

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953, SUBCHAPTER D—MISCELLANEOUS EXCISE TAXES; PART 55—EXCISE TAX ON CERTAIN REAL ESTATE INVESTMENT TRUSTS

Real estate investment trusts and regulated investment companies

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to deficiency dividends paid by certain regulated investment companies (RICs) and real estate investment trusts (REITs). Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. A RIC or REIT whose income is adjusted by a determination will be affected by the regulations.

DATES: The regulations apply to certain court decisions or other determinations occurring after October 4,

1976, for REITs, and after November 6, 1978, for RICs.

FOR FURTHER INFORMATION CONTACT: Michel A. Daze of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, DC 20224, Attention: CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains final amendments to the Income Tax Regulations (26 CFR Part 1) under section 860 of the Internal Revenue Code, which relates to deficiency dividends of RICs and REITs. These regulations were published in proposed form in the FEDERAL REGISTER on March 31, 1980 (45 FR 20925).

Section 1601 of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1742) [1976-3 C.B. (Vol. 1) 1, 218] added a new section 859 to the Code. This section established a procedure by which a REIT could be relieved from the payment of a deficiency in (or be allowed a credit or refund with respect to) certain income taxes that are determined by taking into account the deduction for dividends paid. This procedure allows an additional deduction for dividends paid by a REIT after a determination with respect to its income tax liability. Subject to certain limitations, the deficiency dividend is included in the deduction for dividends paid for the taxable year to which the determination applies. A REIT that pays a deficiency dividend is subject to interest and penalties determined with respect to the amount of the deduction allowed. Section 859 applied to determinations with respect to REITs after October 4, 1976.

Section 362 of the Revenue Act of 1978 (Pub. L. 95-600, 92 Stat. 2848) [1978-3 C.B. (Vol. 1) 1, 82] extended the privilege of paying deficiency dividends to RICs, effective with respect to determinations after November 6, 1978. The 1978 Act also consolidated the deficiency divident provisions for both RICs and REITs into new section 860 of the Code.

A number of provisions in the proposed regulations substantially duplicated proposed regulations published in the FEDERAL REGISTER on July 7, 1978 (43 FR 29317), which dealt with the taxation of REITs and included rules for applying the deficiency dividend procedure of former section 859 to REITs. Since final REIT regulations were published on February 6, 1981 (46 FR 11254) [T.D. 7767, 1981-1 C.B. 82], the substance of many of the amendments proposed on March 31, 1980, has already been incorporated into the Income Tax Regulations. Where the REIT regulations and the proposed regulations differed on matters of style not affecting substance, these final regulations occasionally follow the language of the proposed regulations. The final regulations conform the REIT regulations to section 362 of the 1978 Act and provide rules for applying the deficiency dividend procedure to both RICs and REITs.

Prior to the 1978 Act, section 860 dealt with accounting periods for REITs. The 1978 Act amended the section and redesignated it as section 859. The REIT regulations, which did not reflect the changes made by the 1978 Act, added §1.860-1 to the Income Tax Regulations (§1.860-1 merely followed the language of former section 860). Because this Treasury decision does not provide rules under the new section 859, §1.860-1 has simply been removed.

COMMENTS

Only one comment was received that recommended a change in the regulations as proposed. This comment related to a RIC that has interest income that is excluded from gross income under section 103(a)(1) of the Code. In general, under section 852(a)(1)(B) a RIC which has exempt interest income must distribute dividends which equal or exceed 90 percent of the excess of the exempt interest over certain nondeductible expenses related to that interest. However, in order for a RIC to pay a deficiency dividend, section 860(d)(1) requires that there must be (1) an increase in its investment company taxable income (determined without the dividends paid deduction), (2) an increase in its undistributed net capital gain, or (3) a decrease in its deduction for dividends paid. Section 1.860-2(a)(1) of the proposed regulations provided that since an increase in tax exempt interest does not come within any of these categories, such an increase does not afford the RIC the opportunity to pay a deficiency dividend. This result obtains notwithstanding that the increase may result in the RIC's disqualification.

The commentator argued that the legislative history of section 860 makes clear that Congress enacted that section to ensure that a RIC would not be disqualified as the result of an audit adjustment increasing its income. The commentator urges that Congress intended this result to apply whether the adjusted "income" is exempt interest or other income subject to tax.

After careful consideration, the commentator's suggestion was not adopted. In the case of a RIC, section 860(d)(1)(A) requires an increase in undistributed investment company taxable income (or certain other adjustments not pertinent here) as a condition to the payment of a deficiency dividend. However investment company taxable income does not include exempt interest income. It is clear that Congress recognized this because section 852(a)(1) requires the RIC to distribute the *sum* of (1) 90 percent of its investment company taxable income (computed without the dividends paid deduction) and (2) 90 percent of the excess of its exempt interest income over certain nondeductible expenses related to that income. Moreover, in the "technical corrections" section of the 1978 Act, Congress amended the requirements for RIC status (section 851) to specifically provide that exempt interest income is to be treated as gross income in determining if 90 percent of

the RIC's gross income is from interest (or other qualified sources), and if its gain from certain short-term sales is less than 30-percent of its gross income. The amendments were considered necessary because without them a RIC investing all or most of its assets in tax-exempt obligations could fail to meet the 90-percent and 30-percent tests if it recognized a relatively small amount of nonqualifying income. (Report of the Committee on Ways and Means accompanying H.R. 6715 (H. Rep. No. 95-745, 95th Cong. 2nd Sess. (1978).) Congress, however, did not include a similar provision treating exempt interest as investment company taxable income for purposes of the deficiency dividend procedure.

Accordingly, the final regulations follow the explicit language of section 860(d)(1)(A) and adopt the rule, as proposed, that holds that an increase in exempt interest income is not an adjustment which affords a RIC the opportunity to pay a deficiency dividend.

CHANGE TO THE PROPOSED REGULATIONS

One minor substantive change is made to the regulations as proposed (in addition to stylistic changes not affecting substance and changes reflecting the final REIT regulations). As adopted, the final regulations make clear that the RIC or REIT does not have to distribute the full amount of the adjustment to its income in order to pay a deficiency dividend. Thus the RIC and REIT may pay the maximum amount of deficiency dividends allowed by section 860 or it may choose to pay a lesser amount.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Because the notice of proposed rulemaking for this regulation was filed with the Federal Register on March 31, 1980, no regulatory flexibility analysis is required.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Duane H. Pellervo of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, Part 1 and Part 55 of Title 26 of the Code of Federal Regulations are amended as follows:

Paragraph 1. Section 1.46-4(b)(2) is amended as follows:

1. The fourth sentence of paragraph (b)(2) is amended to read as set forth below.

2. The fifth sentence of paragraph (b)(2) is amended by striking out "See section 859(d)" and inserting in lieu thereof "See section 860(f)".

§1.46-4 Limitations with respect to certain persons.

* * * * *

(b) Regulated investment companies and real estate investment trusts.***

(2) *** The amount of the deduction for dividends paid includes the amount of deficiency dividends (other than capital gains deficiency dividends) taken into account in computing investment company taxable income or real estate investment trust taxable income for the taxable year.***

* * * * *

Par. 2. Section 1.50B-5(b)(2) is amended as follows:

1. The fourth sentence of paragraph (b)(2) is amended to read as set forth below.

2. The fifth sentence of paragraph (b)(2) is amended by striking out "See section 859(d)" and inserting in lieu thereof "See section 860(f)".

§1.50B-5 Limitations with respect to certain persons.

* * * * *

(b) Regulated investment companies and real estate investment trusts.***

(2) *** The amount of the deduction for dividends paid includes the amount of deficiency dividends (other than capital gains deficiency dividends) taken into account in computing investment company taxable income or real estate investment trust taxable income for the taxable year.***

* * * * *

Par. 3. Section 1.316-1 is amended as follows:

1. The first sentence of paragraph (d) is amended by striking out "under section 859 (relating to deficiency dividends), was a real estate investment trust (within the meaning of section 856)" and inserting in lieu thereof "under section 860 (relating to deficiency dividends), was a regulated investment company (within the meaning of section 851), or a real estate investment trust (within the meaning of section 856)".

2. The first sentence of paragraph (d) is further amended by striking out "in section 859(d)" and inserting in lieu thereof "in section 860(f)".

3. Example (7) under paragraph (e) is amended as follows:

a. The second sentence of example (7) is amended by striking out "of section 859" and inserting in lieu thereof "of section 860", and by striking out "under section 859(d)" and inserting in lieu thereof "under section 860".

b. Example (7) is amended by adding a new sentence at the end thereof, to read as follows:

§1.316-1 Dividends.

* * * * *

(e) ***

Example (7). *** See section 316(b)(3).

Par. 4. Section 1.381(c)(25)-1 is amended as follows:

1. The heading of section 1.381(c)(25)-1 is amended by striking out "real estate investment trust" and inserting in lieu thereof "a qualified investment entity".

2. Paragraph (a)(1) is amended by striking out "a real estate investment trust (within the meaning of section 856, as in effect for the applicable tax year)" and inserting in lieu thereof "a qualified investment entity (within the meaning of section 860(b)).

3. Paragraph (a)(2) is amended as follows:

a. The first sentence of paragraph (a)(2) is amended by striking out "section 859(c)" and inserting in lieu thereof "section 860(e)".

b. The first sentence of paragraph (a)(2) is amended by inserting "852 (b)," between "56(a)," and "857 (b)(1)".

c. The first sentence of paragraph (a)(2) is amended by striking out "section 859" and inserting in lieu thereof "section 860".

d. The second sentence of paragraph (a)(2) is amended by striking out "section 859" and inserting in lieu thereof "section 860".

4. Paragraph (b) is amended by striking out "section 859(d)" in the first sentence and inserting in lieu thereof "section 860(f)".

5. Paragraph (c) is amended as follows:

a. The first and fourth sentences of paragraph (c) are amended by striking out "form" and inserting in lieu thereof "Form".

b. The second sentence of paragraph (c) is amended by striking out "paragraph (b)(2) of §1.859-2" and inserting in lieu thereof "§1.860-2(b)(2)".

Par. 5. Section 1.441-1(b)(3) is amended by striking out "see section 860 and §1.860-1" in the last sentence and inserting in lieu thereof "see section 859".

Par. 6. Section 1.442-1 is amended as follows:

1. Paragraph (a)(1) is amended by striking out "see section 860 and §1.860-1" in the last sentence and inserting in lieu thereof "see section 859".

2. Paragraph (c)(1) is amended by striking out "§1.860-1" in the first sentence and inserting in lieu "under section 859".

Par. 7. Section 1.852-4 is amended as follows:

1. Paragraph (c)(1) is amended by striking out "not later than 45 days (30 days for a taxable year ending before February 26, 1964) after the close of its taxable year" in the first sentence and inserting in lieu thereof "within the period specified in paragraph (c)(4) of this section".

2. Paragraph (c)(2) is amended by adding a new sentence at the end thereof, to read as set forth below.

3. A new paragraph (c)(4) is added after paragraph (c)(3), to read as set forth below.

§1.852-4 Method of taxation of shareholders of regulated investment companies.

* * * * *

(c) *Definition of capital gain dividend.****

(2) *Shareholder of record custodian of certain unit investment trusts.* *** If a notice under paragraph (c)(1) of this section is mailed within the 120-day period following the date of a determination pursuant to paragraph (c)(4)(ii) of this section, the 120-day period and the 130-day period following the date of the determination shall be substituted for the 45-day period and the 55-day period following the close of the regulated investment company's taxable year prescribed by this subparagraph (2).

* * * * *

(4) *Mailing of written notice to shareholders.* (i) Except as provided in paragraph (c)(4)(ii) of this section, the written notice designating a dividend or part thereof as a capital gain dividend must be mailed to the shareholders not later than 45 days (30 days for a taxable year ending before February 26, 1964) after the close of the taxable year of the regulated investment company.

(ii) If a determination (as defined in section 860(e)) after November 6, 1978, increases the excess for the taxable year of the net capital gain over the deduction for capital gains dividends paid, then a regulated investment company may designate all or part of any dividend as a capital gain dividend in a written notice mailed to its shareholders at any time during the 120-day period immediately following the date of the determination. The aggregate amount designated during this period may not exceed this increase. A dividend may be designated if it is actually paid during the taxable year, is one paid after the close of the taxable year to which section 855 applies, or is a deficiency dividend (as defined in section 860(f)), including a deficiency dividend paid by an acquiring corporation to which section 381(c)(25) applies. The date of a determination is established under §1.860-2(b)(1).

* * * * *

Par. 8. Section 1.856-0 is amended by striking out "Act of 1978" and inserting in lieu thereof "Act of 1978, other than the changes made by section 362 of the Act, relating to deficiency dividends".

Par. 9. Section 1.856-7(d) is amended as follows:

1. The first sentence of paragraph (d) is amended by striking out "(as defined in section 859(c))".

2. The third sentence is amended by striking out "§1.859-2(b)(1) (other than the second sentence and the last sentence of §1.859-2(b)(1)(iv)) shall apply" and inserting in lieu thereof "section 860(e) and §1.860-2(b)(1) (other than the second, third, and last sentences of §1.860-2(b)(1)(ii)) shall apply".

Par. 10. Section 1.856-9 is amended as follows:

1. Paragraph (a) is amended by striking out "(as defined in section 859(c))" in the third sentence and by adding a new sentence to the end thereof, to read as set forth below.

2. Paragraph (c) is amended as follows:

a. The second sentence of para-

graph (c) is amended by striking out "section 859(c)(1) or (2) shall be determined in accordance with section 859(c) and subdivision (i), (ii), or (iii) of §1.859-2(b)(1)" and inserting in lieu thereof "section 860(e)(1) or (2) shall be determined in accordance with section 860(e) and §1.860-2(b)(1)(i)".

b. The third sentence of paragraph (c) is amended by striking out "section 859(c)(3)" and inserting in lieu thereof "section 860(e)(3)".

3. Paragraph (e) is amended by striking out "section 859(c)(3)" in the first sentence and inserting in lieu thereof "section 860(e)(3)".

§1.856-9 Election with respect to property held for sale in a taxable year beginning before October 5, 1976.

(a) *In general.* *** For purposes of section 1608(d)(2) of the Tax Reform Act of 1976 and this section, the definition of "determination" in section 860(e) shall apply.

* * * * *

Par. 11. Section 1.857-6(f)(2) is amended as follows:

1. The first sentence of paragraph (f)(2) is amended by striking out "section 859(c)" and inserting in lieu thereof "section 860(e)".

2. The third sentence of paragraph (f)(2) is amended by striking out "section 859(d)" and inserting in lieu thereof "section 860(f)".

3. The last sentence of paragraph (f)(2) is amended by striking out "§1.859-2(b)(1)" and inserting in lieu thereof "§1.860-2(b)(1)".

Par. 12. Section 1.860-1 is removed and section 1.859-1 is redesignated as section 1.860-1 and revised to read as follows:

§1.860-1 Deficiency dividends.

Section 860 allows a qualified investment entity to be relieved from the payment of a deficiency in (or to be allowed a credit or refund of) certain taxes. "Qualified investment entity" is defined in section 860(b). The taxes referred to are those imposed by sections 852(b)(1) and (3), 857(b)(1) or (3), the minimum tax on tax preferences imposed by section 56 and, if the entity fails the distribution requirements of section 852(a)(1)(A) or 857(a)(1) (as applicable), the corporate income tax imposed by section 11(a) or 1201(a). The method provided by section 860 is to allow an additional deduction for a dividend distribution (that meets the requirements of section 860 and §1.860-2) in computing the deduction for dividends paid for the taxable year for which the deficiency is determined. A deficiency dividend may be an ordinary dividend or, subject to the limitations of sections 852(b)(3)(C), 857(b)(3)(C), and 860(f)(2)(B), may be a capital gain dividend.

Par. 13. Section 1.859-2 is redesignated as section 1.860-2 and revised to read as follows:

§1.860-2 Requirements for deficiency dividends.

(a) *In general*—(1) *Determination, etc.* A qualified investment entity is allowed a deduction for a deficiency dividend only if there is a determination (as defined in section 860(e) and paragraph (b)(1) of this section) that results in an adjustment (as defined in section 860(d)(1) or (2)) for the taxable year for which the deficiency dividend is paid. An adjustment does not include an increase in the excess of (i) the taxpayer's interest income excludable from gross income under section 103(a) over (ii) its deductions disallowed under sections 265 and 171(a)(2).

(2) *Payment date and claim.* The deficiency dividend must be paid on, or within 90 days after, the date of the determination and before the filing of a claim under section 860(g) and paragraph (b)(2) of this section. This claim must be filed within 120 days after the date of the determination.

(3) *Nature and amount of distribution.* (i) The deficiency dividend must be a distribution of property (including money) that would have been properly taken into account in computing the dividends paid deduction under section 561 for the taxable year for which tax liability resulting from the determination exists if the property had been distributed during that year. Thus, if the distribution would have been a dividend under section 316(a) if it had been made during the taxable year for which the determination applies, the distribution may qualify under sections 316(b)(3), 562(a), and 860(f)(1), even though the distributing corporation, trust, or association has no current or accumulated earnings and profits for the taxable year in which the distribution is actually made. The amount of the distribution is determined under section 301 as of the date of the distribution.

The amount of the deduction is subject to the applicable limitations under sections 562 and 860(f)(2). Thus, if the entity distributes to an individual shareholder property (other than money) which on the date of the distribution has a fair market value in excess of its adjusted basis in the hands of the entity, the amount of the deficiency dividend in the individual's hands for purposes of section 316(b)(3) is determined by using the property's fair market value on that date. Nevertheless, the amount of the deficiency dividend the entity may deduct is limited, under §1.562-1(a), to the adjusted basis of the property and the amount taxable to the individual as a dividend is determined by reference to the current and accumulated earnings and profits for the year to which the determination applies.

(ii) The qualified investment entity does not have to distribute the full amount of the adjustment in order to pay a deficiency dividend. For example, assume that in 1983 a determination with respect to a calendar year regulated investment company results in an increase of $100 in investment company taxable income (computed without the dividends paid deduction) for 1981 and no other change. The regulated investment company may choose to pay a deficiency dividend of $100 or of any lesser amount and be allowed a dividends paid deduction for 1981 for the amount of that deficiency dividend.

(4) *Status of distributor.* The cor-

poration, trust or association that pays the deficiency dividend does not have to be a qualified investment entity at the time of payment.

(5) *Certain definitions to apply.* For purposes of sections 860(d) (defining adjustment) and (f)(2) (limitations) the definitions of the terms "investment company taxable income," "real estate investment trust taxable income," and "capital gains dividends" in sections 852(b)(2), 857(b)(2), 852(b)(3)(C), and 857 (b)(3)(C) apply, as appropriate to the particular entity.

(b) *Determination and claim for deduction*—(1) *Determination.* For purposes of applying section 860(e), the following rules apply:

(i) The date of determination by a decision of the United States Tax Court, the date upon which a judgment of a court becomes final, and the date of determination by a closing agreement shall be determined under the rules in §1.547-2(b)(1)(ii), (iii), and (iv).

(ii) A determination under section 860(e)(3) may be made by an agreement signed by the district director or another official to whom authority to sign the agreement is delegated, and by or on behalf of the taxpayer. The agreement shall set forth the amount, if any, of each adjustment described in subparagraphs (A), (B), and (C) of section 860(d)(1) or (2) (as appropriate) for the taxable year and the amount of the liability for any tax imposed by section 11(a), 56(a), 852 (b)(1), 852(b)(3)(A), 857(b)(1), 857 (b)(3)(A), or 1201(a) for the taxable year. The agreement shall also set forth the amount of the limitation (determined under section 860(f)(2)) on the amount of deficiency dividends that can qualify as capital gain dividends and ordinary dividends, respectively, for the taxable year. An agreement under this subdivision (ii) which is signed by the district director (or other delegate) shall be sent to the taxpayer at its last known address by either registered or certified mail. If registered mail is used, the date of registration is the date of determination. If certified mail is used, the date of the postmark on the sender's receipt is the date of determination. However, if a dividend is paid by the taxpayer before the registration or postmark date, but on or after the date the agreement is signed by the district director (or other delegate), the date of determination is the date of signing.

(2) *Claim for deduction.* A claim for deduction for a deficiency dividend shall be made, with the requisite declaration, on Form 976 and shall contain the following information and have the following attachments:

(i) The name, address, and taxpayer identification number of the corporation, trust, or association;

(ii) The amount of the deficiency and the taxable year or years involved;

(iii) The amount of the unpaid deficiency or, if the deficiency has been paid in whole or in part, the date of payment and the amount thereof;

(iv) A statement as to how the deficiency was established (*i.e.*, by an agreement under section 860(e)(3), by a closing agreement under section 7121, or by a decision of the Tax Court or court judgment);

(v) Any date or other information with respect to the determination that is required by Form 976;

(vi) The amount and date of payment of the dividend with respect to which the claim for the deduction for deficiency dividends is filed;

(vii) The amount claimed as a deduction for deficiency dividends;

(viii) If the amount claimed as a deduction for deficiency dividends includes any amount designated (or to be designated) as capital gain dividends, the amount of capital gain dividends for which a deficiency dividend deduction is claimed;

(ix) Any other information required by the claim form;

(x) A certified copy of the resolution of the trustees, directors, or other authority authorizing the payment of the dividend with respect to which the claim is filed; and

(xi) A copy of any court decision, judgment, agreement, or other document required by Form 976.

(3) *Filing claim.* The claim, together with the accompanying documents, shall be filed with the district director, or director of the internal revenue service center, with whom the income tax return for the taxable year for which the determination applies was filed. In the event that the determination is an agreement with the district director (or other delegate) described in section 860(e)(3) and paragraph (b)(1)(ii) of this section, the claim may be filed with the district director with whom (or pursuant to whose delegation) the agreement was made.

(The reporting requirements of this section have been assigned OMB Control Number 1545-0045.)

Par. 14. Section 1.859-3 is redesignated as section 1.860-3 and revised to read as follows:

§1.860-3 Interest and additions to tax.

(a) *In general.* If a qualified investment entity is allowed a deduction for deficiency dividends with respect to a taxable year, under section 860(c)(1) the tax imposed on the entity by chapter 1 of the Code (computed by taking into account the deduction) for that year is deemed to be increased by the amount of the deduction. This deemed increase in tax, however, applies solely for purposes of determining the liability of the entity for interest under subchapter A of chapter 67 of the Code and for additions to tax and additional amounts under chapter 68 of the Code. For purposes of applying subchapter A of chapter 67 and chapter 68, the last date prescribed for payment of the deemed increase in tax is considered to be the last date prescribed for the payment of tax (determined in the manner provided in section 6601(b)) for the taxable year for which the deduction for deficiency dividends is allowed. The deemed increase in tax is considered to be paid as of the date that the claim for the deficiency dividend deduction described in section 860(g) is filed.

(b) *Overpayments of tax.* If a qualified investment entity is entitled to a credit or refund of an overpay-

ment of the tax imposed by chapter 1 of the Code for the taxable year for which the deficiency dividend deduction is allowed, then, for purposes of computing interest, additions to tax, and additional amounts, the payment (or payments) that result in the overpayment and that precede the filing of the claim described in section 860(g) will be applied against and reduce the increase in tax that is deemed to occur under section 860(c)(1).

(c) *Examples.* This section is illustrated by the following examples.

Example (1). Corporation X is a real estate investment trust that files its income tax return on a calendar year basis. X receives an extension of time until June 15, 1978, to file its 1977 income tax return and files the return on May 15, 1978. X does not elect to pay any tax due on installments. For 1977, X reports real estate investment trust taxable income (computed without the dividends paid deduction) of $100, a dividends paid deduction of $100, and no tax liability. Following an examination of X's 1977 return, the district director and X enter into an agreement which is a determination under section 860(e)(3). The determination is dated November 1, 1979, and increases X's real estate investment trust taxable income (computed without the dividends paid deduction) by $20 to $120. Thus, taking into account the $100 of dividends paid in 1977, X has undistributed real estate investment trust taxable income of $20 as a result of the determination. X pays a dividend of $20 on November 10, 1979, files a claim for a deficiency dividend deduction of this $20 pursuant to section 860(g) on November 15, 1979, and is allowed a deficiency dividend deduction of $20 for 1977. After taking into account this deduction, X has no real estate investment trust taxable income and meets the distribution requirements of section 857(a)(1). However, for purposes of section 6601 (relating to interest on underpayment of tax), the tax imposed by chapter 1 of the Code on X for 1977 is deemed increased by this $20, and the last date prescribed for payment of the tax is March 15, 1978 (the due date of the 1977 return determined without any extension of time). The tax of $20 is deemed paid on November 15, 1979, the date the claim for the deficiency dividend deduction is filed. Thus, X is liable for interest on $20, at the rate established under section 6621, for the period from March 15, 1978, to November 15, 1979. Also, for purposes of determining whether X is liable for any addition to tax or additional amount imposed by chapter 68 of the Code (including the penalty prescribed by section 6697), the amount of tax imposed on X by chapter 1 of the Code is deemed to be increased by $20 (the amount of the deficiency dividend deduction allowed), the last date prescribed for payment of such tax is March 15, 1978, and the tax of $20 is deemed to be paid on November 15, 1979. X, however, is not subject to interest and penalties for the amount of any tax for which it would have been liable under section 11(a), 56(a), 1201(a), or 857(b) had it not been allowed the $20 deduction for deficiency dividends.

Example (2). Assume the facts are the same as in example (1) except that the district director, upon examining X's income tax return, asserts an income tax deficiency of $4, based on an asserted increase of $10 in real estate investment trust taxable income, and no agreement is entered into between the parties. X pays the $4 on June 1, 1979, and files suit for refund in the United States District Court. The District Court, in a decision which becomes final on November 1, 1980, holds that X did fail to report $10 of real estate investment trust taxable income and is not entitled to any refund. (No other item of income or deduction is in issue.) X pays a dividend of $10 on November 10, 1980, files a claim for a deficiency deduction of this $10 on November 15, 1980, and is allowed a deficiency dividend deduction of $10 for 1977. Assume further that $4 is refunded to X on December 31, 1980, as the result of the $10 deficiency dividend deduction being allowed. Also assume that any assessable penalties, additional amounts, and additions to tax (including the penalty imposed by section 6697) for which X is liable are paid within 10 days of notice and demand, so that no interest is imposed on such penalties, etc. X's liability for interest for the period March 15, 1978, to June 1, 1979, is determined with respect to $10 (the amount of the deficiency dividend deduction allowed). X's liability for interest for the period June 1, 1979, to November 15, 1980, is determined with respect to $6, *i.e.*, $10 minus the $4 payment. X is entitled to interest on the $4 overpayment for the period described in section 6611(b)(2), beginning on November 15, 1980.

Par. 15. Section 1.859-4 is redesignated as section 1.860-4 and revised to read as follows:

§1.860-4 Claim for credit or refund.

If the allowance of a deduction for a deficiency dividend results in an overpayment of tax, the taxpayer, in order to secure credit or refund of the overpayment, must file a claim on Form 1120X in addition to the claim for the deficiency dividend deduction required under section 860(g). The credit or refund will be allowed as if on the date of the determination (as defined in section 860(e)) two years remained before the expiration of the period of limitations on the filing of claim for refund for the taxable year to which the overpayment relates.

(The reporting requirements of this section have been assigned OMB Control Number 1545-0045.)

Par. 16. A new section 1.860-5 is added to read as follows:

§1.860-5 Effective date.

(a) *In general.* Section 860 and §§1.860-1 through 1.860-4 apply with respect to determination after November 6, 1978.

(b) *Prior determination of real estate investments trusts.* Section 859 (as in effect before the enactment of the Revenue Act of 1978) [Pub. L. 95-600, 1978-3 C.B. (Vol. 1)1] applies to determinations with respect to real estate investment trusts occurring after October 4, 1976, and before November 7, 1978. In the case of such a determination, the rules in §§1.860-1 through 1.860-4 apply, a reference in this chapter 1 to section 86C (or to a particular provision of section 860) shall be considered to be a reference to section 859 (or to the corresponding substantive provision of section 859), as in effect before enactment of the Revenue Act of 1978, and "qualified investment entity" in §§1.381(c)25-1(a) and 1.860-1 through 1.860-3 means a real estate investment trust.

Par. 17. Section 55.4981-1 is amended by striking out "section 859(d)" in the fourth sentence and inserting in lieu thereof "section 860(f)".

This Treasury decision is issued under the authority contained in the following sections of the Internal Revenue Code of 1954: section 860(e) (92 Stat. 2849, 26 U.S.C. 860(e)); section 860(g) (92 Stat. 2850, 26 U.S.C. 860(g)); and section 7805 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 28, 1983.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 17, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 18, 1984, 49 F.R. 2104)

Subchapter N.—Tax Based on Income from Sources Within or Without the United States
Part I.—Determination of Sources of Income

Section 861.—Income from Sources within the United States

26 CFR 1.861-1: Income from sources within the United States.

T.D. 7928

TITLE 26.—INTERNAL REVENUE CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Source of Income from Certain Leased Aircraft, Vessels, and Spacecraft

AGENCY: Internal Revenue Service, Treasury

ACTION: Final regulations.

SUMMARY: This document amends the Income Tax Regulations under section 861(e) of the Internal Revenue Code of 1954, relating to the source of income with respect to certain aircraft, vessels, and spacecraft that are or have been leased to a United States person. This amendment conforms the regulations to the amendment of section 861(e) by the Miscellaneous Revenue Act of 1980 [Pub. L. 96-605, 1980-2 C.B. 702]. This amendment will affect owners of such craft that are used outside the United States.

DATE: This amendment is effective for income with respect to craft that are first leased after December 28, 1980.

FOR FURTHER INFORMATION CONTACT: Mary Frances Pearson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 5, 1983, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 861 of the Internal Revenue Code of 1954 (48 FR 20244) [LR-57-81, 1983-1 C.B. 986]. These amendments were proposed to conform the regulations to changes made to section 861(e) by section 104 of the Miscellaneous Revenue Act of 1980 (94 Stat. 3523) [1980-2 C.B. 702, 730]. There were no written comments or requests for a public hearing. Therefore, the regulations are being published as they appeared in the notice of proposed rulemaking except for minor clarifying changes.

Section 861(e), as amended, provides that income with respect to aircraft, vessels, and spacecraft that are section 38 property (as defined in section 48) and that are manufactured or constructed in the United States will be treated as income from sources within the United States after the craft is leased to a United States person. Income with respect to a craft includes payments for use of the craft and gain on the sale or exchange of the craft. Section 861(e) alters the general statutory rules that (1) payments under a lease of personal property are considered to be from sources within the United States only if the leased property is used within the United States and (2) gain or loss on the sale or exchange of personal property is treated as from sources within the country in which the transfer of title takes place. Thus, this provision modifies the rules for determining the source of income with respect to certain craft that are used or sold outside the United States.

Section 861(e) does not apply if the lessor and the lessee are members of the same controlled group of corporations. For purposes of this section, if either the lessor or the lessee is a partnership at least 80 percent of which is owned by members of a controlled group of corporations, that partnership is considered to be a member of the controlled group.

Prior law applies to the income with respect to aircraft and vessels first leased on or before December 28, 1980. Those rules allowed taxpayers to elect to treat the subject income as from sources within the United States. The Miscellaneous Revenue Act of 1980 changed this treatment from elective to mandatory and expanded the scope of the provisions to include spacecraft. The statutory source rule was made mandatory to insure that the lease payments from a United States person to the lesser were subject to income taxation by some country. In this regard, see H.R. Rep. No. 96-1278, 96th Cong., 2d Sess. 24 (1980) [1980-2 C.B. 709]; S. Rep. No. 96-1036, 96th Cong., 2d Sess. 16-17 (1980) [1980-2 C.B. 723].

The regulations describe the craft covered by section 861(e) in §1.861-9A(b). The craft must be section 38 property, that is, property for which an investment tax credit is available. The regulations treat a craft as manufactured or constructed within the United States if at least 50 percent of the basis of the craft on the date it is leased to a United States person is attributable to value added within the United States.

The regulations require that later income with respect to a craft be treated as U.S. source income even after the craft is no longer leased to a United States person or the property ceases to be section 38 property. Under §1.861-9A(e) this treatment as U.S. source income also continues when the craft is transferred or distributed if the basis of the craft in the hands of the recipient is determined by reference to the basis it had in the hands of the transferor or distributor.

DRAFTING INFORMATION

The principal author of these regulations is Mary Frances Pearson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

These regulations are not subject to the Regulatory Flexibility Act because they are interpretative and thus the notice and public comment procedure requirements of 5 U.S.C. 553 do not apply. The Commissioner of Internal Revenue has determined that these regulations are not subject to Executive Order 12291.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

PART 1—[AMENDED]

Paragraph 1. Section 1.861-1(a)(4) is revised to read as follows:

§1.861-1 Income from sources within the United States.

(a) *Categories of income.* ***

(4) *Exceptions.* An owner of certain aircraft or vessels first leased on or before December 28, 1980, may elect to treat income in respect of these aircraft or vessels as income from sources within the United States for purposes of sections 861(a) and 862(a). See §1.861-9. An owner of certain aircraft, vessels, or spacecraft first leased after December 28, 1980, must treat income in respect of these craft as income from sources within the United States for purposes of section 861(a) and 862(a). See §1.861-9A.

* * * * *

Par. 2 Section 1.861-9 is amended as follows:

1. The title of the section is revised to read "Income from certain aircraft or vessels first leased on or before December 28, 1980.".

2. The second sentence of paragraph (a) is amended by adding after the word "date", the phrase "of aircraft or vessels first leased by the taxpayer on or before December 28, 1980".

3. A new paragraph (g)(6) is added immediately after paragraph (g)(5), the new paragraph to read as follows:

* * * * *

(g) ***

(6) *Revocation or termination after December 28, 1980.* The rules in paragraph (g)(1) through (g)(5) continue to apply with respect to any election made pursuant to this section even though the revocation or termination may occur after December 28, 1980.

Par. 3. Section 1.861-9A is added immediately after §1.861-9, to read as follows:

§1.861-9A. Income from certain craft first leased after December 28, 1980.

(a) *General rule.* If a taxpayer—

(1) Owns a qualified craft (as defined in paragraph (b) of this section),

(2) Leases such qualified craft after December 28, 1980, to a United States person that is not a member of the same controlled group of corporations as the taxpayer, and

(3) The lease is the taxpayer's first lease of the craft and the taxpayer is not considered to have made an election with respect to the craft under §1.861-9(e)(2),

then the taxpayer shall treat all amounts includible in gross income with respect to the qualified craft as income from sources within the United States for each taxable year ending after commencement of the lease. If this section applies to income with respect to a craft, it applies to all such amounts that are includible in the taxpayer's gross income, whether or not includible during or after the period of a lease to a United States person. Amounts derived by the taxpayer with respect to the qualified craft include any gain from the sale, exchange, or other disposition of the qualified craft. If this section applies to income with respect to a craft and there is a loss with respect to that craft (either due to the allowance of expenses and other deductions or due to a sale, exchange, or other disposition of the qualified craft), such loss is treated as allocable or apportionable to sources within the United States. The fact that a craft ceases to be section 38 property, ceases to be leased by the taxpayer to a United States person, or is leased or subleased for any period of time to a person who is not a United States person will not terminate the application of this section.

(b) *Qualified craft*—(1) *In general.* A qualified craft is a vessel, aircraft, or spacecraft that—

(i) Is section 38 property (or would be section 38 property but for section 48(a)(5), relating to use by governmental units), and

(ii) Is manufactured or constructed in the United States.

(2) *Vessel.* The term "vessel" includes every type of water craft capable of being used as a means of transportation on water, and any items of property that are affixed in a permanent fashion or are integral to the vessel. A vessel that is used predominantly outside the United States must be described in section 48(a)(2)(B)(iii) and §1.48-1(g)(2)(iii), relating to vessels documented for use in the foreign or domestic commerce of the United States, to be a qualified craft.

(3) *Aircraft.* An aircraft used predominantly outside the United States must be described in section 48(a)(2)(B)(i) and §1.48-1(g)(2)(i), relating to aircraft registered by the Administrator of the Federal Aviation Agency, and operated to and from the United States or operated under contract with the United States, to be a qualified craft.

(4) *Spacecraft.* A spacecraft must be described in section 48(a)(2)(B)(viii) and §1.48-1(g)(2)(viii), relating to communications satellites, or any interest therein, of a United States person, to be a qualified craft.

(5) *United States manufacture or construction.* A craft will be considered to be manufactured or constructed in the United States if 50 percent or more of the basis of the craft on the date of the lease to a United States person is attributable to value added within the United States.

(c) *United States person.* For purposes of this section, the term "United States person" includes those persons described in section 7701(a)(30) and individuals with respect to whom an election under section 6013(g) or (h) (relating to nonresident alien individuals married to United States citizens or residents) is in effect.

(d) *Controlled group.* For purposes of paragraph (a)(2) of this section, whether a taxpayer and a United States person are members of the same controlled group of corporations is determined under section 1563. Solely for purposes of this section, if at least 80% of the capital interest, or the profits interest, in a

partnership is owned, directly or indirectly, by a member or members of a controlled group of corporations, then the partnership shall be considered a member of that controlled group of corporations. In addition, if at least 80% of the capital interest, or the profits interest, in a partnership is owned, directly or indirectly, by a corporation, then the partnership and that corporation shall be considered members of a controlled group of corporations.

(e) *Certain transfers and distributions*—(1) *Transfers and distributions involving carryover of basis.* If—

(i) The income with respect to a craft is subject to this section.

(ii) The taxpayer transfers or distributes such craft, and

(iii) The basis of such craft in the hands of the transferee or distributee is determined by reference to its basis in the hands of the transferor or distributor,

then this section will apply to the income with respect to the craft includible in the gross income of the transferee or distributee. This paragraph (e)(1) applies even though the transferor or distributor recognizes an amount of gain that increases basis in the hands of the transferee or distributee and even though the transferee or distributee is a nonresident alien or foreign corporation. For example, if a corporation distributes a craft the income of which is subject to this section to its parent corporation in a complete liquidation described in section 332(b), the parent corporation will be treated as if it satisfied the requirements of paragraph (a) of this section with respect to such craft if the basis of property in the hands of the parent corporation is determined under section 334(b) (relating to the general rule on carryover of basis in liquidations). In further illustration, if a corporation distributes a craft the income of which is subject to this section, in a distribution to which section 301(a) applies, the distributee will be treated as if it satisfied the requirements of paragraph (a) of this section with respect to such craft if its basis is determined under section 301(d)(2) (relating to basis of corporate distributees) even though the basis may be the fair market value of the craft under section 301(d)(2)(A).

(2) *Partnerships.* If a partnership satisfies the requirements of paragraph (a)(1), (2), and (3) of this section, each partner shall treat all amounts includible in gross income with respect to the craft as income from sources within the United States for any taxable year of the partnership ending after commencement of the lease. In addition, if a partnership distributes a craft the income of which is subject to this section, to a partner, the partner will be treated as if he or she satisfied the requirements of paragraph (a) of this section with respect to such craft.

(3) *Affiliated groups.* If a member of a group of corporations that files a consolidated return transfers a craft, the income of which is subject to this section, to another member of that same group, the transferee will be treated as if it satisfied the requirements of paragraph (a) of this section with respect to the craft.

Par. 4. Section 1.862-1(c) is revised to read as follows:

§1.862-1 Income specifically from sources without the United States.

* * * * *

(c) *Income from certain property.* For provisions permitting a taxpayer to elect to treat amounts of gross income attributable to certain aircraft or vessels first leased on or before December 28, 1980, as income from sources within the United States which would otherwise be treated as income from sources without the United States under paragraph (a) of this section, see §1.861-9. For provisions requiring amounts of gross income attributable to certain aircraft, vessels, or spacecraft first leased by the taxpayers after December 28, 1980, to be treated as income from sources within the United States which would otherwise be treated as income from sources without the United States under paragraph (a) of this section, see §1.861-9A.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 2, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 15, 1983; 8:45 a.m.; and published in the issue of the Federal Register for December 16, 1983, 48 F.R. 55845)

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26 CFR 1.861-8: Computation of taxable income from sources within the United States and from other sources and activities.
(Also Section 882; 1.882-5.)

T.D. 7939

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A,—PART I—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Allocation and Apportionment of Deductions

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains amendments to the Income Tax Regulations relating to the allocation and apportionment of deductions for purposes of computing taxable income from sources within the United States and taxable income from other sources. Prior to these amendments, the rules for allocation and apportionment of deductions contained in §1.861-8 and §1.882-5 applied only for taxable years beginning after December 31, 1976. These amendments provide taxpayers the option to apply the rules in §1.861-8 or §1.882-5 to taxable years beginning before January 1, 1977.

DATE: The changes made by this Treasury decision are effective for taxable years beginning after December 31, 1953.

FOR FURTHER INFORMATION CONTACT: Charles Saverude of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-215-78), or call 202-566-3289 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 30, 1982, the FEDERAL REGISTER published a proposed amendment to the Income Tax Regulations (26 CFR Part 1) under section 861(b) of the Internal Revenue Code of 1954 (47 FR 38149) [LR-215-78, 1982-2 C.B. 875]. The amendment proposed was a revision of the effective date provision of §1.861-8 to permit a taxpayer to apply the rules of §1.861-8(e) to taxable years beginning before January 1, 1977. Written comments were received on the proposed amendment, but a public hearing was not requested. The proposed amendment is adopted in this Treasury decision but modified to apply to all of the rules of §1.861-8 instead of only the rules of paragraph (e) of that section. In addition, the effective date of §1.882-5, relating to apportionment of interest expenses of foreign corporations for purposes of determining the taxable income of such corporations connected with a U.S. trade or business, is modified to permit a taxpayer to apply the rules of §1.882-5 to taxable years beginning before January 1, 1977.

EXPLANATION OF PROVISIONS

Section 1.861-8 provides rules for the allocation and apportionment of deductions. This allocation and apportionment may be necessary to compute taxable income from specific sources or activities in order to apply a separate operative section of the Internal Revenue Code of 1954.

Prior to amendment by this Treasury decision, §1.861-8 was effective for taxable years beginning after December 31, 1976. For taxable years beginning before January 1, 1977, the process of allocation and apportionment of deductions was governed by those rules formerly under §1.861-8 which were in effect on October 23, 1957 (T.D. 6258) [1957-2 C.B. 368], as amended on August 22, 1966 (T.D. 6892) [1966-2 C.B. 291] and on September 29, 1975 (T.D. 7378) [1975-2 C.B. 272]. Therefore, the taxpayer was required to allocate and apportion deductions for those taxable years on a basis which was supportable under §1.861-8 as in effect for those years. For this purpose, the past, supportable practices of the taxpayer for allocation and apportionment of deductions were taken into account.

Pursuant to this Treasury decision, paragraph (a)(5) of present §1.861-8 is revised to give taxpayers the option to apply the rules of present §1.861-8 to open taxable years beginning before January 1, 1977. The amendment proposed on August 30, 1982, would have applied only to the rules of paragraph (e) of §1.861-8. This Treasury decision has modified the amendment to make it apply to all of the rules of §1.861-8. The rules of §1.861-8 may be applied on a deduction-by-deduction basis if the rules are applied consistently to all taxable years beginning before January 1, 1977, with respect to which action by the Internal Revenue Service is not barred.

Section 1.882-5 sets forth the methods to be used by a foreign corporation in computing the amount of interest expense it may deduct from its gross income effectively connected with a U.S. trade or business. Prior to amendment by this Treasury decision, §1.882-5 was effective for periods after February 6, 1981 or, at the option of the taxpayer, to taxable years beginning after the last taxable year ending before February 6, 1981, or at the further option of the taxpayer, to open taxable years beginning after 1976. For taxable years beginning before January 1, 1977, the process of allocation and apportionment of interest expense was governed by §1.861-8. A comment was received which recommended that foreign corporate taxpayers also be permitted to apply the rules of §1.882-5 to taxable years beginning before January 1, 1977. That suggestion has been adopted in this Treasury decision.

REGULATORY FLEXIBILITY ACT

The Internal Revenue Service has concluded that these regulations are interpretative and thus the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

REGULATORY IMPACT ANALYSIS

Pursuant to Executive Order 12291, a final regulatory impact analysis has been prepared with respect to these regulations and is available for public inspection and copying at the Internal Revenue Service, Room 4429, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

DRAFTING INFORMATION

The principal author of these final regulations is Herman B. Bouma of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * * *

Adoption of amendments to the regulations

The following amendments to 26 CFR Part 1 are hereby adopted:

Paragraph 1. Paragraph (a)(5) of §1.861-8 is revised to read as follows:

§1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

(a) *In general.* ***

(5) *Effective date*—(i) *Taxable*

years beginning after December 31, 1976. The provisions of this section apply to taxable years beginning after December 31, 1976.

(ii) *Taxable years beginning before January 1, 1977.* For taxable years beginning before January 1, 1977, §1.861-8 applies as in effect on October 23, 1957 (T.D. 6258) [1957-2 C.B. 368], as amended on August 22, 1966 (T.D. 6892) [1966-2 C.B. 291] and on September 29, 1975 (T.D. 7378) [1975-2 C.B. 272]. The specific rules for allocation and apportionment of deductions set forth in this section may, at the option of the taxpayer, apply to those taxable years on a deduction-by-deduction basis if the rules are applied consistently to all taxable years with respect to which action by the Internal Revenue Service is not barred by any statute of limitations. Thus, for example, a calendar year taxpayer may choose to have the rules of paragraph (e)(2) of this section apply for the allocation and apportionment of all interest expenses for the two taxable years ending December 31, 1975 and 1976, which are open years under examination, and may justify the allocation and apportionment of all research and development expenses for those years on a basis supportable under §1.861-8 as in effect for 1975 and 1976 without regard to the rules of paragraph (e)(3) of this section.

* * * * * *

Par. 2. Paragraph (d) of §1.882-5 is revised to read as follows:

§1.882-5 Determination of interest.

* * * * * *

(d) *Effective date.* This section applies to periods after February 6, 1981, or, at the option of the taxayer, to:

(1) Taxable years beginning after the last taxable year ending before February 6, 1981, or

(2) All open taxable years beginning after 1976, or

(3) All open taxable years.

This Treasury decision is issued under the authority contained in sections 882(c) and 7805 of the Internal Revenue Code of 1954 (80 Stat. 1556; 26 U.S.C. 882(c) and 68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 16, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 2, 1984, 8;45 a.m., and published in the issue of the Federal Register for February 3, 1984, 49 F.R. 4206)

Section 862.—Income From Sources Without the United States

26 CFR 1.862-1: Income specifically from sources without the United States.

Income source; payment received from foreign corporation for broadcasting right. The payment received by a domestic corporation from a foreign corporation in exchange for the exclusive or non-exclusive right to broadcast a live boxing match, to take place in the U.S. via closed circuit television, to an audience in the foreign country in which the foreign corporation is incorporated, is foreign source income under section 862(a)(4) of the Code.

Rev. Rul. 84-78

ISSUE

Whether the amount that a domestic corporation receives from a foreign corporation for the right to broadcast a live boxing match taking place in the United States via closed circuit television only in the country in which the foreign corporation is incorporated is foreign source income under the circumstances described below.

FACTS

Situation 1. A domestic corporation, *Y*, obtained from the contestants in a prize fight, which will take place in the United States, the exclusive rights to broadcast the fight live and to record the broadcast for subsequent viewing. *Y* entered into a contract with *FX*, a foreign corporation incorporated in foreign country *FC*. The contract provides that for a stipulated lump-sum payment to be paid by *FX* to *Y*, *FX* will have the right to broadcast the prize fight via closed circuit television only to an audience in *FC*. The payment that *Y* receives from *FX* under the contract is to be refunded to *FX* if the fight is cancelled for any reason. The broadcast and the simultaneous recording of the broadcast will be protected under the copyright laws of Title 17 of the United States Code (1976 and Supp. 1979). The broadcast right that *Y* transfers to *FX* is nonexclusive, and the duration of such right is only for the live showing of the fight. *FX*'s right to broadcast the prize fight does not include recording rights for subsequent viewing. The contract is negotiated, executed and the consideration is paid in the United States.

Situation 2. The facts are the same as in Situation 1, except that *Y* transfers to a foreign corporation, *FXB*, incorporated in foreign country *FCB*, a broadcasting right in the specified prize fight that is exclusive and exercisable only in *FCB*.

LAW AND ANALYSIS

Section 861(a)(3) of the Internal Revenue Code provides that, subject to certain exceptions not relevant here, compensation for labor or personal services performed in the United States will be treated as income from sources within the United States.

Section 861(a)(6) of the Code provides that gains, profits, and income derived from the purchase of personal property without the United States and its sale or exchange within the United States is income from sources within the United States.

Section 1.861-7 of the Income Tax Regulations provides that gains, profits, and income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which the property is sold.

Section 862(a)(4) of the Code provides that rentals or royalties for the use of or for the privilege of using

without the United States copyrights and other like properties shall be treated as income from sources without the United States.

In Rev. Rul. 74-555, 1974-2 C.B. 202, a nonresident alien taxpayer executed a contract with a domestic corporation which gave the corporation the exclusive right to publish in the United States all books, and long and short stories written by the taxpayer. The revenue ruling holds that the payments received by the taxpayer under the contract are royalties for the use of, or for the privilege of using, copyrights in the United States and are not compensation for labor or personal services because the contract did not give the corporation any control over what the taxpayer was to write or when it was to be written, but merely the right to publish any books or stories that were written.

Rev. Rul. 54-409, 1954-2 C.B. 174, holds that a copyright is divisible into separate properties, and that if the owner of a copyright granted to another the exclusive right to exploit the copyrighted work in a particular medium throughout the life of the copyright, then the consideration received for the use of the copyright would be treated as proceeds from the sale of property as long as this consideration was not received in certain periodic forms which were regarded as characteristic of royalty payments. Rev. Rul. 60-226 modified this position by providing that the sale result reached in Rev. Rul. 54-409 would hold regardless of the form of the consideration paid for the right to use the copyright. Although the holding of Rev. Rul. 60-226 has been overridden in part by statute in the case of certain forms of consideration (see section 871(e) of the Code), the ruling remains applicable in the present case.

The source of the payment received by *Y* in exchange for the grant of the right to broadcast the prize fight as United States or foreign income is dependent upon whether the characterization of the income is compensation for labor or personal services, income derived from the sale of personal property, or royalties for the use of or for the privilege of using a copyright or other like property, or some other type of income.

Situation 1. The contract entered into between *Y* and *FX* does not give *FX* any control over when or where the prize fight will take place or how the arrangements for the fight will be made, nor does it confer any legal rights over the contestants in the fight; it merely gives *FX* the right to broadcast the fight if it occurs. Further, the activities of *Y* are not exclusively performed for the benefit of *FX*, such that *FX* would own the product of *Y*'s labor. *See Ingram v. Bowers*, 57 F.2d 65 (2d Cir. 1932) *aff'q*. 47 F.2d 925 (S.D.N.Y. 1931). Accordingly, the payment received by *Y* is not compensation for labor or personal services.

The broadcasting right that *Y* transfers to *FX* is not exclusive, and the duration of such right is not for the remaining life of *Y*'s copyright, but is only for the live broadcast of the specified prize fight. *FX* cannot exploit the broadcast for the life of the copyright since it has no recording rights. The payment that *Y* receives from *FX* for such right, therefore, is not income derived from the sale of personal property. Rev. Ruls. 54-509 and 60-226. The payment that *Y* receives from *FX* for such right is for the use of, or for the privilege of using, a copyright without the United States.

Situation 2. Although the broadcasting right that *Y* transfers to *FXB* is exclusive, the duration of such right is not for the remaining life of *Y*'s copyright, but is limited only to the live broadcast of the specified prize fight. Because the broadcasting right that *Y* transfers is for less than the remaining life of *Y*'s copyright, the payment that *Y* receives from *FXB* for such right is not income derived from the sale of personal property, even though the right is for the exclusive use of *FXB*. *See* Rev. Ruls. 54-409 and 60-226, and *Pickren v. United States*, 249 F. Supp. 560 (M.D. Fla. 1965), *aff'd*, 378 F.2d 595 (5th Cir. 1967), in which the court held that the grant of exclusive rights in secret formulas and trade names for less than the remaining lives of such properties did not constitute a sale. The payment that *Y* receives from *FXB* for the broadcasting right is for the use of, or for the privilege of using, a copyright without the United States. *See also Oak Manufacturing Co. v. United States*, 301 F.2d 259 (7th Cir. 1962).

HOLDINGS

Situation 1. The payment that *Y* receives from *FX* is foreign source income under section 862(a)(4).

Situation 2. The payment that Y receives from *FXB* is foreign source income under section 862(a)(4).

Section 864.—Definitions

26 CFR 1.864-4: U.S. source income effectively connected with U.S. business

T.D. 7958

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART I.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Effectively Connected Income of Foreign Corporations—Stock or Securities Attributable to U.S. Office

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulation.

SUMMARY: This document provides a final regulation under section 864(c)(2) of the Internal Revenue Code of 1954, relating to the definition of U.S. source periodical income effectively connected with the conduct of a banking, financing, or similar business within the United States by a foreign corporation or nonresident alien individual. The regulation provides guidance to foreign banks with U.S. branch offices and to officers and employees of the Internal Revenue Service with respect to taxation of U.S. source interest and dividend income of foreign banks.

EFFECTIVE DATE: This regulation is effective for income includible in taxable years beginning on or after June 18, 1984, except that income received or accrued under a loan made by the taxpayer on or before or pursuant to a written binding commitment entered into on or before May 18, 1984, shall be governed by prior regulations.

FOR FURTHER INFORMATION CONTACT: Mary Frances Pearson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC: LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 4, 1982, the FEDERAL REGISTER published a proposed amendment to the Income Tax Regulations (26 CFR Part 1) under section 864(c)(2) of the Internal Revenue Code of 1954 (47 FR 49981). The amendment was proposed to conform the regulations to the legislative history of section 864(c)(2) and to prevent foreign banks from avoiding all U.S. tax on interest income generated by their U.S. branches. After consideration of all comments regarding the proposed amendment, that amendment is adopted as revised by this Treasury decision.

DISCUSSION

Nonresident alien individuals and foreign corporations are subject to U.S. tax under section 1 or section 11 on net income effectively connected with the conduct of a trade or business in the United States. Section 864(c) provides two tests for determining whether U.S. source fixed or determinable income and capital gains are effectively connected with the conduct of a U.S. trade or business. One test is whether the income is derived from assets used or held for use in the U.S. trade or business. The second test is whether the activities of the U.S. trade or business are a material factor in the realization of the income.

Section 1.864-4(c)(5) of existing regulations provides special rules for determining whether U.S. source fixed or determinable income and capital gains are effectively connected with a U.S. banking, financing, or similar business. Under §1.864-4(c)(5)(ii), if the stock or security giving rise to the U.S. source income, gain, or loss is attributable to the U.S. office and the stock or security meets the criteria set forth in §1.864-4(c)(5)(ii)(*a*) or (*b*), the income, gain, or loss is effectively connected with the U.S. banking, financing, or similar business. Currently, a stock or security (including a note and other evidences of indebtedness) is attributable to a U.S. office only if (1) the U.S. office actively participates in the activities required to arrange the acquisition of the stock or security, and (2) the stock or security is held by or for the U.S. office and is recorded on its books and records.

The requirement that the stock or security be "booked" in the U.S. office in order for the income, gain, or loss arising from it to be effectively connected with the U.S. trade or business could be considered to be contrary to the legislative history of section 864(c)(2). H.R. Rep. No. 1450, [1966-2 C.B. 967] 89th Cong., 2d Sess. 15 (1966); S. Rep. No. 1707, [1966-2 C.B. 1059] 89th Cong., 2d Sess. 19 (1966). This "booking" rule also provides a method for avoiding all U.S. tax on income generated solely by the efforts of the U.S. office in some circumstances.

The proposed amendment to §1.864-4(c)(5)(iii) published on November 4, 1982, [1982-2 C.B. 877] would continue to require the U.S. office to be an active participant in soliciting, negotiating, or performing other activities necessary to acquire the stock or security in order for the resulting income, gain, or loss to be effectively connected with the U.S. banking business. However, whether the stock or security is "booked" in the U.S. office would no longer be a determinative factor, but would be one factor to be considered in determining if the U.S. office was an active participant.

The amendment to the regulations has been modified in response to comments. One comment asked what importance would be placed on "booking" as a factor in determining whether a stock or security was attributable to a U.S. office. To clarify that the office in which a stock or security is "booked" is not controlling, that factor has been added to those of limited importance listed in §1.864-4(c)(5)(iii)(*b*).

Other comments suggested that the standard for attribution of stock or securities to a U.S. office had been changed by the deletion of the word "only" before the active participation test. No such change was intended and the active participation of the U.S. office continues to be required in order for the stock or security to be attributed to the U.S. office. To avoid confusion, the word "only" has been reinserted in the final regulation.

Several comments also requested guidance on the level of activities of the U.S. office that would constitute "active participation". To clarify that incidental activities would not result in attribution of the stock or security to the U.S. office, the final regulations require active and material participation in the activities necessary to acquire the stock or security.

In response to comments requesting guidance through an example and asking if the conclusion of Revenue Ruling 75-253, 1975-1 C.B. 203, would be applied to similar facts involving U.S. source income, an example has been added to §1.864-4(c)(5)(vii) based generally on the fact situation in Rev. Rul. 75-253.

Two comments were critical of the proposed effective date to the extent the amendment would be applied to income arising from loans made by the taxpayer prior to publication of the notice of proposed rulemaking, as the terms of such loans were negotiated on the basis of the regulation then in effect. The effective date of

the final regulation has been modified so that the amendment will not apply to income from loans made by the taxpayer on or before May 18, 1984, or pursuant to a written binding commitment entered into on or before May 18, 1984. The amendment is effective for other income includible by the taxpayer in taxable years beginning on or after June 18, 1984.

Two comments requested that the regulation adopt a rule that if stock or securities are booked in the U.S. office, they will be attributed to the U.S. office. This suggestion was not adopted, as the rationale for the active and material participation test is that a sufficient nexus must exist between the income and the activities of the U.S. office in order for the income to be effectively connected with a U.S. trade or business and to be taxed on a net basis.

One comment requested assurance that the amendment would not affect the tax treatment of U.S. source income of foreign banks that have U.S. representative offices but do not have a banking, financing, or similar business in the United States. As §1.864-4(c)(5) only applies to U.S. source income of a nonresident alien individual or foreign corporation engaged in a banking, financing, or similar business in the United States, no modification of the amendment is necessary.

Comments relating to other regulation provisions were also received. These suggested changes were outside the scope of the notice of proposed rulemaking and, therefore, were not adopted in this Treasury decision.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The amendment to the regulations proposed by the notice of proposed rulemaking published on November 4, 1982, [1982-2 C.B. 877] and adopted by this Treasury decision is interpretative. Therefore, the Regulatory Flexibility Act (5 U.S.C. chapter 6) did not apply to the notice of proposed rulemaking. The Commissioner of Internal Revenue has determined that this final regulation is not subject to Executive Order 12291.

DRAFTING INFORMATION

The principal author of this regulation is Mary Frances Pearson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this regulation, both on matters of substance and style.

LIST OF SUBJECTS IN 26 CFR §§1.861-1 through 1.997-1

Income taxes, Aliens, Exports, DISC, Foreign investment in U.S., Foreign tax credit, Sources of income, United States investments abroad.

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 is amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Section 1.864-4 is amended by revising paragraph (c)(5)(iii) and by adding Example (5) immediately after Example (4) of paragraph (c)(5)(vii), the revised and added provisions to read as follows:

§1.864-4 U.S. source income effectively connected with U.S. business.

* * * * *

(c) *Fixed or determinable income and capital gains*—***

(5) *Special rules relating to banking, financing, or similar business activity*—***

(iii) *Stocks or securities attributable to U.S. office*—(*a*) *In general.* For purposes of paragraph (c)(5)(ii) of this section, a stock or security shall be deemed to be attributable to a U.S. office only if such office actively and materially participated in soliciting, negotiating, or performing other activities required to arrange the acquisition of the stock or security. The U.S. office need not have been the only active participant in arranging the acquisition of the stock or security.

(*b*) *Exceptions.* A stock or security shall not be deemed to be attributable to a U.S. office merely because such office conducts one or more of the following activities:

(*1*) Collects or accounts for the dividends, interest, gain, or loss from such stock or security,

(*2*) Exercises general supervision over the activities of the persons directly responsible for carrying on the activities described in paragraph (c)(5)(iii)(*a*) of this section,

(*3*) Performs merely clerical functions incident to the acquisition of such stock or security,

(*4*) Exercises final approval over the execution of the acquisition of such stock or security, or

(*5*) Holds such stock or security in the United States or records such stock or security on its books or records as having been acquired by such office or for its account.

(*c*) Effective date. This paragraph (c)(5)(iii) shall be effective for income includible in taxable years beginning on or after June 18, 1984, except that 26 CFR §1.864-4(c)(5)(iii) as it appeared in the Code of Federal Regulations revised as of April 1, 1983, shall apply to income received or accrued under a loan made by the taxpayer on or before May 18, 1984 or pursuant to a written binding commitment entered into or before May 18, 1984.

* * * * *

(vii) Illustrations. ***

Example (5). Foreign corporation *Y*, which is created under the laws of foreign country X and is engaged in the active conduct of a banking business in country X and other foreign countries, has a branch, *C*, in the United States that is engaged in the active conduct of a banking business in the United States, within the meaning of paragraph (c)(5)(i) of this section, during the taxable year. *C* handles the negotiation and acquisition of securities involved in loans made by *Y* to U.S. persons. *C* also presents interest coupons with respect to such securities for payment, presents all

such securities for payment at maturity, and maintains complete photocopy files with respect to such securities. The activities of the office of *Y* in country X with respect to these securities consist of giving pro forma approval of the loans, storing the original securities, and recording the securities on the books of the country X office. Pursuant to paragraphs (c)(5)(ii) and (c)(5)(iii) of this section, the U.S. source interest income received by *Y* during the taxable year on these securities is effectively connected for such year with the active conduct by *Y* of a banking business in the United States.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. §7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved: August 18, 1983.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

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26 CFR 1.864-4: U.S. source income effectively connected with U.S. business.

Whether a taxpayer can elect the provisions of the Internal Revenue Code with respect to a loss that is effectively connected with the conduct of a trade or business in the United States and generated by one business activity while in the same taxable year elect the provisions of a tax convention with respect to the taxability of effectively connected gain generated by an independent business activity, so that the loss can be used to offset the gain. See Rev. Rul. 84-17, page 308.

Subpart B.—Foreign Corporations

Section 882.—Tax on Income of Foreign Corporations Connected with United States Business

26 CFR 1.882-5: Determination of interest deduction.

Effective date of rules relating to the apportionment of interest expenses is modified. See T.D. 7939, page 171.

Subpart C.—Miscellaneous Provisions

Section 892.—Income of Foreign Governments and of International Organizations

26 CFR 1.892-1: Income of foreign governments.

Foreign government agency; pension trust; income received from U.S. investments. Dividend and interest income received on certain U.S. investments by a pension trust established by an agency of a foreign government is not exempt from federal income tax under section 892 of the Code because the pension trust is not established exclusively for employees of the foreign government.

Rev. Rul. 84-28

ISSUE

Whether the income received by a pension trust on certain United States investments is exempt from federal income taxation under section 892 of the Internal Revenue Code if nongovernmental employees are participants in the plan.

FACTS

A is an agency of foreign country, *FC*. *A* is an integral part of a foreign sovereign within the meaning of section 1.892-1(b)(2) of the Income Tax Regulations.

A has established a pension trust (Fund) for the benefit of its employees. The Fund, a defined benefit plan, provides definitely determinable benefits to its members. The Fund is administered by *A*'s fiscal director. The income of the Fund is used solely to satisfy the obligation of *A* to participants in the Fund. The Fund's investments in the United States include only stocks and securities of certain United States corporations with regard to which the Fund receives dividend and interest income.

X, a not-for-profit corporation incorporated under the laws of *FC*, was established to provide certain social services to the residents of *FC*. In 1981 *A* admitted employees of *X* as participants in the Fund. Thus, *X* began making contributions to the Fund on behalf of its employees. *X* is neither an integral part of a foreign sovereign within the meaning of section 1.892-1(b)(2) of the regulations nor a controlled entity within the meaning of section 1.892-1(b)(3).

LAW AND ANALYSIS

Section 892 of the Code excludes from gross income and exempts from income taxation the income of foreign governments received from investments in the United States in stocks, bonds, and other domestic securities, from interest on United States bank deposits, and certain income from any other source within the United States.

Section 1.892-1(b)(1) of the regulations states, for the purposes of this section, that a foreign government consists only of integral parts or controlled entities of a foreign sovereign to the extent not engaged in commercial activities in the United States.

Section 1.892-1(b)(4) of the regulations provides that a pension trust established exclusively for employees, or former employees, of a foreign government is a controlled entity if certain requirements are met. These requirements are that the funds that comprise the trust are managed by trustees who are employees of, or persons appointed by, the foreign government and that the trust forming a part of the pension plan provides definitely determinable benefits (defined benefit plan) so that it may be concluded that the income of the trust satisfies the obligations of the foreign government to participants under the plan, rather than inuring to the benefit of a private person.

Since nongovernmental employees were admitted as participants in the Fund in 1981, the Fund can no longer be viewed as established exclusively for the benefit of employees, or former employees, of a foreign government. Therefore, the Fund is not a controlled entity and the dividend and interest income it receives from United States corporations is not exempt from taxation under section 892 of the Code.

HOLDING

The dividend and interest income received by the Fund in 1981 on certain United States investments is not exempt from taxation under section 892 of the Code because the Fund is not established exclusively for employees of *A* when nongovernmental employees become participants.

Section 894.—Income Affected By Treaty

26 CFR 1.894-1: Income affected by treaty.

Whether a taxpayer can elect the provisions of a tax convention with respect to the taxability of business gain that is in part attributable to a permanent establishment and in part not attributable thereto, while in the same taxable year elect the provisions of the Internal Revenue Code with respect to a nonattributable loss generated by an independent business activity, so that the loss can be used to offset the gain. See Rev. Rul. 84-17, page 308.

Part III.—Income From Sources Without the United States
Subpart A.—Foreign Tax Credit

Section 902.—Credit for Corporate Stockholder in Foreign Corporation

26 CFR 1.902-1: Credit for domestic corporate shareholder of a foreign corporation.

Domestic corporate shareholder; stock ownership requirement. The ten percent voting stock ownership requirement of section 902 is determined on the basis of owning voting stock in a foreign corporation possessing at least ten percent of the total combined voting power of all shares of that corporation's voting stock.

Rev. Rul. 84-6

ISSUE

Whether the 10 percent voting stock ownership requirement of section 902 of the Internal Revenue Code is satisfied in the situations described below?

FACTS

Situation 1: FX, a foreign corporation, has outstanding 100 shares of voting stock divided into two classes: 95 shares of Class A stock and 5 shares of Class B stock. The two classes of voting stock are identical in all respects except that the Class A stock, voting as a class, has the right to elect nine of the ten members on *FX*'s board of directors and the Class B stock, voting as a class, has the right to elect one of *FX*'s ten directors. *X*, a domestic corporation, owns all the Class A stock. *Y*, a domestic corporation unrelated to *X*, owns all the Class B stock.

Situation 2: FZ, a foreign corporation, has outstanding 200 shares of voting stock divided into two classes: 100 shares of Class C stock and 100 shares of Class D stock. The two classes of stock are identical in all respects except that each share of Class C stock has one vote for the election of directors and each share of Class D stock has two votes for the election of directors. *Z*, a domestic corporation, owns 20 shares of the Class C stock. The remainder of the Class C and Class D stock is owned by unrelated United States persons none of which owns more than 10 shares of either class of stock.

LAW AND ANALYSIS

Section 902(a) of the Code provides, in general, that a domestic corporation that *owns at least ten percent of the voting stock* of a foreign corporation from which it receives a dividend paid out of the accumulated profits of the foreign corporation shall be deemed to have paid a certain portion of any foreign income tax paid or deemed to have been paid by such foreign corporation on or with respect to such accumulated profits.

Section 902(b)(1) of the Code provides that if the foreign corporation described in section 902(a) *owns ten percent or more of the voting stock* of a second foreign corporation from which it receives a dividend paid out of the accumulated profits of the second foreign corporation, it shall be deemed to have paid a certain portion of any foreign income tax paid or deemed to have been paid by the second foreign corporation on or with respect to such accumulated profits.

Section 902(b)(2) of the Code provides that if the foreign corporation described in section 902(a) *owns ten percent or more of the voting stock* of a second foreign corporation which, in turn, *owns ten percent or more of the voting stock* of a third foreign corporation from which the second foreign corporation receives a dividend paid out of the accumulated profits of the third foreign corporation, the second foreign corporation shall be deemed to have paid a certain portion of any income taxes paid by the third foreign corporation on or with respect to such accumulated profits.

Neither section 902 of the Code nor the Income Tax Regulations thereunder indicate whether the ten percent voting stock ownership requirement, set forth in the underlined phrases above, is satisfied by ownership of at least ten percent of the (a) number, (b) value, or (c) voting power of all shares of stock of the foreign corporation entitled to vote. The more recent legislative history of section 902, however, defines that section's voting stock ownership requirement in terms of voting power. Specifically, when Congress enacted Pub. L. No. 91-684, 1971-1 C.B. 550, it amended section 902 in two ways: first, the voting stock ownership requirement in section 902(b)(1) was reduced from 50 percent to 10 percent; second, the predecessor to the current section 902(b)(2) was added to the Code, and it too imposed a 10 percent voting stock ownership requirement. In making these amendments Congress continued its use of the term "voting stock" in defining the stock ownership requirement imposed. Congress, in its explanation of these amendments, expressly stated that the "voting stock" ownership requirement is to be determined by "voting power". H.R. Rep. No. 91-1739, 91st Cong., 2d Sess. 3 (1970); and S. Rep. No. 91-1527, 91st Cong., 2d Sess. 3 (1970), 1971-1 C.B. 615, 616.

Since Congress intended that the

"voting stock" ownership requirement of section 902(b) be determined by voting power, it is reasonable to conclude that Congress had the same intent in using the identical term, that is "voting stock", in section 902(a).

The voting power held by a shareholder of any class of stock is the shareholder's proportionate share of the percentage of the total number of directors that that class of stock is entitled to elect as a class. *See* section 1.951-1(g)(2) of the regulations.

Thus, in *Situation 1, X* will be considered to own 90 percent of the voting stock of *FX* because *X* owns all the Class A stock and this class of voting stock is entitled to elect, as a class, 90 percent of *FX*'s directors. *Y* will be considered to own 10 percent of the voting stock of *FX* because *Y* owns all the Class B stock and this class of voting stock is entitled to elect, as a class, 10 percent of *FX*'s directors. Therefore, both *X* and *Y* will satisfy the voting stock ownership requirement of section 902(a) of the Code.

In Situation 2, *Z* will be considered to own only 6.67% of the voting stock of *FZ* since the Class C stock, as a class, constitutes one third of the voting power of all the *FZ* voting stock and *Z* owns only 20 percent of the Class C shares.

HOLDINGS

In Situation 1, both *X* and *Y* satisfy the 10 percent ownership requirement of section 902 of the Code.

In Situation 2, *Z* does not satisfy the 10 percent ownership requirement of section 902 of the Code.

Subpart B.—Earned Income of Citizens or Residents of United States

Section 912.—Exemption For Certain Allowances

26 CFR 1.912-1: Exclusion of certain cost of living allowances.

Cost of living allowances; differentials; government employees; Republic of Panama. The overseas tropical differential (OTD) paid to civilian employees of a United States government agency living and working in the Republic of Panama is not excludable from the gross income of such employees under section 912 of the Code.

Rev. Rul. 84-19

ISSUE

Whether the overseas (tropical) differential, paid pursuant to 35 C.F.R. section 253.135 (1979) by an agency of the United States Government to its civilian employees living and working in the Republic of Panama, is excludable from the gross income of such employees under section 912 of the Internal Revenue Code.

FACTS

Taxpayers are United States citizens who are civilian employees of a United States government agency. During the tax year 1979, taxpayers were paid an overseas (tropical) differential (OTD) pursuant to 35 C.F.R. section 253.135 (superseded by 35 C.F.R. sections 251.31 and 251.32 (1982)) while working at their permanent duty station in the Republic of Panama in an area formerly known as the Panama Canal Zone. The OTD is limited to 25 percent of the basic pay of employees entitled to receive it and is not based on any comparison between the cost of living in the District of Columbia and the Republic of Panama.

LAW AND ANALYSIS

Section 61(a) of the Code and section 1.61-1(a) of the Income Tax Regulations provide, in part, that, except as otherwise provided by law, gross income means all income from whatever source derived.

Section 912(1)(C) of the Code provides that amounts received by civilian officers and employees of the United States government as allowances or otherwise (but not amounts received as post-differentials) under Title II of the Overseas Differentials and Allowances Act (ODA), P.L. 86-707, 74 Stat. 793 (1960), shall not be included in gross income and shall be exempt from taxation.

Section 912(2) of the Code provides, in part, that amounts (other than amounts received under Title II of the ODA) received as cost-of-living allowances by civilian officers or employees of the Government of the United States stationed outside the continental United States shall not be included in gross income and shall be exempt from taxation.

Section 1217(a) of the Panama Canal Act of 1979 (PCA), P.L. 96-70, 93 Stat. 452 (1979) provides, in part, that additional compensation may be paid as an overseas recruitment or retention differential to any individual who (1) before October 1, 1979 was employed by an agency in the area then known as the Canal Zone, or (2) is an employee who was recruited on or after October 1, 1979, for placement in the Republic of Panama; provided that, in the judgment of the head of the agency concerned, the recruitment or retention of the individual is essential.

Section 1217(d) of the PCA expressly provides that Subchapter III of Chapter 59 of Title V of the ODA shall not apply with respect to any employee whose permanent duty station is in the Republic of Panama and who is employed by a United States Government agency. Subchapter III of Chapter 59 of Title V of the ODA includes all of Title II of the ODA. Therefore, Title II of the ODA does not apply to civilian employees of the United States Government whose permanent duty station is in the Republic of Panama. Further, Title II of the ODA has never applied to civilian employees of the United States Government working in the former Panama Canal Zone because such Zone was not a foreign area with respect to which Title II of the ODA applied.

Since OTD payments in the present case are not now, nor have they ever been, Title II ODA differentials or allowances, section 912(1)(C) is not applicable to exclude such OTD payments from gross income.

Section 4.02 of Rev. Rul. 59-407, 1959-2 C.B. 19, provides, in general, that a cost-of-living allowance within

the meaning of section 912(1) of the Code (now section 912(2)) is an allowance based on living costs substantially higher than the cost-of-living in the District of Columbia and granted to enable employees to render more complete and efficient service in carrying out their official assignments. Section 4.05 of Rev. Rul. 59-407 provides, in part, that allowances granted by reason of conditions of environment that differ substantially from conditions of environment in the United States and that warrant additional compensation as a recruitment incentive are clearly distinguishable from cost-of-living allowances. Section 4.05 concludes that allowances or differentials granted because of conditions of environment are compensatory in nature and are includable in gross income.

In the present case, the OTD paid to Government civilian employees is limited to 25 percent of their basic pay and is not dependent on any cost of living comparison. In addition, the OTD was intended to provide a compensatory recruitment and retention incentive so that United States Government agencies would not have difficulty recruiting and retaining United States civilian employees with skills that are critical to continue effective operation of the Panama Canal and essential support activities. H.R. Rep. No. 98 (Part I), 96th Cong., 1st Sess. 54-55 (1979). Therefore, the OTD is not a cost-of-living allowance within the meaning of section 912(2) of the Code.

HOLDING

The overseas (tropical) differential (OTD) paid to civilian employes of a United States Government agency living and working in the Republic of Panama is not excludable from the gross income of such employees under section 912 of the Code.

Subpart F.—Controlled Foreign Corporations

Section 957.—Controlled Foreign Corporations; United States Person

26 CFR 1.957-3: Corporations organized in United States possessions. (Also Section 103; 1.103-1.)

Puerto Rican government bonds; interest excluded from gross income; corporation organized in Puerto Rico. The term "gross income" as used in section 957(c) of the Code does not include interest received by a corporation organized under the laws of the Commonwealth of Puerto Rico from investments in bonds issued by the Commonwealth, that is excluded from gross income under section 103(a)(1) of the Code.

Rev. Rul. 84-20

ISSUE

Whether interest received by a corporation organized under the laws of the Commonwealth of Puerto Rico from investments in bonds issued by the Commonwealth of Puerto Rico, which is excluded from gross income under section 103(a)(1) of the Internal Revenue Code, is also excluded from gross income for purposes of computing the gross income tests described in sections 957(c)(1) and 957(c)(2).

FACTS

FX is a corporation organized under the laws of the Commonwealth of Puerto Rico. All of the outstanding stock of *FX* is held by *A*, a United States citizen. *FX* is engaged in the manufacture of goods in the Commonwealth of Puerto Rico. In addition, *FX* receives interest from investments in bonds issued by the Commonwealth of Puerto Rico which satisfy the conditions of section 103 of the Code and the interest on which is excluded from gross income under section 103(a)(1).

LAW AND ANALYSIS

Section 957(a) of the Code provides that for purposes of subpart F, Part III, Subchapter N, chapter 1 of the Code, the term "controlled foreign corporation" means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

Section 957(c) of the Code provides that for purposes of this subpart F of the Code, the term "controlled foreign corporation" does not include any corporation created or organized in the Commonwealth of Puerto Rico or a possession of the United States or under the laws of the Commonwealth of Puerto Rico or a possession of the United States if—

(1) 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Commonwealth of Puerto Rico or a possession of the United States; and

(2) 50 percent or more of the gross income of such corporation for such period, or for such part thereof, was derived from the active conduct within the Commonwealth of Puerto Rico or a possession of the United States of any trades or businesses constituting the manufacture or processing of goods, wares, merchandise, or other tangible personal property; the processing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, or fur-bearing animals); the catching or taking of any kind of fish or the mining or extraction of natural resources, or any manufacturing or processing of any products or commodities obtained from such activities; or the ownership or operation of hotels.

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a possession of the United States.

Section 7701(c) of the Code provides that, when not otherwise distinctly expressed or manifestly incompatible with the intent thereof, references in the Code to possessions of

the United States shall be treated as also referring to the Commonwealth of Puerto Rico.

Since section 103(a)(1) of the Code excludes from gross income interest received on obligations of possessions of the United States and the Commonwealth of Puerto Rico is considered a possession for purposes of this exclusion, the term "gross income" as used in section 957(c) does not include interest received on obligations of the Commonwealth of Puerto Rico. See Rev. Rul. 57-435, 1957-2 C.B. 462, which provides that for purposes of the gross income percentage tests in former section 921, dealing with whether a corporation qualifies as a Western Hemisphere Trade Corporation, gross income does not include section 103(a)(1) interest on the obligations of a possession.

HOLDING

The interest received by *FX* from the bonds issued by the Commonwealth of Puerto Rico, which is excluded from gross income under section 103(a)(1) of the Code, is also excluded from gross income for purposes of computing the gross income tests described in sections 957(c)(1) and 957(c)(2).

Section 958.—Rules for Determining Stock Ownership

26 CFR 1.958-1: Direct and indirect ownership of stock.

Whether the earnings and profits of *FS2*, a foreign subsidiary of *FS1*, a foreign corporation, that were accumulated from 1964 to the date of *FS1*'s sale by P, the domestic parent of *FS1*, are deemed to be included with all the earnings and profits of *FS1* for purposes of applying section 1248(a) and (c)(2) of the Code to P's gain on the sale of *FS1*. See Rev. Rul. 84-72, page 182.

Subpart I.—Admissibility of Documentation Maintained in Foreign Countries
Part IV.—Domestic International Sales Corporations
Subpart A.—Treatment of Qualifying Corporations

Section 994.—Inter-Company Pricing Rules

26 CFR 1.994-1: Inter-company pricing rules for DISC's.

Whether certain adjustments of accounts and reclassification of actual distributions will be made in cases in which intercompany prices paid by a DISC to its related supplier or commissions paid by a related supplier to a DISC are redetermined by the Service in a manner which results in an increase of the intercompany prices or reduction of the commissions. See Rev. Proc. 84-3, page 361.

Subchapter O.—Gain or Loss on Disposition of Property
Part I.—Determination of Amount of and Recognition of Gain or Loss

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

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26 CFR 1.1001-2: Discharge of indebtedness.

A partner has a single basis in a partnership interest, even if the partner is both a general partner and a limited partner in the same partnership. See Rev. Rul. 84-53, page 159.

Part II.—Basis Rules of General Application

Section 1012.—Basis Of Property—Cost

26 CFR 1.1012-1: Basis of property.

A cash rebate paid to an automobile dealer must be treated by the dealer as a reduction in the cost of the automobile in the year of purchase. See Rev. Rul. 84-41, page 130.

Part III.—Common Nontaxable Exchanges

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)-1: Involuntary conversions, nonrecognition of gain.
(Also Sections 351, 1071; 1.351-1, 1.1071-1.)

Involuntary conversions; sale to effectuate policies of F.C.C.; assets purchased transfered to new subsidiary. The transfer, under section 351 of the Code, of assets previously purchased in accordance with sections 1033 and 1071, to a taxpayer's newly organized subsidiary will not disqualify the assets as eligible replacement property.

Rev. Rul. 84-29

ISSUE

Does the transfer of assets under section 351 of the Internal Revenue Code, previously purchased by the taxpayer in accordance with the involuntary conversion provisions of sections 1033 and 1071, to its newly organized subsidiary disqualify the assets as eligible replacement property?

FACTS

The taxpayer, a domestic corporation, is principally engaged in the broadcasting business. In 1978, the taxpayer sold the assets of television station *TV1*. The sale was certified by the Federal Communications Commission (FCC) to be necessary or appropriate to effectuate compliance with FCC rules. The taxpayer elected to treat the sale as an involuntary conversion under sections 1071 and 1033 of the Code, and within the applicable replacement period purchased the assets of television station *TV2*. The assets of *TV2* qualified as eligible replacement property under section 1033. The purchase price of TV2 exceeded the proceeds from the sale of *TV1*.

The taxpayer transferred all the assets of *TV2* to a new domestic subsidiary in a transaction which qualifies under section 351 of the Code. In exchange for the assets, the taxpayer received all of the stock of the subsidiary. The subsidiary assumed the liabilities of *TV2*. The transfer was done to facilitate the orderly management of the taxpayer's business. The taxpayer has no intention of disposing of any of the stock of the subsidiary, and the subsidiary has no intention of disposing of any of the assets of *TV2* other than in the ordinary course of business.

LAW AND ANALYSIS

Section 1071(a) of the Code provides that if a sale or exchange of property (including stock in a corporation) is certified by the FCC to be necessary or appropriate to effectuate a change in a policy of, or the adop-

tion of a new policy by, the FCC with respect to the ownership and control of radio broadcasting stations, such sale or exchange shall, if the taxpayer so elects, be treated as an involuntary conversion of such property within the meaning of section 1033 of the Code.

Section 1.1071-1(d) of the Income Tax Regulations provides that, for purposes of section 1071, the term "radio broadcasting" includes telecasting.

Section 1033 of the Code governs the federal income tax treatment of involuntary conversions. The general rule permits nonrecognition of any gain realized if property is compulsorily or involuntarily converted into property similar or related in service or use to the converted property. If property is converted into money or dissimilar property, then gain is recognized only to the extent the amount realized upon the conversion exceeds the cost of property similar in service or use which is purchased as a replacement.

In Rev. Rul. 77-422, 1977-2 C.B. 307, the Service clarified its position with respect to *John Richard Corp. v. Commissioner*, 46 T.C. 41 (1966), *nonacq.*, 1974-2 C.B. 5, withdrawing *acq.*, 1967-2 C.B. 3, which held that a taxpayer was entitled to nonrecognition or gain on involuntarily converted property that was replaced by purchasing control of a newly formed corporation that subsequently purchased property similar in service or use to the converted property. This revenue ruling holds that the Service will not follow the decision in *John Richard Corp.* In order for the nonrecognition provisions of section 1033 of the Code to apply to a situation similar to that in *John Richard Corp.*, the acquired corporation must own the replacement property when control of the corporation is acquired.

In the instant situation the taxpayer transferred all of the assets of *TV2* to its new domestic subsidiary in exchange for all of its stock. The assets were transferred to its new domestic subsidiary merely to facilitate the orderly management of the taxpayer's business. Unlike the situation described in Rev. Rul. 77-422, the taxpayer in the present case maintained control of the *TV2* assets both before and after the transfer of the assets of the new subsidiary. Neither the purpose of the original transaction nor the tax result under sections 1033 and 1071 of the Code have been affected in any way.

HOLDING

The transfer of the assets to the taxpayer's newly-organized subsidiary, as described above, will not disqualify the assets of *TV2* as eligible replacement property under sections 1033 and 1071 of the Code.

Part V.—Changes to Effectuate F.C.C. Policy

Section 1071.—Gain From Sale Or Exchange To Effectuate Policies of F.C.C.

26 CFR 1.1071-1: Gain from sale or exchange to effectuate policies of Federal Communication Commission.

Whether the transfer of assets under section 351 of the Code, previously purchased by the taxpayer in accordance with the involuntary conversion provisions of sections 1033 and 1071, to its newly organized subsidiary disqualify the assets as eligible replacement property. See Rev. Rul. 84-29, page 181.

Subchapter P.—Capital Gains and Losses
Part III.—General Rules for Determining Capital Gains and Losses

Section 1223.—Holding Period of Property

26 CFR 1.1223-1: Determination of period for which capital assets are held.

Conversion of a general partnership interest into a limited partnership interest in the same partnership. See Rev. Rul. 84-52, page 157.

Part IV.—Special Rules for Determining Capital Gains and Losses

Section 1232.—Bonds and Other Evidences of Indebtedness

26 CFR 1.1232-1: Bonds and other evidences of indebtedness; scope of section.

Whether income from an interest in a mortgage pool attributable to original issue discount shall be included in the gross income of the holder. See Rev. Rul. 84-10, page 155.

Section 1232A.—Original Issue Discount

Whether income from an interest in a mortgage pool attributable to original issue discount shall be included in the gross income of the holder. See Rev. Rul. 84-10, page 155.

Section 1248.—Gain from Certain Sales or Exchanges of Stock in Certain Foreign Corporations

26 CFR 1.1248-1: Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.
(Also Section 958; 1.958-1.)

Gain from sale of stock in foreign corporation. The earnings and profits of *FS2*, a foreign subsidiary of *FS1*, a foreign corporation, that were accumulated from 1964 to the date of *FS1*'s sale by P, the domestic parent of *FS1*, are deemed to be included with all the earnings and profits of *FS1* for purposes of applying section 1248(a) and (c)(2) of the Code to P's gain on the sale of *FS1*.

Rev. Rul. 84-72

ISSUE

Under the facts described below, whether upon the sale by *P*, a domestic corporate parent, of *FS1*, a first tier foreign subsidiary, all or only part of the earnings of *FS2*, a second tier foreign subsidiary owned by *FS1*, should be included in computing the earnings and profits of *FS1* for purposes of applying the ordinary income provisions of section 1248(a) of the Internal Revenue Code to *P*'s gain on the sale of *FS1*.

FACTS

P, a domestic corporation, has owned directly all the stock of *FS1* since its incorporation in 1964 under the laws of a foreign country. Until 1980, *P* had owned all the stock of *FS2* since its incorporation in 1964 under the laws of a foreign country. In 1980, *P* transferred the stock of *FS2* to *FS1* for *FS1* nonvoting stock

in an exchange for which favorable rulings were obtained from the Commissioner pursuant to sections 367(a) and 351 of the Code. This transaction was not a reorganization as defined in section 368(a)(1)(B) of the Code. *FS1* and *FS2* have had earnings and profits in every year of their existence. Both *FS1* and *FS2* are controlled foreign corporations within the meaning of section 957(a) of the Code. In 1982, in an unrelated transaction, *P* sold all the *FS1* stock at a gain for an amount that exceeded the earnings and profits of *FS1* and *FS2* accumulated from 1964 through the date of the sale of *FS1*.

LAW AND ANALYSIS

Section 1248(a) of the Code provides that if a United States person who meets certain ownership requirements sells or exchanges stock in a foreign corporation, the gain recognized on the sale or exchange will be included in the gross income of that person as a dividend to the extent of the earnings and profits of the foreign corporation attributable to the stock that were accumulated in taxable years of the foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by the person while the foreign corporation was a controlled foreign corporation as defined in section 957.

Section 1248(c) of the Code, which provides rules for the determination of earnings and profits of the foreign corporation, states:

(1) IN GENERAL—Except as provided in section 312(k)(4), for purposes of this section, the earnings and profits of any foreign corporation for any taxable year shall be determined according to rules substantially similar to those applicable to domestic corporations, under regulations prescribed by the Secretary.

(2) EARNINGS AND PROFITS OF SUBSIDIARIES OF FOREIGN CORPORATIONS. —If—

(A) subsection (a) or (f) applies to a sale, exchange, or distribution by a United States person of stock of a foreign corporation and, by reason of the ownership of the stock sold or exchanged, such person owned within the meaning of section 958(a)(2) stock of any other foreign corporation; and

(B) such person owned, within the meaning of section 958(a), or was considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such other foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such other foreign corporation was a controlled foreign corporation (as defined in section 957),

then, for purposes of this section, the earnings and profits of the foreign corporation the stock of which is sold or exchanged which are attributable to the stock sold or exchanged shall be deemed to include the earnings and profits of such other foreign corporation which—

(C) are attributable (under regulations prescribed by the Secretary) to the stock of such other foreign corporation which such person owned within the meaning of section 958(a)(2) (by reason of its ownership within the meaning of section 958(a)(1)(A) of the stock sold or exchanged) on the date of such sale or exchange (or on the date of any sale or exchange of the stock of such other foreign corporation occurring during the 5-year period ending on the date of the sale or exchange of the stock of such foreign corporation, to the extent not otherwise taken into account under this section but not in excess of the fair market value of the stock of such other foreign corporation sold or exchanged over the basis of such stock (for determining gain) in the hands of the transferor); and

(D) were accumulated in taxable years of such other corporation beginning after December 31, 1962, and during the period or periods—

(i) such other corporation was a controlled foreign corporation, and

(ii) such person owned within the meaning of section 958(a)(2) the stock of such other foreign corporation.

Section 958(a)(1) of the Code provides that, for purposes of Subpart F, stock owned means (A) stock owned directly, and (B) stock owned with the application of section 958(a)(2).

Section 958(a)(2) of the Code provides that, for purposes of section 958(a)(1)(B), stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, or foreign trust or foreign estate shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

Section 1248 of the Code was enacted to prevent the repatriation by a shareholder, at a capital gains tax rate instead of an ordinary income tax rate, of earnings accumulated by a foreign corporation. This objective is to be accomplished, in the case of taxable liquidations and sales or exchanges of stock of a controlled foreign corporation by a U.S. person, by taking such accumulated earnings as dividends (to the extent of any gain) at the time of the liquidation, sale, or exchange by a U.S. person. S. Rep. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 813. In 1976, Congress amended section 1248 of the Code in order to ensure that repatriated earnings and profits of a controlled foreign corporation are taxed to a U.S. person on a liquidation, sale, or exchange even if certain gains otherwise would qualify for non-recognition treatment. S. Rep. No. 94-938, 94th Cong., 2d Sess. 264 (1976), 1976-3 (Vol. 3) C.B. 57, 302.

The language of section 1248(c)(2)(D)(ii), when read literally, provides that only the earnings and profits of *FS2* that were accumulated while *FS2* was a subsidiary of *FS1* should be aggregated with those of *FS1* for purposes of section 1248(a). However, section 1248(c)(2)

does not really address a situation in which there is a sequential mixture of direct and indirect ownership of *FS2* by *P*. Certainly section 1248(c)(2)(D)(ii) expressly covers the period of *P*'s indirect ownership of *FS2*, when *FS2* was a subsidiary of *FS1*. But the omission of any prior periods of *P*'s direct ownership of *FS2* from the express language of the section 1248(c)(2)(D)(ii) coverage is not dispositive of the present issue.

To fail to aggregate all the earnings and profits of *FS2* (from 1964 through 1982) with those of *FS1* in this case is clearly unwarranted. There is nothing about the pre-1980 earnings and profits of *FS2* that suggests they should be differentiated (for section 1248(a) purposes) from the post-1979 earnings and profits of *FS2* except for the nature of *P*'s ownership interest, and that distinction between direct and indirect ownership has no relevance to the purpose of Congress in enacting section 1248. If the pre-1980 earnings and profits of *FS2* has been accumulated while it was a wholly-owned subsidiary of *FS3*, which in turn was wholly-owned by *P*, and *FS2* had then been transferred to *FS1* in 1980, as in this case, there would be no question that all of *FS2*'s earnings and profits would be aggregated with those of *FS1* upon the sale of *FS1* for purposes of section 1248. That result is clear because all of *FS2*'s earnings and profits would have been accumulated while *P* had an indirect ownership interest in *FS2* (either through *FS3* or *FS1*) within the scope of section 1248(c)(2)(D)(ii). To reach a contrary conclusion here simply because there was no intermediary corporation between *P* and *FS2* during the pre-1980 taxable years when *P* owned *FS2* directly is unwarranted and inconsistent with the Congressional purpose in enacting section 1248.

Likewise, if *FS2* had been sold by *P* prior to 1980 (that is, before *FS2* was transferred to *FS1*), all of *FS2*'s accumulated earnings and profits would have been included for purposes of section 1248(a). Because the sale of *FS1* necessarily involves the sale of its subsidiary, *FS2*, the earnings and profits considered under section 1248(a) for purposes of the *FS1* sale must now include those of *FS2* that were derived during *P*'s direct and indirect ownership of *FS2*. That is, to give proper effect to section 1248(a) and (c)(2), all the earnings and profits of *FS2* from 1964 through the date of the sale of *FS1* must be taken into account on *P*'s sale of *FS1* without regard to the intervening transfer of *FS2* to *FS1* in 1980.

HOLDING

The earnings and profits of *FS2* that were accumulated from 1964 to the date of *P*'s sale of *FS1* are deemed to be included with all the earnings and profits of *FS1* for purposes of the application of section 1248(a) and (c)(2) of the Code to *P*'s gain on the sale of *FS1*.

Subchapter S.—Tax Treatment of S Corporations and Their Shareholders
Part I.—In General

Section 1362.—Election; Revocation; Termination

26 CFR 18.1362-1: Election to be an S corporation.

Whether the Service will recognize as valid certain corporations' elections to be S corporations under limited circumstances. See Rev. Proc. 84-25, page 468.

Part IV.—Definitions; Miscellaneous

Section 1378.—Taxable Year of S Corporation

26 CFR 18.1378-1: Taxable year of S corporation.

Whether the Service will recognize as valid certain corporations' elections to be S corporations under section 1362 of the Code under the circumstances described. See Rev. Proc. 84-25, page 468.

Subchapter T.—Cooperatives and Their Patrons
Part I.—Tax Treatment of Cooperatives

Section 1381.—Organizations To Which Part Applies

26 CFR 1.1381-1: Organizations to which part applies.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed using the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-27, page 469.

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26 CFR 1.1381-1: Organizations to which part applies.

A mandatory procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to loans for which the interest computed under the Rule of 78's exceeds the loan payments made during any year of the term of the loan. See Rev. Proc. 84-28, page 475.

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26 CFR 1.1381-1: Organizations to which part applies.

A procedure is provided for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation. This procedure applies to short-term consumer loans that are covered by the administrative exception of Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-30, page 482.

Chapter 2.—Tax on Self-Employment Income

Section 1401.—Rate of Tax

Reduction of self-employment tax computation by amount of wages paid to a federal employee. See Rev. Rul. 84-56, below.

Section 1402.—Definitions

(Also Sections 1401, 3101, 3111, 3121, 6413; 26 CFR 31.6413(c)-1.)

Federal employees; self-employed or employed during off-duty hours. If a federal employee who has been continuously employed since December 31, 1983, is also self-employed

during off-duty hours, the individual's maximum income that is subject to the hospital insurance self-employment tax is reduced by the amount of wages subject to the hospital insurance tax. If the federal employee was employed instead of self-employed during off-duty hours, both the federal and outside wages are subject to the hospital insurance tax, but a credit may be taken on the individual's federal income tax return for any excess taxes deducted because of the dual employment.

Rev. Rul. 84-56

ISSUES

1. For a federal employee, hired in 1983, who is also self-employed, is the maximum income that is subject to the hospital insurance self-employment tax reduced by the amount of wages earned by the federal employee for federal employment?

2. Are the wages of a federal employee hired in 1983 subject to the hospital insurance tax, even though the employee also has outside employment that is subject to social security taxes?

FACTS

Issue 1. A federal employee, hired in 1983, whose service is covered by a United States retirement system, is also self-employed during off-duty hours as the operator of a bookbinding business.

Issue 2. A federal employee, hired in 1983, whose service is covered by a United States retirement system, is also employed during off-duty hours as a sales clerk.

LAW

Sections 3101(a) and 3111(a) of the Internal Revenue Code impose old age, survivors and disability insurance taxes on employees and employers, respectively, based on wages paid for "employment." Sections 3101(b) and 3111(b) impose hospital insurance taxes on employees and employers, respectively, based on wages paid for "employment."

Section 3121(b)(5) of the Code excepts from the term "employment" service performed in the employ of the United States by most career employees if the service is covered by a retirement system established by a law of the United States and if the service is performed by an individual who has been continuously in the employ of the United States since December 31, 1983 (including those with a break in service of 365 or fewer consecutive days whether the period of separation began before, on, or after December 31, 1983). For those employees, effective with respect to remuneration paid after December 31, 1982, section 3121(u)(1) provides that the section 3121(b)(5) exception shall not apply for purposes of the hospital insurance taxes imposed by sections 3101(b) and 3111(b). (Section 3121(b)(5), as amended by section 101(b)(1) of the Social Security Amendments of 1983, 1983-2 C.B. 309, 310; and section 3121(u)(1), as added by section 278(a)(1) of the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, 539, and amended by section 101(b)(2) of the 1983 amendments at page 21.)

LAW AND ANALYSIS—
ISSUE 1

Section 1401(a) of the Code imposes an old age, survivors, and disability insurance tax on the self-employment income of every individual. In addition to that tax, section 1401(b) imposes a hospital insurance tax on that income.

Section 1402(b) of the Code provides that self-employment income does not include amounts above a certain maximum and also provides that the maximum is to be reduced by the amount of the wages subject to social security taxes paid to the individual for the taxable year. Effective with respect to remuneration paid after December 31, 1982, those wages include, but only with respect to the hospital insurance tax imposed by section 1401(b), remuneration paid to federal employees continuously in the employ of the United States since December 31, 1983, that is subject to the taxes imposed by sections 3101(b) and 3111(b) because of the provisions of section 3121(u)(1), as amended.

Therefore, federal employees continuously in the employ of the United States since December 31, 1983, who are subject to the hospital insurance tax by reason of section 3121(u)(1) of the Code and who are also self-employed must use the wages that are subject to the hospital insurance tax to reduce their maximum liability for the hospital insurance portion of the self-employment tax.

LAW AND ANALYSIS—
ISSUE 2

Rev. Rul. 55-584, 1955-2 C.B. 394 (as modified by Rev. Rul. 57-32, 1957-1 C.B. 301), holds that, in determining whether an employee has been paid the maximum wages subject to social security taxes in a calendar year, an employer may not take into consideration wages paid to the employee by another employer (except a predecessor).

However, under section 6413(c) of the Code, the employee may secure a special refund of or credit for any excess employee social security tax deducted by the two employers.

HOLDINGS

Issue 1. The bookbinder's maximum income that is subject to the hospital insurance self-employment tax imposed by section 1401(b) of the Code is reduced by the amount of federal wages subject to the hospital insurance tax because of section 3121(u)(1) of the Code. However, the bookbinder may not take federal wages into account in computing self-employment income for purposes of liability for the old-age, survivors, and disability insurance tax imposed by section 1401(a).

Issue 2. The sales clerk's federal wages are subject to withholding for the hospital insurance tax, but a credit may be taken on his or her federal income tax return for any excess employee hospital insurance tax deducted in a calendar year by the two employers. To determine the amont of the credit the individual should use Form 4469, Computation of Excess

Hospital Insurance Benefits Tax Credit.

Federal employees hired on or after January 1, 1984, including those with previous periods of government service if the period of separation from government service exceeds 365 days, are subject to all social security taxes, including both the old-age, survivors, and disability insurance tax under section 3101(a) of the Code and the hospital insurance tax under section 3101(b). Therefore, they are treated the same as all workers subject to those taxes.

Chapter 6.—Consolidated Returns
Subchapter A.—Returns and Payment of Tax

Section 1502.—Regulations

26 CFR 1.1502-1: Definitions.
(See also 1.1502-21.)

Consolidated return change of ownership; "old members" of affiliated group. Two newly formed subsidiaries of parent affiliated group, to which all of the assets of two former divisions of parent were contributed as a part of a plan of bankruptcy reorganization, are treated as "old members" of the parent affiliated group for the year there was a consolidated return change of ownership as defined in section 1.1502-1(g) of the regulations.

Rev. Rul. 84-33

ISSUE

Are *X* and *Y* treated as "old members" of the *P* affiliated group for purposes of sections 1.1502-1(g)(3) and 1.1502-21(d) of the Income Tax Regulations under the circumstances described below?

FACTS

P is the common parent corporation of an affiliated group of corporations and files a consolidated federal income tax return on a calendar-year basis. Prior to January 19, 1982, *P*'s businesses were divided into three divisions: Division *A*, Division *B* and Division *C*. On January 19, 1982, *P* filed a petition for reorganization under chapter 11 of the Bankruptcy Code. Pursuant to a plan of bankruptcy reorganization, *P* organized two wholly owned subsidiaries, *X* and *Y*, by contributing all the assets of Division *A* and Division *B* to *X* and *Y*, respectively, subject to all the liabilities incurred by Division *A* and Division *B*. In December 1982 there was a consolidated return change of ownership (CRCO) as defined in section 1.1502-1(g) of the regulations; that is, in December 1982 there was a more than 50 percentage point change in ownership in *P*.

On the consolidated federal income tax return *P* filed for calendar year 1982, a net operating loss carryover attributable to *P* for years preceding 1982 was utilized against the profits of *X* and *Y*.

LAW AND ANALYSIS

Section 1.1502-1(g)(1) of the regulations provides that a CRCO occurs during any taxable year (referred to as the "year of change") of the corporation that is the common parent for the taxable year to which the tax attribute is to be carried, if, at the end of the year of change (i) any one or more of the ten persons who own the greatest percentage of the fair market value of the stock of the parent corporation increase such ownership by more than 50 percentage points from what they owned at the beginning of such year or the beginning of the preceding year, and (ii) such increase in ownership is attributable to a purchase of stock from an unrelated person or as the result of the liquidation or redemption of the stock of the parent.

Section 1.1502-21(d) of the regulations contains limitations on the use of loss *carryovers* (but not carrybacks) from taxable years ending *before* a CRCO. Section 1.1502-21(d)(2) provides that, if a CRCO occurs, the net operating loss carryovers of the "old members," which were sustained in consolidated or separate return filing years before the year of change, can be carried to the year of change or later years *only* to the extent of the consolidated taxable income of the old members in such year.

Section 1.1502-1(g)(3) of the regulations provides that the term "old members" of a group means those corporations that were members of such group immediately preceding the first day of the taxable year in which the CRCO occurs.

In *Wolter Construction Co., Inc. v. Commissioner*, 634 F.2d 1029 (6th Cir., 1980), *aff'g* 68 T.C. 39 (1977), the United States Court of Appeals for the Sixth Circuit explained the application of the CRCO regulations as follows:

> The carryforward of net operating losses attributable to the common parent is also subject to a similar limitation designed to prevent loss trafficking in the event of a "consolidated return change of ownership" (CRCO). Reg. 1.1502-21(d). A "consolidated return change of ownership" is defined generally in section 1.1502-1(g) of the Treasury Regulations as a more than 50 percentage point change in ownership in the common parent corporation that occurs during a two-year period. (Citation omitted.) If a consolidated return change of ownership occurs, then under section 1.1502-21(d) of the Regulations, the net operating losses attributable to the common parent before the change (together with the net operating losses attributable to other corporations, if any, that were members of the group before the change) may be carried over to the consolidated return years ending after the change only to the extent that the common parent (and the other corporations that were members of the group before the change) contribute to the consolidated taxable income of the group. This limitation hampers the tax avoidance motive of a party which infuses new capital into the common parent with the intention of having it acquire profitable subsidiaries.

In the present situation, *X* and *Y* do not represent new businesses added to the *P* affiliated group with funds obtained from a post-acquisition equity infusion. Instead, both *X* and *Y* represent a continuation of businesses previously carried on by *P*. With respect to the CRCO that took place in December 1982, *P* is an "old member" as defined in section 1.1502-1(g)(3) of the regulations, and but for the separate incorporation of its Division *A* and Division *B* in January 1982 *P* would be able to attribute the income of these two businesses to an old member for purposes of computing the limitation on the use of carryovers of the old members.

X and *Y* do not literally satisfy the definition of an "old member" with

respect to the CRCO that took place in December 1982 because they were not in existence as of the end of 1981; that is, they were not members of the *P* affiliated group immediately preceding the first day of the taxable year in which the CRCO occurred. See section 1.1502-1(g)(3). Nevertheless, their contribution to consolidated taxable income for 1982 should be treated as attributable to old members because their assets and businesses were derived solely from *P*, an old member.

HOLDING

X and *Y* are treated as "old members" of the *P* affiliated group for *P*'s taxable year 1982 in which a CRCO with respect to *P* occurred. Consequently, net operating losses of *P* occurring prior to 1982 may be carried forward and applied against the consolidated taxable income of the old members of the group, including *X* and *Y*.

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26 CFR 1.1502-21: Consolidated net operating loss deduction.

Whether *X* and *Y* are treated as "old members" of the *P* affiliated group for *P*'s tax year in which a consolidated return change of ownership (CRCO) is filed. See Rev. Rul. 84-33, page 186.

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26 CFR 1.1502-32: Investment adjustment.

Computing earnings and profits of a member holding one or more motor carrier operating authorities. See T.D. 7947, page 280.

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26 CFR 1.1502-43: Consolidated accumulated earnings tax.

T.D. 7937

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Consolidated return accumulated earnings and profits regulations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the tax imposed with respect to certain accumulated earnings of an affiliated group of corporations that makes a consolidated income tax return.

DATE: The regulations are effective for taxable years for which the due date (without extensions) for filing returns is after January 26, 1984.

FOR FURTHER INFORMATION CONTACT: Charles M. Whedbee of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention CC:LR:T (202-566-3487 not a toll-free call).

BACKGROUND

On May 14, 1979, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1954 (44 FR 28001). The amendments were proposed to provide rules for the application of the accumulated earnings tax on a consolidated basis. A public hearing was held on October 3, 1979. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

GENERAL DESCRIPTION

The purpose of the amendments is to provide rules for the application of the accumulated earnings tax imposed by section 531 of the Code on a consolidated basis.

Under the regulations, the consolidated accumulated earnings tax applies to any affiliated group of corporations making a consolidated income tax return that is formed or availed of to avoid or prevent the imposition of the individual income tax on the shareholders of any member of the group, or any other corporation, by failing to distribute earnings and profits.

If it is determined that the group is formed or availed of to avoid the individual income tax on shareholders, the tax imposed by section 531 is applied against the group's consolidated accumulated taxable income. This income is defined as the excess of consolidated taxable income for the taxable year (adjusted in the manner required by section 535(b) of the Code) over the consolidated dividends paid deduction and the consolidated accumulated earnings credit.

Reconsideration of Certain Rules

Under the notice of proposed rulemaking published on May 14, 1979, special rules would apply if the personal holding company tax is computed on a member-by-member basis under section 542(b)(2) or (3) of the Code. Certain of these rules have been reconsidered. These are the rules relating to the treatment of intercompany dividends and distributions when a personal holding company is a member, the accumulated earnings credit, and the presumption of the proscribed purpose when earnings and profits are allowed to accumulate beyond the reasonable business needs. The Internal Revenue Service expects to publish a new notice of proposed rulemaking on these subjects. Accordingly, portions of the regulations adopted by this document are reserved for rules on these subjects.

Discussion of comments received

Several comments related to the proper treatment of intercompany dividends and distributions when a personal holding company is a member. These comments will be considered in connection with the new notice of proposed rulemaking.

The only other comment related to taxable years before 1976. On July 9, 1968, there was published in the FEDERAL REGISTER (33 FR 9830) a notice of proposed rulemaking containing proposed amendments to the income tax regulations under section 1502 of the Code, relating in part to the determination of the accumulated earnings tax on a consolidated basis.

The relevant portion of the 1968 proposed regulations was withdrawn on August 25, 1971 (36 FR 1661).

The regulations adopted by this document area substantially similar in many respects to the 1968 proposed regulations that related to the consolidated accumulated earnings tax and are effective for taxable years for which the due date (without extensions) for filing returns is after January 26, 1984. However, the regulations adopted by this document, when proposed in May, 1979, did not contain certain provisions in the 1968 proposed regulations that would have applied only to the determination of the consolidated accumulated earnings tax for taxable years beginning after July 9, 1968, and before January 1, 1976. These provisions provided in effect that liability for the accumulated earnings tax for these pre-1976 years should be computed on the basis of the separate accumulated taxable income of each member if the group did not elect under §1.1502-33(c)(4)(iii) to adjust earnings and profits currently. Thus, under the 1968 proposed regulations, in the absence of such an election, the dividends paid deduction of each member would be computed under sections 561 and 562 without regard to consolidation.

The commentator argued that, in the absence of final regulations on the application of the accumulated earnings tax when consolidated returns were filed, the 1968 proposed regulations may have been taken into account in tax planning. Accordingly, the Internal Revenue Service should allow taxpayers to follow these provisions in the 1968 proposed regulations for transactions which occurred prior to January 1, 1976 (or, alternatively, during the period July 9, 1968, to August 25, 1971, while the 1968 proposed regulations were outstanding).

The commentator's suggestion was not adopted. Section 1503(a) provides that, if a consolidated return is made, the tax is determined, computed, etc., in accordance with the regulations prescribed before the last day prescribed by law for filing the return. In accordance with section 1503(a), it is the general practice not to prescribe consolidated return regulations that apply rules to taxable years for which the return is due before the Treasury decision is prescribed. In this case, section 1503(a) requires that new consolidated return regulations not be prescribed for prior years.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Because the notice of proposed rulemaking for this regulation was filed with the Federal Register on May 11, 1979, no regulatory flexibility analysis is required.

Drafting information

The principal author of these regulations is Charles M. Whedbee of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

ADOPTION OF AMENDMENTS TO THE REGULATIONS

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. The second sentence of §1.531-1 is amended by deleting "§1.1502-2(d)" and inserting in lieu thereof "§1.1502-43".

Par. 2. Paragraph (d) of §1.1502-2 is revised to read as follows:

§1.1502-2 Computation of tax liability

* * * * *

(d) If paragraph (b) of this section does not apply, the tax imposed by section 531 on the consolidated accumulated taxable income (see §1.1502-43);

* * * * *

Par. 3. Immediately after §1.1502-42, add the following new section:

§1.1502-43 Consolidated accumulated earnings tax

(a) *Group subject to tax*—(1) *General rule.* For a group filing a consolidated return for the taxable year, the accumulated earnings tax under section 531 is imposed on consolidated accumulated taxable income (as defined in paragraph (b) of this section). This tax applies to any group that is formed or availed of to avoid or prevent the imposition of the individual income tax on the shareholders of either any of its members or any other corporation by permitting earnings and profits to accumulate instead of dividing or distributing them. Section 531 and this section do not apply to a group that is treated as a "personal holding company" under section 542(a)(1) as a result of the application of section 542(b)(1). Special rules are provided in this section for other groups which include one or more personal holding companies.

(2) *Evidence of purpose to avoid income tax.* (i) Under section 533(a), the fact that the group's earnings and profits are permitted to accumulate beyond the reasonable needs of its business is determinative of the purpose to avoid the income tax with respect to shareholders, unless the group by the preponderance of the evidence proves to the contrary.

(ii) The fact that a group is a mere holding or investment group is prima facie evidence of the group's purpose to avoid the income tax with respect to the shareholders. The activities of a member which is a personal holding company are not taken into account in determining if the group is a mere holding or investment group.

(3) *Earnings and profits.* For purposes of this paragraph (a) and paragraph (d) of this section, the following rules apply:

(i) If no member of the group is a personal holding company, the group's earnings and profits are the

aggregate of the earnings and profits (or deficit) of each corporation that is a member at the close of the taxable year, determined in accordance with §1.1502-33.

(ii) Earnings and profits resulting from the application of §1.1502-33(c)(4)(ii) are not taken into account.

(iii) Earnings and profits resulting from the disposition of a member's stock are determined under §1.1502-33(c)(4)(i)(*b*) whether or not it otherwise applies.

(4) *Reasonable needs of the business.* The reasonable needs of the group's business include the reasonable needs of the business of any corporation (other than a personal holding company) that is a member at the close of the taxable year. Thus, the earnings and profits of one member may be accumulated with respect to the reasonable business needs of another member. If under §1.537-3(b) the business of a nonmember corporation is considered the business of a member, then the earnings and profits of any member may be accumulated with respect to such nonmember's reasonable business needs.

(5) *Burden of proof.* The notification described in section 534(b) and the statement described in section 534(c) are made to or by the common parent corporation in accordance with §1.1502-77.

(b) *Consolidated accumulated taxable income*—(1) *In general.* "Consolidated accumulated taxable income" is the group's consolidated taxable income determined under §1.1502-11 adjusted in the manner provided in paragraph (b)(2) of this section, minus the sum of—

(i) The consolidated dividends paid deduction determined under paragraph (c) of this section and

(ii) The consolidated accumulated earnings credit determined under paragraph (d) of this section.

(2) *Adjustments to consolidated taxable income.* For purposes of paragraph (b)(1) of this section, consolidated taxable income is adjusted as follows:

(i) Under section 535(b)(1), the deduction for taxes is the excess of—

(A) The consolidated liability for tax determined without §1.1502-2(b) through (d) and without the foreign tax credit provided by section 33, over

(B) The consolidated foreign tax credit determined pursuant to §1.1502-4. Foreign taxes deductible under §1.535-2(a)(2) are also allowed as a deduction under section 535(b)(1).

(ii) The consolidated charitable contributions deduction under §1.1502-24 does not apply. Under section 535(b)(2), there shall be allowed the aggregate charitable contributions of the members allowable under section 170, determined without section 170(b)(2) and (d)(2).

(iii) Under section 535(b)(3), the deductions provided in §§1.1502-26 and 1.1502-27 are not allowed.

(iv) Under section 535(b)(4), the consolidated net operating loss deduction described in §1.1502-21(a) is not allowed.

(v) Under section 535(b)(5), there is allowed as a deduction the consolidated net capital loss, determined under §1.1502-22(a).

(vi) Under section 535(b)(6), there is allowed as a deduction an amount equal to (A) the excess of the consolidated net long-term capital gain (determined under §1.1502-41(a)) over the consolidated net short-term capital loss (determined under §1.1502-41(b)), minus (B) the taxes attributable to this excess. This consolidated net short-term capital loss is determined without the consolidated net capital loss carryovers or carrybacks to the taxable year.

(vii) Under section 535(b)(7), the consolidated net capital loss carryovers and carrybacks are not allowed. See §1.1502-22(b).

(viii) Section 1.1502-15 (built-in deductions) does not apply.

(3) *Personal holding company a member.* If a member is a personal holding company for the taxable year—

(i) [Reserved]

(ii) In applying paragraph (b)(2)(i) of this section, consolidated liability for tax (as determined under that paragraph (b)(2)(i)) is reduced by the portion thereof allocable to that member under section 1552(a)(1), (2), (3), or (4) (or §1.1502-33(d)), whichever is applicable. The consolidated foreign tax credit is computed by excluding the taxable income and any foreign taxes paid or accrued by that member, and foreign taxes deductible under §1.535-2(a)(2) do not include foreign taxes attributable to that member.

(c) *Consolidated dividends paid deduction*—(1) *General rule.* For purposes of this section, the consolidated dividends paid deduction is the aggregate of the members' deductions under section 561(a)(1) and (2). This deduction is determined by excluding deductions for dividends paid to other members.

(2) *Exception for certain personal holding companies.* [Reserved]

(3) *Dividends paid defined.* For purposes of this paragraph (c), "dividends paid" and "dividend (or portion thereof) paid" include amounts treated as dividends paid during the taxable year under sections 562(b)(1), 563, and 565 (relating respectively to liquidating distributions, dividends paid after year end, and consent dividends).

(4) *Examples.* This paragraph (c) can be illustrated by the following examples:

Example (1). Corporations P and S constitute an affiliated group which files a consolidated return on a calendar year basis for 1984 and 1985. P owns all of S's stock and two individuals own all of P's stock. Neither member of the group is a personal holding company for 1984. Assume that on December 15, 1984, S pays a dividend (as defined in section 316(a)) of $2,000 to P, and P pays a dividend (as so defined) of $3,000 on January 15, 1985, to its individual shareholders. All dividends are paid in cash and are pro rata with no preference as to any shares or class of stock. For purposes of this paragraph (c), the consolidated dividends paid deduction for 1984 is $3,000, *i.e.*, the dividend paid on January 15, 1985, by P to its nonmember shareholders. See section 563(a). The $2,000 dividend paid by S to P is not taken into account in computing the consolidated dividends paid deduction.

Example (2). [Reserved]

(d) *Consolidated accumulated earnings credit*—[Reserved]

(This Treasury decision is issued under the authority contained in sec-

tions 1502 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 637, 917; 26 U.S.C. 1502, 7805).)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

Approved January 9, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 26, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 27, 1984, 49 F.R. 3461)

Section 1504.—Definitions

26 CFR 1.1504-1: Definitions.

Consolidated returns; affiliation; direct ownership of stock; revocable trust. A parent corporation that is the grantor and sole beneficiary of a revocable voting trust "directly" own's stock that it transfers to that voting trust under section 1504(a) of the Code.

Rev. Rul. 84-79

ISSUE

Does a corporation that is the grantor and sole beneficiary of a revocable voting trust "directly" own stock that it transfers to that voting trust for purposes of section 1504(a) of the Internal Revenue Code under the circumstances described below?

FACTS

P, a domestic corporation, owns all the outstanding stock of *S* corporation. *S* owns certain aircraft. Under Federal Aviation Administration (FAA) regulations, 75 percent of the voting interest of a corporation wishing to register its aircraft with the FAA must be owned or controlled by United States citizens. *See* 14 C.F. R. section 47 (1982). For purposes of the FAA regulations (14 C.F.R. section 47.2 (1982)), *P* does not qualify as a United States citizen. As a result, *P* transferred all of its *S* stock to a revocable voting trust to enable *S* to register its aircraft with the FAA in accordance with FAA regulations. *See* 14 C.F.R. section 47.8 (1982).

Under the terms of the trust agreement, the trustee has all voting powers associated with the *S* stock while the trust agreement is in force. However, the trustee may not vote the *S* stock in favor of either a sale of substantially all of *S*'s assets or a dissolution of *S* without *P*'s authorization.

The trust agreement provides that all dividends (except stock dividends) will be paid directly to *P*. The trustee may not alienate or dispose of any of the *S* stock without *P*'s authorization. *P* may remove the trustee at any time without cause and appoint a qualified successor trustee. The trust agreement may be amended or terminated at any time by *P* and, unless so terminated, will continue for 10 years.

P and *S* filed a consolidated federal income tax return that included income, gain and loss of both *P* and *S* for the entire tax year that included the transfer by *P* of its *S* stock to the voting trust.

LAW AND ANALYSIS

Section 1501 of the Code provides that an affiliated group of corporations shall have the privilege of filing a consolidated return.

Section 1504(a) of the Code provides that the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation that is an includible corporation if (1) stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations, and (2) the common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

The direct ownership requirement of section 1504(a) of the Code is interpreted to mean beneficial ownership. *Miami National Bank v. Commissioner*, 67 T.C. 793 (1977). This recognizes that substance rather than form should control in determining ownership. "The direct ownership required by the statute is not merely possession of the naked legal title, but beneficial ownership, which carries with it dominion over the property." *Macon, Dublin & Savannah Railroad Co. v. Commissioner*, 40 B.T.A. 1266, 1273 (1939), *acq.*, 1940-1 C.B. 3. The court in *Macon* premised its decision on the Supreme Court's statement that "taxation is not so much concerned with the refinement of title as it is with actual command over the property taxed. . . ." *Corliss v. Bowers*, 281 U.S. 376, 378 (1930), IX-1 C.B. 254. Therefore, legal title alone does not constitute direct ownership for purposes of section 1504(a). *Miami National Bank*. As a corollary, possession of everything but legal title is equivalent to direct ownership. *See* Rev. Rul. 70-469, 1970-2 C.B. 179.

In Rev. Rul. 70-469, a corporation, *P*, owns 80 percent of the stock of corporation *S*. P causes the name of *A*, as nominee, to appear as the record owner of a share of *S*'s stock. Rev. Rul. 70-469 concludes that *P* directly owns that share of stock for purposes of section 1504(a) of the Code, because the only thing lacking in *P*'s complete and absolute ownership of that share is the legal title, which *P* may at any time obtain by a demand upon *A*.

In the instant situation, *P*'s ownership of the *S* stock is equivalent to the ownership *P* has in the share *A* holds in Rev. Rul. 70-469. In this case, as in Rev. Rul. 70-469, *P* lacks legal title to the *S* stock. In Rev. Rul. 70-469, *P* can request legal title of the *S* stock from its nominee at any time. Likewise, in this case, *P* has the ability to regain legal title to the *S* stock at any time by revoking the trust. Further, *P*'s control of *S* is demonstrated by *P*'s power to replace the trustee without cause at any time.

The voting trust agreement in the instant situation indicates that *P*'s dominion over the *S* stock is "as complete as the dominion exercisable by

one having both beneficial and legal ownership." Rev. Rul. 70-469. *P*, therefore, owns the *S* stock "directly" within the meaning of section 1504(a) of the Code.

HOLDING

P "directly" owns all of the stock of *S* within the meaning of section 1504(a) of the Code, nonwithstanding the transfer of all of the *S* stock to a revocable voting trust under the circumstances described below.

Subtitle B.—Estate and Gift Taxes
Chapter 11.—Estate Tax
Subchapter A.—Estate of Citizens or Residents
Part I.—Tax Imposed

Section 2001.—Imposition And Rate of Tax

(Also Sections 2053, 2511, 2512; 20.2053-4, 25.2511-1, 25.2512-4.)

Promissory note unsatisfied at death. The gratuitous transfer of a legally binding promissory note is a completed gift under section 2511 of the Code. If the note has not been satisfied at the promisor's death, no deduction is allowable under section 2053(a)(3) for the promisee's claim with respect to the note. The complete gift is not treated as an adjusted taxable gift in computing the tentative estate tax under section 2001(b)(1). Rev. Rul. 67-396 clarified.

Rev. Rul. 84-25

ISSUE

What are the gift and estate tax consequences if a donor/decedent gratuitously transfers a legally binding promissory note that has not been satisfied at the decedent's death?

FACTS

On August 1, 1977, *D* gratuitously transferred to *A* a promissory note in which *D* promised to pay *A* a sum of money on December 31, 1982. The note was legally enforceable under state law.

On May 30, 1982, *D* died. The note had not been satisfied at *D*'s death.

LAW AND ANALYSIS

In the case of a legally enforceable promise for less than an adequate and full consideration in money or money's worth, the promisor makes a completed gift under section 2511 of the Internal Revenue Code on the date when the promise is binding and determinable in value rather than when the promised payment is actually made. *Commissioner v. Copley's Estate*, 194 F.2d 364 (7th Cir. 1952), *aff'g* 15 T.C. 17 (1950), *acq.*, 1965-2 C.B. 4; *Harris v. Commissioner*, 178 F.2d 861 (2d Cir. 1949), *reversed on other grounds*, 340 U.S. 106 (1950), 1950-2 C.B. 77; Rev. Rul. 81-110, 1981-1 C.B. 479, Rev. Rul. 79-384, 1979-2 C.B. 344; Rev. Rul. 69-347, 1969-1 C.B. 227. In such a case, the amount of the gift is the fair market value of the contractual promise on the date it is binding. Section 25.2512-4 of the Gift Tax Regulations. See also Rev. Rul. 81-286, 1981-2 C.B. 177.

Section 2053(a)(3) of the Code provides for an estate tax deduction for the amount of claims against the estate as are allowable by the laws of the state under which the estate is being administered. These deductions, when founded on a promise or agreement, are limited by section 2053(c)(1) to the extent that the obligations are contracted bona fide and for an adequate and full consideration in money or money's worth. See *Estate of Feinburg v. Commissioner*, T.C.M. 1976-396; *Estate of Davis v. Commissioner*, 57 T.C. 833 (1972).

Under section 2001(b) of the Code, the estate tax is computed by determining a tentative tax on the sum of the taxable estate and the adjusted taxable gifts (section 2001(b)(1)) and subtracting from that amount the tax payable, calculated as provided in section 2001(b)(2), with respect to gifts made after 1976. The adjusted taxable gifts include only the value of the taxable gifts made by the decedent after 1976 that are not includible in the decedent's gross estate.

In this case, *D* made a completed gift under section 2511 of the Code on August 1, 1977, the date on which *D*'s promise was legally binding and determinable in value. See *Copley's Estate* and *Harris*, cited above. Compare, Rev. Rul. 67-396, 1967-2 C.B. 351, which provides that the transfer of a promissory note that is unenforceable under state law is not a completed gift.

No deduction is allowable under section 2053 of the Code for *A*'s claim as promisee on *D*'s note, because the note was not contracted for an adequate and full consideration in money or money's worth. Section 2053(c)(1).

Since the note has not been paid, the assets that are to be used to satisfy *D*'s promissory note are a part of *D*'s gross estate. Therefore, *D*'s 1977 gift to *A* is deemed to be includible in *D*'s gross estate for purposes of section 2001 of the Code. Thus, *D*'s 1977 gift is not an adjusted taxable gift as defined in section 2001(b) of the Code. Consequently, the value of *D*'s 1977 gift is not added under section 2001(b)(1)(B) to *D*'s adjusted taxable gifts in computing the tentative estate tax under section 2001(b)(1).

Of course, a different situation would be presented had the note been partially satisfied prior to *D*'s death. To the extent that the note had been paid, the assets used to satisfy the note would not be included in *D*'s estate and hence there would be no reason not to treat the satisfied portion of the note as an adjusted taxable gift. Therefore, the holding of this ruling applies only to the extent the promissory note remains unsatisfied at *D*'s death.

HOLDING

The gratuitous transfer of a legally binding promissory note is a completed gift under section 2511 of the Code. If the note has not been satisfied at the promisor's death, no deduction is allowable under section 2053(a)(3) for the promisee's claim with respect to the note. The completed gift is not treated as an adjusted taxable gift in computing the tentative estate tax under section 2001(b)(1).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 67-396 is clarified to the extent that is implies that the transfer of a legally enforceable promissory note is an incomplete gift. The promissory notes in the court cases cited in Rev. Rul. 67-396 were unenforceable. Rev. Rul. 67-396 is clarified to hold that the transfer of a legally unenforceable promissory note is an incomplete gift.

Part III.—Gross Estate

Section 2031.—Definition of Gross Estate

26 CFR 20.2031-2: Valuation of stocks and bonds.

Guidelines for the determination of the fair market value of participating interests in common trust funds between bank valuation dates. See Rev. Proc. 84-17, page 432.

26 CFR 20.2031-7: Valuation of annuities, life estates, terms for years, remainders, and reversions for estates of decedents dying after November 30, 1983.

Revised actuarial tables and interest factors are provided for valuing certain property for estate tax purposes. See T.D. 7955, page 40.

Section 2032.—Alternate Valuation

26 CFR 20.2032-1: Alternate valuation.

Guidelines for the determination of the fair market value of participating interests in common trust funds between bank valuation dates. See Rev. Proc. 84-17, page 432.

Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036-1: Transfers with retained life estate.

Whether the value of real property includible in a decedent's gross estate under section 2036 is reduced by the value of a mortgage on the property that was made to secure a loan. See Rev. Rul. 84-42, page 194.

Section 2039.—Annuities

26 CFR 20.2039-1: Annuities.

T.D. 7956

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 20—ESTATE TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1978

Employee Retirement Benefits Excluded from Gross Estate

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the estate tax exclusion for lump-sum distributions payable under qualified employee pension, profit-sharing and stock bonus plans. The final regulations have been prepared to remove administrative difficulties encountered by taxpayers and the Service and would affect both the estates of decedents with respect to whom such distributions are payable under such plans and the individuals receiving such distributions.

DATES: The regulations are generally effective July 13, 1984.

FOR FURTHER INFORMATION CONTACT: Patricia K. Keesler of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 27, 1983, the Federal Register published proposed amendments to the Estate Tax Regulations (26 CFR Part 20) under section 2039 (f) of the Internal Revenue Code of 1954 (48 FR 44087) [1983-2 C.B. 625]. Only one public comment was received and there were no requests for a public hearing. After consideration of the written comment received, the regulations are adopted as revised by this Treasury decision.

PUBLIC COMMENT

These final regulations require the recipient's signature to appear on the election statement so that the executor may not file the election statement on behalf of the recipient, without the recipient's knowledge.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for interpretative regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply and no Regulatory Flexibility Analysis is required for this rule.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this final regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

PAPERWORK REDUCTION ACT

The recordkeeping requirements contained in section 20.2039-4(d) of this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Patricia K. Keesler of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, the proposed amendments to 26 CFR Part 20 are hereby adopted, subject to the change set forth below:

Paragraph 1. Section 20.2039-4(d)(2) is revised by inserting the phrase "be signed by the recipient and" in the third sentence after "The statement must".

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805). (Approved by the Office of Management and Budget under control number).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved April 23, 1984.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 11, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 14, 1984, 49 F.R. 20283)

Part IV.—Taxable Estate

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053.1: Deductions for expenses, indebtedness, and taxes; in general.

Administration expenses; estimated future interest payments. A deduction is not allowable for the estimated amount of interest that will accrue upon funds borrowed by an executor on behalf of an estate to pay the federal estate tax if repayment of the loan can be accelerated.

Rev. Rul. 84-75

ISSUE

For purposes of section 2053 of the Internal Revenue Code, is a current deduction allowable for the estimated amount of interest that will accrue upon funds borrowed by an executor on behalf of an estate to pay the federal estate tax?

FACTS

The decedent *D*, died in 1982. *D*'s estate consisted almost entirely of stock of a closely held corporation. No election to extend the time for payment of the estate tax was made pursuant to Code section 6166. There was an insufficient amount of funds available to pay the federal estate tax, and a forced sale would have been required to convert estate assets into sufficient cash. Therefore, the executor borrowed funds, on behalf of the estate, to pay the tax obligation.

The principal amount of the loan is to be repaid over a period of six years, with ten percent interest payable annually. The loan could be fully repaid at any time at the executor's option, without penalty. If the executor fails to timely make any payment, the remaining payments can be accelerated at the lender's option.

On the federal estate tax return filed for the estate, the executor deducted 25*x* dollars as the estimated total amount of future interest to be paid during the loan term. The 25*x* dollars will be allowed as an administrative expense under applicable local law.

LAW AND ANALYSIS

Section 2053(a)(2) of the Code provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

Section 20.2053-1(b)(3) of the Estate Tax Regulations provides that an item may be entered on the return for deduction, though its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid. No deduction may be taken upon the basis of a vague or uncertain estimate.

Section 20.2053-3 of the regulations provides that the amounts deductible as "administration expenses" are limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property.

Interest on a loan, obtained by an executor for an estate, is a deductible administration expense, provided the loan was reasonably and necessarily incurred in the administration of the estate. *Estate of Todd v. Commissioner*, 57 T.C. 288 (1971), *acq.* 1973-2 C.B. 4; *Hibernia Bank v. United States*, 581 F.2d 741 (9th Cir. 1978); *see Estate of Bahr v. Commissioner*, 68 T.C. 74 (1977), *acq.*, 1978-1 C.B. 1.

In this case, because the loan was obtained to avoid a forced sale of assets, the loan was reasonably and necessarily incurred in administering *D*'s estate. Therefore, interest incurred on the loan is deductible as an expense of administration under section 2053(a)(2).

In situations where the estate's obligation to make installment payments may be accelerated, the amount of future interest that will be paid is indefinite because a premature repayment will stop the accrual of interest. *See* Rev. Rul. 80-250, 1980-2 C.B. 278. Consequently, for section 2053(a)(2) deduction purposes, the possibility of prepayment renders any estimate of future interest vague and uncertain within the meaning of section 20.2053-1(b)(3). In this case, because accelerated payment could be made at the executor's option or could be required upon failure to make a timely scheduled payment, the 25*x* dollars estimated future interest expense is not allowable as a deductible administrative expense. Rather, the future interest expense will become deductible only as it accrues. See, for example, Rev. Proc. 81-27, 1981-2 C.B. 548, explaining the procedure for claiming interest deductions in situations where the estate tax liability has not been fully paid when the interest accrues. In those situations where a deduction is sought for interest that has accrued after the federal estate tax liability has been paid, a refund of tax may be requested by filing a claim for refund of tax on Form 843 within the applicable period of limitation set forth in section 6511 of the Code.

HOLDING

For purposes of section 2053 of the Code, a deduction is not allowable

for the estimated amount of interest that will accrue upon funds borrowed by an executor on behalf of an estate to pay the federal estate tax if repayment of the loan could be accelerated. The interest is deductible as an administrative expense only to the extent it has accrued.

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26 CFR 20.2053-4: Deduction for claims against the estate; in general.

Whether a deduction is allowable where a donor/decedent gratuitously transfers a legally enforceable promissory note that has not been satisfied at the promisor's death. See Rev. Rul. 84-25, page 191.

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26 CFR 20.2053-7: Deduction for unpaid mortgages.
(Also Section 2036: 20.2036-1.)

Transfers; retained life estate; transferee's loan secured by mortgage on transferred property. Property in which a decedent retained a life estate is includible in the decedent's gross estate without an offset or deduction for a mortgage that was contracted for by the remainderman, even though the decedent was surety for the mortgage.

Rev. Rul. 84-42

ISSUE

What amount is includible in *D*'s gross estate under section 2036 of the Internal Revenue Code, and what amount is deductible by *D*'s estate under section 2053, if *D* is guarantor of a loan to *A* secured by a mortgage on property *D* previously transferred to *A* subject to a retained life estate?

FACTS

In 1976, *D*, a resident of State *X*, gratuitously conveyed a remainder interest in real estate to *A*, retaining a life estate.

In 1976, a bank in State *X* loaned *A* 100*x* dollars and as security received a mortgage on the property signed by both *A* and *D*. Under the law of State *X*, *D*, was a guarantor and, as such, had a right of reimbursement against *A*, the primary obligor, in the event *D* was required to pay the loan directly or if *D*'s life estate was sold in foreclosure. *A* was solvent at the time of the loan transaction, and *D* had a reasonable expectation of reimbursement from *A* in the event *D* was required to pay the loan for *A*. At and after *D*'s death, *A* remained solvent and was expected to continue paying the loan.

D died in 1981. Because *D* retained a life estate in the transferred property, the value of property was subject to inclusion in *D*'s gross estate under section 2036 of the Code. The executor of *D*'s estate sought to deduct the mortgage balance alternatively under section 2053(a)(3) or (a)(4) of the Code.

LAW AND ANALYSIS

Section 2036(a)(1) of the Code provides that the gross estate includes the value of all property to the extent of any interest therein of which the decedent has made a transfer under which the decedent retained for life the possession of, enjoyment of, or right to the income from, the property. The statute also provides an exception for bona fide sales for full and adequate consideration in money or money's worth, in which case section 2036 would not be applicable. Section 20.2036-1(a) of the Estate Tax Regulations states that if the decedent retained or reserved an interest or right with respect to all of the transferred property, the entire value of the transferred property is included in the decedent's gross estate.

Section 2053(a)(3) of the Code provides a deduction from the value of the gross estate for claims against the estate. Section 2053(a)(4) provides a deduction for unpaid mortgages on property where the value of the decedent's interest in the property is included in the gross estate.

In Rev. Rul. 76-235, 1976-1 C.B. 277, the decedent gratuitiously transferred property in contemplation of death. Subsequent to the transfer and one month prior to the decedent's death, the transferee obtained a loan mortgaging the property to secure the loan. The decedent received no proceeds from the loan, and neither the decedent nor the decedent's estate was liable for the loan.

The ruling holds that the full value of the transferred property is includible in the decedent's gross estate under section 2035 of the Code as in effect prior to amendment by the Tax Reform Act of 1976, and the amount of the mortgage is not deductible from the decedent's gross estate under section 2053 of the Code.

In the present case, the decedent made a transfer described in section 2036 of the full value of the unencumbered remainder interest. The property was encumbered after the transfer, and *D* received no proceeds from the loan. Furthermore, the encumbrance of the property had no immediate effect on *D*'s continued retention of the lifetime enjoyment of the property. Other than as a guarantor, neither *D* nor his estate was liable for the loan. Therefore, in accordance with Rev. Rul. 76-235, the entire value of the property is includible in *D*'s gross estate under section 2036 of the Code, and no deduction is allowed for the mortgage under section 2053(a)(4).

Unlike the situation in Rev. Rul. 76-235, in the present case *D* participated in the loan transaction as guarantor. However, where the decedent is a guarantor, and there is a right of reimbursement, the amount deductible under section 2053(a)(3) cannot exceed the amount the estate actually pays on the debt and is further limited by any expectation of reimbursement. *See Commissioner v. Wragg*, 141 F.2d 638, 640 (1st Cir. 1944); and *Estate of DuVal v. Commissioner*, 4 T.C. 722, 726 (1945), *aff'd*, 152 F.2d 103 (9th Cir. 1945), *cert. denied* 328 U.S. 838 (1945).

If the executor of *D*'s estate is not called upon to pay the indebtedness, the amount of the indebtedness is not deductible as a claim against the estate for purposes of section 2053(a)(3) of the Code. *See* Rev. Rul. 60-247, 1960-2 C.B. 272. If the executor is called upon and pays the indebtedness, the amount of the indebtedness is not deductible for purposes of section 2053 because *A* was solvent at that time and *D*'s estate has a right of

reimbursement. *If*, in the situation described above, *A* became insolvent subsequent to the loan transaction and was delinquent in making the loan payments, *D*'s estate could deduct, under section 2053, the amount paid on the indebtedness reduced by the reasonable value of the right of reimbursement. *See* Rev. Rul. 60-247 and *Commissioner v. Wragg*, cited above, at page 640.

HOLDING

If *D* is guarantor of a loan to *A*, with a right of reimbursement, and the loan is secured by a mortgage on property *D* had previously transferred to *A* subject to a retained life estate, the entire value of the property, unreduced by the mortgage, is includible in *D*'s gross estate under secton 2036 of the Code. If *D*'s estate is not called upon to pay the indebtedness, no amount of the indebtedness is deductible under section 2053.

Section 2055.—Transfers for Public, Charitable and Religious Uses

26 CFR 20.2055-1: Deduction for transfers for public, charitable, and religious uses; in general.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

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26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.
(Also Section 2522; 25.2522(c)-3.)

T.D. 7957

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954; PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Estate and Gift Tax Treatment of Certain Contributions of Works of Art

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the estate and gift tax treatment of contributions of copyrighted works of art. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. These regulations will provide guidance to taxpayers who make charitable contributions of copyrighted tangible personal property.

DATES: The regulations are effective for estates of decedents dying after December 31, 1981, and for charitable transfers after such date.

FOR FURTHER INFORMATION CONTACT: Robert B. Coplan of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 21, 1983, the FEDERAL REGISTER (48 FR 48837) [LR-210-81, 1983-2 C.B. 726] published proposed amendments to the Estate and Gift Tax Regulations (26 CFR Parts 20 and 25) under sections 2055 and 2522 of the Internal Revenue Code of 1954 (Code). The amendments were proposed to conform the regulations to section 423 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 316) [1981-2 C.B. 256, 332]. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

This Treasury decision is issued under the authority contained in section 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805).

CHANGES IN REGULATIONS IN RESPONSE TO COMMENTS

In response to a comment, examples have been added to §20.2055-2(e)(1)(ii). One example clarifies the estate tax treatment of an artist whose will transfers a work of art to charity in a transfer that is not a qualified contribution under §20.2055-2(e)(1)(ii)(*c*). The example indicates that the allowance of a deduction under section 2055 for such a charitable bequest depends on whether under local law the transfer of the work of art is treated as transferring both the work of art and the related copyright interest. The second example clarifies that if the will of an art collector transfers to a charity a work of art in which the collector never owned the copyright interest, then the estate will be allowed a deduction under section 2055 regardless of whether the transfer was a qualified contribution.

SPECIAL ANALYSIS

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 533 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is Robert B. Coplan of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Parts 20 and

25 are amended as follows:

Paragraph 1. (a) Paragraph (e)(1) of §20.2055-2 is amended by redesignating paragraph (e)(1) as paragraph (e)(1)(i) and adding a heading thereto, by removing the words "In general," from the first sentence of newly designated paragraph (e)(1)(i), by substituting the words "this paragraph (e)(1)(i)" for the words "this subparagraph" in the second and fourth sentences and Examples (1), (2), (3), and (6) of new paragraph (e)(1)(i), and by adding a new paragraph (e)(1)(ii) to read as follows:

§20.2055-2 Transfers not exclusively for charitable purposes.

(*e*) *Limitation applicable to decedents dying after December 31, 1969*—(1) *Disallowance of deduction*—(i) *In general.* In the case of decedents dying after December 31, 1969,***

(iii) *Works of art and copyrights treated as separate properties*—(a) *In general.* For purposes of paragraphs (e)(1)(i) and (e)(2) of this section, in the case of decedents dying after December 31, 1981, if a decedent makes a qualified contribution of a work of art, the work of art and the copyright on such work of art shall be treated as separate properties. Thus, a deduction is allowable under section 2055 for a qualified contribution of a work of art, whether or not the related copyright is simultaneously transferred to a charitable organization.

(*b*) *Work of art defined.* For purposes of paragraph (e)(1)(ii)(*a*) of this section, the term "work of art" means any tangible personal property with respect to which a copyright exists under Federal law.

(*c*) *Qualified contribution defined.* For purposes of paragraph (e)(1)(ii)(*a*) of this section, the term "qualified contribution" means any transfer of property to a qualified organization (as defined in paragraph (e)(1)(ii)(*d*) of this section) if the use of the property by the organization is related to the purpose or function constituting the basis for its exemption under section 501. The rules contained in §1.170A-4(b)(3) shall apply in determining if the use of property by an organization is related to such purpose or function.

(*d*) *Qualified organization defined.* For purposes of paragraph (e)(1)(ii)(*c*) of this section, the term "qualified organization" means any organization described in section 501(c)(3) other than a private foundation (as defined in section 509). A private operating foundation (as defined in section 4942(j)(3) shall be considered a qualified organization under this paragraph.

(*e*) *Examples.* The application of paragraphs (e)(1)(i) and (e)(1)(ii)(*a*) through (*d*) of this section may be illustrated by the following examples:

Example (1). A, an artist, died in 1983. A work of art created by A and the copyright interest in that work of art were included in A's estate. Under the terms of A's will, the work of art is transferred to X charity, the only charitable beneficiary under A's will. X has no suitable use for the work of art and sells it. It is determined under the rules of §1.170A-4(b)(3) that the property is put to an unrelated use by X charity Therefore, the rule of paragraph (e)(1)(ii)(*a*), which treats works of art and their copyrights as separate properties, does not apply because the transfer of the work of art to X is not a qualified contribution. To determine whether paragraph (e)(1)(i) of this section applies to disallow a deduction under section 2055, it must be determined which interests are treated as passing to X under local law.

(i) If under local law A's will is treated as fully transferring both the work of art and the copyright interest to X, then paragraph (e)(1)(i) of this section does not apply to disallow a deduction under section 2055 for the value of the work of art and the copyright interest.

(ii) If under local law A's will is treated as transferring only the work of art to X, and the copyright interest is treated as part of the residue of the estate, no deduction is allowable under section 2055 to A's estate for the value of the work of art because the transfer of the work of art is not a qualified contribution and paragraph (e)(1)(i) of this section applies to disallow the deduction.

Example (2). B, a collector of art, purchased a work of art from an artist who retained the copyright interest. B died in 1983. Under the terms of B's will the work of art is given to Y charity. Since B did not own the copyright interest, paragraph (e)(1)(i) of this section does not apply to disallow a deduction under section 2055 for the value of the work of art, regardless of whether or not the contribution is a qualified contribution under paragraph (e)(1)(ii)(*c*) of this section.

§20.2055-2 [Amended]

(b) Paragraph (e)(2)(i) of §20.2055-2 is amended by removing the seventh sentence thereof.

PART 25—[AMENDED]

Par. 2. (a) Paragraph (c)(1) of §25.2522(c)-3 is amended by redesignating paragraph (c)(1) as paragraph (c)(1)(i) and adding a heading thereto, by substituting the words "this paragraph (c)(1)(i)" for the words "this subparagraph" in the second and fourth sentences and Examples (1), (2), and (3) of newly designated paragraph (c)(1)(i), and by adding a new paragraph (c)(1)(ii) to read as follows:

§25.2522(c)-3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(c) *Transfers of partial interest in property*—(1) *Disallowance of deduction*—(i) *In general.****

(ii) *Works of art and copyright treated as separate properties.* For purposes of paragraphs (c)(1)(i) and (c)(2) of this section, rules similar to the rules in §20.2055-2(e)(1)(ii) shall apply in the case of transfers made after December 31, 1981.

(b) Paragraph (c)(2)(i) of §25.2522(c)-3 is amended by removing the seventh sentence thereof.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved May 7, 1984,
JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 16, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 17, 1984, 49 F.R. 20811)

Subchapter C.—Miscellaneous

Section 2204.—Discharge of Fiduciary from Personal Liability

26 CFR 20.2204-1: Discharge of executor from personal liability.

Special lien for estate tax deferred under section 6166 or 6166A. See T.D. 7941, page 251.

26 CFR 20.2204-3: Special rules for estates of decedents dying after December 31, 1976; special lien under section 6324A.

Special lien for estate tax deferred under section 6166 or 6166A. See T.D. 7941, page 251.

Chapter 12.—Gift Tax
Subchapter A.—Determination of Tax Liability

Section 2501.—Imposition of Tax

(Also Section 2511; 26 CFR 1.2511-1.)

Ct. D. 2025

SUPREME COURT
OF THE
UNITED STATES
No. 82-1041

Esther C. Dickman, et al.,
Petitioners,
v.
Commissioner of Internal Revenue
[465 U.S.]

On Writ of Certiorari to
the United States Court of Appeals
for the Eleventh Circuit
[February 22, 1984]

Section 2501(a)(1) of the Internal Revenue Code of 1954 (Code) imposes a tax upon "the transfer of property by gift." Section 2511(a) provides that such tax shall apply whether "the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." Petitioner wife and her husband, now deceased, made substantial interest-free demand loans to their son and a closely held family corporation. The Commissioner of Internal Revenue determined that the loans resulted in taxable gifts to the extent of the value of the use of loaned funds, and assessed gift tax deficiencies. Petitioner wife and petitioner personal representative of her husband sought redetermination of the deficiencies in the Tax Court, which held that the loans were not subject to the gift tax. The Court of Appeals reversed.

Held: The loans in question resulted in taxable gifts of the reasonable value of the use of the money lent.

(a) The language of §§2501(a)(1) and 2511(a) is clear and admits of only one reasonable interpretation: transfers of property by gift, by whatever means effected, are subject to the federal gift tax. The gift tax was designed to encompass all transfers of property and property *rights* having significant value.

(b) The interest-free loan of funds is a "transfer of property by gift" within the contemplation of the Code. The transfer of cash, interest-free and repayable on demand, is a grant of the use of valuable property. And the right to use the money without charge is a valuable interest in the money lent, although the value of such interest may be reduced by virtue of its demand status.

(c) Failure to impose the gift tax on interest-free loans would seriously undermine Congress' goal in enacting the gift tax as a protection against income tax avoidance by the transferor and as a supplement to the estate tax.

(d) Subjecting interest-free loans to the gift tax does not impose upon the transferor a duty to invest profitably, but rather merely recognizes that certain tax consequences flow from a decision to make "a transfer of property by gift."

(e) There is no merit to petitioners' contention that imposing a gift tax on interest-free loans could result in imposing the tax on routine neighborly or familial gifts, thus intruding into cherished zones of privacy. Any such administrative problems are rendered illusory by the generous exclusions, exceptions, and credits provided by the Code for gifts to both family members and others.

(f) Assuming, *arguendo*, that the Commissioner's present position represents a departure from prior administrative practice, he may, nevertheless, change an earlier interpretation of the law, even if such a change is made retroactive in effect, and even though a taxpayer may have relied to his detriment upon the Commissioner's prior position Pp. 12-13.

690 F.2d 812, affirmed.

BURGER, C.J., delivered the opinion of the Court, in which BRENNAN, WHITE, MARSHALL, BLACKMUN, STEVENS, and O'CONNER, JJ., joined. POWELL, J., filed a dissenting opinion, in which REHNQUIST J., joined.

CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari to resolve a conflict among the Circuits as to whether intrafamily, interest-free demand loans result in taxable gifts of the value of the use of the money lent.

I

A

Paul and Esther Dickman were husband and wife; Lyle Dickman was their son. Paul, Esther, Lyle, and Lyle's wife and children were the owners of Artesian Farm, Inc. (Artesian), a closely-held Florida corporation. Between 1971 and 1976, Paul and Esther loaned substantial sums to Lyle and Artesian. Over this five-year interval, the outstanding balances for the loans from Paul to Lyle varied from $144,715 to $342,915; with regard to Paul's loans to Artesian, the outstanding balances ranged from $207,875 to $669,733. During the same period, Esther loaned $226,130 to Lyle and $68,651 to Artesian. With two exceptions, all the loans were evidenced by demand notes bearing no interest.[1]

Paul Dickman died in 1976, leaving a gross estate for federal estate tax purposes of $3,464,011. The Commissioner of Internal Revenue audited Paul Dickman's estate and determined that the loans to Lyle and Artesian resulted in taxable gifts to the extent of the value of the use of the loaned funds.[2] The Commissioner then issued statutory notices of gift tax deficiency both to Paul Dickman's estate and to Esther Dickman.[3]

Esther Dickman and the estate, petitioners here, sought redetermination of the deficiencies in the Tax Court. Reaffirming its earlier decision in *Crown* v. *Commissioner*, 67 T.C. 1060 (1977), aff'd, 585 F.2d 234 (CA7 1978), the Tax Court concluded that intrafamily, interest-free demand loans do not result in taxable gifts. 41 TCM 620, 623 (1980). Because the Tax Court determined that all the loans to Lyle and Artesian were made payable on demand, it held that the loans were not subject to the federal gift tax. *Id.*, at 624.

B

The United States Court of Appeals for the Eleventh Circuit reversed, holding that gratuitous inter-

[1] One exception was a loan made to Lyle on "open account" and payable on demand; the parties have agreed that the gift tax consequences of this "open account" loan are identical to those of the loans evidenced by the demand notes. 41 TCM 620, 623 n. 4 (1980). The other exception was a loan made to Artesian and memorialized by a no-interest note having a term of 10 years, the characterization of which has been a matter of dispute. Although the Tax Court held that this loan to Artesian was in substance a demand loan, *id.*, at 624, the Court of Appeals declined to reach the issue, suggesting that the Tax Court consider the valuation consequences of the loan's characterization on remand. 690 F.2d 812, 814 n. 3 (CA11 1982). For present purposes, we shall refer to all the loans from Paul and Esther Dickman to Lyle and Artesian as demand loans.

[2] In valuing the gifts, the Commissioner multiplied the loan balances outstanding at the end of each taxable quarter by interest rates ranging from six percent to nine percent per annum. These interest rates were taken from §6621 of the Internal Revenue Code of 1954, 26 U.S.C. §6621, made applicable by Code §6601 to underpayments of tax.

[3] The Commissioner asserted a $42,212.91 deficiency against Paul Dickman's estate and a $41,109.78 deficiency against Esther Dickman.

est-free demand loans give rise to gift tax liability. 690 F.2d 812, 819 (1982). Reviewing the language and history of the gift tax provisions of the Internal Revenue Code of 1954 (Code), 26 U.S.C. §2501 *et seq.*, the Court of Appeals concluded that Congress intended the gift tax to have the broadest and most comprehensive coverage possible. The court reasoned that the making of an interest-free demand loan constitutes a "transfer of property by gift" within the meaning of 26 U.S.C. §2501(a)(1), and accordingly is subject to the gift tax provisions of the Code. In so holding, the Court of Appeals squarely rejected the contrary position adopted by the United States Court of Appeals for the Seventh Circuit in *Crown* v. *Commissioner*, 585 F.2d 234 (1978). We granted certiorari to resolve this conflict, 465 U.S. ____ (1983); we affirm.

II

A

The statutory language of the federal gift tax provisions purports to reach any gratuitous transfer of any interest in property. Section 2501 (a)(1) of the Code imposes a tax upon "the transfer of property by gift." 26 U.S.C. §2501(a)(1). Section 2511(a) highlights the broad sweep of the tax imposed by §2501, providing in pertinent part:

"Subject to the limitations contained in this chapter, the tax imposed by section 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. . . ." *Id.*, at §2511(a).

The language of these statutes is clear and admits of but one reasonable interpretation: transfers of property by gift, by whatever means effected, are subject to the federal gift tax.

The committee reports accompanying the Revenue Act of 1932, 47 Stat. 169, which established the present scheme of federal gift taxation, make plain that Congress intended the gift tax statute to reach all gratuitous transfers of any valuable interest in property. Among other things, these reports state:

"The terms 'property,' 'transfer,' 'gift,' and 'indirectly' are used in the broadest and most comprehensive sense; the term 'property' reaching every species of right or interest protected by law and having an exchangeable value.

The words 'transfer. . .by gift' and 'whether. . .direct or indirect' are designed to cover and comprehend all transactions. . .whereby, and to the extent. . .that, property or a property right is donatively passed to or conferred upon another, regardless of the means or the device employed in its accomplishment." H.R. Rep. No. 708, 72d Cong., 1st Sess., 27-28 (1932); S. Rep. No. 665, 72d Cong., 1st Sess., 39 (1932).

The plain language of the statute reflects this legislative history; the gift tax was designed to encompass all transfers of property and property *rights* having significant value.[4]

On several prior occasions, this Court has acknowledged the expansive sweep of the gift tax provisions. In *Commissioner* v. *Wemyss*, 324 U.S. 303, 306 (1945) [1945 C.B. 416] the Court explained that:

"Congress intended to use the term 'gifts' in its broadest and most comprehensive sense. . . .[in order] to hit all the protean arrangements which the wit of man can devise that are not business transactions within the meaning of ordinary speech."

The Court has also noted that the language of the gift tax statute "is broad enough to include property, however conceptual or contingent," *Smith* v. *Shaughnessy*, 318 U.S. 176, 180 (1943) [1943 C.B. 1144] so as "to reach every kind and type of transfer by gift," *Robinette* v. *Helvering*, 318 U.S. 184, 187 (1943) [1943 C.B. 1141]. Thus, the decisions of this Court reinforce the view that the gift tax should be applied broadly to effectuate the clear intent of Congress.

B

In asserting that interest-free demand loans give rise to taxable gifts, the Commissioner does not seek to impose the gift tax upon the principal amount of the loan, but only upon the reasonable value of the use of the money lent. The taxable gift that assertedly results from an interest-free demand loan is the value of receiving and using the money without incurring a corresponding obligation to pay interest along with the loan's repayment.[5] Is such a gratuitous transfer of the right to use money a "transfer of property" within the intendment of §2501(a)(1)?

We have little difficulty accepting the theory that the use of valuable property—in this case money—is itself a legally protectible property interest. Of the aggregate rights associated with any property interest, the right of use of property is perhaps of the highest order. One court put it succinctly:

" 'Property' is more than just the physical thing—the land, the bricks, the mortar—it is also the sum of all the rights and powers incident to ownership of the physical thing. Property is composed of constituent elements and of these elements the right to *use* the physical thing to the exclusion of others is the most essential and beneficial. Without this right all other elements would be of little value. . . ." *Passailaigue* v. *United States*, 224 F. Supp. 682, 686 (MD Ga. 1963) (emphasis in original).[6]

What was transferred here was the use of a substantial amount of cash for an indefinite period of time. An analogous interest in real property, the use under a tenancy at will, has long been recognized as a property right. *E.g.*, Restatement (Second) of Property §1.6 (1977); G. Thompson, Commentaries on the Modern Law of Real Property §1020 (J. Grimes ed. 1980). For example, a parent who

[4] The comprehensive scope of the gift tax, reflected by its statutory language and legislative history, is analogous to that of §61 of the Code, 26 U.S.C. §61, which defines gross income as "all income from whatever source derived." Section 61 has long been interpreted to include all forms of income except those specifically excluded from its reach. See, *e.g.*, *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955) [1955-1 C.B. 207]. Similarly, the gift tax applies to any "transfer of property by gift," Code §2501(a)(1), "[s]ubject to the limitations contained in this chapter," Code §2511(a). Accordingly, absent an express exclusion from its provisions, any transfer meeting the statutory requirements must be held subject to the gift tax.

[5] The Commissioner's tax treatment of interest-free demand loans may perhaps be best understood as a two-step approach to such transactions. Under this theory, such a loan has two basic economic components: an arm's-length loan from the lender to the borrower, on which the borrower pays the lender a fair rate of interest, followed by a gift from the lendor to the borrower in the amount of that interest. See *Crown* v. *Commissioner*, 585 F.2d 234, 240 (CA7 1978).

[6] See also *Barker* v. *Publishers' Paper Co.*, 103 A. 757 758 (N.H. 1918) ("In its final analysis, the property in anything consists in the use."); G. Thompson, Commentaries on the Modern Law of Real Property §5, at 31 (J. Grimes ed. 1980) ("The use of a given object is the most essential and beneficial quality or attribute of property.").

grants to a child the rent-free, indefinite use of commercial property having a reasonable rental value of $8000 a month has clearly transferred a valuable property right. The transfer of $100,000 in cash, interest-free and repayable on demand, is similarly a grant of the use of valuable property. Its uncertain tenure may reduce its value, but it does not undermine its status as property. In either instance, when the property owner transfers to another the right to use the object, an identifiable property interest has clearly changed hands.

The right to the use of $100,000 without charge is a valuable interest in the money lent, as much so as the rent-free use of property consisting of land and buildings. In either case, there is a measurable economic value associated with the use of the property transferred.The value of the use of money is found in what it can produce; the measure of that value is interest—"rent" for the use of the funds. We can assume that an interest-free loan for a fixed period, especially for a prolonged period, may have greater value than such a loan made payable on demand, but it would defy common human experience to say that an intrafamily loan payable on demand is not subject to accommodation; its value may be reduced by virtue of its demand status, but that value is surely not eliminated.

This Court has noted in another context that the making of an interest-free loan results in the transfer of a valuable economic right:

"It is virtually self-evident that extending interest-free credit for a period of time is equivalent to giving a discount equal to the value of the use of the purchase price for that period of time." *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 648 (1980) *(per curiam)*.

Against this background, the gift tax statutes clearly encompass within their broad sweep the gratuitous transfer of the use of money. Just as a tenancy at will in real property is an estate or interest in land, so also is the right to use money a cognizable interest in personal property. The right to use money is plainly a valuable right, readily measurable by reference to current interest rates; the vast banking industry is positive evidence of this reality. Accordingly, we conclude that the interest-free loan of funds is a "transfer of property by gift" within the contemplation of the federal gift tax statutes.[7]

C

Our holding that an interest-free demand loan results in a taxable gift of the use of the transferred funds is fully consistent with one of the major purposes of the federal gift tax statute: protection of the estate tax and the income tax. The legislative history of the gift tax provisions reflects that Congress enacted a tax on gifts to supplement existing estate and income tax laws. H.R. Rep. No. 708, *supra*, at 28; S. Rep. No. 665, *supra*, at 40; see also 65 Cong. Rec. 3119-3120, 8095-8096 (1924); Harriss, Legislative History of Federal Gift Taxation, 18 Taxes 531, 536 (1940). Failure to impose the gift tax on interest-free loans would seriously undermine this estate and income tax protection goal.

A substantial no-interest loan from parent to child creates significant tax benefits for the lender quite apart from the economic advantages to the borrower. This is especially so when an individual in a high income tax bracket transfers income-producing property to an individual in a lower income tax bracket, thereby reducing the taxable income of the high-bracket taxpayer at the expense, ultimately, of all other taxpayers and the government. Subjecting interest-free loans to gift taxation minimizes the potential loss to the federal fisc generated by the use of such loans as an income tax avoidance mechanism for the transferor. Gift taxation of interest-free loans also effectuates Congress' desire to supplement the estate tax provisions. A gratuitous transfer of income-producing property may enable the transferor to avoid the future estate tax liability that would result if the earnings generated by the property—rent, interest, or dividends—became a part of the transferor's estate. Imposing the gift tax upon interest-free loans bolsters the estate tax by preventing the diminution of the transferor's estate in this fashion.

III

Petitioners contend that administrative and equitable considerations require a holding that no gift tax consequences result from the making of interest-free demand loans. In support of this position, petitioners advance several policy arguments; none withstands studied analysis.

A

Petitioners first advance an argument accepted by the Tax Court in *Crown v. Commissioner, supra*:

"[O]ur income tax system does not recognize unrealized earnings or accumulations of wealth and no taxpayer is under any obligation to continuously invest his money for a profit. The opportunity cost of either letting one's money remain idle or suffering a loss from an unwise investment is not taxable merely because a profit *could have been made* from a wise investment." 67 T.C., at 1063-1964.

Thus, petitioners argue, an interest-free loan should not be made subject to the gift tax simply because of the possibility that the money lent *might* have enhanced the transferor's tax-

[7] Petitioners argue that no gift tax consequences should attach to interest-free demand loans because no "transfer" of property occurs at the time the loan is made. Petitioners urge that the term "transfer" connotes a discrete, affirmative act whereby a person conveys something to another person, not a continuous series of minute failures to require return of something loaned." Brief for Petitioners 22. We decline to adopt that construction of the statute.

In order to make a taxable gift, a transferor must relinquish dominion and control over the transferred property. Treas. Reg. §25.2511-2(b), 26 CFR §25.2511-2(b) (1983). At the moment an interest-free demand loan is made, the transferor has not given up all dominion and control; he could terminate the transferee's use of the funds by calling the loan. As time passes without a demand for repayment, however, the transferor allows the use of the principal to pass to the transferee, and the gift becomes complete. See *ibid.*; Rev. Rul. 69-347, 1969-1 Cum. Bull. 227; Rev. Rul. 69-346, 1969-1 Cum. Bull. 227. As the Court of Appeals realized, 690 F.2d, at 819, the fact that the transferor's dominion and control over the use of the principal is relinquished over time will become especially relevent in connection with the valuation of the gifts that result from such loans; it does not, however, alter the fact that the lender has made a gratuitous transfer of property subject to the federal gift tax.

able income or gross estate had the loan never been made.

This contention misses the mark. It is certainly true that no law requires an individual to invest his property in an income-producing fashion, just as no law demands that a transferor charge interest or rent for the use of money or other property. An individual may, without incurring the gift tax, squander money, conceal it under a mattress, or otherwise waste its use value by failing to invest it. Such acts of consumption have nothing to do with lending money at no interest. The gift tax is an excise tax on *transfers* of property; allowing dollars to lie idle involves no transfer. If the taxpayer chooses not to waste the use value of money, however, but instead transfers the use to someone else, a taxable event has occurred. That the transferor himself could have consumed or wasted the use value of the money without incurring the gift tax does not change this result. Contrary to petitioners' assertion, a holding in favor of the taxability of interest-free loans does not impose upon the transferor a duty profitably to invest; rather, it merely recognizes that certain tax consequences inevitably flow from a decision to make a "transfer of property by gift." 26 U.S.C. §2501(a)(1).

B

Petitioners next attack the breadth of the Commissioner's view that interest-free demand loans give rise to taxable gifts. Carried to its logical extreme, petitioners argue, the Commissioner's rationale would elevate to the status of taxable gifts such commonplace transactions as a loan of the proverbial cup of sugar to a neighbor or a loan of lunch money to a colleague. Petitioners urge that such a result is an untenable intrusion by the government into cherished zones of privacy, particulary where intra-family transactions are involved.

Our laws require parents to provide their minor offspring with the necessities and conveniences of life; questions under the tax law often arise, however, when parents provide more than the necessities, and in quantities significant enough to attract the attention of the taxing authorities. Generally, the legal obligation of support terminates when the offspring reach majority. Nonetheless, it is not uncommon for parents to provide their adult children with such things as the use of cars or vacation cottages, simply on the basis of the family relationship. We assume that the focus of the Internal Revenue Service is not on such traditional familial matters. When the government levies a gift tax on routine neighborly or familial gifts, there will be time enough to deal with such a case.

Moreover, the tax law provides liberally for gifts to both family members and others; within the limits of the prescribed statutory exemptions, even substantial gifts may be entirely tax free. First, under §2503(e) of the Code, 26 U.S.C. §2503(e), amounts paid on behalf of an individual for tuition at a qualified educational institution or for medical care are not considered "transfer[s] of property by gift" for purposes of the gift tax statutes. More significantly, section 2503(b) of the Code provides an annual exclusion from the computation of taxable gifts of $10,000 per year, per donee; this provision allows a taxpayer to give up to $10,000 annually to each of any number of persons, without incurring any gift tax liability.[8] The "split gift" provision of Code §2513(a), which effectively enables a husband and wife to give each object of their bounty $20,000 per year without liability for gift tax, further enhances the ability to transfer significant amounts of money and property free of gift tax consequences.[9] Finally, should a taxpayer make gifts during one year that exceed the §2503(b) annual gift tax exclusion, no gift tax liability will result until the unified credit of Code §2505 has been exhausted.[10] These generous exclusions, exceptions, and credits clearly absorb the sorts of *de minimis* gifts petitioners envision and render illusory the administrative problems that petitioners perceive in their "parade of horribles".

C

Finally, petitioners urge that the Commissioner should not be allowed to assert the gift taxability of interest-free demand loans because such a position represents a departure from prior Internal Revenue Service practice. This contention rests on the fact that, prior to 1966, the Commissioner had not construed the gift tax statutes and regulations to authorize the levying of a gift tax on the value of the use of money or property. See *Crown* v. *Commissioner*, 585 F.2d, at 241; *Johnson* v. *United States*, 254 F. Supp. 73 (ND Tex. 1966). From this they argue that it is manifestly unfair to permit the Commissioner to impose the gift tax on the transactions challenged here.

Even accepting the notion that the Commissioner's present position represents a departure from prior administrative practice, which is by no means certain,[11] it is well established

[8] During the taxable periods involved in this case, Code §2503(b) provided an annual exclusion of $3000 per year, per donee. Section 441(a) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 319, amended §2503(b) by raising the annual exclusion to $10,000 for transfers made after December 31, 1981.

[9] Under Code §2513(a), U.S.C. §2513(a), a husband and wife may elect to treat a gift in fact made by one spouse as having been made one-half by each spouse. Simply put, the net effect of this gift-splitting provision is to double the gift tax exclusions and exemptions applicable to each gift by the donor. In some states, of course, community property laws achieve the same "gift-splitting" result. See generally C. Lowndes, R. Kramer, and J. McCord, Federal Estate & Gift Taxes §35.1 (1974).

[10] Under the gift tax system in effect during the taxable periods involved in this case, former Code §2521 provided a lifetime gift tax exemption of $30,000 for each taxpayer. Section 2001(b)(3) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1849, replaced the lifetime exemption with a unified credit. As modified by the Economic Recovery Tax Act of 1981, *supra*, the unified credit provided by Code §2505 is scheduled to increase each year until 1987; at that time, the credit will total $192,800, the equivalent of a lifetime exemption of $600,000 per taxpayer. See Code §2505(b), 26 U.S.C. §2505(b).

[11] The Treasury Regulations implementing the gift tax provisions have always reflected the broad scope of the statutory language. See Treas. Regs. 79, Art. 2 (1983); Treas. Regs. 79, Art. 2 (1936); Treas. Regs. 108, §86.2(a) (1943). The regulation presently in force is virtually identical to those in effect during the pre-

that the Commissioner may change an earlier interpretation of the law, even if such a change is made retroactive in effect. *E.g., Dixon* v. *United States*, 381 U.S. 68, 72-75 (1965) [1965-2 CB 479]; *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180, 183-184 (1957) [1957-1 CB 513]. This rule applies even though a taxpayer may have relied to his detriment upon the Commissioner's prior position. *Dixon* v. *United States, supra*, at 73. The Commissioner is under no duty to assert a particular position as soon as the statute authorizes such an interpretation.[12] See also *Bob Jones University* v. *United States*, 461 U.S.____(1983). Accordingly, petitioners' "taxpayer reliance" argument is unavailing.[13]

IV

As we have noted, *supra* at____, Congress has provided generous exclusions and credits designed to reduce the gift tax liability of the great majority of taxpayers. Congress clearly has the power to provide a similar exclusion for the gifts that result from interest-free demand loans. Any change in the gift tax consequences of such loans, however, is a legislative responsibility, not a judicial one. Until such a change occurs, we are bound to effectuate Congress' intent to protect the estate and income tax systems with a broad and comprehensive tax upon all "transfer[s] of property by gift." Cf. *Diedrich* v. *Commissioner*, 457 U.S. 191, 199 (1982) [1982-2 CB 186].

We hold, therefore, that the interest-free demand loans shown by this record resulted in taxable gifts of the reasonable value of the use of the money lent.[14] Accordingly, the judgment of the United States Court of Appeals for the Eleventh Circuit is

Affirmed.

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ceding five decades; it provides:

"The gift tax also applies to gifts indirectly made. Thus, all transactions whereby property or property rights or interests are gratuitously passed or conferred upon another, regardless of the means or device employed, constitute gifts subject to tax." Treas. Reg. §25.2511-1(c), 26 CFR §25.2511-1(c) (1983).

The longstanding interpretation of the statute embodied in these regulations indicates that the Commissioner's allegedly novel assertion in 1966 regarding the gift taxability of interest-free demand loans was not without a reasonable and well-established foundation.

[12] Indeed, the explanation for the dearth of pre-1966 cases presenting this precise issue is probably economic; the low interest rates that prevailed until recent years diminished the attractiveness of the interest-free demand loan as a tax-planning device and reduced the likelihood that the value of such loans would exceed the annual gift tax exclusion.

[13] Petitioners' detrimental reliance argument must fail for an additional reason. The interest-free demand loans challenged by the Commissioner in this case were made between 1971 and 1976. The Commissioner first litigated the question of the gift taxability of such loans in *Johnson* v. *United States*, 254 F. Supp. 73 (ND Tex. 1966). Six years later, in Rev. Rul. 73-61, 1973-1 Cum. Bull. 408, the Commissioner formally announced the position that interest-free demand loans give rise to taxable gifts. Because approximately half the loans in this case were made after the Commissioner had issued Rev. Rul. 73-61, petitioners are hardly in a position to argue that they relied to their detriment on a different interpretation of the gift tax statute.

[14] In determining the value of the gifts made by Paul and Esther Dickman to Lyle Dickman and Artesian, the Commissioner applied to the loan balances outstanding during each taxable quarter certain interest rates derived from §6621 of the Code, 26 U.S.C. §6621. See n. 2, *supra*. The Court of Appeals declined to address the question, but remanded to the Tax Court for consideration of the method by which the gifts associated with interest-free demand loans should be valued. 690 F.2d, at 820 and n. 11. The valuation issue is therefore not presented on the record before us. We note, however, that to support a gift tax on the transfer of the use of $100,000 for one year, the Commissioner need not establish that the funds lent did in fact produce a particular amount of revenue; it is sufficient for the Commissioner to establish that a certain yield could readily be secured and that the reasonable value of the use of the funds can be reliably ascertained.

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26 CFR 25.2501-1: Imposition of tax.

Whether the donor's use of the unified credit against the gift tax is a payment or assessment of the gift tax which precludes a subsequent adjustment to the value of the gift. See Rev. Rul. 84-11, this page.

Section 2504.—Taxable Gifts for Preceding Calendar Periods

26 CFR 25.2504-2: Valuation of certain gifts for preceding calendar periods.

Whether the donor's use of the unified credit against the gift tax is a payment or assessment of the gift tax which precludes a subsequent adjustment to the value of the gift. See Rev. Rul 84-11, this page.

Section 2505.—Unified Credit Against Gift Tax

(Also Sections 2501, 2504; 26 CFR 25.2501-1, 25.2504-2.)

Unified credit; adjustment to value. A donor's use of the unified credit does not result in the payment or assessment of the gift tax which would preclude the subsequent adjustment to the value of the gift.

Rev. Rul. 84-11

ISSUE

Does a donor's use of the unified credit under section 2505 of the Internal Revenue Code result in a payment or assessment of gift tax that would preclude an adjustment to the value of the gift under section 2504(c)?

FACTS

In December 1977, *D*, the donor, made a gift of stock to *A*. *D* made no other gifts during that calendar quarter. On April 15, 1978, *D* filed a gift tax return reporting the fair market value of the gift to be $123,000.

The annual exclusion was allowable under section 2503 of the Code. Therefore, the return indicated a tentative gift tax liability of $29,800 which was fully offset by the unified credit.

In 1982, *D* made a gift to *B* of $230,000. Upon audit of the gift tax return filed for 1982, an adjustment was made to increase the value of the 1977 gift to reflect the correct fair market value of the stock at the time of the gift. Although no gift tax could be assessed for the gift to *A* because the period of limitations on assessment had expired, the adjustment increased the aggregate sum of *D*'s taxable gifts. Therefore, the rate of tax applicable to the 1982 gift was increased. *D* contended that the adjustment was barred by section 2504(c) of the Code because, since the unified credit was used, a tax was assessed or paid for the 1977 gift.

LAW AND ANALYSIS

Section 2501 of the Code as amended by the Economic Recovery Tax Act of 1981 (the Act), imposes a tax

for each calendar year on the transfer of property by gift during the calendar year.

Section 2502 of the Code, as amended by the Act, provides, in general, that the tax imposed by section 2501 shall be an amount equal to the excess of—

(1) a tentative tax on the aggregate sum of the taxable gifts for the calendar year and for each of the preceding calendar periods, over

(2) a tentative tax on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

Section 2505(a) of the Code, as amended by the Act, allows a credit of $192,800 against the gift tax imposed by section 2501. The credit is reduced by the sum of the amounts allowable as a credit to the individual for all preceding calendar periods. Section 2505(b) provides that the amount of the unified credit is phased in over several years. The maximum amount of the unified credit available for gifts made after December 31, 1981, and before January 1, 1983, is $62,800. In the case of gifts made after June 30, 1977, and before January 1, 1978, the maximum amount of unified credit available is $30,000. Further, because the unified credit is mandatory any unified credit that is allowable must be applied to the extent of gift taxes that are imposed under section 2501. Rev. Rul. 79-398, 1979-2 C.B. 338.

Section 2504(c) of the Code, as amended by the Act, provides that, if the time has expired within which a tax may be assessed on the transfer of property by gift made during a preceding calendar period, and if a tax has been assessed or paid for such preceding calendar period, the value of the gift shall, for purposes of computing the tax for any calendar year, be the value of the gift which was used in computing the tax for the last preceding calendar period for which a tax was assessed or paid.

Explaining section 2504(c), H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 93, A 322 (1954) states:

> Subsection (c) of this section will prevent the value of a gift from being adjusted under such circumstances in cases *where a tax was paid for the prior year in question.* This subsection, however, will not prevent such an adjustment *if no tax was paid for the prior year. . .* (Emphasis added)

See also Sen. Rep. No. 1622, 83rd Cong., 2d Sess. 127 (1954), which states:

> [O]nce the value of a gift has been accepted for purposes of the tax by both the Government and the taxpayer, this value should be acceptable to both in measuring the tax to be applied to subsequent gifts. For that reason the bill provides that the value of the gift as reported on a taxable gift tax return for a prior year is to be conclusive as to the value of the gift (after the statute of limitations has run) in determining the tax rate to be applied to subsequent gifts. This substantially increases certainty in the gift tax area.

The unified credit is a substitute for the specific exemption formerly provided under section 2521, and a gift tax liability is incurred only after the credit has been exhausted. See H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 15 (1976), 1976-3 (Vol. 3) C.B. 735, 749; see also, Rev. Rul. 79-398, 1979-2 C.B. 338.

Section 6501 provides in general, that the amount of any tax imposed shall be assessed within three years after the return was filed.

Sections 6201, 6202 and 6203, and the regulations thereunder, provide for the time and method of assessment of taxes. Generally, only taxes, net of credits, are the subject of assessment. There are exceptions, such as the assessment of erroneous credits and the deficiency assessment procedures, but none of them are applicable here. Taxes that are entirely offset by a correctly claimed credit are not assessed or paid within the meaning of section 2504(c) of the Code.

This conforms to the Congressional intent underlying section 2504(c), which was to prevent the valuation of a past transfer to be placed in doubt after the Service had previously been satisfied as to the correctness of the taxpayer's valuation. On the other hand, an undervaluation of a gift that fell within the limits of the unified credit might have little or no current tax consequence, and it should not acquire any finality from the fact that it went unchallenged at the time the return was filed.

Accordingly, in this situation, there was no payment or assessment of the gift tax on *D*'s 1977 gift and, therefore, the value of the stock can be adjusted for purposes of computing the aggregate sum of taxable gifts made by *D*.

Further, as noted above, section 6501 of the Code bars an assessment after the expiration of the period of limitations. However, in this situation, where use of the additional unified credit for the 1977 gift offsets the tax imposed by section 2501, no assessment of tax results on the return filed for the gift. The only assessment made, within the meaning of section 6201, would be to the return filed for the gift made in 1982. Therefore, there is no bar to adjusting *D*'s available unified credit to reflect the credit that would have been used had *D* correctly valued the 1977 gift. Consequently, the unified credit available to *D* for the 1982 gift must be adjusted to reflect the credit that would have been used had *D* correctly valued the 1977 gift, even though no tax can be assessed for the 1977 gift.

HOLDING

A donor's use of the unified credit, under section 2505 of the Code, does not result in a payment or assessment of gift tax that would preclude an adjustment to the value of the gift under section 2504(c) of the Code.

Subchapter B.—Transfers

Section 2511.—Transfers in General

26 CFR 1.2511-1: Transfers in general.

Whether intrafamily, interest-free demand loans resulted in taxable gifts of the value of

the use of the money lent under section 2501 of the Code. See Ct. D. 2025, page 197.

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26 CFR 25.2511-1: Transfers in general.

Whether the gratuitous transfer of a legally binding promissory note is a completed gift. See Rev. Rul. 84-25, page 191.

Section 2512.—Valuation of Gifts

26 CFR 25.2512-1: Valuation of property; in general.

Guidelines for the determination of the fair market value of participating interests in common trust funds between bank valuation dates. See Rev. Proc. 84-17, page 432.

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26 CFR 25.2512-4: Valuation of notes.

Whether the value of a gratuitous transfer of a legally enforceable promissory note that has not been satisfied at the promisor's death is treated as an adjusted taxable gift. See Rev. Rul. 84-25, page 191.

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26 CFR 25.2512-5: Valuation of annuities, life estates, terms for years, remainders, and reversions transferred after November 30, 1983.

Revised actuarial tables and interest factors are provided for valuing certain property for gift tax purposes. See T.D. 7955, page 40.

Subchapter C.—Deductions

Section 2522.—Charitable and Similar Gifts

26 CFR 25.2522(c)(3): Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

Gift tax treatment of contributions of copyrighted works of art. See T.D. 7957, page 195.

Subtitle C.—Employment Taxes
Chapter 21.—Federal Insurance Contributions Act
Subchapter A.—Tax on Employees

Section 3101.—Rate of Tax

Remuneration of federal employees subject to the hospital insurance tax. See Rev. Rul. 84-56, page 184.

Subchapter B.—Tax on Employers

Section 3111.—Rate of Tax

Remuneration of federal employees subject to the hospital insurance tax. See Rev. Rul. 84-56, page 184.

Subchapter C.—General Provisions

Section 3121.—Definitions

Services of federal employees included in "employment" for purposes of the hospital insurance tax. See Rev. Rul. 84-56, page 184.

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26 CFR 31.3121(b)(8)-2: Services in employ of religious, charitable, educational, or certain other organizations exempt from income tax.

Services not subject to social security tax prior to January 1, 1984. See Rev. Proc. 84-40, page 515.

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26 CFR 31.3121(k)-1: Waiver of exemption from taxes.

Organizations exempt from social security taxes prior to January 1, 1984. See Rev. Proc. 84-40, page 515.

Chapter 22.—Railroad Retirement Tax Act
Subchapter D.—General Provisions

Section 3231.—Definitions

26 CFR 31.3231(a)-1: Who are employers.

Railroad retirement; employer; casual service. Insubstantial railroad-related services performed by a company that is wholly owned by a railroad fall within the "casual service" exception contained in section 3231(a), even though they are regularly carried on.

Rev. Rul. 84-91

ISSUE

Under the circumstances described below, is a company an "employer" within the meaning of section 3231(a) of the Internal Revenue Code, relating to the Railroad Retirement Tax Act?

FACTS

X is a wholly owned subsidiary of a railroad company that is a "carrier" as defined in section 3231(g) of the Code. Although the majority of *X*'s business activities is nonrailroad related, *X* regularly provides nontrucking services in connection with the transportation of property by railroad. These services constitute less than 4 percent of *X*'s overall activities and generate less than 4 percent of *X*'s gross receipts.

LAW AND ANALYSIS

For purposes of the Railroad Retirement Tax Act, the term "employer" means any carrier as defined in section 3231(g) of the Code and any company that is directly or indirectly owned or controlled by a carrier and that performs any service, except trucking or casual service, in connection with the transportation of passengers or property by railroad. Section 3231(a). The Railroad Retirement Act contains a similar definition. 45 U.S.C. sections 231(a)(1)(i) and (ii) (Supp. 1983).

Because *X* is owned by a carrier and performs nontrucking services in connection with the transportation of property by railroad, *X* is an employer within the meaning of section 3231(a) of the Code, unless the services *X* performs are "casual services."

Section 202.6 of the regulations under the Railroad Retirement Act, 20 C.F.R. (1982), provides, in part, that the service rendered by a controlled company or person in connection with the transportation of passengers or property by railroad is "casual" whenever the service is so irregular or infrequent as to afford no substantial basis for an inference that the service will be repeated, or whenever the service is insubstantial.

In *Adams v. Railroad Retirement Board*, 214 F.2d 534 (9th Cir. 1954), the court stated that the definition of "casual" in 20 C.F.R. section 202.6 is a fair statement of the usual or common meaning of that term. *See* Rev. Rul. 77-386, 1977-2 C.B. 356; Rev. Rul. 77-455, 1977-2 C.B. 357.

Here, the services *X* renders in connection with railroad transportation constitute less than 4 percent of *X*'s overall activities and generate less than 4 percent of *X*'s gross receipts. *X*'s railroad related activities are thus insubstantial and so fall within the "casual service" exemption contained in section 3231(a) of the Code. Compare Rev. Rul. 69-42, 1969-1 C.B. 266, and Rev. Rul. 69-306, 1969-1 C.B. 267, in which the services performed were not considered to be "casual."

HOLDING

X is not an "employer" within the meaning of section 3231(a) of the Code.

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26 CFR 31.3231(e)-1: Compensation.

Rev. Rul. 84-92

FACTS

Rev. Rul. 72-341, 1972-2 C.B. 32, holds that payments by a corporation to its employees resulting from a suit for violation of Title VII of the Civil Rights Act of 1964 are includible in the employees' gross income as compensation and are wages for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and federal income tax withholding.

HOLDING

Payments made to employees by an employer, as defined in section 3231(a) of the Internal Revenue Code, that are includible in their gross incomes pursuant to Rev. Rul. 72-341 are "compensation" for purposes of the Railroad Retirement Tax Act.

EFFECTS ON OTHER DOCUMENTS

Rev. Rul. 72-341 is amplified.

Chapter 23.—Federal Unemployment Tax Act

Section 3302.—Credits Against Tax

26 CFR 31.3302(c)-1: Limit on total credits.

Reductions (for 1983) in credit applicable to employers for whom services are performed in various "states." See Rev. Proc. 84-5, page 365.

Chapter 24.—Collection of Income Tax at Source
Subchapter A.—Withholding from Wages

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(b)-1: Percentage method of withholding.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 84-41, page 515.

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26 CFR 31.3402(f)(5)-1: Form and contents of withholding exemption certificates.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 84-41, page 515.

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26 CFR 31.3402(h)(4)-1: Other methods.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 84-41, page 515.

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26 CFR 31.3402(p)-1: Voluntary withholding agreements.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 84-41, page 515.

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26 CFR 31.3402(q)-1: Extension of withholding to certain gambling winnings.

General requirement of return, statement, or list. See T.D. 7943, page 233.

Section 3406.—Backup Withholding

Requirements for payers of interest, dividends, or patronage dividends that wish to submit magnetic tape files to the Service to verify the names and taxpayer identification numbers of payees. See Rev. Proc. 84-10, page 406.

Subchapter B.—Withholding from Interest and Dividends

Section 3451.—Income Tax Collected at Source on Interest, Dividends and Patronage Dividends

26 CFR 31.3451(a)-1: Requirement of withholding on payments of interest, dividends and patronage dividends.
(Also Sections 3452, 3454, 6011; 31.3452(a)-1, 31.3454(a)-1, 31.6011(a)-10.)

T.D. 7949

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE REGULATIONS

Removal of regulations on mandatory withholding from interest and dividends

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides a Treasury decision that removes the final regulations contained in T.D. 7880 [1983-1 C.B. 242] relating to 10 percent withholding on interest and dividends. Repeal of the applicable tax law was made by the Interest and Dividend Tax Compliance Act of 1983 [Pub. L. 98-67, 1983-2 C.B. 352]. This Treasury decision affects persons who would have been required to withhold under the repealed provisions.

DATES: The Treasury decision is effective on March 22, 1983, except for §31.3452(f)-1 which is effective February 1, 1983. The regulations apply to payments of interest, dividends, and patronage dividends paid or credited after June 30, 1983, except that the regulations relating to exemption certificates (§31.3452(f)-1) are effective on February 1, 1983.

FOR FURTHER INFORMATION CONTACT: Diane Kroupa of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Final regulations under section 3451 *et seq.* relating to 10 percent withholding on interest and dividends were published in the FEDERAL REGISTER for March 28, 1983 (48 FR 12940) [T.D. 7880, 1983-1 C.B. 242], after a public hearing was held on February 1, 1983. Those amendments were issued to conform the regulations to statutory changes enacted by sections 301 through 308 of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97-248, 96 Stat. 324, 576). [1982-2 C.B. 462, 548-556]. Section 102 of the Interest and Dividend Tax Compliance of 1983 (97 Stat. 369) [Pub. L. 98-67, 1983-2 C.B. 352] repealed the statu-

tory provisions. This document, therefore, removes the regulatory provisions issued under section 3451 *et seq.*

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this Treasury decision is not a major rule subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

The Secretary of the Treasury has certified that this rule, if issued, will not have a significant economic impact on a substantial number of small entities since it merely removes regulations that implemented statutory provisions that have been repealed. A Regulatory Flexibility Analysis is, therefore, not required under the Regulatory Flexibility Act (5 U.S.C. 605(b)).

DRAFTING INFORMATION

The principal author of this Treasury decision is Diane Kroupa of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and Treasury Department participated, however, in developing this Treasury decision, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 31 is amended as follows:

The following sections are removed:

1. §31.3451(a)-1
2. §31.3451(b)(1)-1
3. §31.3451(b)(2)-1
4. §31.3451(b)(3)-1
5. §31.3451(b)(4)-1
6. §31.3451(c)-1
7. §31.3452(a)-1
8. §31.3452(b)-1
9. §31.3452(c)-1
10. §31.3452(d)-1
11. §31.3452(e)-1
12. §31.3452(f)-1
13. §31.3453(a)-1
14. §31.3453(b)-1
15. §31.3453(c)-1
16. §31.3453(d)-1
17. §31.3453(e)-1
18. §31.3454(a)-1
19. §31.3454(b)-1
20. §31.3454(c)-1
21. §31.3455(b)-1
22. §31.3456(b)-1
23. §31.3456(c)-1
24. §31.3456(d)-1
25. §31.6011(a)-10
26. §31.6071(a)-2
27. §31.6302(c)-5
28. §31.7512-1

This Treasury decision removes the regulations issued to conform to statutory provisions that have been repealed. For this reason, it is found impracticable and unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, Jr.,
Commissioner of Internal Revenue.

Approved March 30, 1984.

JOHN E. CHAPOTON,
Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on March 30, 1984, 3:59 p.m., and published in the issue of the Federal Register for April 3, 1984, 49 F.R. 13143)

Section 3452.—Exemptions from Withholding

26 CFR 31.3452(a)-1: Exemptions from withholding.

Exemptions from the withholding of tax on payments of interest, dividends, and patronage dividends. See T.D. 7949, page 204.

Section 3454.—Definitions of Interest, Dividend, and Patronage Dividend

26 CFR 31.3454(a)-1: Definition of interest.

Definitions of interest, dividends, and patronage dividends for purposes of the withholding of income tax at source. See T.D. 7949, page 204.

Chapter 25.—General Provisions Relating to Employment Taxes

Section 3504.—Acts to be Performed by Agents

26 CFR 31.3504-1: Acts to be performed by agents.

Requirements for filing Form 941 on magnetic tape by reporting agents. See Rev. Proc. 84-11, page 414.

Subtitle D.—Miscellaneous Excise Taxes
Chapter 31.—Retail Excise Taxes
Subchapter A.—Special Fuels

Section 4041.—Imposition of Tax

26 CFR 48.4041-11: Sales to states or political subdivisions thereof.
(Also Sections 4221, 4253, 4483; 48.4221-5.)

Local humane society; state and local government exemptions. A local human society which, under state law, is authorized to appoint agents with law enforcement powers and is under contract with the county to provide animal shelter and quarantine kennels, qualifies for state and local government exemptions. Rev. Rul. 57-170 modified and superseded.

Rev. Rul. 84-7

ISSUE

Does the local humane society described below qualify for the exemptions from federal excise taxes provided for state and local governments?

FACTS

X is a nonprofit corporation organized under a state law that allows citizens in each county to establish humane societies for the prevention of cruelty to animals. This law authorizes *X* to appoint agents who have law enforcement powers, including the power to investigate and arrest

persons suspected of violating the state's anti-cruelty statutes. The appointment of these agents, however, must be approved by the county government, which also pays part of the agents' salaries. The state's anti-cruelty laws can also be enforced by any police or sheriff's officer.

X is also under contract with the county to provide an animal shelter for sick and abandoned animals and to provide quarantine kennels for animals suspected of having rabies. *X*'s animal ambulances patrol the county and pick up strays and rescue animals in distress. When necessary animals are painlessly put to death.

X also sponsors a humane education program and lobbies for additional animal protection legislation. These functions are merely incidental to *X*'s other responsibilities and form only a minor part of *X*'s total activities.

LAW AND ANALYSIS

Section 4041(g)(2) of the Internal Revenue Code exempts from the taxes on diesel and special fuels imposed by section 4041 sales for the exclusive use of any state, political subdivision of a state, or the District of Columbia. Comparable exemptions from the manufacturers excise taxes, the tax on communications, and the highway use tax are provided by sections 4221(a)(4), 4253(i) and 4483(a), respectively.

In determining whether a sale to, or use by, an organization is for the exclusive use of a state or local government, it must be established that the organization is either (a) controlled, directly or indirectly, by an agency of a state or local government, or (b) is performing a traditional governmental function on a nonprofit basis.

Ordinarily an organization will not be considered to be performing a traditional governmental function for purposes of the exemption unless it is performing an essential governmental function that state or local governments generally have performed directly and that would have to be carried on by the state or local government if the organization did not exist. The term traditional governmental function does not include activities of an organization merely because they are of the type that could appropriately be carried on by a state or local government if it chose to do so, or merely because they supplement existing government activities. The separate exemptions provided for hospitals (section 4253(h)) and schools (section 4041(g)(4), 4221(a)(5), and 4253(j)) make clear that the state and local government exemptions were not intended to apply to every organization that performs an important social or charitable function that is also sometimes performed by the government. Rev. Rul. 82-30, 1982-1 C.B. 165; Rev. Rul. 82-31, 1982-1 C.B. 166. Where the organization performs functions which are not traditional governmental functions, but that are merely incidental to its traditional governmental functions and form only an insubstantial part of its total activities (which otherwise are traditional governmental functions), the organization will be classified overall as one performing traditional governmental functions.

The humane society in the instant case is authorized by state law to appoint agents who have law enforcement powers, including the power to investigate and arrest persons suspected of violating the state's anti-cruelty laws. The society also provides quarantine kennels for animals suspected of having rabies. This facet of the society's program shields the public from the ravages of rabid animals and thus protects the public health. Both these activities come well within the definition of traditional governmental functions.

Moreover, it has long been recognized that the state has preeminent authority over unclaimed animals. The removal of stray domestic animals from the public streets and their ultimate disposal is a necessary governmental function, traditionally performed or arranged for by municipalities in the interest of humane treatment of the animals and of public health and safety.

Thus, the humane society described above is performing a traditional governmental function as that term is defined in Rev. Rul. 82-30.

Rev. Rul. 57-170, 1957-1 C.B. 411, held that certain humane societies organized under state laws like those described above, were exempt from certain excise taxes because they were instrumentalities of a political subdivision of a state. The societies clearly were not municipal corporations and could be considered to be instrumentalities of political subdivisions only if they were formed to achieve a recognized public purpose and had been delegated the right to exercise part of the sovereign power of a state. The society in question is clearly not a municipal corporation and it has not been delegated, in whole or in part, the right to exercise the sovereign power of a state. Sovereign power is recognized as encompassing the powers of eminent domain, taxation and the police power. The society has not been delegated the power to tax or the power of eminent domain. In addition, the society has not been delegated police power. Only the agents of the humane society who are appointed under state statute can prosecute persons committing acts of cruelty to animals. Although these agents are appointed by the humane society, the appointments must be approved by the city or county where the agents reside and such agents are paid by these governmental units. Thus, the agents receive their police power from the city or county rather than from the society. Thus, Rev. Rul. 57-170 was incorrect in concluding that such a society was an instrumentality of a political subdivision of a state.

HOLDING

The local humane society described above qualifies for the exemptions from federal excise taxes provided for state and local governments because it performs a traditional governmental function, and sales to it are thus for the exclusive use of the local government.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 57-170, 1957-1 C.B. 411, holds that a substantially similar organization is entitled to the excise tax exemptions under former sections 4055, 4224, and 4292 of the Code. Under this revenue ruling the organization described in Rev. Rul. 57-170 would also be entitled to the tax exemptions presently provided in sections 4041(g)(2), 4221(a)(4), 4253(i) and 4483(a).

Rev. Rul. 57-170 is modified and superseded.

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26 CFR 48.4041-11: Sales to States or political subdivisions thereof.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

Section 4042.—Tax on Fuel Used in Commercial Transportation on Inland Waterways

26 CFR 48.4042-1: Tax on fuel used in commercial waterway transportation.

Commercial waterway transportation; specified waterway; Gulf Intracoastal Waterway (G.I.W.W.). The Houston Ship Channel is not considered part of the G.I.W.W. for purposes of section 4042 of the Code.

Rev. Rul. 84-8

ISSUE

For purposes of the tax imposed by section 4042 of the Internal Revenue Code on fuel used in commercial transportation on inland waterways, is the Houston Ship Channel a part of the Gulf Intracoastal Waterway (G.I.W.W.) as that term is used in section 48.4042-1(g)(11) of the Manufacturers and Retailers Excise Tax Regulations?

FACTS

The Houston Ship Channel is a 40 foot deep waterway, 40 miles long, that connects the City of Houston, Texas, with the Gulf of Mexico. A few miles from the channel's termination into the Gulf of Mexico, it intersects the G.I.W.W., which runs parallel to the Gulf coast. The channel is utilized by both deep draft and commercial shallow draft vessels.

LAW AND ANALYSIS

Section 4042(a) of the Code imposes a tax on any liquid used during any calendar quarter by any person as a fuel in a vessel in commercial waterway transportation.

Section 4042(d)(1) of the Code defines "commercial waterway transportation" as any use of a vessel on any inland or intracoastal waterway of the United States (A) in the business of transporting property for compensation or hire, or (B) in transporting property in the business of the owner, lessee, or operator of the vessel (other than fish or other aquatic life caught on the voyage.)

Section 4042(d)(2) of the Code defines "inland or intracoastal waterway of the United States" as any inland or intracoastal waterway of the United States which is described in section 206 of the Inland Waterways Revenue Act of 1978, Pub. L. 95-502, 1978-2 C.B. 393, 394.

The waterways described in that section of the Act are enumerated in section 48.4042-1(g) of the regulations, which states that only fuel used on those waterways specified in that section is taxable. Section 48.4042-1(g)(11) lists the G.I.W.W. as a specified waterway and provides that such waterway includes its entire length from the mouth of St. Mark's River, Florida, to Brownsville, Texas, a distance of 1134.5 miles. For vessels traveling along the G.I.W.W., no matter how short the distance, the G.I.W.W. includes the main channel, all alternate channels, and all adjoining bays and sounds, regardless of depth. However, vessels merely crossing the G.I.W.W. on route either to a coastal port or to a nonspecified waterway will not be treated as traveling on the G.I.W.W.

Section 206 of the Inland Waterways Revenue Act of 1978 describes only the main G.I.W.W. as a "specified waterway" with no references to adjoining bodies of water. Section 48.4042-1(g)(11) of the regulations expands the definition of the G.I.W.W. to include bodies of water which can be used as alternate means of navigation by a vessel traveling along the G.I.W.W. This was done to tax the fuel consumed in such vessel during transportation along the G.I.W.W. itself and also where the vessel leaves the main G.I.W.W. to use an alternate body of water to get to the same destination. A channel which merely crosses the G.I.W.W., and which could not be used as an alternate waterway by those vessels traveling along the G.I.W.W., was not intended to fall within the regulatory definition of the G.I.W.W.

HOLDING

For purposes of section 4042 of the Code, the Houston Ship Channel is not considered part of the Gulf Intracoastal Waterway.

Chapter 32.—Manufacturers Excise Taxes
Subchapter A.—Automotive and Related Items
Part I.—Motor Vehicles

Section 4061.—Imposition of Tax

26 CFR 145.1-1: Extension of time for filing excise tax returns and for paying taxes included on such returns for second and fourth quarters of 1965.

T. D. 7930

TITLE 26—INTERNAL REVENUE—CHAPTER 1, SUBCHAPTER D, PART 145—TEMPORARY EXCISE TAX REGLATIONS UNDER THE HIGHWAY REVENUE ACT OF 1982 (TITLE V OF THE SURFACE TRANSPORTATION ASSISTANCE ACT OF 1982).

Floor Stocks Tax and Floor Stocks Refunds on Unused Tires, Inner Tubes, and Tread Rubber Held for Sale on January 1, 1984.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations with respect to the floor stocks tax and floor stocks refunds on unused tires, inner tubes and tread rubber, held for sale on the first moment of January 1, 1984. Changes to the applicable tax law were made by the Highway Revenue Act of 1982 [Pub. L. 97-424, 1983-1 C.B. 405]. These regulations will affect dealers who hold unused tires, inner tubes, and tread rubber for sale on January 1, 1984, and will provide them with the guidance needed to comply with the law.

DATE: These temporary regulations apply to tires, inner tubes, and tread rubber which are unused and held for sale on the first moment of January 1, 1984.

FOR FURTHER INFORMATION CONTACT: Neil W. Zyskind of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, N.W. Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3287),(not a toll free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to the floor stocks tax and refunds on unused tires, inner tubes, and tread rubber held for sale on the first moment of January 1, 1984, which are imposed by sections 521(b), 522 and 523 of the Highway Revenue Act of 1982 (Pub. L. 97-424, 96 Stat. 2184, 2185, and 2186) [1983-1 C.B. 405, 413, 414]. The temporary regulations provided by this document will remain in effect unless superseded by final regulations on this subject.

FLOOR STOCKS REFUNDS

The temporary regulations revise T.D. 7882 (48 FR 14361) [1983-1 C.B. 274] with respect to its implementation of sections 522 and 523 of the Highway Revenue Act of 1982, relating to floor stocks refunds or credits in the case of tax-repealed tires, inner tubes, and tread rubber which are unused and held for sale by a dealer on January 1, 1984. New paragraphs (b)(3) and (b)(4) are added to §145.1-7 to clarify the term "dealer" for purposes of the floor stocks refunds or credits. In addition, a new §145.1-7(c) has been added to allow taxpayers entitled to floor stocks refunds as of January 1, 1984, for tires, inner tubes, or tread rubber, an automatic extension of time for filing the fourth quarter 1983 Form 720. This will enable taxpayers entitled to floor stocks refunds additional time to claim a credit on their fourth quarter 1983 Form 720. There are no floor stocks credits or refunds for those highway tires on which the tax was reduced, but not repealed, effective January 1, 1984

FLOOR STOCKS TAX

The regulations explain the application of the floor stocks tax imposed by section 521(b) of the Highway Revenue Act of 1982 to highway tires which are unused and held for sale on the first moment of January 1, 1984. Dealers are required to take an inventory of the unused highway tires they hold for sale on the first moment of January 1, 1984, and to keep records of the inventory. Under the regulations, the floor stocks tax must be paid by February 16, 1984. A return of the tax must be filed on Form 720. In the case of dealers not otherwise required to file Form 720, the due date for the return is February 16, 1984. Dealers not otherwise required to file Form 720 should mark "FINAL" on their Form 720. In the case of all other dealers, the due date for filing is the date prescribed by the instructions on the Form 720 for the quarter ending March 31, 1984. Section 145.4-2(c) defines the term "dealer."

NEED FOR TEMPORARY REGULATIONS

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

SPECIAL ANALYSIS

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule. The Commissioner of Internal Revenue has determined that these temporary regulations are not subject to Executive Order 12291.

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these regulations is Neil W. Zyskind of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 145 is amended as follows:

Paragraph 1. Section 145.1-7 is amended as follows:

(a) Paragraphs (a) and (b)(2) are revised by inserting "or (b)" after the phrase "section 4071(a)" each time it appears.

(b) New paragraphs (b)(3) and (b)(4) are added immediately following paragraph (b)(2) to read as set forth below.

(c) Paragraph (c) is redesignated as paragraph (d) and a new paragraph (c) is inserted immediately following paragraph (b)(4) to read as set forth below.

§145.1-7 Credit or refund in respect of floor stocks of tires, inner tubes, and tread rubber.

* * * * *

(b) *Definitions*— ***

(3) *Dealer.* For purposes of this section, the term "dealer" includes—

(i) A wholesaler, jobber, distributor, or retailer of tires, inner tubes, or tread rubber, including a manufacturer's retail outlet under §48.4071-3;

(ii) A manufacturer, producer, or importer (manufacturer) who holds tires, inner tubes, or tread rubber for sale on, or in connection with, other articles manufactured, produced, or imported by the manufacturer; or

(iii) A wholesaler, jobber, distributor, or retailer (retailer) of vehicles who holds tires, inner tubes, or tread rubber for sale on, or in connection with, other articles sold by the retailer.

(4) *Examples.* The application of paragraphs (b)(3)(i) through (iii) of this section may be illustrated by the following examples:

Example (1). X, a manufacturer of vehicles, has in inventory on January 1, 1984, tax-paid highway tires to be placed on vehicles to be held for sale, as well as tax-paid highway tires which have already been placed on vehicles held for sale. Under paragraph (b)(3) of this section, X is considered a dealer with respect to both groups of tires.

Example (2). Y, a retailer of vehicles, has in inventory on January 1, 1984, tax-paid highway tires held for sale, as well as tax-paid highway tires which have already been placed on vehicles (including demonstrator vehicles) held for sale. Under these circumstances, both groups of tires will be considered as held by a dealer.

Example (3). Z, a manufacturer of tires, has in inventory on January 1, 1984, retreaded tires, for which tax was paid on the tread rubber, and tax-paid tread rubber. Under these circumstances, Z will be eligible for a floor stocks refund for the tread rubber but not for the tread rubber on the retreaded tires since the tread rubber lost its identity when placed on the retreaded tires. See §48.4072-1(b).

(c) *Automatic extensions of time for filing returns and paying tax in certain cases.* Notwithstanding the provisions of any other regulation, each person required to make a return for the calendar quarter ending December 31, 1983, of a tax imposed by section 4071(a) or (b) (relating to tires, inner tubes, or tread rubber), who is also entitled to floor stocks refunds as of January 1, 1984, for tires, inner tubes, or tread rubber, is granted an extension of time to March 31, 1984, for filing the excise tax return on Form 720 for all taxes reportable on such Form for such quarter.

* * * * *

Par. 2. There is inserted in the appropriate place the following new sections:

§145.4-1 Scope of floor stocks tax on tires.

A floor stocks tax under section 521(b) of the Highway Revenue Act of 1982 (Pub. L. 97-424, 96 Stat. 2184) is imposed on certain tax-paid highway tires which are unused, held by a dealer, and intended for sale by such dealer on the first moment of January 1, 1984. A tire will be regarded as held by a dealer if title to the tire is held by the dealer on the first moment of January 1, 1984 (whether or not delivery has been made), and if, for purposes of consumption by any person other than a dealer, possession or right to possession thereof has not at any time been transferred prior to the first moment of January 1, 1984. The determination as to who holds title or the time possession or right to possession is obtained for purposes of consumption shall be made under applicable local law. A tire will be regarded as held by a manufacturer's retail outlet upon delivery to such outlet within the meaning of §48.4071-3(c). The floor stocks tax on tires does not apply to tires held by any person for the person's own use rather than for sale.

§145.4-2 Application of the floor stocks tax on tires.

(a) *Highway tires.* The floor stocks tax applies to tires weighing more than 81 pounds 7 ounces which are of the type used on vehicles that are highway vehicles (within the meaning of §48.4061(a)-1(d)), including trucks, trailers, semitrailers, or highway tractors.

(b) *Rate of tax.* The floor stocks tax on tires is computed as follows:

(1) For tires weighing more than 81 pounds 7 ounces and less than 82 pounds, the floor stocks tax is .375 cents plus 1.27 cents for each ounce in excess of 81 pounds 8 ounces;

(2) For tires weighing 82 pounds or more and less than 90 pounds 1 ounce, the floor stocks tax is 10.5 cents plus 20.25 cents per pound in excess of 82 pounds; and

(3) For tires weighing more than 90 pounds, the floor stocks tax is $1.725 plus 40.25 cents per pound in excess of 90 pounds.

The floor stocks tax on tires is computed by applying to the total weight (including a fractional part of a pound) of the tire the rates specified in this paragraph (b). See §48.4071-2 for rules on determining the weight of a tire.

(c) *Definition of dealer.* For purposes of §§145.4-1 through 145.4-4, the term "dealer" includes—

(1) A wholesaler, jobber, distributor, or retailer of highway tires, including a manufacturer's retail outlet under §48.4071-3;

(2) A manufacturer, producer, or importer (manufacturer) who holds highway tires for sale on, or in connection with, other articles manufactured, produced, or imported by the manufacturer; or

(3) A wholesaler, jobber, distributor, or retailer (retailer) of vehicles who holds highway tires for sale on, or in connection with, other articles sold by the retailer.

See examples (1) and (2) of §145.1-7(b)(4).

§145.4-3 Inventory.

Every dealer liable for the floor stocks tax on tires shall prepare an inventory of unused highway tires held for sale on the first moment of January 1, 1984. A dealer holding tires subject to the tax at more than one location shall prepare a separate inventory statement, in duplicate, for each location. One copy of the separate inventory shall be retained at each location and one copy shall be kept at the principal place of business of the dealer. Each inventory shall show—

(a) The name and taxpayer identification number of the dealer;

(b) The location of the particular

premises for which the inventory is made;

(c) The address shown on the dealer's Form 720;

(d) The total number of tires of each type, size, grade, classification, and trade name held at the particular location that are subject to the floor stocks tax on tires; and

(e) The weight of the tires described in §145.4-3(d). See §48.4071-2 for rules relating to determining the weight of tires.

The inventory statements shall not be filed with the return required in §145.4-4 but shall be retained by the taxpayer.

§145.4-4 Requirements with respect to the return and payment of the tax.

(a) *Form.* Every dealer liable for the floor stocks tax on tires shall make a return of the tax on Form 720.

(b) *Time and place for filing return.* The return shall be filed with the Service Center indicated by the instructions for the Form 720. In the case of dealers not otherwise required to file Form 720, the return must be filed on or before February 16, 1984, and must be marked "FINAL." In the case of all other dealers, the return must be filed on or before the date prescribed by the instructions for the Form 720 for the quarter ending March 31, 1984. For provisions relating to timely mailing treated as timely filing and paying, see section 7502. For provisions relating to additions to the tax in case of failure to file a return within the prescribed time, see section 6651 and §301.6651-1.

(c) *Time and place for paying tax.* The tax is due and payable without assessment or notice on or before February 16, 1984. If a dealer is not required to make a deposit of any tax under chapter 31 or chapter 32 of the Code using a Federal Tax Deposit Coupon for the quarter ending March 31, 1984, the dealer shall pay the tax by check or money order. The dealer must write the dealer's taxpayer identification number and "Form 720, Floor Stocks Tax on Tires, IRS No. 57" on the check or money order. The check or money order must be sent, together with the Form 720, to the Service Center described in paragraph (b) of this section. All other dealers shall pay the tax by making a deposit of the tax, together with a Federal Tax Deposit Coupon on or before February 16, 1984, at an authorized depositary or the Federal Reserve Bank serving the dealer's area. See the applicable sections of Part 301 of this chapter (Regulations on Procedure and Administration) for provisions relating to interest on underpayments, additions to tax, and penalties.

§145.4-5 Credit or refund.

Any person who has paid a floor stocks tax on tires may be entitled, subject to the provisions of section 6416 and §301.6402-2, to a credit or refund of the tax for any of the reasons specified in section 6416. Claims for refund under section 6416 are to be filed on Form 843. Any person entitled to claim a refund of tax under this section may, in lieu of claiming a refund, claim a credit for the tax on any return of tax under chapter 31 or 32 of the Code that the person subsequently files.

§145.4-6 Records.

(a) *Inventories.* Every person liable for the floor stocks tax on highway tires shall maintain records of the separate inventories required by §145.4-3.

(b) *Copies of returns and other relevant papers and material.* Every person liable for the floor stocks tax on highway tires shall keep a duplicate copy of the return, together with other relevant papers and material.

(c) *Records of claimants.* Any person claiming a refund or credit of the floor stocks tax on highway tires shall keep a complete and detailed record with respect to the claim.

(d) *Place and period for keeping records.* All records required by this section shall be kept, by the person required to keep them, at a convenient and safe location within the United States that is accessible to internal revenue officers. The records shall at all times be available for inspection by such officers. If the person has a principal place of business in the United States, the records shall be kept at that place of business. Records required by paragraphs (a) and (b) of this section shall be maintained for a period of at least 3 years after the date the tax becomes due or the date the tax is paid, whichever is later. Records required by paragraph (c) of this section (including any record required by paragraph (a) or (b) that relates to a claim) shall be maintained for a period of at least 3 years after the claim is filed.

This Treasury decision is issued under the authority contained in sections 521, 522, and 523 of the Highway Revenue Act of 1982 (96 Stat. 2184, 2185, and 2186) and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

Approved by the Office of Management and Budget under control number 1545-0804.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 20, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 21, 1983; 3:55 p.m., and published in the issue of the Federal Register for December 23, 1983, 48 F.R. 56749)

Subchapter D.—Recreational Equipment
Part I.—Sporting Goods

Section 4161.—Imposition of Tax

26 CFR 48.4161(a)-2: Artificial lures, baits, and flies.
(Also Section 7805; 301.7805-1.)

Lures; jig. A jig, consisting of a cadmium plated hook with an integral lead weight, designed to be used with artificial worms and grubs, is an artificial lure the sales of which are subject to the manufacturers excise tax imposed by section 4161(a) of the Code. Rev. Rul. 76-169 revoked.

Rev. Rul. 84-57

FACTS

The Internal Revenue Service has reconsidered Rev. Rul 76-169, 1976-1 C.B. 342, which holds that a jig, described as a cadmium plated hook with an integral lead weight, is not an artificial lure within the meaning of section 4161(a) of the Internal Revenue Code.

LAW AND ANALYSIS

Section 4161(a) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of fishing rods, creels, reels, and artificial lures, baits and flies (including parts or accessories of such articles sold on or in connection therewith, or with the sale thereof).

Secition 48.4161(a)-2(d) of the Manufacturers and Retailers Excise Tax Regulations defines the term "artificial lures, baits, and flies" to include all artifacts, of whatever materials made, that simulate an article considered edible to fish, and that are designed to be attached to a line or hook to attract fish so that they may be captured. Thus, the term includes such artifacts as imitation flies, blades, spoons, spinners, etc., and edible materials that have been processed so as to resemble a different edible article considered more attractive to fish, such as bread crumbs treated so as to simulate salmon eggs, and pork rind cut and dyed to resemble frogs, eels or tadpoles.

Rev. Rul. 76-169 holds that a jig, described as a cadmium plated hook with an integral lead weight, is not an artificial lure because it does not attract fish; the artificial worms and grubs used with the jig attract the fish.

In *Herring Magic v. United States*, 258 F 2d 197 (9th Cir. 1958), the court held that a fishing device called Herring Magic was an artificial lure. The device consisted of a piece of odorless, colorless plastic with hooks attached. It was designed to be used with the head and body of a dead minnow or herring, which had to be fastened inside the device. It was not functional without the attached bait. When the device was trolled through the water with the attached dead fish, it produced a swimming action claimed to be identical to that of a live fish.

In *Hine v. United States*, 113 F. Supp. 340 (Ct. Cl. 1953) the court held that kits containing materials from which a fishing rod might be assembled were "fishing rods", the sales of which were subject to the manufacturers excise tax, even though the purchaser was required to provide and install certain items not contained in the kit. The court held that "having reached the stage of manufacture or development where they became recognizable as one of the sporting goods described in. .(the Code) the rods upon being sold were subject to tax even though there remained one or more finishing operations to be performed." 133 F. Supp. at 343. The court used the words "fishing rods" in the ordinary and usual sense, and found that the items sold by the taxpayer would be known as "fishing rods" by the majority of people. Furthermore, the items had no practical use other than as fishing rods.

The article described in Rev. Rul. 76-169 is a lead head jig and simply requires the addition of an artificial worm or grub or feathers or hair to use it to catch a fish. Like the kit in *Hine*, or the *Herring Magic* device, the bare jig has reached the stage of manufacture where it is recognizable as an artificial lure even though one or more finishing operations (addition of artificial worms or grubs) remains to be performed. The bare jig has no practical use other than as an artificial lure. Although the bare jig may look like a hook, it is not sold as a hook, nor is it intended to be used as a hook. It is designed and marketed as an artificial lure.

HOLDING

The jig described in Rev. Rul. 76-169 is an artificial lure, the sales of which are subject to the manufacturers excise tax imposed by section 4161(a) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-169 is revoked.

PROSPECTIVE APPLICATION

Under the authority granted by section 7805(b) of the Code, this revenue ruling is effective with respect to sales made by the manufacturer on or after July 1, 1984.

Subchapter G.—Exemptions, Registrations, etc.

Section 4221.—Certain Tax-Free Sales

26 CFR 48.4221-5: Tax-free sales of articles to State and local governments for their exclusive use.

Whether a local humane society qualifies for exemption from the manufacturers excise taxes. See Rev. Rul. 84-7, page 205.

26 CFR 48.4221-5: Tax-free sale of articles to State and local governments for their exclusive use.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

Chapter 33.—Facilities and Services
Subchapter B.—Communications

Section 4253.—Exemptions

Whether a local humane society qualifies for exemption from the communications taxes. See Rev. Rul. 84-7, page 205.

26 CFR 49.4253-12: Cross reference.

Certain revenue rulings suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

Subchapter C.—Transportation by Air
Part I.—Persons

Section 4261.—Imposition of Tax

26 CFR 49.4261-2: Application of tax.

Taxability of airline bonus tickets. Free bonus tickets issued to airline company customers who have satisfied all requirements to qualify for the bonus tickets are not subject to the tax imposed by section 4261(a) of the Code. Tax will apply to

amounts paid by customers for advance bonus tickets where such customers have traveled insufficient mileage to fully qualify for the free advance bonus tickets.

Rev. Rul. 84-12

ISSUE

Does the tax imposed by section 4261(a) of the Internal Revenue Code on amounts paid for the taxable transportation of persons by air apply in the case of free bonus tickets issued by an airline company to its customers?

FACTS

X is an airline company engaged in the business of providing air transportation for persons within the United States. *X* has instituted a travel program for frequent travelers through which those travelers who amass sufficient mileage on the company's route system over a specified period of time become entitled to a free round-trip ticket on *X*'s system. A traveler who enrolls prior to a certain date in *X*'s program is entitled, without prior accrual of any mileage, to a "free" bonus round-trip ticket on *X*'s route system. The traveler must then accumulate a requisite amount of mileage on *X*'s system by a specified date. If the enrollee does not accrue the requisite mileage he or she is then billed by *X* for the bonus ticket. The amount billed will vary depending on the amount of mileage accrued.

LAW AND ANALYSIS

Section 4261(a) of the Code imposes upon the amount paid for taxable air transportation of any person a tax equal to 8 percent of the amount so paid.

Section 4262(a) of the Code defines "taxable transportation" as (1) transportation by air which begins in the United States or in the 225-mile zone (that portion of Canada and Mexico which is not more than 225 miles from the nearest point in the continental United States) and ends in the United States or in the 225-mile zone, and (2) in the case of transportation other than transportation described in (1), that portion of such transportation which is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if such portion is not a part of uninterrupted international transportation.

Section 49.4261-2(a) of the Facilities and Services Excise Tax Regulations provides that the tax is measured by the total amount paid.

Revenue Ruling 54-332, 1954-2 C.B. 417, holds that where a telephone company furnishes telephone service to certain employees free of charge, no communications excise tax attaches. Where telephone service is furnished to employees at a reduced rate, the tax applies to the amount actually paid for such service.

Rev. Rul. 72-245, 1972-1 C.B. 347, holds that where an airline furnishes an employee the use of its international air travel facilities entirely free of charge, the $3 tax imposed by section 4261(c) of the Code does not apply, since there is no "amount paid" for transportation, within the meaning of 4261(c).

For purposes of section 4261(a) of the Code, the amount subject to tax is the actual amount paid for taxable air transportation. Where no amount is paid, the tax does not apply. Where payment is made at a reduced rate, to that extent it is an amount paid for air transportation that is subject to the section 4261(a) tax.

HOLDING

The tax imposed by section 4261(a) of the Code does not apply in the case of free bonus tickets issued by an airline company to customers who have already satisfied all requirements to qualify for the bonus. In the case of an advance bonus ticket issued to a customer this tax also will not apply at the time such bonus ticket is used. However, this tax will apply to any amount that a customer subsequently pays in respect of an advance bonus ticket because of traveling insufficient mileage to fully qualify for the free advance bonus ticket.

Chapter 36.—Certain Other Excise Taxes
Subchapter D.—Tax on Use of Certain Vehicles

Section 4483.—Exemptions

Whether a local humane society qualifies for exemption from the highway use tax. See Rev. Rul. 84-7, page 205.

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26 CFR 41.4483-1: State and local governmental exemption.

Certain revenue ruling suspended as to their respective applications to Indian tribes, or subdivisions thereof. See Rev. Rul. 84-93, page 279.

Chapter 42.—Private Foundations; Black Lung Benefit Trusts
Subchapter A.—Private Foundations

Section 4941.—Taxes on Self-Dealing

26 CFR 53.4941(d)-2: Specific acts of self-dealing.

Limited exception to the self-dealing rule for leases of office space by a disqualified person to a private foundation. See T.D. 7938, below.

Section 4942.—Taxes on Failure to Distribute Income

26 CFR 53.4942(a)-3: Qualifying distributions defined.
(Also Section 4941; 53.4941(d)-2.)

T.D. 7938

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Set-aside made by private foundations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to set-asides made by private foundations. Changes to the applicable tax law were made by Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. This document also provides final regulations relating to certain leasing arrangements that are excepted from the self-dealing rules

generally applicable to transactions between private foundations and disqualified persons. Changes to the applicable tax law were made by section 5 of the Act of December 28, 1980 (Pub. L. 96-608, 94 Stat. 3553) [1980-2 C.B. 728, 729]. The regulations provide necessary guidance to foundation managers and disqualified persons for compliance with these Acts, and affect private foundations that make set-asides and certain disqualified persons leasing office space to private foundations.

DATES: The regulations relating to set-asides are generally effective for taxable years beginning after December 31, 1974. The regulations relating to certain leasing arrangements excepted from the self-dealing rules are effective for taxable years beginning after December 31, 1979.

FOR FURTHER INFORMATION CONTACT: George Baker of the Employee Plans and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:EE-156-78 (202-566-3422).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 26, 1980, the Federal Register published proposed amendments to the Regulations on Foundation and Similar Excise Taxes (26 CFR Part 53) under section 4942(g)(2) of the Internal Revenue Code of 1954 (45 FR 56840). The amendments were proposed to conform the regulations to section 1302(a) of the Tax Reform Act of 1976 (90 Stat. 1713) [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 189]. No public hearing was requested or held. After consideration of the comments received in response to the notice of proposed rulemaking, the amendments are adopted, as revised, by this Treasury decision.

EXPLANATION OF PROVISIONS

SET-ASIDES; IN GENERAL

Section 4942(a) imposes an excise tax on private foundations for failure to distribute income for charitable purposes. To avoid liability, a private foundation must make "qualifying distributions" each year equal to the foundation's "distributable amount." An amount "set aside" in one year for a specific project, but actually paid out in future years, may be treated as a qualifying distribution if the requirements of section 4942(g)(2) are satisfied.

OLD LAW

Under section 4942(g)(2) as it existed prior to the Tax Reform Act of 1976 and §53.4942(a)-3(b) of the regulations, a set-aside was treated as a qualifying distribution if it was approved in advance by the Commissioner of Internal Revenue. To obtain such approval, section 4942(g)(2) required a private foundation to (1) establish that the amount set aside would be paid for the specific project within five years, and (2) establish the "suitability" of the set-aside to achieve the goals of the specific project.

NEW LAW

As amended by section 1302 of the Tax Reform Act of 1976, section 4942(g)(2) now provides an alternative means of treating a set-aside as a qualifying distribution under which a private foundation must distribute minimum amounts of cash or its equivalent during specific "test" years.

FINAL REGULATIONS

APPROVAL REQUIREMENTS

The regulations, as proposed, provided that a set-aside made by a private foundation must be approved in advance by the Commissioner, regardless of whether the set-aside is made under the "suitability test" or the "cash distribution test." Three comments objected to the requirement that a set-aside made under the cash distribution test be approved in advance by the Commissioner. The commentators urged that the cash distribution test was intended by Congress to permit a private foundation to make set-asides without obtaining prior Service approval. See S. Rep. No. 94-938, 94th Cong., 2d Sess. 594 (1976) [1976-3 C.B. (Vol. 3) 49, 632]; H.R. Rep. No. 94-1515, 94th Cong., 2d Sess. 522 (1976).

In response to these comments, the final regulations do not require a private foundation to obtain prior Service approval for a set-aside made under the cash distribution test. Rather, the regulations require a foundation to supply certain information regarding a set-aside made under the cash distribution test with the foundation's annual information return for the taxable year in which the set-aside is made and for certain subsequent taxable years. The regulations provide that the submission of this information will satisfy the requirement of section 4942(g)(2)(B) that a foundation establish to the satisfaction of the Commissioner that the amount set aside will be paid within 5 years. This information requirement is made effective for taxable years ending after April 2, 1984.

DEFINITION OF START-UP PERIOD

Under the cash distribution test, a private foundation must distribute certain minimum amounts of cash during an initial "start-up period." The proposed regulations generally defined a foundation's start-up period as the four taxable years following the taxable year in which the foundation was "created." One commentator noted that many foundations are technically "created" long before they receive funds and become subject to the distribution requirements of section 4942. For example, it is not an uncommon practice to establish (or create) a foundation during an individual's lifetime and fund it under that individual's will. To ensure that such foundations are not precluded from using the cash distribution test to qualify set-asides, the

final regulations provide that, for purposes of determining a foundation's start-up period, a foundation will b econsidered "created" in the taxable year in which the foundation's distributable amount first exceeds $500.

FAILURES TO DISTRIBUTE REQUIRED AMOUNTS

The proposed regulations provided that a private foundation would incur substantial penalties if it failed to make a distribution required in connection with a set-aside made under the cash distribution test. These penalties provided that (1) any set-asides previously made by the foundation that were not approved under the suitability test would not be treated as qualifying distributions and (2) any set-asides made by the foundation subsequent to the failure to distribute would be treated as qualifying distributions only if the set-asides were approved under the suitability test. Two commentators objected to the first penalty as being unclear and unduly punitive. Accordingly, the final regulations clarify this provision and limit its application.

The proposed regulations also provided an exception from the penalty provisions if a foundation's failure to distribute the full-payment period minimum amount during a taxable year of the full-payment period was not willful and was due to reasonable cause. In this regard, the regulations provided that a "willful failure to distribute" does not occur if a foundation cannot determine the full-payment period minimum amount for a taxable year in the full-payment period until after the end of that year and the foundation makes the required distribution within a reasonable time after the end of the year. One commentator advocated expanding this exception to include failures to distribute the start-up period minimum amount during the start-up period. Another commentator requested that the final regulations define the "reasonable time" in which a foundation may make the required distribution.

It is clear that under section 4942(g)(2)(C), the exception provided for certain failures to distribute applies only to a failure to distribute the full-payment period minimum amount. However, a valid question is raised whether a similar but more limited exception should apply to a failure to distribute the start-up period minimum amount. In the typical case, a new foundation will not be able to definitely determine its start-up period minimum amount until after the expiration of the fourth taxable year of the start-up period.

In response to these concerns, the final regulations provide a limited exception for certain failures to distribute the start-up period minimum amount during the start-up period. In addition, the final regulations provide that when the full-payment period minimum amount cannot be determined before the end of a taxable year in the full-payment period, no "willful failure to distribute" will occur if the foundation makes the required distribution within 5½ months after the end of the year.

CERTAIN LEASING ARRANGEMENTS

In general, the leasing of property between a disqualified person and a private foundation constitutes an act of self-dealing under section 4941(d)(1)(A). As added by section 5 of Pub. L. 96-608 [1980-2 C.B. 728, 729], section 4941(d)(2)(H) provides, subject to certain conditions, a limited exception to this rule for leases of office space by a disqualified person to a private foundation. The regulations amend §53.4941(d)-2 and §53.4941(d)-3 to reflect this new exception. Because the exception is of limited applicability, the amendments are adopted, without notice, as final regulations.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for interpretative regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply and no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal author of these regulations is Charles K. Kerby, III of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

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Adoption of amendments of the regulations

Accordingly, 26 CFR Part 53 is amended as follows:

Paragraph 1. Section 53.4941(d)-2(b) is amended by striking out "subparagraph (2)" from the first sentence of subparagraph (1), inserting in lieu thereof "subparagraphs (2) and (3)", and by adding a new subparagraph (3) to read as follows:

§53.4941(d)-2 Specific acts of self-dealing.

* * * * *

(b) *Leases.* ***

(3) *Certain leases of office space.* For taxable years beginning after December 31, 1979, the leasing of office space by a disqualified person to a private foundation shall not be an act of self-dealing if—

(i) The leased space is in a building in which there are other tenants who are not disqualified persons,

(ii) The lease is pursuant to a binding lease which was in effect on October 9, 1969, or pursuant to renewals of such a lease,

(iii) The execution of the lease was not a prohibited transaction (within the meaning of section 503(b) or the corresponding provisions of prior

law) at the time of such execution, and

(iv) The terms of the lease (or any renewal) reflect an arm's length transaction. A lease or renewal of such lease is described in this subparagraph (3) only if it satisfies the requirements of §53.4941(d)-4(c)(1) and (2), applied without regard to the December 31, 1979 deadline described therein.

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Par. 2. Section 53.4941(d)-3(a) is amended by revising the first two sentences thereof to read as follows:

§53.4941(d)-3 Exceptions to self-dealing.

(a) *General rule.* In general, a transaction described in section 4941(d)(2)(B), (C), (D), (E), (F), (G), or (H) is not an act of self-dealing. Section 4941(d)(2)(B), (C), and (H) provide limited exceptions to certain specific transactions, as described in paragraphs (b)(2), (b)(3), (c)(2), and (d)(3) of §53.4941(d)-2. ***

Par. 3. Section 53.4942(a)-3(b) is amended to read as follows:

§53.4942(a)-3 Qualifying distributions defined

* * * * *

(b) *Certain set-asides*—(1) *In general.* An amount set aside for a specific project that is for one or more of the purposes described in section 170(c)(1) or (2)(B) may be treated as a qualifying distribution in the year in which set aside (but not in the year in which actually paid), if the requirements of section 4942(g)(2) and this paragraph (b) are satisfied. The requirements of this paragraph (b) are satisfied if the private foundation establishes to the satisfaction of the Commissioner that the amount set aside will be paid for the specific project within 60 months after it is set aside, and

(i) The set-aside satisfies the suitability test described in subparagraph (2) of this paragraph, or

(ii) With respect to a set-aside made in a taxable year beginning after December 31, 1974, the private foundation satisfies the cash distribution test described in subparagraph (3) of this paragraph. If suitability test or cash distribution test is otherwise satisfied, the 60 month period for paying the amount set aside may, for good cause shown, be extended by the Commissioner.

(2) *Suitability test.* The suitability test is satisfied if the private foundation establishes to the satisfaction of the Commissioner that the specific project for which the amount is set aside is one that can be better accomplished by the set-aside than by the immediate payment of funds. Specific projects that can be better accomplished by the use of a set-aside include, but are not limited to, projects in which relatively long-term grants or expenditures must be made in order to assure the continuity of particular charitable projects or program-related investments (as defined in section 4944(c)) or where grants are made as part of a matching-grant program. Such projects include, for example, a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private foundation (such as a museum building in which paintings are to be hung), even though the exact location and architectural plans have not been finalized; a plan to purchase an additional group of paintings offered for sale only as a unit that requires an expenditure of more than one year's income; or a plan to fund a specific research program that is of such magnitude as to require an accumulation of funds before beginning the research, even though not all of the details of the program have been finalized.

(3) *Cash distribution test; in general.* The cash distribution test is satisfied if—

(i) The specific project for which the amount is set aside will not be completed before the end of the taxable year in which the set-aside is made,

(ii) The private foundation actually distributes, in cash or its equivalent and for one or more of the purposes described in section 170(c)(1) or (2)(B), the "start-up period minimum amount" described in subparagraph (4) of this paragraph during the private foundation's start-up period, and

(iii) The private foundation actually distributes, in cash or its equivalent and for one or more of the purposes described in section 170(c)(1) or (2)(B), the "full-payment period minimum amount" described in subparagraph (5) of this paragraph in each taxable year of the private foundation's full-payment period. For purposes of the cash distribution test, an amount set aside will be treated as distributed in the year in which actually paid and not in the year in which set aside.

(4) *Minimum distribution required during start-up period*—(i) *Start-up period.* For private foundations created before January 1, 1972, the start-up period is the four taxable years immediately preceding the taxable year beginning in calendar year 1976. For private foundations created after December 31, 1971 (or for organizations that first become private foundations after that date), the start-up period is the four taxable years following the taxable year in which the private foundation was created (or otherwise became a private foundation). For purposes of this subparagraph (4), a private foundation will be considered "created" in the taxable year in which the private foundation's distributable amount (as determined under section 4942(d)) first exceeds $500.

(ii) *Start-up period minimum amount.* The amount that a private foundation must actually distribute in cash or its equivalent during the private foundation's start-up period is not less than the sum of—

(*a*) Twenty percent of the private foundation's distributable amount (as determined under section 4942(d)) for the first taxable year of the start-up period,

(*b*) Forty percent of the private foundation's distributable amount for the second taxable year of the start-up period,

(*c*) Sixty percent of the private foundation's distributable amount

for the third taxable year of the start-up period, and

(*d*) Eighty percent of the private foundation's distributable amount for the fourth taxable year of the start-up period.

(iii) *Timing of distribution.* The requirement that a private foundation distribute the start-up period minimum amount during the start-up period is a requirement that such amount be distributed before the end of the start-up period, and is not a requirement that any portion of such amount be distributed in any one taxable year of the start-up period.

(iv) *Distribution actually made during start-up period.* In general, only a distribution actually made during the start-up period is taken into account in determining whether a private foundation has distributed the start-up period minimum amount. However, in the case of a private foundation created after December 31, 1971 (or an organization that first became a private foundation after that date), a distribution actually made during the taxable year in which the foundation was created (the year immediately preceding the first taxable year of the private foundation's start-up period) may be treated as a distribution actually made during the start-up period. In addition, a distribution actually made by a private foundation within 5½ months after the end of the start-up period will be treated as a distribution actually made during the start-up period if—

(*a*) The private foundation was unable to determine the distributable amount for the fourth taxable year of the start-up period until after the end of such period, and

(*b*) The private foundation actually made distributions prior to the end of the start-up period based upon a reasonable estimate of the private foundation's distributable amount for the fourth taxable year of the start-up period.

(v) *Examples.* The provisions of this subparagraph (4) may be illustrated by the following examples:

Example (1). F, a private foundation created on January 1, 1975, uses the calendar year as its taxable year. The start-up period for F is January 1, 1976 through December 31, 1979. F has distributable amounts under section 4942(d) for taxable years 1976 through 1979 in the following amounts: 1976, $100,000; 1977, $120,000; 1978 $150,000; 1979, $200,000. F's start-up period minimum amount is the sum of the following amounts: 20% of $100,000 ($20,000); 40% of $120,000 ($48,000); 60% of $150,000 ($90,000); and 80% of $200,000 ($160,000); which equals $318,000. Thus F is required to actually distribute at least $318,000 in cash or its equivalent during the start-up period.

Example (2). F, a private foundation created in 1969, uses the calendar year as its taxable year, F's start-up period is the calendar years 1972 through 1975. F makes two cash distributions in 1972. The first distribution is made on account of a set-aside made in 1969. Under section 4942(g), that distribution is treated as a qualifying distribution made in 1969. The second distribution is treated under section 4942(h) as made out of F's undistributed income for 1971. In addition, F makes a cash distribution in 1976 that is treated under section 4942(h) as made out of F's undistributed income for 1975. In determining whether F has distributed its start-up period minimum amount within the start-up period, the 1972 distributions are both taken into account because they were actually made during F's start-up period. The 1976 distribution is not taken into account, however, because that distribution was not actually made during F's start-up period.

(5) *Minimum distribution required during full-payment period*—(i) *Full-payment period.* A private foundation's full-payment period includes each taxable year that begins after the end of the private foundation's start-up period.

(ii) *Full-payment period minimum amount.* The amount that a private foundation must actually distribute in cash or its equivalent in a taxable year of the private foundation's full-payment period is not less than 100 percent of the private foundation's distributable amount determined under section 4942(d) (without regard to section 4942(i)) with respect to the taxable year.

(iii) *Carryover of distributions in excess of full-payment period minimum amount.* If, in a taxable year beginning after December 31, 1975, a private foundation distributes an amount in excess of the full-payment period minimum amount for the taxable year, the excess shall be used to reduce the full-payment period minimum amount in the taxable years in the adjustment period. The amount of the excess distribution used to reduce the full-payment period minimum amount in each successive taxable year of the adjustment period shall be equal to the amount of such excess less the sum of the full-payment period minimum amounts for all prior taxable years in the adjustment period to which the excess was previously applied. The taxable years in the adjustment period are the five taxable years immediately following the taxable year in which the excess distribution is made. Any distribution in excess of the full-payment period minimum amount made during a taxable year of the adjustment period shall not be taken into account under this subparagraph (iii) until any earlier excess has been completely applied against full-payment period minimum amounts during its adjustment period.

(iv) *Distributions actually made during a taxable year.* Except as described in subdivision (ii) of subparagraph (6), only a distribution actually made during a taxable year of the full-payment period is taken into account in determining whether a private foundation has distributed the full-payment period minimum amount for such year.

(v) *Examples.* The provisions of this subparagraph (5) may be illustrated by the following examples:

Example (1). F, a private foundation created on January 1, 1973, uses the calendar year as its taxable year. F has a start-up period of January 1, 1974, through December 31, 1977, and a full-payment period that includes every taxable year beginning after December 31, 1977. F's distributable amount (as determined under section 4942(d)) for 1978 is $500,000. Thus, F's full-payment period minimum amount for 1978 is $500,000. During 1978 F distributes $100,000 in cash to Charity X and $400,000 in cash to Charity Y on account of a set-aside made in 1973. F has distributed its full-payment period minimum amount for 1978 because it has made actual cash distributions during that year which total $500,000. However, F has made qualifying distributions (as determined under section 4942(g)) with respect to 1978 of only $100,000. In order to avoid liability for the tax on undistributed income under section 4942(a), F must distribute or set aside an additional $400,000 before January 1, 1980.

Example (2). Assume the facts as stated in Example (1) except that in 1978 F makes cash distributions totaling $600,000. Since the total cash distributions made in 1978 ($600,000) exceed the full-payment period minimum amount for 1978 ($500,000), there exists a $100,000 excess which must be used by F to reduce its full-

payment period minimum amounts for the years 1979-1983 (the taxable years in the adjustment period with respect to the 1978 excess). Therefore, if F's distributable amount (as determined under section 4942(d)) for 1979 is $500,000, F's full-payment period minimum amount for 1979 is $400,000 ($500,000-$100,000).

(6) *Failure to distribute minimum amounts*—(i) *In general.* If a private foundation fails to actually distribute the start-up period minimum amount during the start-up period or, except as described in subdivision (ii) of this subparagraph (6), if a private foundation fails to actually distribute the full-payment period minimum amount during a taxable year of the full-payment period, then any set-aside made by the private foundation during the start-up period (if the failure relates to the start-up period) or during the taxable year (if the failure relates to the full-payment period) that was not approved by the Commissioner under the suitability test described in subparagraph (2) of this paragraph will not be treated as a qualifying distribution. Further, any set-aside made after the year of such a failure to so distribute a minimum amount will be treated as a qualifying distribution only if the Commissioner approves the set-aside under the suitability test. In any case in which a set-aside ceases to be treated as a qualifying distribution as a result of a failure to distribute the full-payment period minimum amount, a private foundation may be assessed a deficiency under section 4942(a) within the period described in section 6501(n)(3).

(ii) *Correction of certain failures to distribute.* If a private foundation's failure to distribute the full-payment period minimum amount during a taxable year of the full-payment period was not willful and was due to reasonable cause, the private foundation may correct the failure to so distribute. Correction will be achieved if the private foundation distributes within the correction period cash or its equivalent in an amount not less than the difference between the full-payment period minimum amount for the taxable year and the amount actually distributed during the taxable year. The correction period is the correction period as defined in section 4962(e), determined with respect to the earliest occurring taxable event (as defined in section 4962(e)(2)(A)) that would result if the failure to distribute a full-payment period minimum amount were not corrected. The additional distribution will be treated for purposes of subparagraph (5) of this paragraph as made during the taxable year with respect to which the failure occurred. If a private foundation fails to distribute the full-payment period minimum amount during a taxable year of the full-payment period because such amount can be determined only after the end of the taxable year, no "willful failure to distribute" the full-payment period minimum amount will occur if the private foundation makes an additional distribution within 5½ months after the end of the taxable year.

(7) *Approval and information requirements*—(i) *Suitability test.* If an amount is set aside under the suitability test of section 4942(g)(2)(B)(i) and subparagraph (2) of this paragraph, the private foundation must apply for the Commissioner's approval of the set-aside before the end of the taxable year in which the amount is set aside. The Commissioner will either approve or disapprove the set-aside in writing. An otherwise proper set-aside will not be treated as a qualifying distribution under this paragraph (b) with respect to a taxable year if the Commissioner's approval is not sought before the end of the taxable year in which the amount is actually set aside. To obtain approval by the Commissioner for a set-aside under the suitability test, the private foundation must write to Commissioner of Internal Revenue, Attention: OP:E:EO:T, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, and include—

(*a*) A statement describing the nature and purposes of the specific project and the amount of the set-aside for which approval is requested;

(*b*) A statement describing the amounts and approximate dates of any planned additions to the set-aside after its initial establishment;

(*c*) A statement of the reasons why the project can be better accomplished by a set-aside than by the immediate payment of funds;

(*d*) A detailed description of the project, including estimated costs, sources of any future funds expected to be used for completion of the project, and the location or locations (general or specific) of any physical facilities to be acquired or constructed as part of the project; and

(*e*) A statement by an appropriate foundation manager (as defined in section 4946(b)) that the amounts to be set aside will actually be paid for the specific project within a specified period of time that ends not more than 60 months after the date of the first set-aside, or a statement showing good cause why the period for paying the amount set aside should be extended (including a showing that the proposed project could not be divided into two or more projects covering periods of no more than 60 months each) and setting forth the extension of time required.

(ii) *Cash distribution test.* If an amount is set aside under the cash distribution test of section 4942(g)(2)(B)(ii) and subparagraphs (3), (4), and (5) of this paragraph, then for taxable years ending after April 2, 1984, the private foundation must submit an attachment with the return required by section 6033 for the taxable year in which the amount is set aside and for certain subsequent taxable years. For the taxable year in which the amount is set aside the attachment must include—

(*a*) A statement describing the nature and purposes of the specific project for which amounts are to be set aside;

(*b*) A statement that the amounts set aside for the specific project will actually be paid for the specific project within a specified period of time that ends not more than 60 months after the date of the set-aside;

(*c*) A statement that the project will not be completed before the end of the taxable year of the private

foundation in which the set-aside is made;

(*d*) A statement showing the distributable amounts determined under section 4942(d) for any past taxable years in the private foundation's start-up and full-payment periods; and

(*e*) A statement showing the aggregate amount of actual payments made in cash or its equivalent, for purposes described in section 170(c)(1) or (2)(B), during each taxable year in the private foundation's start-up and full-payment periods. This statement should include a detailed description of any payments that are to be treated, pursuant to the rules of subparagraphs (4)(iv) and (6)(ii) of this paragraph (b), as distributed during a taxable year prior to the taxable year in which such payments were actually made and, in addition, should explain the circumstances that justify the application of those rules.

For the five taxable years following the taxable year in which the amount is set aside (or, if longer, for each taxable year in the extended period for paying the amount set aside), the attachment must include the statements required by (*d*) and (*e*) of this subdivision (ii). The submission of the statement required by (*b*) of this subdivision (ii) will satisfy the requirement of section 4942(g)(2)(B) and subparagraph (1) of this paragraph (b) that the private foundation establish to the satisfaction of the Commissioner that the amount set aside will be paid for the specific project within 60 months after it is set aside.

(8) *Evidence of set-aside.* A set-aside that is approved by the Commissioner or which satisfies the cash distribution test shall be evidenced by the entry of a dollar amount on the books and records of a private foundation as a pledge or obligation to be paid at a future date or dates. Any amount which is set aside shall be taken into account for purposes of determining the private foundation's minimum investment return under §53.4942(a)-2(c)(1), and any income attributable to such set-aside shall be taken into account in computing adjusted net income under §53.4942(a)-2(d).

(9) *Contingent set-aside.* In the event a private foundation is involved in litigation and may not distribute assets or income because of a court order, the private foundation may (except as provided in §53.4942(a)-2(e)(1)(i) or (ii)) seek and obtain a set-aside for a purpose described in §53.4942(a)-3(a)(2). The amount to be set aside shall be equal to that portion of the private foundation's distributable amount which is attributable to the assets or income that are held pursuant to court order and which, but for the court order precluding the distribution of such assets or income, would have been distributed. In the event that the litigation encompasses more than one taxable year, the private foundation may seek additional contingent set-asides. Such amounts must actually be distributed by the last day of the taxable year following the taxable year in which the litigation is terminated. Amounts not distributed by the close of the appropriate taxable year shall be treated as described in §53.4942(a)-2(d)(2)(iii)(*c*) for the succeeding taxable year.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805). (Approved by the Office of Management and Budget under control number 1545-0792.)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 20, 1984.

JOHN W. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 30, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 31, 1984, 49 F.R. 3846)

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26 CFR 53.4942(b)-1: Operating foundations.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification or exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

Section 4943.—Taxes on Excess Business Holdings

26 CFR 53.4943-4: Present holdings.

T.D. 7944

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 53—FOUNDATION EXCISE TAXES

Excess business holdings of private foundations.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations dealing with matters reserved in the regulations relating to taxes on the excess business holdings of private foundations. Changes in the applicable tax law were made by the Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3C.B. 10]. These regulations provide necessary guidance to the public for compliance with the law and affect private foundations.

DATES: The amendments are generally effective for taxable years beginning after December 31, 1969.

FOR FURTHER INFORMATION CONTACT: Richard J. Wickersham of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20024 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Proposed regulations under section 4943 were first published in the FEDERAL REGISTER on January 3, 1973 (38 FR 32). Those regulations, except for certain reserved portions, were adopted in T.D. 7496, published on July 6, 1977 (42 FR 34499) [1977-2

C.B. 390]. A second notice of proposed rulemaking, setting forth new proposed regulations under the portions reserved in T.D. 7496, was published on May 22, 1979 (44 FR 29680). A third notice, modifying the transitional rules proposed in the second notice, was published on August 16, 1979 (44 FR 47958).

The portions reserved in T.D. 7496 related to reorganizations, redemptions and distributions; the definition of a purchase for purposes of the five-year period provided in section 4943(c)(6) to dispose of excess business holdings acquired other than by purchase; the application of the constructive ownership rules in section 4943(d)(1) to corporations engaged in the active conduct of a trade or business and to partnerships; and the conversion of a passive holding into an active business.

A public hearing concerning the reserved portions was held on September 6, 1979. Comments at that hearing were addressed to all three notices of proposed rulemaking. After consideration of all comments regarding the three notices, the reserved portions of regulations under section 4943 are adopted as revised by this Treasury decision.

EXCESS BUSINESS HOLDINGS GENERALLY

Section 4943 generally imposes an excise tax on a private foundation if the foundation and all disqualified persons with respect to the foundation in combination hold more than 20 percent of the voting stock of a business enterprise. If it can be demonstrated that one or more persons unrelated to the foundation have effective control over the business, the 20-percent limit is raised to 35 percent. A foundation must hold directly or indirectly more than two percent of the voting stock or value of a business enterprise before the limitations of section 4943 come into play, however. These limitations on ownership are applicable both to corporations and to non-corporate businesses such as partnerships, estates, and trusts.

Section 4943(c)(4) provides special grandfather rules that allow the 20- or 35-percent ownership limits to be increased, subject to certain conditions, for combined holdings that exceeded the 20- or 35-percent limits on May 26, 1969. Under these grandfather rules, the combined foundation-disqualified person holdings must be reduced, during an initial transition period, to no more than 50 percent, with certain additional reductions required thereafter.

CONSTRUCTIVE OWNERSHIP

In computing the percentage of stock held by the foundation and disqualified persons, stock held by or for a corporation, partnership, estate or trust is generally deemed to be held by or for the shareholders, partners, or beneficiaries of that entity. The regulations proposed in 1973 exempted from this constructive ownership rule holdings of corporations engated in an active trade or business. This exception from the general constructive ownership rule ("the myopia rule") did not apply in four situations: (1) if assets used in active trades or businesses are insubstantial when compared with passive assets; (2) if a small active corporation acquires stock in a much larger active corporation; (3) if an active corporation's trade or business assets before an acquisition of assets are insubstantial when compared to its trade or business assets after the acquisition; or (4) if a transaction constitutes a device to acquire or retain excess business holdings.

The myopia rule is adopted in the final regulations with one significant change. This change treats the passive parent of an affiliated group of active businesses as an active business. Under §53.4943-8(c)(4) and §53.4943-10(c)(3), consolidated gross income will be used to determine whether the parent of an affiliated group is a business enterprise and the assets of the entire group will be used in determining whether the parent is an active corporation for purposes of the myopia rule. These changes were made because several commentators pointed out that the myopia rule as originally proposed in 1973 would result in different tax treatment of foundations with interests in controlled groups depending solely on how the controlled groups were structured. If the parent corporation were passive, acquisition of stock in unrelated corporations could result in excess business holdings. An identical group structured so that the parent was an active corporation could acquire interests in other corporations without creating any excess business holdings problems. Because the structure of a controlled group is generally dictated by considerations other than the excess business holdings liability of foundation shareholders, the rule has been changed to create identical results irrespective of how the controlled group is structured.

In addition, the cases in which the myopia rule does not apply have been clarified.

CORPORATE READJUSTMENTS AND DISTRIBUTIONS

Section 4943(c)(4)(A)(iv) provides that the grandfather rules are to be applied to mergers, recapitalizations, or other reorganizations in a manner determined by regulations. Section 53.4943-7 of the final regulations provides these rules. The term "readjustment" has been substituted for "reorganization" to avoid the implication that only transactions meeting the requirements of section 368(a) will qualify for application of the grandfather rules. A readjustment is defined broadly in §53.4943-7(d)(1) to include mergers, consolidations, recapitalizations, stock or asset acquisitions, asset transfers, other changes in identity, form, or place of organization, redemptions, and distributions of assets or stock, including distributions to which section 301, 302, 331, or 355 applies and distributions of stock of the distributing corporation.

Generally stock received in a corporate readjustment or distribution is treated as the stock surrendered in (or held prior to) the readjustment for purposes of the grandfather rules. However, under §53.4943-7(b), stock

received in a readjustment will not be treated as the stock surrendered to the extent the stock received represents a greater percentage ownership than the highest percentage ownership in any entity held prior to the readjustment. In general, the excess stock will be treated as an interest acquired other than by purchase (see below). The percentage limits are applied separately to voting percentages and value percentages and are also applied separately to foundation holdings and combined holdings of the foundation and disqualified persons.

INTEREST ACQUIRED OTHER THAN BY PURCHASE

Under section 4943(c)(6), an interest acquired by a foundation in a business enterprise that would otherwise cause the private foundation to have excess business holdings is treated as held by a disqualified person rather than by the foundation for a five-year period if the interest is acquired "other than by purchase by the private foundation or by a disqualified person." The final regulations do not define the term purchase as did the regulations proposed in 1979, but instead follow the 1973 proposed regulations in detailing some acquisitions that are not purchases for purposes of section 4943. Acquisitions by gift, devise, bequest, legacy or intestate succession are not purchases, as under the 1973 proposed regulations. The final regulations clarify the rules under the 1979 proposed regulations as to when certain acquisitions by estates will be treated as purchases. Because the proposed regulations were unclear, the final regulations are prospective.

Under the 1973 proposed regulations, any increase in holdings resulting from a corporate readjustment would be treated as acquired other than by purchase. However, the 1973 proposed regulations also stated in the constructive ownership rules that exceptions similar to the exceptions to the myopia rule would apply with respect to interests acquired in a readjustment. The final regulations adopt the rule that an increase in holdings resulting from a corporate readjustment will be treated as acquired other than by purchase, subject to exceptions similar to the exceptions to the myopia rule.

Neither the 1973 nor the 1979 proposed regulations contained rules governing reorganizations involving section 4943(c)(2) or (3) holdings (stock subject to the normal 20% or 35% limits) or (c)(6) holdings (interests acquired other than by purchase). Under the final regulations, §53.4943-6(d), any increase in holdings as a result of a readjustment will be treated as acquired other than by purchase except to the extent that the increase is attributable to holdings that were excess business holdings before the readjustment, and subject to exceptions similar to the exceptions to the myopia rule. However, any increase in holdings attributable to holdings that would have been excess business holdings except for the fact that such holdings were treated as held by a disqualified person prior to the readjustment will not be treated as held by a disqualified person after the date on which the original holdings would have ceased to be treated as held by a disqualified person.

ACQUISITIONS, REDEMPTIONS AND HOLDINGS BY ENTITIES THAT ARE DISQUALIFIED PERSONS

The final regulations contain two rules covering situations in which a private foundation owns stock in a corporation or other entity that is itself a disqualified person. If the entity is a business enterprise, redemption of stock by the business enterprise will not be treated as a purchase by a disqualified person merely because the redeeming entity is a disqualified person. Although technically a disqualified person (*i.e.*, the business enterprise) is purchasing stock and, as a result, the foundation's holdings are increased, several commentators suggested that the results should be the same in the situation in which a foundation owns stock in a corporation which is a disqualified person and a situation in which a foundation owns stock in a corporation which is not a disqualified person. In addition, in situations where an entity which is a disqualified person holds stock in a business enterprise, the holdings of the disqualified person entity will be treated as held proportionately by its shareholders, partners, or beneficiaries, rather than by the disqualified person entity, to the extent the constructive ownership rules under §53.4943-8 apply. Thus, for example, if a private foundation has as a substantial contributor a passive holding company, which under section 4946(a)(1)(A) is a disqualified person with respect to the foundation, and the foundation owns 40 percent of the stock of the passive holding company, an acquisition of a 50 percent interest in a business enterprise by the holding company would not create excess business holdings for the foundation because the foundation would be treated as owning 20 percent of the business enterprise under the normal constructive ownership rules and, assuming that no disqualified persons hold stock in the passive holding company, no disqualified persons will be treated as holding stock in the business enterprise. However, where the disqualified person entity is an entity to which the constructive ownership rules do not apply under the myopia rule (*e.g.*, an active business enterprise), or in the case of another private foundation that is a disqualified person by reason of section 4946(a)(1)(H), the holdings of the disqualified person entity will all be treated as held by a disqualified person.

CHANGES FROM PASSIVE HOLDINGS TO BUSINESS ENTERPRISE

The 1973 proposed regulations treated a change from passive holdings to an active business enterprise as an interest in a business enterprise acquired other than by purchase. The 1979 proposed regulations treated such a change as an acquisition other than by purchase only if the private foundation established that the busi-

ness enterprise was not effectively controlled by the private foundation, its disqualified persons, or both, at the time of the change. The final regulations under §53.4943-10(d)(2) adopt an intermediate rule under which a change from passive holdings to an active business enterprise is treated as an acquisition by purchase by the private foundation unless the private foundation establishes that it did not effective control the events which caused the change to occur. This control test is different from the test under section 4943(c)(2) in that it allows the foundation to establish control in third parties and disqualified persons. The rule with respect to changes that are treated as occurring by purchase will apply only to change occurring after the publication of the final regulations.

CORPORATIONS WITH MORE THAN ONE CLASS OF STOCK

Under section 4943(c)(4)(A), the combined holdings of the foundation and disqualified persons and foundation holdings separately may not exceed the lowest percentages held on or after May 26, 1969. This provision was intended to permit a foundation that had holdings on May 26, 1969, to retain its holdings (subject to certain limits), but to prevent an increase in the holdings. Because the percentage limitations of section 4943(c)(4) are applied to the percentage of value held as well as the percentage of voting stock held, a change in the relative values of stock of different classes can result in excess business holdings even though the percentages of stock held in each class remains unchanged. This result was not intended. Therefore, a new §53.4943-4(d)(10) has been added to the final regulations to provide that increases resulting solely from a change in relative values of stock of different classes will not result in excess business holdings.

DRAFTING INFORMATION

The principal author of these regulations is Richard J. Wickersham of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for interpretative regulations. Accordingly, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply and no Regulatory Flexibility Analysis is required for this rule.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291 or the Treasury and Office of Management and Budget implementation of the Order dated April 29, 1983.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 53 is amended as follows:

Paragraph 1. Section 53.4943-4(d) is amended by adding a new subparagraph (10) to read as follows:

§53.4943-4 Present holdings.

* * * * *

(d) *Permitted holdings under section 4943(c)(4).****

(10) *Special rule for changes in the relative values of stock of different classes.*

(i) In the case of a corporation that has more than one class of stock outstanding, if the percentage of value held by the private foundation, its disqualified persons, or both, increases over a period of time solely as a result of changes in the relative values of the stock of different classes, then the foundation value level, the disqualified person value level, and the substituted combined value level, as defined in paragraph (d)(2) of this section, shall be adjusted to reflect such increase. An increase in the percentage of value held shall not be considered to have occurred solely as a result of changes in the relative values of the stock of different classes if:

(A) There has been any increase during the period in the percentage of any class of stock held by the private foundation, its disqualified persons, or both, or

(B) There has been any issuance, redemption, or purchase by the issuing corporation of any stock during the period.

See §53.4943-6(d) for rules relating to increases caused by readjustments.

(ii) *Example.* The provisions of this subparagraph (10) may be illustrated by the following example:

Example. (i) At all times since May 26, 1969, F, a private foundation, has held 25% (500,000 shares) of the outstanding class of voting stock of X corporation. No disqualified person with respect to F holds any voting stock of X. In addition X has had outstanding since May 26, 1969, a class of non-voting preferred stock, none of which is held by F or a disqualified person. X is an active business corporation and third parties do not have effective control of X. On May 26, 1969, the voting stock (2 million shares outstanding) was trading for $5 a share on the New York Stock Exchange. The non-voting preferred stock, not publicly traded, was valued at $1 million. The total value of all outstanding stock was $11 million ($10 million voting stock plus $1 million non-voting preferred). On May 26, 1969, F held 22.73% of the value of X's outstanding stock ($2.5 million/$11 million).

(ii) On October 31, 1982, X's voting stock is trading for $20 a share and the nonvoting stock is valued at $3 million. At all times during the period May 26, 1969, through October 31, 1982, F has held 25 percent of the voting stock and none of the nonvoting stock of X. No stock of X is owned by disqualified persons. No stock of X has been issued, redeemed or purchased by X during this period. On October 13, 1982, the total value of X's outstanding stock (is $43 million ($40 million voting stock and $3 million nonvoting stock) and F holds 23.26 percent of the value of X's outstanding stock ($10 million/$43 million). F's foundation value level and the substituted combined value level are increased from 22.73 percent to 23.26 percent to reflect this change.

(iii) On November 1, 1982, X corporation distributes the stock of Y corporation, a wholly-owned subsidiary, to X's shareholders. Y is a business enterprise. Under this paragraph (d)(10), all of F's stock in X is permitted holdings under section 4943(c)(4) even though the percentage of value held by F has increased from 22.73 percent on May 26, 1969, to 23.26 percent on November 1, 1982. F's permitted holdings in Y will be determined by reference to F's permitted holdings in X under §53.4943-7. Therefore, assuming no prohibited transaction occurs, F's permitted holdings in Y stock

equal 25 percent of Y's voting stock and, separately, 23.26 percent of the value of all of Y's outstanding stock.

Par. 2. Section 4943-6 is amended by adding new paragraph (a)(2), by amending paragraph (b)(1), by amending paragraph (c)(3), and by adding new paragraphs (c)(4) and (d). The new and revised portions read as follows:

§53.4943-6 Five-year period to dispose of gifts, bequests, etc.

(a) *In general.* ***

(2) *Acquisitions that are not purchases.* Section 4943(c)(6) does not apply if a change in holdings in a business enterprise is the result of a purchase by the private foundation or a disqualified person. For purposes of subparagraph (a) of this paragraph, the term "purchase" shall not include any acquisition by gift, devise, bequest, legacy, or intestate succession. Paragraph (d) of this section provides rules for the treatment of increases in holdings received in a readjustment (as defined in §53.4943-7(d)(1)).

* * * * *

(b) *Special rules for acquisitions by will or trust*—(1) *In general.* In the case of an acquisition of holdings in a business enterprise by a private foundation pursuant to the terms of a will or trust, the five-year period described in section 4943(c)(6) and in this section shall not commence until the date on which the distribution of such holdings from the estate or trust to the foundation occurs. See §53.4943-5(b)(1) for rules relating to the determination of the date of distribution under the terms of a will or trust. For purposes of this subparagraph, holdings in a business enterprise will not be treated as acquired by a private foundation pursuant to the terms of a will where the holdings in the business enterprise were not held by the decedent. Thus, in the case of after-acquired property, this subparagraph shall not apply, the five-year period described in section 4943(c)(6) and this section shall commence on the date of acquisition of such holdings by the estate, and such five-year period may expire prior to the date of distribution of such holdings from the estate. To the extent that an interest to which section 4943(c)(6) and this paragraph (b)(1) apply is constructively held by a private foundation under section 4943(d)(1) and §53.4943-8 prior to the date of distribution, it shall be treated as held by a disqualified person prior to such date by reason of section 4943(c)(6). See §53.4943-8 for rules relating to constructive holdings held in an estate or trust for the benefit of the foundation.

* * * * *

(c) *Exceptions.* ***

(3) The purchase of holdings by an entity whose holdings are treated as constructively owned by a foundation, its disqualified persons, or both, under section 4943(d)(1) shall be treated as a purchase by a disqualified person if the foundation, its disqualified persons or both have effective control of the entity or otherwise can control the purchase. For example, if a foundation is the beneficiary of a specific bequest of $20,000 and its consent is required for the estate to make a purchase using such cash, then a purchase by the estate using such cash would be treated as a purchase by a disqualified person. Similarly, if an executor of an estate is a disqualified person with respect to a private foundation, any purchase by the estate would be treated as a purchase by a disqualified person.

(4) If a private foundation, its disqualified persons, or both, hold an interest in specific property under the terms of a will or trust, and if the private foundation, its disqualified persons, or both, consent or otherwise agree to the substitution of holdings in a business enterprise for such specific property, such holdings shall be treated as acquired by purchase by a disqualified person. For example, if a private foundation is the beneficiary of a specific bequest of $20,000 and the private foundation agrees to accept certain of the estate's holdings in a business enterprise in satisfaction of such specific bequest, such holdings will be treated as acquired by purchase by a disqualified person even if such holdings were held by the decedent.

(d) *Readjustments and distributions*—(1) *General rule.* Except as otherwise provided in subparagraph (2) of this paragraph, any increase in holdings in a business enterprise that is the result of a readjustment (as defined in §53.4943-7(d)(1)) shall be treated as acquired other than by purchase. However, holdings that are attributable to holdings owned by the private foundation that would have been excess business holdings except for the fact that such holdings were treated as held by a disqualified person prior to the readjustment shall in no event be treated as held by a disqualified person after the date on which the holdings to which the change is attributable would have ceased to be treated as held by a disqualified person.

(2) *Exceptions.* Any increase in holdings in a business enterprise that is the result of a readjustment (as defined in §53.4943-7(d)(1)), including any change resulting from application of the rule in §53.4943-8(c)(3), shall be treated as occurring by purchase by a disqualified person:

(i) To the extent the increase is attributable to holdings that were excess business holdings prior to the readjustment, and separately

(ii) To the full extent of the increase if the readjustment includes a prohibited transaction, unless the foundation establishes to the satisfaction of the Commissioner that effective control of all parties to the transaction was, at the time of the transaction, in one or more persons (other than the foundation) who are not disqualified persons with respect to the foundation. See §53.4943-7(d)(2) for the definition of prohibited transaction.

(3) *Section 4943(c)(6) holdings.* If, immediately prior to a readjustment (as defined in §53.4943-7(d)(1)), a private foundation has holdings in a business enterprise that are treated under section 4943(c)(6) as held by a disqualified person, then any holdings in a business enterprise that are received in the readjustment in ex-

change for such section 4943(c)(6) holdings shall be treated as the holdings surrendered in the exchange to the same extent as provided in §53.4943-7 with respect to exchanges involving holdings to which section 4943(c)(4) or (5) applies. Rules similar to those in §53.4943-7(a)(2) shall be applied to determine when holdings are treated as surrendered or received in a readjustment for purposes of this paragraph.

(4) *Redemption by a corporation that is a disqualified person.* If a foundation holds an interest in a corporation that is a disqualified person, an increase in the holdings of the private foundation, its disqualified persons, or both, as a result of a redemption or a purchase of stock of the disqualified person corporation by such corporation shall not be treated as acquired by purchase by a disqualified person based solely on the status of the corporation as a disqualified person.

(5) *One percent rule for redemptions.* If the holdings of a foundation, its disqualified persons, or both, in a business enterprise are increased as a result of one or more redemptions during any taxable year then, unless the aggregate of such increases equals or exceeds one percent of the outstanding voting stock or one percent of the value of all outstanding shares of all classes of stock, the determination of whether such increases cause the foundation to have excess business holdings shall be made only at the close of the private foundation's taxable year. The five-year period described in section 4943(c)(6) or the 90-day period described in §53.4943-2(a)(1)(ii), whichever is applicable, shall begin on the last day of such taxable year. If, however, the aggregate of such increases equals or exceeds one percent of the outstanding voting stock or one percent of the value of all outstanding shares of all classes of stock, the determination of whether such increases cause the foundation to have excess business holdings shall be made, and the applicable five-year or 90-day period shall begin, as of the date the increases, in the aggregate, equal or exceed one percent.

(6) *Examples.* The provisions of this paragraph are illustrated in §53.4943-7(f) and by the following examples:

Example (1). (i) F, a private foundation, holds 20% of the voting stock of X corporation, an active business enterprise. No disqualified person with respect to F holds any X stock. In 1980, X redeems 10% of its outstanding shares, increasing F's holdings to 22% of the X stock. Assume the redemption by X is not a prohibited transaction.

(ii) All of F's holdings before the redemption are permitted holdings under section 4943(c)(2). There is no effective control of X by third parties so the 35% permitted holdings rule is inapplicable. F's holdings after the redemption exceed the permitted holdings under section 4943(c)(2) (20%). Because the increase is attributable to stock that was permitted holdings prior to the readjustment, and the readjustment does not involve a prohibited transaction, the 2% increase in F's holdings of X stock is treated as acquired other than by purchase. Therefore, under section 4943(c)(6) and this section, F will have 5 years from the date of the redemption to dispose of the 2% excess.

Example (2). Assume the same facts as in *Example* (1) except that the 20% of X stock held by F was donated by X corporation, was worth more than $5,000 and represented 20% of the contributions received by the foundation through the end of the taxable year in which the gift of stock was made.

(ii) X corporation is a disqualified person with respect to F under section 4946(a)(1)(A). Under subparagraph (4), the redemption of X stock is not treated as a purchase by a disqualified person merely because X is a disqualified person with respect to F. Therefore the rules of this paragraph apply as if the redemption were made by a corporation which is not a disqualified person. The analysis and result are the same as in *Example (1).*

Example (3). (i) On May 1, 1990, F, a private foundation, received a donation of 40% of the stock of X corporation, a business enterprise. Neither F nor any disqualified person with respect to F holds any other interest in X. On June 1, 1992, the X corporation redeemed F's 40% interest in exchange for 100% of the stock of Y corporation, a wholly-owned subsidiary of X. Assume the redemption by X is not a prohibited transaction.

(ii) Under section 4943(c)(6), the X stock acquired by gift is treated as held by disqualified persons through April 30, 1995. Under subparagraph (3) of this paragraph (d), 40% of the 100% interest in Y received in exchange for F's 40% interest in X is treated as F's 40% interest in X and is therefore treated as held by disqualified persons through April 30, 1995. In addition, under subparagraph (1) of this paragraph (d), the 60% interest in Y that represents an increase in holdings above the 40% held before the readjustment will be treated as acquired other than by purchase. However, F's 20% interest in X in excess of the 20% permitted holdings under 4943(c)(2) would have been excess business holdings if such interest had not been treated as held by as disqualified person on June 1, 1992. Therefore, to the extent of a 30% interest in Y (*i.e.*, the portion of the increased holdings in *Y* attributable to F's 20% holdings in X) the increased holdings will be treated as held by disqualified person only through April 30, 1995, since this is the latest date on which F's original 40% interest in X would have been treated as held by disqualified persons. The remaining 30% interest in Y will be treated as held by disqualified persons for five years from the date of the exchange (through May 31, 1997).

(e) *Constructive holdings.* Any change in holdings in a business enterprise that occurs because a corporation ceases to be actively engaged in a trade or business, thus causing its holdings to be constructively owned by its shareholders, shall be treated as acquired other than by purchase.

(f) *Certain transactions treated as purchases; cross references.* For the application of section 4943(c)(6) to holdings that were not an interest in a business enterprise when acquired but that subsequently become holdings in a business enterprise, see §53.4943-10(d)(2).

Paragraph 3. A new section 53.4943-7 is added to read as follows:

§53.4943-7 Special rules for readjustments involving grandfathered holdings.

(a) *General rules*—(1) *Readjustments.* Except to the extent provided in paragraph (b) of this section, if a private foundation, its disqualified persons, or both together have holdings in a corporation to which section 4943(c)(4) or (5) applies, stock of a corporation received by the foundation, its disqualified persons, or both together in a readjustment (as defined in paragraph (d)(1) of this section) in exchange for such holdings to which section 4943(c)(4) or (5) applies shall be treated, for purposes of section 4943(c)(4) or (5), as the stock surrendered in the exchange.

(2) *No exchange necessary.* Paragraph (a)(1) of this section shall apply to all readjustments even if no exchange occurs. For purposes of this section, all stock held (directly or indirectly) before a readjustment in any corporation involved in the readjustment shall be treated as stock surrendered in the readjustment and all stock held (directly or indirectly) after the readjustment in any corporation

involved in the readjustment shall be treated as stock received in the readjustment in exchange for the stock treated as surrendered.

(b) *Exceptions and limitations*— (1) *Limitation on increases in percentage of voting stock.* (i) If the percentage of voting stock in a business enterprise owned (directly or indirectly) by a private foundation by reason of its ownership of stock received in an exchange described in paragraph (a) of this section exceeds the greatest percentage of voting stock in any business enterprise owned (directly or indirectly) by the private foundation prior to such exchange by reason of its ownership of the stock surrendered by it in the exchange, then—

(A) That portion of the stock received by the private foundation in the exchange which represents such excess is to be treated as an increase in the holdings of the private foundation in accordance with §53.4943-6(d), and

(B) Only the remaining portion of the stock received by the private foundation in the exchange shall be treated as the stock surrendered by the private foundation in the exchange.

(ii) If the sum of the percentage of voting stock in a business enterprise owned (directly or indirectly) by disqualified persons by reason of their ownership of stock received in an exchange described in paragraph (a) of this section plus the percentage of voting stock in the business enterprise owned (directly or indirectly) by the private foundation by reason of its ownership of stock received in the exchange and treated as the stock surrendered under paragraph (b)(1)(i) of this section exceeds the greatest percentage of voting stock in any business enterprise owned (directly or indirectly) by the private foundation and its disqualified person in combination by reason of their ownership of the stock surrendered by them in the exchange, then—

(A) That portion of the stock received by the disqualified persons in the exchange which represents such excess is to be treated as an increase in the holdings of the disqualified persons in accordance with §53.4943-6(d), and

(B) Only the remaining portion of the stock received by the disqualified persons in the exchange is to be treated as the stock surrendered by the disqualified persons in the exchange.

(2) *Limitation on increase in percentage of value.* (i) If the percentage of value of all outstanding shares of all classes of stock in a business enterprise owned (directly or indirectly) by a private foundation by reason of its ownership of stock received in an exchange described in paragraph (a) of this section exceeds the greatest percentage of such value in any business enterprise owned (directly or indirectly) by the private foundation prior to such exchange by reason of its ownership of the stock surrendered by it in the exchange, then—

(A) That portion of the stock received by the private foundation in the exchange which represents such excess is to be treated as an increase in the holdings of the private foundation in accordance with §53.4943-6(d), and

(B) Only the remaining portion of the stock received by the private foundation in the exchange shall be treated as the stock surrendered by the private foundation in the exchange.

(ii) If the sum of the percentage of value of all outstanding shares of all classes of stock in a business enterprise owned (directly or indirectly) by disqualified persons by reason of their ownership of stock received in an exchange described in paragraph (a) of this section plus the percentage of such value in the business enterprise owned (directly or indirectly) by the private foundation by reason of its ownership of stock received in the exchange and treated as the stock surrendered under paragraph (b)(2)(i) of this section exceeds the greatest percentage of such value in any business enterprise owned (directly or indirectly) by the private foundation and its disqualified persons in combination prior to the exchange by reason of their ownership of the stock surrendered by them in the exchange, then—

(A) That portion of the stock received by the disqualified persons in the exchange which represents such excess is to be treated as an increase in the holdings of the disqualified persons in accordance with §53.4943-6(d), and

(B) Only the remaining portion of the stock received by the disqualified persons in the exchange is to be treated as the stock surrendered by the disqualified persons in the exchange.

(3) *Increases in percentage of both voting stock and value.* (i) If, as the result of an exchange described in paragraph (a) of this section, a private foundation has excesses determined under both paragraphs (b)(1)(i) and (b)(2)(i) of this section, then—

(A) That portion of the stock received by the private foundation in the exchange that represents the larger excess is to be treated as an increase in the holdings of the private foundation in accordance with §53.4943-6(d), and

(B) Only the remaining portion of the stock received by the private foundation in the exchange is to be treated as the stock surrendered by the private foundation in the exchange.

(ii) If as the result of an exchange described in paragraph (a) of this section, disqualified persons have excesses determined under both paragraphs (b)(1)(ii) and (b)(2)(ii) of this section, then—

(A) That portion of the stock received by the disqualified persons in the exchange that represents the larger excess is to be treated as an increase in the holdings of the disqualified persons in accordance with §53.4943-6(d), and

(B) Only the remaining portion of the stock received by disqualified persons in the exchange is to be treated as the stock surrendered by disqualified persons in the exchange.

(4) *Exception for prohibited transactions.* If a readjustment includes a

prohibited transaction, as defined in paragraph (d)(2) of this section, then this paragraph shall be applied substituting, for purposes of paragraph (b)(1) and (b)(2), the lowest percentage of voting power or value owned prior to the exchange in any business enterprise involved in the readjustment to which the exchange relates for the greatest percentage of voting power or value in any business enterprise owned by reason of ownership of the stock surrendered in the exchange.

(5) *Voting and value levels.* After an exchange described in paragraph (a) of this section, the private foundation voting and value levels, and the substituted combined voting and value levels (as defined in §53.4943-4(d)(2)) shall be the lesser of each respective level immediately prior to the exchange with respect to the stock surrendered in the exchange and each such respective level determined immediately after the exchange by taking into account only the stock received in the exchange that is treated under this paragraph as the stock surrendered in the exchange. If the stock of more than one corporation is surrendered in exchange for stock of one corporation, the highest of each voting or value level determined immediately prior to the exchange with respect to the stock of the corporations surrendered in the exchange shall be treated as such level immediately prior to the exchange.

(6) *Determination of phases*—(i) *In general.* Stock received in an exchange described in paragraph (a) of this section that is treated as stock surrendered in the exchange under this paragraph shall be treated as subject to the same first, second, and third phases that were applicable to the stock surrendered for it. For purposes of determining the applicable phases, stock received in an exchange shall be treated as received in exchange for particular holdings of stock surrendered based on the terms of the exchange. Where only a portion of the stock received is treated as the stock surrendered, such portion of the stock received shall be treated as exchanged for particular holdings of stock surrendered in the same proportions as the total stock received was exchanged for particular holdings of stock surrendered. For example, if 20 shares of X stock owned by a private foundation, subject to a first phase beginning on January 1, 1978 and ending on December 31, 1987, are exchanged for 20 shares of Y stock, and 40 shares of X stock owned by the private foundation, subject to a first phase beginning on June 1, 1980 and ending on May 31, 1990, are exchanged for 40 shares of Y stock, then 1/3 of the Y stock received by the private foundation is treated as received in exchanged for X stock having the January 1, 1978 - December 31, 1987 first phase and 2/3 of the Y stock received by the private foundation is treated as received in exchange for the X stock having the June 1, 1980 - May 31, 1990 first phase. If only 30 shares of the Y stock received by the private foundation are treated as the stock surrendered, then 1/3 (10 Y shares) will be subject to the January 1, 1978 - December 31, 1987 first phase and 2/3 (20 Y shares) will be subject to the June 1, 1980 - May 31, 1990 first phase.

(ii) *Transitional rule.* In any case in which holdings subject to section 4943(c)(4) or 4943(c)(5) have been consolidated prior to May 22, 1984, then the longest first phase applicable to any of the holdings surrendered in the consolidation shall be applied to the holdings received by the foundation in the consolidation that are treated as the holdings surrendered in the consolidation. For purposes of this clause, a consolidation is any readjustment that results in a reduction in the number of entities in which the foundation has direct holdings.

(c) *Plan to dispose of excess business holdings.* (1) Notwithstanding §53.4943-4(d)(i)(4)(D)) (relating to restrictions on increases in levels) and paragraphs (a) and (b) of this section, if a readjustment occurs under an approved plan to dispose of stock to which section 4943(c)(4) or (5) applies, in order to meet the requirements of section 4943(c)(4) (*i.e.*, to meet the reduced limits that will be applicable after the first phase holding period described in §53.4943-4(c)) or to meet the requirements of section 4943(c)(2)), all of the stock received in the readjustment shall be treated as held by disqualified persons through the end of the longest first phase holding period applicable to stock surrendered in the readjustment. The foundation and substituted combined voting and value levels shall not be increased on account of the readjustment.

(2) For purposes of this paragraph, a plan is an approved plan only if it is approved by the Commissioner and may be subject to such conditions as the Commissioner determines. A plan must be approved prior to any exchange or distribution pursuant to the plan except for a showing of good cause such as a business emergency.

(d) *Definitions*—(1) *Readjustments.* For purposes of this section, the term "readjustment" includes, but is not limited to—

(i) A merger or consolidation;

(ii) A recapitalization;

(iii) An acquisition of stock or assets;

(iv) A transfer of assets;

(v) A change in identity, form, or place of organization, however effected;

(vi) A redemption;

(vii) A distribution of assets or of stock, including a distribution to which section 301, 302, 331, or 355 applies or a distribution of stock of the distributing corporation.

(2) *Prohibited transaction.* A prohibited transaction is any transaction involving a private foundation that has holdings in a business enterprise which—

(i) Acquires stock (or similar interest in the case of an unincorporated entity) or assets of a business enterprise or redeems its own stock (or similar interest in the case of an unincorporated entity) using cash or other property transferred to the acquiring business enterprise (*e.g.*, as a contribution to capital) by the private foun-

dation, its disqualified persons, or both;

(ii) Acquires stock (or similar interest in the case of an unincorporated entity) or assets of a business enterprise or redeems its own stock (or similar interest in the case of an unincorporated entity) using the proceeds of a loan made to, or guaranteed by, the private foundation, its disqualified persons, or both;

(iii) Acquires 40 percent or more of the voting stock (or similar interest in the case of an unincorporated entity), 40 percent or more of the value of all outstanding shares of all classes of stock (or similar interest in the case of an unincorporated entity), or 40 percent or more of the assets of a business enterprise if the acquiring business enterprise's net assets used in its trade or business prior to such acquisition are insubstantial when compared to the net assets acquired or when compared to the net assets of the business enterprise, the stock (or similar interest in the case of an unincorporated entity) of which was acquired. For this purpose, an insubstantial ratio means a ratio that is 15% or less; or

(iv) Is used as a device to acquire or expand excess business holdings. The determination of whether a business enterprise is used as a device to acquire or expand excess business holdings shall be determined based on all the facts and circumstances. A business enterprise shall be presumed to have been used as a device to acquire or expand excess business holdings if it acquires 40 percent or more of the voting stock (or similar interest in the case of an unincorporated entity), 40 percent or more of the value of all outstanding shares of all classes of stock (or similar interest in the case of an unincorporated entity), or 40 percent or more of the assets of a business enterprise if the consideration for the acquisition consists primarily of nonvoting stock (or similar interest in the case of an unincorporated entity) of the acquiring business enterprise.

(3) *Corporation involved in a readjustment.* A corporation shall be treated as involved in a readjustment if, as part of the readjustment, any stock of the corporation is issued or redeemed, or any stock or assets of the corporation are distributed, exchanged, purchased, sold, acquired, or otherwise transferred.

(e) *Application to unincorporated business enterprise.* The rules of this section shall apply equally to partnerships and other unincorporated business enterprises, applying the rules and substitutions provided in §53.4943-3(c)(2), (3), and (4).

(f) *Examples.* The provisions of this section and §53.4943-6(d) are illustrated by the following examples, which assume no prohibited transactions are involved unless otherwise stated:

Example (1). (i) F, a private foundation, has owned 80% of the one outstanding class of stock of X corporation since 1965. The X stock is subject to section 4943(c)(4) with a first phase ending on May 25, 1984. On January 1, 1982, X merges with Y corporation to form Z corporation. X, Y, and Z are active business corporations. F owns no Y stock. No disqualified person with respect to F owns any stock in X, Y, or Z. After the merger, F owns 25% of the one outstanding class of Z stock. Third parties do not control Z so that the 35% permitted holdings rule under section 4943(c)(2) is inapplicable.

(ii) F's percentage of voting power and value in Z after the merger (25%) are less than F's percentages of voting power and value in X before the merger (80%). Therefore, under paragraph (a)(1) of this section, all of F's holdings in Z are treated as the X stock surrendered. Therefore, the Z stock is treated as subject to section 4943(c)(4) with a first phase ending on May 25, 1984. Under the downward ratchet of paragraph (a)(5) of this section, the foundation voting and value levels and the substituted combined voting and value levels are reduced to 25%.

Example (2). (i) F, a private foundation, owns 100% of the one outstanding class of stock in X corporation and 30% of the one outstanding class of stock in Y corporation. F has held this stock continuously since 1960, and no disqualified person has even owned any stock in X or Y. Under section 4943(c)(4), F's holdings in X are treated as held by disqualified persons through the end of the first phase on May 25, 1989, and F's holdings in Y are permitted holdings during the second phase, which began on May 26, 1979. On January 1, 1985, X and Y consolidate, forming a new corporation Z. In the consolidation, F acquires 50% of the one class of outstanding stock of Z, 40% in exchange for F's 100% interest in X and 10% in exchange for F's 30% interest in Y. Unrelated parties hold the remaining 50% of Z.

(ii) F's percentages of voting power and value in Z after the merger (50%) are less than F's percentages of voting power and value in X before the merger (100%). Thus, under paragraph (a)(1) of this section, the 50% interest in Z held by F is treated as the stock surrendered in the exchange for purposes of section 4943(c)(4). Under paragraph (b)(6) of this section, the 10% interest in Z received for the Y stock is subject to the same second phase period as the surrendered Y stock. The 40% interest in Z received for the X stock is subject to the same first phase period as the surrendered X stock.

Example (3). (i) F, a private foundation, owns 50% of the one class of outstanding stock in X corporation which F has held continuously since 1935. No disqualified person with respect to F owns any stock in X. Neither F nor any disqualified person with respect to F owns any stock in Y corporation. On July 1, 1982, X and Y enter into an agreement to consolidate their businesses in a reorganization to which section 368(a)(1)(A) will apply. As a result of the contemplated consolidation, F will own 60% of the voting stock in Z, the resulting corporation. In addition, parties unrelated to F will own the remaining 40% of the Z voting stock and 100% of a new issue of nonvoting preferred stock in Z. Assume for purposes of this example, that the 60% of the voting stock to be held by F in Z will represent 50% of the fair market value of the outstanding Z stock.

(ii) Under the provisions of paragraph (b)(1) of this section, that portion of the Z stock held by F which represents a percentage of voting power equivalent to that held by F in X immediately prior to the consolidation (i.e., 50%) will be treated as the X stock held by F on May 26, 1969, for purposes of section 4943(c)(4). Therefore, 50% of the Y stock will be treated as subject to a second phase ending on May 25, 1994. The remaining portion of the Z voting stock held by F (10%) is subject to the provisions of §53.4943-6(d)(1). F will have five years from the date of the merger in which to dispose of 10% of the Z stock without incurring the tax on excess business holdings.

Example (4). (i) F, a private foundation, owns 80% of the one class of outstanding stock in X corporation, an active business corporation. F has held this stock continuously since 1960 and no disqualified person with respect to F owns any stock in X. X has two operating divisions, one which manufactures shoes and the other which manufactures refrigerators. On January 1, 1978, in a section 351(a) exchange, X transferred all of the assets of its shoe manufacturing division to Y, a corporation which X has formed for this purpose, and receives 100% of the stock of Y so that Y is a wholly-owned subsidiary of X. X then transfers all of the Y stock to F in exchange for all of F's holdings of X stock in a distribution to which section 355 applies.

(ii) Under paragraph (b)(1) of this section, 80% of the Y stock is treated as the X stock surrendered in the exchange for purposes of section 4943(c)(4). The 80% is treated under §53.4943-4(c) as held by disqualified persons through May 25, 1984, which constitutes the 15-year first phase holding period applicable to the 80% holding in X. The 80% of the Y stock must be reduced to the permitted holdings allowed during the second and third phase as provided by section 4943(c)(4)(D) in the same manner as F's holdings of X stock would have had to have been reduced.

(iii) Under §53.4943-6(d)(1), the remaining 20% of Y stock is treated as held by a disqualified person for five years from the date of the exchange. F will have five years from the date of the exchange in which to dispose of 20% of

the Y stock without incurring the tax on excess business holdings.

Example (5). (i) X corporation, an active business corporation, has outstanding 1,000 shares of one class of stock, of which 600 shares have been held by F1, a private foundation; 100 shares have been held by F2, another private foundation; and 100 shares have been held by D, a disqualified person with respect to both F1 and F2. Unrelated parties hold the remaining 200 shares. F1 and F2 are disqualified persons with respect to each other under section 4946(a)(1)(H). Thus, F1 holds 60% of the X stock (600/1000); F2 and D each hold 10% (100/1000); and the foundation group (F1, F2 and D) holds 80% of X (800/1000). The holdings of F1 and F2 were acquired on January 1, 1980 pursuant to a pre-1969 will and are subject to section 4943(c)(5). There have been no changes in holdings since January 1, 1980.

(ii) On January 1, 1985, pursuant to a plan to dispose of excess business holdings approved by the Commissioner under paragraph (c) of this section, X redeems for cash the 600 shares held by F1. After the redemption, D and F2 each hold 25% of X (100/400). F1 no longer holds any X stock. The foundation group's holdings (F1, F2 and D) have decreased from 80% to 50% while holdings of unrelated parties have increased from 20% to 50%. At the same time F2's and D's holdings each have increased from 10% to 25%.

(iii) Notwithstanding the increase in F2's and D's holdings, under paragraph (c) of this section, all of the X stock held by F2 will be treated as held by a disqualified person through the end of the first phase (December 31, 1994). However, the foundation voting and value levels do not increase. Therefore, after the end of the first phase, F2's holdings in X may not exceed 10 percent (if the combined holdings of F1, F2 and D exceed the permitted holdings under section 4943(c)(2)).

Example (6). (i) X corporation, an active business corporation, has outstanding 1,000 shares of its one class of stock. Since 1960, 100 shares (10%) have been held by F, a private foundation and 350 shares (35%) have been held by D, a disqualified person with respect to F. All of the stock held by F is permitted holdings under section 4943(c)(4) and the substituted combined voting and value levels are 45% (10% + 35%). Because of disagreements concerning management of X between D and A, an unrelated party who holds 300 shares (30%) of the X stock, X redeems all of A's shares on December 1, 1981.

(ii) After the redemption, F holds 14.3% (100/700) of the X stock and D holds 50% (350/700), for combined holdings of 64.3%. Because the combined holdings exceed the substituted combined voting level (45%) by more than F's entire holdings, all of the F stock is excess business holdings. However, all of F's stock will be treated as acquired other than by purchase under §53.4943-6(d)(1) and therefore will be treated under section 4943(c)(6) and this section, as held by a disqualified person for five years from the date of the redemption (through November 30, 1986). If the combined holdings of F and its disqualified person are reduced to 45 percent by the end of the five year period, F may retain a portion of its holdings in X (limited to no more than the foundation voting and value level of 10 percent).

Example (7). Assume the same facts as in *Example (6)*, except that D loaned the money to X that was used to redeem A's shares. Under these facts, the increased holdings result from a prohibited transaction described in paragraph (d)(2) of this section. Therefore, all of F's stock will be treated as acquired by purchase by a disqualified person under §53.4943-6(d)(2). F will have 90 days after the redemption in which to dispose of its holdings or to reduce its holdings and the combined holdings to the levels held prior to the redemption as discussed in *Example (6)*.

Example (8). (i) F, a private foundation, has held 100% of the outstanding stock of X corporation since 1960. F also holds 15% of the voting stock of Y corporation. Both X and Y are active business corporations. X has $1 million in net assets used in its trade or business and Y has $6.7 million used in its trade or business. On June 1, 1985, Y is merged into X. After the merger F holds 25% of the voting stock of X. No person other than F controls X after the merger.

(ii) Because more than 40% of Y was acquired and the net assets of X, the acquiring corporation, used in its trade or business prior to the merger represent less than 15% of the net assets of Y used in its trade or business, the merger is a prohibited transaction described in paragraph (d)(2)(iii). Therefore, only 15% of the stock of X is treated, pursuant to paragraph (b), as the stock held by F prior to the redemption. F's holding of 5% (the excess of F's 25% holdings over the 20% permitted holdings in X (determined under section 4943(c)(2)) are treated as purchased by a disqualified person pursuant to §53.4943-6(d)(2). F will have 90 days after June 1, 1985, in which to dispose of the 5% excess holdings.

Par. 4. Section 53.4943-8 is amended by adding new paragraph (a)(3), (4) and (5),(c),(d) and (e) to read as follows:

§53.4943-8 Business holdings; constructive ownership.

(a) *Constructive ownership.* ***

(3) *Determination of extent of constructive ownership.* If an interest in a business enterprise owned by a corporation is constructively owned by a shareholder, each shareholder's proportion of ownership is generally computed on the basis of the voting stock each shareholder has in the corporation. In determining holdings permitted under section 4943(c)(4) and (5), each shareholder's proportion of ownership in the business enterprise shall also be computed on the basis of value, taking into account both voting and nonvoting stock held by the shareholder.

(4) *Nonvoting stock.* If a private foundation, its disqualified persons, or both, own (directly or constructively) nonvoting stock of a parent corporation, the holdings of which are treated as constructively owned by its shareholders by reason of section 4943(d)(1) and this section, such nonvoting stock shall be treated as nonvoting stock of any corporation in which the parent corporation holds an interest for purposes of the limitation on the holding of nonvoting stock under section 4943(c)(2)(A) and §53.4943-3(b)(2).

(5) *Interests held by certain disqualified persons.* In the case of an entity that is a disqualified person (other than an entity described in section 4946(a)(1)(H)), the holdings of which are treated as constructively owned by its shareholders, partners, or beneficiaries, for purposes of determining the total holdings of disqualified persons the holdings of the entity shall be considered held by a disqualified person only to the extent such holdings are treated as constructively owned by disqualified persons who are shareholders, partners, or beneficiaries of the entity. In the case of an entity described in section 4946(a)(1)(H) or an entity, the holdings of which are not treated as constructively owned by its shareholders, partners, or beneficiaries, all holdings of such entity shall be treated as held by a disqualified person only if and only if the entity itself is a disqualified person.

* * * * *

(c) *Corporation actively engaged in a trade or business*—(1) *In general.* Except as provided in paragraphs (c)(2) and (3) of this section, any interest (whether or not in a separate entity) owned by a corporation which is actively engaged in a trade or business shall not be deemed to be constructively owned by such corporation's shareholders.

(2) *Actively engaged in a trade or business.* For purposes of paragraph (c)(1) of this section—

(i) A corporation shall not be considered to be actively engaged in a trade or business if the corporation is not a business enterprise by reason of section 4943(d)(3)(A) or (B) and §53.4943-10(b) or (c);

(ii) In the case of a corporation which owns passive holdings and is

actively engaged in a trade or business, such corporation shall not be considered to be actively engaged in a trade or business if the net assets used in such trade or business are insubstantial when compared to passive holdings.

(3) *Exceptions.* If a corporation has been involved in a prohibited transaction, any interest in a business enterprise owned by such corporation shall be treated as constructively owned by its shareholders, whether or not such corporation is actively engaged in a trade or business. For a definition of prohibited transaction, see §53.4943-7(d)(2).

(4) *Affiliated group.* In applying this paragraph to the common parent in an affiliated group (as defined in §53.4943-10(c)(3)(ii)), the assets and activities of the affiliated group shall be treated as the assets and activities of the common parent.

(d) *Partnerships.* Any interest in a business enterprise which is owned by a partnership shall be deemed to be constructively owned by the partners in such partnerships.

(e) *Examples.* The provisions of this section are illustrated by the following examples.

Example (1). F, a private foundation, directly owns voting stock of X, a holding company described in section 4943(d)(3)(B). That stock represents 40% of the voting power in X and 20% of the value of all outstanding shares of all classes of stock in X. F also owns nonvoting stock in X that represents 10% of the value of all outstanding shares of all classes of stock in X. D, a disqualified person, owns voting stock of X that represents 40% of the voting power in X and 20% of the value. D does not own any nonvoting stock in X. X corporation's only holding is stock of Y corporation. The Y voting stock held by X represents 50% of the voting power in Y and 25% of the value of all outstanding shares of all classes of stock in Y. X also owns nonvoting stock in Y that represents 25% of the value of all outstanding shares of all classes of stock in Y. Under paragraph (a)(3) of this section, F and D each constructively owns 20% of the voting power in Y through their voting interest in X (40% of X's 50% of Y). F also constructively owns 15% of the value of all outstanding shares of all classes of stock in Y through F's interest in X (F's 30% of the value of X multiplied by X's 50% of the value of Y), while D constructively owns 10% of the value of Y (D's 20% of the value of X multiplied by X's 50% of the value of Y).

Example (2). (i) F, a private foundation, owns 50% of the one class of nonvoting stock of X corporation, a corporation described in section 4943(d)(3)(B) and paragraph (c)(2)(i) above. D, a disqualified person with respect to F as described in section 4946(a)(1)(A), owns 40% of the one class of voting stock of X. X corporation is a disqualified person with respect to F because D owns more than 35% of the voting of X. (See section 4946(a)(1)(E)). On January 1, 1980, X purchases for cash 40% of the only class of stock of Y corporation, a retail clothing store, from unrelated third parties.

(ii) Under paragraph (a)(4) of this section, F is treated as owning nonvoting stock of Y. Although X is a disqualified person, its holdings are not treated as held by disqualified persons except as constructive holdings. Therefore, the "deemed" nonvoting stock in Y is a permitted holding because D, a disqualified person with respect to F, constructively owns only 16% of the voting stock of Y (less than 20% permitted under section 4943(c)(2)).

Example (3). (i) The facts are the same as in *Example (2)*, except that X purchases 100% of the stock of Y corporation. Under paragraph (a)(4) of this section, F is treated as owning nonvoting stock of Y. The "deemed" nonvoting stock in Y is not a permitted holdings because D, a disqualified person with respect to F, constructively owns 40% of the voting stock of Y.

Example (4). (i) D, a disqualified person with respect to F, owns 40% of the one class of stock in X corporation, an active business. X is a disqualified person with respect to F. X acquires 40% of the voting stock in Y corporation. Under paragraph (a)(5) of this section, the holdings of X in Y are treated as held by a disqualified person. F cannot hold any Y stock, voting or nonvoting.

Par. 5. Section 53.4943-10 is amended by adding new paragraphs (c)(3) and (d)(2) to read as follows:

§53.4943-10 Business enterprise; definition.

* * * * *

(c) *Income derived from passive sources.*

***

(3) *Affiliated group.* (i) For a common parent corporation in an affiliated group, substitute "consolidated gross income" in subparagraph (1) of this paragraph.

(ii) For purposes of this section, the term "affiliated group" shall have the same meaning as in section 1504(a), without regard to section 1504(b) through (e).

(iii) Section 53.4943-11(d) provides a transitional rule for certain parent corporations.

(d) *Application of section 4943(c)(6).* ***

(2) *Passive holdings, etc.* (i) Except as provided in subdivision (ii), if a private foundation holds an interest that is not an interest in a business enterprise, and the interest later becomes an interest in a business enterprise (other than by reason of a readjustment as defined in §53.4943-7(d)(1)), the interest will be treated as having been acquired by purchase by a disqualified person at the time the interest become an interest in a business enterprise. The treatment of an interest that becomes an interest in a business enterprise by reason of a readjustment shall be determined under §53.4943-6 and §53.4943-7.

(ii) If a private foundation establishes that the events which caused an interest not originally a business enterprise to become a business enterprise were not effectively controlled by the private foundation, then such interest shall be treated as acquired other than by purchase from the time of the change for purposes of section 4943(c)(6).

(iii) See §53.4943-3(b)(3)(ii) for the definition of effective control.

Par. 6. Section 53.4943-11 is amended by adding new paragraphs (c), (d) and (e) to read as follows:

§53.4943-11 Effective date.

* * * * *

(c) *Special transitional rule for acquisition by will, etc.* (i) The rule in §53.4943-6(b)(1) whereby holdings not held by a decedent are not treated as acquired under a will shall not apply to acquisitions of after-acquired property of a decedent's estate occurring on or before May 22, 1984.

(ii) The rule in §53.4943-6(b)(1) treating a purchase by an estate as a purchase by a disqualified person where the executor is a disqualified person shall not apply to purchases occurring on or before May 22, 1984.

(d) *Special transitional rule for affiliated groups.* If on or before May 22, 1984 a foundation holds an interest in a common parent corporation in an affiliated group, as defined in §53.4943-10(c)(3)(ii), the foundation may elect to have both §53.4943-8(c)(4) and §53.4943-10(c)(3) not apply to such common parent corporation. No election may be made to have only one section not apply. Such election shall be made by the governing body of the private foundation at any time prior to February 22, 1985.

(e) *Special transitional rule for changes to a business enterprise.* Any interest that is not an interest in a business enterprise which becomes an interest in a business enterprise under §53.4943-10(d)(2) prior to May 22, 1984 will be treated as having been acquired other than by purchase for purposes of section 4943(c)(6).

This Treasury decision is issued under the authority contained in sections 4943(c)(4)(A) and 7805 of the Internal Revenue Code of 1954 (83 Stat. 507, 68A Stat. 917; 26 U.S.C. 4943(c)(4)(A)(iv) and 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved February 6, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 21, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 22, 1984, 49 F.R. 6476)

Chapter 45.—Windfall Profit Tax on Domestic Crude Oil
Subchapter A.—Imposition and Amount of Tax

Section 4986.—Imposition of Tax

26 CFR 51.4986-1: Imposition of tax. (Also Sections 4988, 4996; 51.4988-1, 150.4996-1.)

Windfall profit tax; production payments. A question and answer format is used to explain which party is liable for the payment of the windfall profit tax on oil removed from the property that is applied to the satisfaction of a production payment in the case of (1) the owner of a production payment carved out for exploration or development of an oil and gas property, and (2) the owner of a production payment retained on the sale of a mineral property.

Rev. Rul. 84-16

The following questions and answers relate to which party is liable for the payment of the Crude Oil Windfall Profit Tax on oil removed from the property that is applied to the satisfaction of a production payment in the case of (1) the owner of a production payment carved out for exploration or development of an oil and gas property, and (2) the owner of a production payment retained on the sale of a mineral property.

Q.1 Is the owner of a production payment pledged for exploration or development, within the meaning of section 1.636-1(b)(1) of the Income Tax Regulations, liable for the windfall profit tax on the crude oil removed from the property applied to the satisfaction of the production payment?

A.1 Yes. The owner of a production payment pledged for exploration or development is liable for the windfall profit tax on the crude oil removed from the property applied to the satisfaction of the production payment. Section 51.4996-1(b)(1) of the Excise Tax Regulations provides that the owner of a production payment shall be treated as a producer only to the extent that the production payment is treated as an economic interest by section 636 of the Internal Revenue Code, taking into account the effective date of that section.

The owner of a production payment pledged for exploration or development is treated, under section 636, as the owner of an economic interest in the oil in place. The owner of an economic interest is a "producer" under section 4996(a) of the Code and section 51.4996-1(b)(1) of the regulations and is thus subject to tax. Section 4988(b)(5) of the Code provides that for purposes of determining the net income limitation on the windfall profit tax under section 4988(b)(2), both parties to a production payment must include in their gross income from the property the gross income attributable to any portion of the crude oil removed from the property that is applied in discharge of the production payment.

Q.2 Is the owner of a retained production payment created after August 6, 1969, on the sale of a property liable for the windfall profit tax on any oil removed from the property?

A.2 No. The owner of a production payment, created after August 6, 1969 and retained on the sale of a mineral property, is not liable for the windfall profit tax on any oil removed from the property. Section 51.4996-1(b)(1) of the regulations provides that the owner of a production payment shall be treated as a producer only to the extent that the production payment is treated as an economic interest by section 636, taking into account the effective date of that section. Under section 636 of the Code, a retained production payment, created after August 6, 1969, is treated as a purchase money mortgage loan (rather than as an economic interest in the mineral property). Because the payor of the production payment owns the economic interest in the property, the payor is liable for the payment of the windfall profit tax on crude oil removed from the property.

Section 4988—Windfall Profit; Removal Price

26 CFR 51.4988-1: Windfall profit; removal price.

Whether the windfall profit tax is imposed on the owner of a production payment pledged for development and whether the windfall profit tax is imposed on the owner of a produc-duction payment retained on the sale of the property. See Rev. Rul. 84-16, this page.

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26 CFR 51.4988-2: Windfall profit, removal price.

Windfall profit tax; costs incurred in drilling injection wells. Costs incurred in drilling injection wells must be capitalized into the taxpayer's "as if" cost depletion basis for the purposes of determining the taxpayer's net income from the property under section 4988(b) of the Code. These costs cannot be excluded as costs of drilling a nonproductive well.

Rev. Rul. 84-65

ISSUE

Under the circumstances described below, how are costs incurred in drill-

ing and completing injection wells taken into account in determining the taxpayer's net income from the property under section 4988(b) of the Internal Revenue Code?

FACTS

The taxpayer owned an economic interest in all of the oil and gas contained in a certain "oil field." For several years the taxpayer, an operator, produced oil by natural flow from the central part of the field. The perimeter area of the field, however, could not be developed for production in commercial quantities in the absence of a water flooding program because the natural reservoir energy in this area was inadequate. The taxpayer developed the perimeter area of the field by setting up several "five-spot" well patterns. The taxpayer drilled water injection wells at four points with one oil producing well in the center. The injection of water supplemented the natural reservoir energy (pressure) causing oil to flow to the oil wells in the center of the "five spot" patterns. Production from these oil wells was maintained by water flooding through the injection wells from a central plant.

LAW AND ANALYSIS

Section 4988(b) of the Code provides for a net income limitation on the windfall profit attributable to a barrel of crude oil. Section 4988(b)(2) defines net income in terms of the taxable income from the property. Section 4988(b)(3) states that taxable income from the property for purposes of section 4988(b)(2) is determined under section 613(a) with certain exceptions. Two of these exceptions are that no deduction is allowed, in computing this taxable income from the property, (1) for section 263(c) costs, and (2) for depletion other than cost depletion computed in accordance with section 4988(b)(3)(C). Under section 4988(b)(3)(C), this cost depletion deduction is that amount that would have been allowed if all section 263(c) costs incurred by the taxpayer had been capitalized and taken into account in computing cost depletion and cost depletion had been used by the taxpayer for all taxable years. Section 4988(b)(3)(D) defines the term "section 263(c) costs" for these purposes as intangible drilling and development costs incurred by the taxpayer that, by reason of an election under section 263(c), may be deducted as expenses, but that such term does not include costs incurred in drilling a nonproductive well.

Section 51.4988-2(b)(3)(iii) of the regulations provides that for purposes of calculating the net income limitation a nonproductive well is any well that has been abandoned or is reasonably expected never to produce oil or gas in commercial quantities. Implicit in this definition is that the well was drilled for the purpose of producing oil or gas through it.

Injection wells are not drilled for the purpose of producing oil and gas through them. Therefore, wells drilled and completed as injection wells cannot be treated as nonproductive wells under section 4988(b)(3)(D) of the Code and section 51.4988-2(b)(3)(iii) of the regulations.

The manner in which the costs of drilling injection wells are taken into account for purposes of section 4988(b) depends on how these costs are treated in computing the income from the property for federal income tax purposes.

If the drilling costs are properly expensed under section 263(c), for federal income tax purposes, then for windfall profit purposes they are capitalized into the hypothetical basis of the property used to calculate the cost depletion that would have been allowable if certain costs had been capitalized and the taxpayer had used cost depletion for prior tax years. Section 4988(b)(3)(C)(i)(I) of the Code and section 51.4988-2(b)(3) of the regulations.

If the drilling costs are capitalized, however, the taxpayer may allocate the costs as provided in section 1.612-4(b) of the regulations. Most of the expenses are allocated to the hypothetical cost depletion basis. Costs representing physical property such as the amounts paid for wages, fuel, repairs, hauling, supplies, etc., used in installation of casing and equipment or in the construction on the property of derricks and other physical structures, must be allocated to depreciable property and are taken into account over the depreciable life of that property.

HOLDING

Under the circumstances described, the costs of wells drilled and completed as injection wells, whether capitalized or expensed under section 263(c) of the Code, are not costs of drilling nonproductive wells. In determining the taxpayer's net income from the property under section 4988(b) and the cost depletion that would have been allowable for the taxable year under section 4988(b)(3)(C), such costs must be capitalized.

Section 4989.—Adjusted Base Price

26 CFR 51.4989-1: Adjusted base price.

T.D. 7905—Correction

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER D, PART 51—EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Base Prices of Tier 2 and 3 Oil

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final rule.

SUMMARY: This document contains corrections to the FEDERAL REGISTER publication beginning at 48 FR 35092 of the final regulations that were the subject of Treasury Decision 7905 [1983-2 C.B. 205]. T.D. 7905 relates to determination of base prices of tier 2 and 3 oil for purposes of the windfall profit tax on domestically produced crude oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1,2].

EFFECTIVE DATE: Except as otherwise stated in the amendments that constitute T.D. 7905, the regulations that are the subject of this correction are effective with respect to tax liability for windfall profit tax on crude oil removed from the premises after September 30, 1980.

FOR FURTHER INFORMATION CONTACT: Donald W. Stevenson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, Washington, D.C. 20224 (Attn: CC:LR:T), telephone 202-566-3297 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 3, 1983, the FEDERAL REGISTER published final regulations (48 FR 35092) [T.D. 7905, 1983-2 C.B. 205] relating to the determination of base prices of tier 2 and 3 oil for purposes of the windfall profit tax on domestically produced crude oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980. The regulations were issued under the authority of sections 4989(d), 4997(b) and 7805 of the Internal Revenue Code of 1954 (94 Stat. 233, 26 U.S.C. 4989(d); 94 Stat. 249, 26 U.S.C. 4997(b); 68A Stat. 917, 26 U.S.C. 7805).

NEED FOR A CORRECTION

As published, the amendatory language of T.D. 7905, beginning at the bottom of page 35093, right column [1983-2 C.B. 206], has raised some questions with regards to the 1984 revision of Title 26 CFR. This correction notice restates the amendatory language of T.D. 7905 in a format that resolves those uncertainties.

CORRECTION OF PUBLICATION

Accordingly, the publication of Treasury Decision 7905, which was the subject of FR Doc. 83-21096, is corrected by revising the amendatory language that begins at the bottom of the right column on page 35093 to read as follows:

PART 51—[AMENDED]

§51.4989-1 [AMENDED]

Paragraph 1. The proposed regulations under section 4989(d)(1) of the Internal Revenue Code of 1954, the text of which is set out as temporary regulations §150.4989-1(c)(1)-(7), are adopted as final regulations under §51.4989-1(c)(1)-(7).

Paragraph 2. Paragraph (c)(2) of §51.4989-1 is amended by removing "March 1, 1980." and adding in its place "April 1, 1980.", and by removing "§150.6050C-1" and adding in its place "§51.6050C-1".

Paragraph 3. Paragraph (c)(3) of §51.4989-1 is amended by removing "March 1, 1980." and adding in its place "April 1, 1980.".

Paragraph 4. Paragraph (c)(7) of §51.4989-1 is amended by removing "§150.4995-1" everywhere it appears and adding in those places "§51.4995-1", and by removing "§150.4995-3" everywhere it appears and adding in those places "§51.4995-3".

PART 150—[AMENDED]

§150.4989-1 [AMENDED]

Paragraph 5. Paragraphs (c)(1)-(7) of §150.4989-1 are removed.

GEORGE H. JELLY,
Director, Legislation and
Regulations Division.

(Filed by the Office of the Federal Register on April 17, 1984, 8:45 a.m., and published in the issue of the Federal Register for April 18, 1984, 49 F.R. 15187)

Subchapter C.—Miscellaneous Provisions

Section 4995.—Withholding; Depositary Requirements

26 CFR 51.4995-1: Requirement of withholding.
(Also Section 4997; 51.4997-2.)

Windfall profit tax; withholding adjustments for suspense accounts. First purchasers must make withholding adjustments for crude oil sales proceeds held in suspense accounts until Form 6248, Annual Information Return of Windfall Profit Tax, is provided to the producer.

Rev. Rul. 84-47

ISSUE

Is a first purchaser of crude oil required to make windfall profit tax withholding adjustments for crude oil sales proceeds held in a suspense account under the circumstances described below?

FACTS

In October, 1982, *X*, a first purchaser of crude oil, bought taxable crude oil produced from property *B*. Because the title to the royalty interest in *B* was being litigated, *X* was unable to identify the owner of that interest. Therefore, *X* withheld windfall profit tax from the proceeds attributable to that interest and placed the balance of the proceeds in a suspense account.

On April 30, 1983, *X* filed with the Internal Revenue Service Form 6248, Annual Information Return of Windfall Profit Tax, for the suspense account. On May 15, 1983, *X* discovered that too little windfall profit tax had been withheld and that the amount reported on the filed Form 6248 with respect to the October purchase was, thus, incorrect. As of May 15, 1983, the proceeds held in the suspense account had not been distributed.

LAW AND ANALYSIS

Section 4986 of the Internal Revenue Code imposes a tax on the windfall profit from taxable crude oil removed from the premises during each taxable period. The tax is to be paid by the producer of the crude oil.

Under section 4955(a)(1)(A) of the Code, except to the extent provided in regulations prescribed by the Secretary, the first purchaser of any domestic crude oil is required to withhold a tax equal to the amount of tax imposed by section 4986 with respect to such oil from amounts payable by such purchaser to the producer of such oil. Under section 4995(a)(2)(B),

the net income limitation is not to be applied for this purpose.

Under section 4955(a)(3) of the Code, to the extent provided in regulations prescribed by the Secretary, withholding errors made by a purchaser with respect to the crude oil of a producer shall be corrected by that purchaser by making proper adjustments in the amounts withheld from subsequent payments to such producer for crude oil.

Section 51.4995-1(c)(1)(ii) of the Excise Tax Regulations (relating to withholding adjustments) provides the full adjustment must be made, if possible, in the next payment. If it is not possible to complete the adjustment in the next payment, the purchaser shall adjust to the fullest extent possible in each subsequent payment until the adjustment is completed. However, no adjustment is to be made in the amount withheld from payments made after the statement required by section 51.4997-2(c) (relating to annual statement of windfall profit tax liability) is furnished.

Under Section 51.4997-2(c) of the regulations, for each calendar year purchasers must furnish a statement to each producer, operator, partnership, or disburser to whom the purchaser made payments and file with the Service a separate information return on Form 6248. Generally, the yearly statement is to be furnished by March 31 of the year immediately following the calendar year to which the statement applies, and the information return is to be filed with the Service by April 30 of that year.

Under section 51.4997-2(e) of the regulations, if, due to the fact that the identity of the producer is not known or is in dispute, the sales proceeds from crude oil have been placed in escrow or otherwise held in suspense and have not been distributed to the producer at the time the information return is required to be filed under section 51.4997-2(c), a return (on Form 6248), clearly identified as relating to suspended funds, shall be filed for each account. Not later than 60 days after the sales proceeds have been released to the producer, a return shall be filed identifying the producer and the statements required by section 51.4997-2(c) (and section 51.4997-2(d) if requested by the producer) for past periods shall be furnished to the producer.

Generally, a first purchaser of crude oil making payments to producers is not permitted to adjust errors in windfall profit tax withholding after providing the producer an annual statement on Form 6248 for the calendar year to which the error relates. Under ordinary circumstances the annual statement must be provided not later than March 31 of the year following the year to which it relates. When the sales proceeds of crude oil are not paid to the producer because the identity of the producer is not known or is in dispute and the proceeds are placed by the purchaser in a suspense account and have not been distributed to the producer at the time the annual information return required by section 51.4997-2(c) of the regulations is required to be filed, the time for furnishing the annual statement to the producer is extended not to exceed 60 days from the date the suspended proceeds are distributed. By that date another information return identifying the producer must also be furnished to the Service.

In the situation described above, the statement has not been furnished to the producer as of the date the withholding error is discovered because there is a dispute over the identity of the producer, the holder of the royalty interest, and the sales proceeds held in the suspense account were for that reason not distributed as of that date. Therefore, a withholding adjustment must be made with respect to the suspended funds.

HOLDING

The first purchaser must adjust the underwithholding error by withholding additional tax from the amounts payable for the October production held in the suspense account and deposit the additional tax on or before the next regular deposit date.

Section 4996.—Other Definitions and Special Rules

26 CFR 51.4996-1: Definitions.

Procedures for applying partnership audit rules to the crude oil windfall profit tax for 1983. See Rev. Proc. 84-4, page 363.

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26 CFR 150.4996-1: Definitions.

Whether the windfall profit tax is imposed on the owner of a production payment pledged for development and whether the windfall profit tax is imposed on the owner of a production payment retained on the sale of a property. See Rev. Rul. 84-16, page 229.

Section 4997.—Records and Information; Regulations

26 CFR 51.4997-1: Returns and recordkeeping.

Procedures for the filing of consolidated windfall profit tax returns by certain partnerships for 1983. See Rev. Proc. 84-4, page 363.

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26 CFR 51.4997-2: Certain information to be furnished by purchaser and others.

Procedures for the filing and furnishing of Form 6248 by certain partnerships for 1983. See Rev. Proc. 84-4, page 363.

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26 CFR 51.4997-2: Certain information to be furnished by purchaser and others.

Requirements and conditions for filing Form 6248, Annual Information Return of Windfall Profit Tax, on magnetic tape. See Rev. Proc. 84-31, page 487.

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26 CFR 51.4997-2: Certain information to be furnished by purchaser and others.

Whether a first purchaser is required to make withholding adjustments after filing the return on Form 6248 for crude oil windfall profit tax on amounts held in suspense because the identity of the producer is not known or is in dispute. See Rev. Rul. 84-47, page 231.

Subtitle F.—Procedure and Administration
Chapter 61.—Information and Returns
Subchapter A.—Returns and Records
Part I.—Records, Statements, and Special Returns

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 31.6001-5: Additional records in connection with collection of income tax at source on wages.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 84-41, page 515.

Part II.—Tax Returns or Statements
Subpart A.—General Requirement

Section 6011.—General Requirement of Return, Statement or List

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

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26 CFR 1.6011-1: General requirement of return, statement, or list.

Requirements for the reproduction and private design and printing of federal tax return forms and the conditions under which the Service will accept computer-prepared and computer-generated tax forms and substitutes. See Rev. Proc. 84-9, page 375.

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26 CFR 1.6011-3: Requirement of statement from payees of certain gambling winnings (Also Section 3402; 31.3402(q)-1.)

T.D. 7943

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, SUBCHAPTER C, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 31.—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Postponement of effective date —Information from recipients of gambling winnings

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document postpones the effective date of regulations relating to information from recipients of gambling winnings (T.D. 7919) published in the FEDERAL REGISTER on Wednesday, October 12, 1983 (48 FR 46296) [1983-2 C.B. 213].

DATE: Those regulations are effective for payments of gambling winnings made after December 31, 1983, instead of for payments of winnings made after November 14, 1983.

FOR FURTHER INFORMATION CONTACT: Barry L. Wold of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3808).

SUPPLEMENTARY INFORMATION:

IN GENERAL

On Wednesday, October 12, 1983, the FEDERAL REGISTER published amendments to the Income Tax Regulations (26 CFR Part 1) and the Employment Taxes and Collection of Income Tax at Source Regulations (26 CFR Part 31) under sections 3402(q) and 6011 of the Internal Revenue Code of 1954 (48 FR 46296). Those regulations provided that, effective for payment of gambling winnings made after November 14, 1983, gambling winnings from certain identical bets must be aggregated to determine whether those winnings are subject to 20 percent withholding. These regulations postpone the effective date of those regulations to payments of gambling winnings made after December 31, 1983. The Service had previously announced its intention to extend the effective date in a news release dated November 23, 1983 (IR-83-147) [Announcement 83-188, 1983-50 I.R.B. 23].

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this final regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Pursuant to 5 U.S.C. 605(b), the Secretary of the Treasury has certified that the requirements of the Regulatory Flexibility Act do not apply to this final regulation as it will not have a significant impact on a substantial number of small entities.

DRAFTING INFORMATION

The principal author of this regulation is Barry L. Wold of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation on matters of both substance and style.

LIST OF SUBJECTS IN 26 CFR §§1.6001-1 - 1.6109-2

Income taxes, Administration and procedure, Filing requirements.

26 CFR Part 31

Employment taxes, Income taxes, Lotteries, Railroad retirement, Social security, Unemployment tax, Withholding.

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 31 are amended by adding December 31, 1983, as the effective date in the date section of T.D. 7919 (48 FR 46296) in place of November 14, 1983; by removing the phrase "November 14, 1983" from the first sentence of §31.3402(q)-1(c)(1)(ii) and inserting in lieu thereof the phrase "December 31, 1983"; by removing the phrase "December 1, 1983" from the first sentence of §31.3402(q)-1(d) Example (3) and inserting in lieu thereof the phrase "January 1, 1984"; and by removing the phrase "November 14, 1983" from the first sentence of §31.3402(q)-1(f)(1)(vi) and inserting in lieu thereof the phrase "December 31, 1983".

This Treasury decision is issued under the authority contained in sections 6011 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 732, 917; 26 U.S.C. 6011, 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 23, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 11, 1983, 8:45 a.m., and published in the issue of the Federal Register for October 12, 1983, 48 F.R. 46296)

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26 CFR 31.6011(a)-1: Returns under Federal Insurance Contributions Act.

Requirements for filing Form 941 on magnetic tape by reporting agents. See Rev. Proc. 84-11, page 414.

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26 CFR 31.6011(a)-10: Returns of income tax withheld from interest, dividends, and patronage dividends.

Returns to be made by payors who are required to withhold income tax on payments of interest, dividends, and patronage dividends. See T.D. 7949, page 204.

Part III.—Information Returns
Subpart A.—Information Concerning Persons Subject to Special Provisions

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Section 6031.—Return of Partnership Income

26 CFR 1.6031-1: Return of partnership income.

Guidelines are provided under which partnerships with 10 or fewer partners will not be subject to the penalty under section 6698 of the Code for not filing a partnership return. Rev. Proc. 81-11 is superseded. See Rev. Proc. 84-35, page 509.

Section 6032.—Returns of Banks with Respect to Common Trust Funds

26 CFR 1.6032-1: Returns of banks with respect to common trust funds.

Returns of member banks of an affiliated groups with respect to common trust funds. See T.D. 7935, page 136.

Section 6039C.—Returns with Respect to United States Real Property Interests

26 CFR 6a.6039C-1: Returns with respect to United States real property interests.

T.D. 7940

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 6a—INCOME TAX; TEMPORARY INCOME TAX REGULATIONS UNDER TITLE XI OF THE OMNIBUS RECONCILIATION ACT OF 1980

Foreign Investment in United States Real Property

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to the temporary regulations under section 6039C of the Internal Revenue Code of 1954, relating to foreign investment in U.S. real property, published in the FEDERAL REGISTER on September 21, 1982, (47 FR 41532) [T.D. 7832, 1982-2 C.B. 122] as revised by T.D. 7890 published in the FEDERAL REGISTER on April 28, 1983 (48 FR 19163) [1983-1 C.B. 305]. These temporary regulations are necessary to provide the public with immediate guidance with respect to the requirements of section 6039C.

EFFECTIVE DATE: The amendments are effective as of January 31, 1984.

FOR FURTHER INFORMATION CONTACT: Robert E. Culbertson, Jr. of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W. Washington, D.C. 20224, Attention: CC:LR:T (202-566-3289), not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

This document contains amendments to the Temporary Income Tax Regulations under Title XI of the Omnibus Reconciliation Act of 1980 (26 CFR Part 6a) [Pub. L. 96-499, 1980-2 C.B. 509, 512] under section 6039C of the Internal Revenue Code of 1954, as added by section 1123 of the Foreign Investment in Real Property Tax Act of 1980 (94 Stat. 2682) [1980-2 C.B. 524, 526], and as amended by section 831 of the Economic Recovery Tax Act of 1981 (Pub. L. No. 97-34; 95 Stat. 172) [1981-2 C.B. 256, 350]. The amendments are issued under the authority contained in sections 6039C (94 Stat. 2687; 26 U.S.C. §6039C) and 7805 (68A Stat. 917; 26 U.S.C. §7805), both of the Internal Revenue Code of 1954.

DISCUSSION

Temporary and proposed regulations pertaining to the reporting provisions of section 6039C were published in the Federal Register on September 21, 1982. A public hearing on those regulations was held on February 3, 1983. On April 28, 1983, the reporting requirements for 1980, 1981, and 1982 were postponed by amendments to the temporary regulations. These amendments to the temporary regulations similarly postpone all reporting-related deadlines under section 6039C with respect to calendar year 1983, including the deadline for applying for a security agreement in lieu of reporting. The final regulations will establish dates that allow taxpayers sufficient time to determine whether to file information returns or apply for security agreements, and to assemble the necessary information. The postponement of these deadlines by the amendments to the temporary regulations does not affect the obligation to file an income tax return if one is required and to pay any liability arising under the operation of section 897 and the regulations thereunder.

NEED FOR TEMPORARY REGULATIONS

Because of the possibility that amendments to the regulations will affect taxpayers' reporting obligations under section 6039C, it is necessary that the relevant deadlines be postponed until the amendments are issued. Because of the immediate need for these changes, the Internal Revenue Service has found it to be impractical to issue these regulations with notice and public comment procedures as outlined under subsection (b) of section 553 of Title 5 of the

United States Code or subject to the effective date limitation of subsection (d) of that section.

DRAFTING INFORMATION

The principal author of these amendments to the temporary regulations is Robert E. Culbertson, Jr. of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations both on matters of substance and style.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

No notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule. The Commissioner of Internal Revenue has determined that these temporary regulations are not subject to Executive Order 12291.

* * * * *

Adoption of amendments to the temporary regulations.

Accordingly, 26 C.F.R. Part 6a is amended as follows:

Paragraph 1. Section 6a.6039C-1 is amended by revising the first sentence of paragraph (c) to read as follows: "The information returns required by section 6039C must be filed no later than May 15 of the calendar year following the calendar year covered by the return, except that information returns for calendar years 1980, 1981, 1982, and 1983 must be filed no later than the date established by final regulations."

Par. 2. Section 6a.6039C-2 is amended by revising the third sentence of paragraph (d) to read as follows: "The notification by the corporation required by this paragraph (d) must be made by January 31 of the year following the year for which the return must be filed, except that the notification must be made by the date established by final regulations for calendar years 1980, 1981, 1982, and 1983."

Par. 3. Section 6a.6039C-3 is amended by revising the third sentence of paragraph (h) to read as follows: "The statement must be furnished no later than January 31 of the calendar year following the calendar year for which a statement is required, except that it must be furnished by the date established by final regulations for calendar years 1980, 1981, 1982, and 1983."

Par. 4. Section 6a.6039C-5 is amended by revising the last sentence of paragraph (e)(1) and the first sentence of paragraph (h) to read as set forth below.

§6a.6039C-5 Furnishing of security instead of filing information return.

* * * * *

(e) *Appraised fair market value of U.S. real property interests.*—(1) *In general.* *** With respect to security in lieu of filing 1980, 1981, 1982, and 1983 returns, the appraised fair market value of U.S. real property interests shall be determined no later than the date established by final regulations.

* * * * *

(h) *Application for security agreement.* Applications to the Director for a security agreement or for a renewal thereof must be made within 30 days of the close of the calendar year for which a security agreement is desired, or by the date established by final regulations for calendar years 1980, 1981, 1982, and 1983.***

This Treasury decision is issued under the authority contained in sections 6039C and 7805 of the Internal Revenue Code of 1954 (94 Stat. 2687, 26 U.S. §6039C; 68A Stat. 917, 26 U.S.C. §7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved January 26, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 31, 1984, 3:53 p.m., and published in the issue of the Federal Register for February 2, 1984, 49 F.R. 4074)

Subpart B.—Information Concerning Transactions with Other Persons

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payment of $600 or more.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

Section 6043.—Returns Regarding Liquidation, Dissolution, Termination, or Contraction

26 CFR 1.6043-1: Return regarding corporate dissolution or liquidation.

T.D. 7926

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Income Tax—Return Regarding Corporate Liquidation Within One Calendar Month

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations eliminating a requirement that additional information be included in the information return of a corporation liquidating within one calendar month.

DATES: These regulations are effective as of December 16, 1983.

FOR FURTHER INFORMATION CONTACT: Charles W. Culmer of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attn: CC:LR:T) (202-566-4336; not a toll-free number).

SUPPLEMENTARY INFORMATION:

EXPLANATION OF PROVISIONS

This document contains final amendments to the Income Tax Regulations (26 CFR Part 1) under section 6043(a)(1) of the Internal Revenue Code of 1954. The amendments eliminate paragraph (b)(2) from §1.6043-1. Paragraph (b)(2) specifies additional information required to be included in the section 6043(a)(1) information return of a corporation liquidating pursuant to section 333 (Form 966). The amendments will permit the deletion of Item 11 from the existing Form 966.

The Internal Revenue Service has determined that paragraph (b)(2) imposes a burden on taxpayers which is not justified by the use which the Service makes of the additional information.

OMISSION OF NOTICE

Issuance of these regulations was not preceded by publication in the Federal Register of a notice of proposed rulemaking and request for comments. These steps were dispensed with as unnecessary because it is believed that these regulations, which liberalize existing requirements, are beneficial to all interested parties.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. The Internal Revenue Service has concluded that the regulations contained herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

DRAFTING INFORMATION

The principal author of this Treasury decision is Charles W. Culmer of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in drafting this Treasury decision, both on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Section 1.6043-1 is amended by striking out paragraph (b)(2) and renumbering paragraph (b)(3) as paragraph (b)(2).

This Treasury decision liberalizes existing rules with respect to information required to be included in the section 6043(a)(1) information return of a corporation liquidating pursuant to section 333. This change does not affect the tax liability of any taxpayer and is considered to be beneficial to all interested parties. For these reasons, it is found unnecessary to issue this Treasury decision with notice and public procedure under 5 U.S.C. 553.

This Treasury decision is issued under the authority contained in Code sections 6043(a)(1) (68A Stat. 746, 26 U.S.C. 6043(a)(1)) and 7805 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 2, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 15, 1983, 8:45 a.m., and published in the issue of the Federal Register for December 16, 1983, 48 F.R. 55847)

Section 6045.—Returns of Brokers

26 CFR 1.6045-1: Returns of information of brokers.

T.D. 7932

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Information returns of barter exchanges.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to information returns of barter exchanges. The amendments provide that barter exchanges may make information returns with respect to their corporate members or clients on an aggregate basis (transactional reporting is still required for non-corporate members or clients). The purpose of these amendments is to reduce the reporting burden on barter exchanges. These regulations generally affect barter exchanges.

DATES: The regulations are effective after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Bruce H. Jurist of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 [Attention: CC:LR:T] (202-566-3238).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains final Income Tax Regulations (26 CFR Part 1) under section 6045 of the Internal Revenue Code of 1954, relating to information returns of brokers. These amendments clarify the information reporting requirements for barter exchanges. The amendments are issued under the authority of sections 6045 and 7805 of the Internal Revenue Code of 1954 (96 Stat. 600, 26 U.S.C. 6045; 68A Stat. 917, 26 U.S.C. 7805).

EXPLANATION OF PROVISIONS

The current regulations under section 6045 require transactional reporting by barter exchanges with respect to their corporate and non-corporate members or clients. These final regulations allow barter exchanges to report the transactions of their corporate members or clients on an aggregate basis. The regulations also define the term "corporate member or client." These regulations remove a substantial portion of the information reporting requirements of barter exchanges (due to go into effect on January 1, 1984). As these regulations merely remove a portion of a regulatory burden which had previously been promulgated, it is unnecessary to issue the regulations with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that these final regulations are not subject to review under Executive Order 12991 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Pursuant to 5 U.S.C. 605(b), the Secretary of the Treasury has certified that the requirements of the Regulatory Flexibility Act do not apply to these final regulations as they will not have a significant economic impact on a substantial number of small entities.

DRAFTING INFORMATION

The principal author of these regulations is Bruce H. Jurist of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph. Section 1.6045-1 is amended by revising paragraph (f)(2). The revised provision reads as follows:

§1.6045-1 Returns of information of brokers and barter exchanges.

(f) *Information required.****

(2) *Transactional reporting*—(i) *In general.* As to each exchange with respect to which a barter exchange is required to make a return of information under this section, the barter exchange, except as provided in paragraph (p)(2), shall show on Form 1099 the name, address, and taxpayer identification number of each member or client providing property or services in the exchange, the property or services provided, the amount received by the member of client for such property or services, the date on which the exchange occurred, and such other information as may be required by Form 1099, in the form, manner, and number of copies required by Form 1099.

(ii) *Exception for corporate member or client.* As to each corporate member or client providing property or services in an exchange for which a return of information is required under this section, the barter exchange may report the name, address, and taxpayer identification number of the corporate member or client, the aggregate amount received by the corporate member or client during the reporting period for property or services provided by such corporate member or client in exchange for which a return of information is required, and such other information as may be required by Form 1099, in the form, manner, and number of copies required by Form 1099.

(iii) *Definition.* For purposes of paragraph (f)(2)(ii) of this section, the term "corporate member or client" means a member or client of a barter exchange which is a corporation as defined in section 7701(a)(3) (including an insurance company). The term corporation includes a pool, syndicate, partnership, or unincorporated association composed exclusively of corporations. A barter exchange may treat a member or client as a corporation (and therefore as a corporate member or client) if such member or client provides an exemption certificate as described in A-29 of §35a.9999-1 of the Temporary Employment Tax Regulations or provided that—

(A) The name of the member or client contains the term "insurance company," "indemnity company," "reinsurance company," or "assurance company";

(B) The name of the member or client contains one of the following unambiguous expressions of corporate status: Incorporated, Inc., Corporation, Corp., or P.C., but not Company or Co.; or

(C) The member or client is known to the barter exchange to be a corporation through a corporate resolution or similar document on file with the barter exchange clearly indicating corporate status.

* * * * *

These regulations merely remove a portion of a regulatory burden that had previously been promulgated. Therefore, it is unnecessary to issue the regulations with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 6045 and 7805 of the Internal Revenue Code of 1954 (96 Stat. 600, 26 U.S.C. 6045; 68A Stat. 917, 26 U.S.C. 7805). Approved by the Office of Management and Budget under control number 1545-0715.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 27, 1983.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 28, 1983, 12:44 p.m., and published in the issue of the Federal Register for December 30, 1983, 48 F.R. 57485)

Section 6046.—Returns as to Organization or Reorganization of Foreign Corporations and as to Acquisitions of Their Stock

26 CFR 1.6046-1: Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock, on or after January 1, 1963.

Time for filing information returns of owners, officers and directors of foreign corporations. See T.D. 7925, page 261.

Section 6047.—Information Relating to Certain Trusts and Annuity and Bond Purchase Plans

26 CFR 1.6047.1: Information to be furnished with regard to employee retirement plan covering an owner-emplyee.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRS Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049-1: Returns of information as to interest paid in calendar years before 1983 and original issue discount includible in gross income for calendar years before 1983.

Proper identifying number to be used by banks in reporting interest payments credited to savings accounts after the death of the account owner. See Rev. Rul. 84-73, page 240.

Subpart C.—Information Regarding Wages Paid Employees

Section 6051.—Receipts for Employees

26 CFR 31.6051-1: Statements for employees.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

26 CFR 1.6051-2: Information returns on Form W-3 and Internal Revenue Service copies of Forms W-2.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

Subpart E.—Registration of and Information Concerning Pension, etc., Plans

Section 6057.—Annual Registration, etc.

26 CFR 301.6057-1: Employee retirement benefit plans; identification of participant with deferred vested retirement benefit.

Whether Schedule SSA (Form 5500) is considered an applicable accompanying schedule to the forms prescribed by section 6058(a) of the Code. See Rev. Rul. 84-54, page 260.

Section 6058.—Information Required in Connection with Certain Plans of Deferred Compensation

26 CFR 301.6058-1: Information required in connection with certain plans of deferred compensation.

Whether Schedule B (Form 5500) and Schedule SSA (Form 5500) are considered applicable accompanying schedules to the forms prescribed by section 6058(a) of the Code. See Rev. Rul. 84-54, page 260.

Section 6059.—Periodic Report of Actuary

26 CFR 301.6059-1: Periodic report of actuary.

Whether the actuarial report is considered an applicable accompanying schedule to the forms prescribed by section 6058(a) of the Code. See Rev. Rul. 84-54, page 260.

Part V.—Time for Filing Returns and Other Documents

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 31.6071(a)-1: Time for filing returns and other documents.

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

Part VI.—Extension of Time for Filing Returns

Section 6081.—Extension of Time for Filing Returns

26 CFR 31.6081(a)-1: Extension of time for filing returns.

Printing of substitutes for Form W-2, Wage ang Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

Part VII.—Place for Filing Returns or Other Documents

Section 6091.—Place for Filing Returns of Other Documents

Printing of substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 84-44, page 523.

Subchapter B.—Miscellaneous Provisions

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

Procedures for Federal and State agencies wishing to request data from the Service under the provisions of sections 7 and 8 of the Debt Collection Act of 1982. See Rev. Proc. 84-20, page 434.

Section 6107.—Income Tax Return Preparer Must Furnish Copy of Return to Taxpayer and Must Retain a Copy or List

26 CFR 1.6107-1: Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record.
(Also Section 7216; 301.7216-2.)

T.D. 7948

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART I—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER F, PART 301—PROCEDURE AND ADMINISTRATION

TAX RETURN PREPARERS

AGENCY: Internal Revenue Service, Treasury

ACTION: Final regulations.

SUMMARY: This document contains amendments to the Income Tax Regulations under sections 6107(b) and the Regulations on Procedure and Administration under section 7216(b) of the Internal Revenue Code of 1954. The amendment under section 6107(b) relates to the retention of records of income tax returns prepared by a corporation or a partnership as an income tax return preparer. The amendment under section 7216(b) relates to disclosure to grand juries of income tax return information by the preparers of the returns. These amendments to the regulations clarify existing regulations under sections 6107(b) and 7216(b).

EFFECTIVE DATES: The changes made by this Treasury decision are effective on April 9, 1984.

FOR FURTHER INFORMATION CONTACT: Mary Frances Pearson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-290-82) or call 202-566-3289 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 16, 1983, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 6107(b) and the Regulations on Procedure and Administration under section 7216(b) (26 CFR Part 301) (48 FR 52087) [LR-290-82, page 771, this Bulletin]. The proposed amendment to section 6107(b) designated the person required to retain records of income tax returns when the income tax return preparer is a corporation or partnership which has been dissolved. The proposed amendment to regulations under section 7216(b) clarified that disclosure of tax return information by an income tax return preparer to a grand jury does not trigger the penalty provision of section 7216(a). There were no written comments or requests for a public hearing. Therefore, the regulations are being published as they appeared in the notice of proposed rulemaking.

DISCUSSION

Section 6107(b) provides that an income return preparer must retain a copy of each income tax return prepared, or a list of the taxpayers for whom such returns were prepared, available for inspection upon request for a specified 3-year period. When the preparer is a corporation or a partnership which is dissolved before expiration of the 3-year period, the question has arisen as to who must retain the above described records for inspection until the 3-year period has expired. This amendment to the regulation would place that duty upon all persons under state law who are responsible for winding up the affairs of the corporation or partnership. If no persons are designated under state law, then the regulations provide that, collectively, the directors of the corporation or the general partners of the partnership shall be required to retain the records for the requisite 3-year period.

Section 7216(b) provides that the penalty provision of section 7216(a) will not apply to the disclosure or use of information by preparers of returns if the disclosure is made pursuant to provisions of the Code or pursuant to an order of a court. Section 7216(b)(3) gives the Secretary regulatory authority to prescribe other exceptions to section 7216(a). This amendment to the regulation would clarify that disclosure of tax return information by an income tax return preparer to a grand jury does not trigger the penalty provisions of section 7216(a).

DRAFTING INFORMATION

The principal author of these regulations is Mary Frances Pearson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

REGULATORY FLEXIBILITY ACT OF 1980 AND EXECUTIVE ORDER 12291

Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The Commissioner of Internal Revenue has determined that this regulation is not subject to Executive Order 12291.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 301 are amended as follows:

INCOME TAX REGULATIONS

Paragraph 1. Section 1.6107-1(b) is amended by adding three sentences at the end thereof to read as set forth below:

§1.6107-1 Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record

* * * * *

(b) *Copy or record to be retained.* *** If the person subject to the record retention requirements of this paragraph (b) is a corporation or a partnership which is dissolved before completion of the 3-year period, then all persons who under state law are responsible for the winding up of the affairs of the corporation or partnership shall be subject, on behalf of the corporation or partnership, to these record retention requirements until completion of the 3-year period. If state law does not specify any person or persons as responsible for winding up, then, collectively, the directors or general partners shall be subject, on behalf of the corporation or partner-

ship, to the record retention requirements of this paragraph (b). For purposes of the penalty imposed by section 6695(d), such designated persons shall be deemed to be the income tax return preparer and will be jointly and severally liable for each failure.

* * * * *

REGULATIONS ON PROCEDURE AND ADMINISTRATION

Par. 2. Section 301.7216-2 is amended as follows:

(1) Paragraph (c)(2) is redesignated as (c)(3) and a new paragraph (c)(2) is added as set forth below:

(2) Paragraph (d) is amended by removing the period at the end thereof and adding ", or before any grand jury which may be convened by the court."

§301.7216-2 Disclosure or use without formal consent of taxpayer.

* * * * *

(c) *Disclosure pursuant to an order of a court or a Federal or State agency.****

(2) A subpoena issued by a grand jury, Federal or State, or

* * * * *

This Treasury decision is issued under the authority contained in sections 7216(b)(3) and 7805 of the Internal Revenue Code of 1954 (85 Stat. 529; 26 U.S.C. 7216 and 68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved February 15, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 7, 1984, 8:45 a.m., and published in the issue of the Federal Register for March 8, 1984, 49 F.R. 8601)

Section 6109.—Identifying Numbers

26 CFR 301.6109.-1: Identifying numbers. (Also Sections 6049, 6676; 1.6049-1, 301.6676-1.)

Taxpayer identification number; savings account interest; decedents. Payors of interest must use the identifying number of the person to whom the account is payable in reporting interest on a Form 1099. Interest is reported under the decedent's social security number only until the date of death. From the date of death, interest is either reported under the estate's identifying number or the social security number of the surviving owner.

Rev. Rul. 84-73

ISSUE

What taxpayer identification numbers should be used by a financial institution for reporting interest payments credited to single-owner and joint accounts after the death of the account owner?

FACTS

A died on October 1, 1983. On the date of death *A* had 2 savings accounts, both of which carried *A*'s taxpayer identification number. One account was in *A*'s name only. It earned interest of $500 from January 1, 1983, to *A*'s death, and an additional $60 from *A*'s death to November 1, 1983, when *A*'s spouse, the executor of *A*'s estate, closed the account.

The other account was in the name of *A* and *A*'s spouse, as joint owners with rights of survivorship. At *A*'s death, *A*'s spouse became sole owner. This account earned $3,000 interest from January 1, 1983, to *A*'s death, and an additional $1,200 from *A*'s death until December 31, 1983. As executor, *A*'s spouse notified the bank in which the accounts were held of *A*'s death on November 1, 1983, and provided it with the estate's identifying number, as well as the spouse's own social security number, by filing Forms W-9, Payer's Request for Taxpayer Identification Number.

LAW AND ANALYSIS

Under section 6049 of the Internal Revenue Code, every person who makes interest payments, or who receives interest payments as a nominee, totalling $10 or more during any calendar year must make a return, according to the forms or regulations prescribed by the Secretary, setting forth the total amount of such payments, or the total amount includible in gross income, and the name and address of the person to whom paid.

Section 1.6049-1 of the Income Tax Regulations sets forth the requirements for the reporting of interest and designates Forms 1099, Statement for Recipient, and 1096, Annual Summary and Transmittal of U.S. Information Returns, as the proper forms to use for the information return.

Under section 6109(a) of the Code, every person required to make a return must include the identifying number prescribed for securing proper identification of the person. Any person required to make a return for another person must request the proper identifying number from that person, and that person must furnish the proper number to the person making the return.

Under section 31.6109-1(a) of the regulations, returns required to be filed must reflect such identifying numbers as are required by each return and its related instructions.

Section 6676(a) of the Code imposes a penalty of $5 for each failure of a person to include his or her taxpayer identification number in any return, and a $50 penalty for each failure to furnish a taxpayer identification number to another person and for the failure to include the identification number of another person in any return for the other person unless the failure was due to reasonable cause and not wilful neglect. The total amount imposed on a person for all failures during any calendar year may not exceed $50,000. For payments made after December 31, 1983, section 105 of the Interest and Dividend Tax Compliance Act of 1983, 1983-2 C.B. 352,

358, amended section 6676 by adding a new section 6676(b), which provides a $50 penalty for any payor of interest, dividends or patronage dividends that fails to include a number, or includes an incorrect number, unless the payor can show that it exercised due diligence in attempting to satisfy the requirements.

Rev. Rul. 64-99, 1964-1 (Part I) C.B. 482, holds that if a return or other document is required to be filed for an estate or trust, including returns of information under sections 6042 and 6049 of the Code, the fiduciary must obtain and furnish an identifying number to be included in that return or document even though the estate or trust will be closed during the year. The identifying number to be used by an estate or trust is an employer identification number. It must be furnished to any payor of interest or other person required to make a return with respect to the estate.

Payors of interest must use the identifying number of the person to whom the account is payable in reporting interest on Form 1099. If the interest is payable to an estate, under Rev. Rul. 64-99 the administrator or executor must furnish the estate's employer identification number, not the decedent's social security number, to the payor. If the interest is paid to a surviving joint owner, the survivor must furnish his or her identifying number to the payor.

HOLDING

A's social security number must be used for both accounts to report interest earned prior to *A*'s death.

After *A*'s death, the estate's employer identification number must be used to report the $60 paid to *A*'s estate in 1983.

The social security number of *A*'s spouse must be used to report $1,200 payable to the spouse after *A*'s death.

Under the above facts, failure by a bank to use the proper identification number may result in imposition of the penalty imposed under section 6676 of the Code.

Chapter 62.—Time and Place for Paying Tax
Subchapter A.—Place and Due Date for Payment of Tax

Section 6151.—Time and Place for Paying Tax Shown on Returns

26 CFR 20.6151-1: Time and place for paying tax shown on the return.

When there is an overpayment of federal estate tax, may the Government reinstate flower bonds previously tendered at par in payment of the tax? See Rev. Rul. 84-38, page 250.

Section 6152.—Installment Payments

26 CFR 1.6152-1: Installment payments.

The proper application of an overpayment of income tax to the estimated income tax of the succeeding taxable year. See Rev. Rul. 84-58, page 254.

Section 6154.—Installment Payments of Estimated Income Tax by Corporations

2 CFR 1.6154-2: Payment of estimated tax by corporations.

The proper application of an overpayment of income tax to estimated tax for the succeeding tax year. See Rev. Rul. 84-58, page 254.

Chapter 63.—Assessment
Subchapter C.—Tax Treatment of Partnership Items

Section 6231.—Definitions and Special Rules

Guidelines are provided under which Partnerships with 10 or fewer partners will not be subject to the penalty under section 6698 of the Code for not filing a partnership return. Rev. Proc. 81-11 is superseded. See Rev. Proc. 84-35, page 509.

Section 6232.—Extension of Subchapter to Windfall Profit Tax

Procedures for applying partnership audit rules to the crude oil windfall profit tax for 1983. See Rev. Proc. 84-4, page 363.

Chapter 64.—Collection
Subchapter A.—General Provisions

Section 6302.—Mode or Time of Collection

26 CFR 1.6302-1: Use of Government depositaries in connection with corporation income and estimated income taxs.

T.D. 7953

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, INCOME TAX, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER C, EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE, PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE, PART 36—REGULATIONS RELATING TO CONTRACT COVERAGE OF EMPLOYEES OF FOREIGN SUBSIDIARIES; SUBCHAPTER D, MISCELLANEOUS EXCISE TAXES, PART 46—REGULATIONS RELATING TO MISCELLANEOUS EXCISE TAXES PAYABLE BY RETURN, PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES, PART 49—FACILITIES AND SERVICES EXCISE TAXES, PART 51—EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX OF 1980, PART 52—ENVIRONMENTAL TAXES ON PETROLEUM AND CERTAIN CHEMICALS AND HAZARDOUS WASTE, PART 154—TEMPORARY REGULATIONS IN CONNECTION WITH THE AIRPORT AND AIRWAY REVENUE ACT OF 1970; SUBCHAPTER H, INTERNAL REVENUE PRACTICE, PART 601—STATEMENT OF PROCEDURAL RULES

Federal Tax Deposit System

AGENCY: Internal Revenue Service, Treasury.

ACTION: Treasury decision.

SUMMARY: This document con-

tains amendments to the regulations relating to the Federal Tax Deposit (FTD) system. The amendments would provide guidance to persons who use the FTD system.

DATES: These regulations are effective for Federal tax deposits remitted on or after January 1, 1984.

FOR FURTHER INFORMATION CONTACT: Mitchell H. Rapaport of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3829).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Effective January 1, 1984, taxpayers who use the Federal Tax Deposit (FTD) system will no longer be required to use a specific FTD card for each type of tax remitted (*e.g.*, Form 501 for deposits of Withheld Income and FICA Taxes, Form 503 for Corporation Income Taxes). All current FTD forms will be replaced by a universal Federal Tax Deposit form, Form 8109, which will be scannable using optical character recognition equipment. This Treasury decision would conform the regulations to this change by deleting references to specific FTD forms and inserting references to the universal Federal Tax Deposit form in lieu thereof.

This Treasury decision would also remove references to provisions of law which are no longer applicable.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Because this regulation relates merely to a rule of agency procedure or practice the Internal Revenue Service has determined that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

The collection of information requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) under section 3507 of the Paperwork Reduction Act. (Control No. 1545-0257).

DRAFTING INFORMATION

The principal author of this regulation is Mitchell H. Rapaport of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulation on matters of substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly 26 CFR Parts 1, 31, 36, 46, 48, 49, 51, 52, 154, and 601 are amended as follows:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. Paragraph (c) of §1.1461-3 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 2. Paragraph (d)(1) of §1.6151-1 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions". Paragraph (d)(2) of §1.6151-1 is amended by removing the words "such banks" and inserting, in their place, the words "such financial institutions".

Par. 3. Paragraph (a)(3) of §1.6152-1 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 4. Section 1.6154-4 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 5. Paragraph (a) of §1.6302-1 is amended by removing the last two sentences. Paragraph (c) of §1.6302-1 is amended by removing "Form 503, the Federal Tax Deposit, Corporation Income Taxes, form" and by adding "the Federal Tax Deposit form" in lieu thereof. Paragraph (b) of §1.6302-1 is amended to read as follows:

§1.6302-1 Use of Government depositaries in connection with corporation income and estimated income taxes.

* * * * *

(b) *Depositary forms.* A deposit required to be made by this section shall be made separately from a deposit required by any other section. A corporation may make one, or more than one, remittance of the amount required by this section to be deposited. Each remittance shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. The remittance, together with the Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the corporation, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit will be determined by the date stamped on the Federal Tax Deposit form by the Federal Reserve bank or the authorized financial institution, or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each corporation making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to the instructions that apply to such return. Amounts deposited under this section shall be considered as payment of the tax.

* * * * *

Par. 6. Subparagraph (1) of paragraph (a) of §1.6302-2 is amended by removing the words "commercial bank" whenever they appear and inserting, in their place, the words "financial institution". Subparagraph (2) of paragraph (a) of §1.6302-2 is removed. Subparagraph (3) of paragraph (a) of §1.6302-2 is redesignated as subparagraph (2). Subparagraph (2) of paragraph (b) of §1.6302-2 is removed. Subparagraphs (3), (4), (5), and (6) of §1.6302-2(b) are redesignated as subparagraphs (2), (3), (4), and (5), respectively. Subparagraph (2), as redesignated, is amended by removing the last sentence. Subparagraph (1) of paragraph (b) and paragraph (c) of §1.6302-2 are amended to read as follows:

§1.6302-2 Use of Government depositaries for payment of tax withheld on nonresident aliens and foreign corporations.

* * * * *

(b) Depository forms—(1) *Remittances.* Each remittance of amounts required to be deposited by paragraph (a) of this section shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. The remittance, together with the Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the withholding agent, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit will be determined by the date stamped on the Federal Tax Deposit form by the Federal Reserve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each withholding agent making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to the instructions that apply to such return.

* * * * *

(c) *Procurement of Federal Tax Deposit form.* Copies of the Federal Tax Deposit form will so far as possible be furnished withholding agents. A withholding agent will not be excused from making a deposit, however, by the fact that no form has been furnished to it. A withholding agent not supplied with the form should make application therefore in ample time to make the required deposits within the time prescribed. The withholding agent may secure the form or additional forms by applying therefor and supplying its name, identification number, address, and the taxable period to which the deposit will relate. Copies of the Federal Tax Deposit form may be secured by application therefor to the district director or director of a service center.

* * * * *

EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE REGULATIONS (26 CFR Part 31)

Par. 7. Paragraphs (a)(1) and (c) of §31.6071(a)-1 are amended by removing the words "commercial bank" wherever they appear and inserting, in their place, the words "financial institution".

Par. 8. Paragraph (b) of §31.6151-1 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 9. Paragraph (a)(1)(i)(A) of §31.6302(c)-1 is amended by removing the words "paragraph (a)(1)(i)" wherever they appear and inserting, in their place, the words "subdivision (i)"; paragraph (a)(1)(i)(a) is further amended by inserting "(as defined in paragraph (a)(1)(iii) of this section)" after the words "undeposited taxes" and before the words "is $500". Paragraph (a)(1)(ii) of §31.6302(c)-1 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution". Subparagraph (2) of §31.6302(c)-1(a) is removed. Subparagraphs (3) and (4) of §31.6302(c)-1(a) are redesignated as subparagraphs (2) and (3), respectively, and are revised to read as set forth below.

§31.6302(c)-1 Use of Government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

(a) *Requirement.* ***

(2) *Depository forms*—(i) *In general.* A deposit required to be made by this section shall be made separately from a deposit required by any other section. An employer may make one, or more than one, remittance of the amount required to be deposited. However, a deposit for a period in one calendar quarter shall be made separately from any deposit for a period in another calendar quarter. An amount of tax which is not required to be deposited may nevertheless be deposited if the employer so desires.

(ii) *Deposits.* Each remittance of amounts required to be deposited under paragraph (a)(1) of this section shall be accompanied by a Federal Tax Deposit form. Such form shall be prepared in accordance with the instructions applicable thereto. The remittance, together with the Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the employer, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve Bank, see 31 CFR Part 214.7. The timeliness of the deposit will be determined by the date stamped on the Federal Tax Deposit form by the Federal Reserve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each employer making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to

the instructions that apply to such return and pay at that time (or deposit by the due date of such return) the balance, if any, of the taxes due for such period.

(iii) *Time deemed paid.* In general, amounts deposited under subdivision (ii) of this subparagraph shall be considered as paid on the last day prescribed for filing the return in respect of such tax (determined without regard to any extension of time for filing such return), or at the time deposited, whichever is later. For purposes of section 6511 and the regulations thereunder, relating to period of limitation on credit or refund, if an amount is so deposited prior to April 15th of a calendar year immediately succeeding the calendar year which contains the period for which such amount was so deposited, such amount shall be considered as paid on such April 15th.

(3) *Procurement of prescribed form.* Copies of the Federal Tax Deposit form will so far as possible be furnished employers. An employer will not be excused from making a deposit, however, by the fact that no form has been furnished to it. An employer not supplied with the Federal Tax Deposit form should make application therefor in ample time to make the required deposits within the time prescribed. The employer may secure the form or additional forms by application therefor to the district director or director of a service center; such application shall supply the employer's name, identification number, address, and the taxable period to which the deposits will relate.

* * * * *

Par. 10. Paragraph (a) of §31.6302(c)-2 is amended by removing the words "commercial bank" wherever they appear and inserting, in their place, the words "financial institution". Subparagraph (2) of paragraph (b) of §31.6302(c)-2 is removed. Subparagraphs (3) and (4) of §31.6302(c)-2(b) are redesignated as (2) and (3), respectively. Subparagraph (3), as redesignated, is amended by removing "subparagraph (3)" and adding "subparagraph (2)" in lieu thereof. Subparagraph (2), as redesignated, of paragraph (b) and paragraph (c) of §31.6302(c)-2 are revised to read as follows:

§31.6302(c)-2 Use of Government depositaries in connection with employee and employer taxes under Railroad Retirement Tax Act.

* * * * *

(b) *Depositary Forms.* ***

(2) *Deposits.* Each remittance of amounts required to be deposited shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. Except as provided in paragraph (a)(1), the remittance, together with the form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the employer, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit will be determined by the date stamped on the Federal Tax Deposit form by the Federal Reserve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each employer making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to the instructions that apply to such return and pay at that time (or deposit by the due date of such return) the balance, if any, of the taxes due for such period.

* * * * *

(c) *Procurement of prescribed form.* Copies of the Federal Tax Deposit form will so far as possible be furnished employers. An employer will not be excused from making a deposit, however, by the fact that no form has been furnished to it. An employer not supplied with the form should make application therefor in ample time to make the required deposits within the time prescribed. The employer may secure the form or additional forms by applying therefor and supplying its name, identification number, address, and the taxable period to which the deposits will relate. Copies of the Federal Tax Deposit form may be secured by application therefor to the district director or director of a service center.

Par. 11. Paragraph (a) of §31.6302(c)-3 is amended by removing the words "commercial bank" wherever they appear and inserting, in their place, the words "financial institution". Subparagraph (4) of paragraph (b) of §31.6302(c)-3 is amended by removing "*forms*" from the caption and adding "*form*" in lieu thereof. Subparagraph (4) is further amended by removing "applicable deposit form" and adding "Federal Tax Deposit form" in lieu thereof and by removing "Form 508" and adding "the Federal Tax Deposit form" in lieu thereof. Subparagraph (2) of paragraph (b) is amended to read as follows:

§31.6302(c)-3 Use of Government depositaries in connection with tax under the Federal Unemployment Tax Act.

* * * * *

(b) *Depositary forms.* ***

(2) *Use of Federal Tax Deposit form.* Each remittance of amounts required to be deposited under this section shall be accompanied by a prepunched and preinscribed Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. The employer shall forward such remittance, together with the Federal Tax Deposit form, to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the employer, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of deposits is determined by the date stamped on the Federal Tax Deposit form by the Federal Re-

serve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e).

* * * * *

Par. 12. Section 31.6302(c)-5 is removed.

REGULATIONS RELATING TO CONTRACT COVERAGE OF EMPLOYEES OF FOREIGN SUBSIDIARIES (26 CFR Part 36)

Par. 13. Section 36.3121(l)(10)-4 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution".

REGULATIONS RELATING TO MISCELLANEOUS EXCISE TAXES PAYABLE BY RETURN (26 CFR Part 46)

Par. 14. Paragraph (a) of §46.6071(a)-1 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution".

Par. 15. Section 46.6151-1 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 16. Paragraph (a)(2) of §46.6302(c)-1 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution". Subparagraph (2) of paragraph (c) of §46.6302(c)-1 is removed. Subparagraphs (3) and (4) of paragraph (c) of §46.6302(c)-1 are redesignated as (2) and (3), respectively. Subparagraph (2), as redesignated, of paragraph (c), and paragraph (d) of §46.6302(c)-1 are amended to read as follows:

§46.6302(c)-1 Use of Government depositaries.

* * * * *

(c) *Depositary forms.* ***

(2) *Deposits.* Each remittance of amounts required to be deposited shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. The remittance, together with a Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the person making the remittance, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit is determined by the date stamped on the Federal Tax Deposit form by the Federal Reserve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each person making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to the instructions that apply to such return and pay at that time (or deposit by the due date of such return) the balance, if any, of the taxes due for such period.

* * * * *

(d) *Procurement of prescribed form.* Copies of the Federal Tax Deposit form will so far as possible be furnished persons required to deposit. Such a person will not be excused from making a deposit, however, by the fact that no form has been furnished to it. A person not supplied with the proper form should make application therefor in ample time to make the required deposits within the time prescribed. The person may secure the Federal Tax Deposit form or additional forms by applying therefor and supplying its name, identification number, address, and the taxable period to which the deposits will relate. Copies of the Federal Tax Deposit form may be secured by application therefor to the district director or director of a service center.

REGULATIONS ON MANUFACTURERS AND RETAILERS EXCISE TAXES (26 CFR Part 48)

Par. 17. Paragraph (a) of §48.6071(a)-1 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution".

Par. 18. Section 48.6151-1 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 19. Subdivision (ii)(c)(1) of subparagraph (1) of §48.6302(c)-1(a) is amended by removing "(the preceding calendar month for periods ending before Feb. 1, 1971)". Subdivision (ii)(c)(2) of subparagraph (1) of §48.6302(c)-1(a) is amended by removing "(the last day of the first following month, in the case of a semimonthly period ending before Feb. 1, 1971)". Subparagraph (2) of paragraph (a) of §48.6302(c)-1 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution". Subparagraph (2) of §48.6302(c)-1(b) is amended by removing "(i)" and the words "for semimonthly periods beginning after January 31, 1971,". Subparagraph (2) of §48.6302(c)-1(b) is further amended by removing subdivision (ii). Subparagraph (2) of §48.6302(c)-1(c) is removed and subparagraphs (3) and (4) are redesignated as subparagraphs (2) and (3), respectively. Subparagraph (3), as redesignated, is amended by removing "subparagraph (3)" and adding "subparagraph (2)" in lieu thereof. Subparagraph (2) of paragraph (c) and paragraph (d) of §48.6302(c)-1 are amended to read as follows:

§48.6302(c)-1 Use of Government depositaries.

(c) *Depositary forms.* ***

(2) *Deposits.* Each remittance of amounts required to be deposited shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. The remittance, together with a Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the person making the

remittance, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit is determined by the date stamped on the Fedeal Tax Deposit form by the Federal Reserve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each person making deposits under this section shall report on the return, for the period with respect to with such deposits are made, information regarding such deposits according to the instructions that apply to such return and pay at that time (or deposit by the due date of such return) the balance, if any, of the taxes due for such period.

* * * * *

(d) *Procurement of prescribed form.* Copies of the Federal Tax Deposit form will so far as possible be furnished persons required to deposit. Such a person will not be excused from making a deposit, however, by the fact that no form has been furnished to it. A person not supplied with the form should make application therefor in ample time to make the required deposits within the time prescribed. The person may secure the form or additional forms by applying therefor and supplying its name, identification number, address and the taxable period to which the deposits will relate. Copies of the Federal Tax Deposit form may be secured by application therefor to the district director or director of a service center.

* * * * *

REGULATIONS ON FACILITIES AND SERVICES EXCISE TAXES (26 CFR Part 49)

Par. 20. Paragraph (a) of §49.6151-1 is amended by removing the words "commercial banks" and inserting, in their place, the words "financial institutions".

Par. 21. Subdivision (i) of paragraph (a)(1) of §49.6302(c)-1 is amended by removing "Except as provided in subdivision (ii) of this subparagraph, if" and adding "If" in lieu thereof. Subdivision (i) is further amended by adding a period after "the month following such month" and by removing the balance of the subdivision. Subdivision (ii) of subparagraph (1) of §49.6302(c)-1(a) is amended by removing "during February and March 1967, or during a calendar quarter thereafter" and by removing the last sentence thereof. Paragraph (a)(2) of §49.6302(c)-1 is amended by removing the words "commercial bank" and inserting, in their place, the words "financial institution". Subparagraph (2) of paragraph (c) of §49.6302(c)-1 is removed. Subparagraphs (3), (4), and (5) of paragraph (c) of §49.6302(c)-1 are redesignated as subparagraphs (2), (3), and (4), respectively. Subparagraph (3), as redesignated, is amended by removing "subparagraph (3)" and adding "subparagraph (2)" in lieu thereof. Paragraph (d) is removed. Paragraph (e) is redesignated as paragraph (d). Paragraph (c)(2) and (4), as redesignated, of §49.6302(c)-1 is amended to read as follows:

§49.6302(c)-1 Use of Government depositaries.

* * * * *

(c) *Depositary forms.* ***

(2) *Deposits.* Each remittance of amounts required to be deposited shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the instructions applicable thereto. The remittance, together with a Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the person making the remittance, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit is determined by the date stamped on the Federal Tax Deposit form by the Federal Reserve bank or the authorized financial institution or, if section 7502(e) applies, by the date the deposit is treated as received under section 7502(e). Each person making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to the instructions that apply to such return and pay at that time (or deposit by the due date of such return) the balance, if any, of the taxes due for such period.

* * * * *

(4) *Procurement of prescribed form.* Copies of the Federal Tax Deposit form will so far as possible be furnished persons required to deposit. Such a person will not be excused from making a deposit, however, by the fact that no form has been furnished to it. A person not supplied with the form should make application therefor in ample time to make the required deposits within the time prescribed. The person may secure the form or additional forms by applying therefor and supplying its name, identification number, address, and the taxable period to which the deposits will relate. Copies of the Federal Tax Deposit form may be secured by application therefor to the district director or director of a service center.

* * * * *

EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980 (26 CFR Part 51)

Par. 22. Subparagraph (2) of paragraph (i) of §51.4995-3 is amended by removing "an FTD (Federal Tax Deposit, Excise Taxes) Form (Form 504)" and adding "a Federal Tax Deposit form" in lieu thereof. Subparagraph (2) is further amended by removing "FTD Form 504" and adding "the Federal Tax Deposit form" in lieu thereof. Subparagraph (3) of paragraph (i) is amended to read as follows:

§51.4995-3 Depositary requirements.

* * * * *

(i) *Depositary forms.* ***

(3) *Procurement of prescribed form.* Copies of the Federal Tax Deposit form will so far as possible be furnished to purchasers and producers. Such a person will not be excused from making a deposit, however, by the fact that no form has been furnished to it. A person not supplied with the form should make application therefor in ample time to make the required deposits within the time prescribed. A person may secure the form or additional forms by applying therefor and supplying its name, identification number, address, and the taxable period to which the deposits will relate. Copies of the Federal Tax Deposit form may be secured by application to a director of an Internal Revenue Service Center.

ENVIRONMENTAL TAXES ON PETROLEUM AND CERTAIN CHEMICALS AND HAZARDOUS WASTE (26 CFR Part 52)

Par. 23. Subparagraph (4) of paragraph (d) of §52.6302(c)-1 is amended by removing "Form 504" and adding "the Federal Tax Deposit form", in lieu thereof. Subparagraph (4) is further amended by removing "proper". Subparagraph (2) of paragraph (d) of §52.6302(c)-1 is amended to read as follows:

§52.6302-1 Use of Government depositaries.

(d) *Depositary forms.* ***

(2) *Remittance.* Each remittance of an amount required to be deposited shall be accompanied by a Federal Tax Deposit form which shall be prepared in accordance with the applicable instructions. The remittance, together with a Federal Tax Deposit form, shall be forwarded to a financial institution authorized as a depositary for Federal taxes in accordance with 31 CFR Part 214 or, at the election of the person making the remittance, to a Federal Reserve bank. For procedures governing the deposit of Federal taxes at a Federal Reserve bank, see 31 CFR Part 214.7. The timeliness of the deposit will be determined by the date stamped on the Federal Tax Deposit form by a Federal Reserve bank or by the authorized financial institution, whichever is earlier. Section 7502(e), relating to timely mailing treated as timely filing and paying, shall apply to the same extent it applies to the collection of taxes under Chapter 32, relating to Manufacturers' Excise Taxes. Each person making deposits under this section shall report on the return, for the period with respect to which such deposits are made, information regarding such deposits according to the instructions that apply to such return and pay at that time (or deposit by the due date of such return) the balance, if any, of the taxes due for such period.

* * * * *

TEMPORARY REGULATIONS IN CONNECTION WITH THE AIRPORT AND AIRWAY REVENUE ACT OF 1970 (26 CFR Part 154)

Par. 24. Paragraph (f)(3) of §154.2-1, relating to tax on transportation of property by air, is amended by removing the words "authorized commercial bank" and inserting, in their place, the words "authorized financial institution".

STATEMENT OF PROCEDURAL RULES (26 CFR Part 601)

Par. 25. Paragraph (a)(5) of §601.401, relating to employment taxes, is amended by removing the words "*commercial banks and trust companies*" from the caption and inserting, in their place, the words "*financial institutions*" and by removing the words "commercial bank or trust company" wherever they appear and inserting, in their place, the words "financial institution". Subdivision (i) of subparagraph (5) of paragraph (a) of §601.401 is removed. Subdivisions (ii), (iii), (iv), (v), (vi), and (vii) of subparagraph (5) of §601.401(a) are redesignated as (i), (ii), (iii), (iv), (v), and (vi), respectively. Subdivision (ii), as redesignated, of subparagraph (5) is amended by removing the phrase "or (ii)" and by removing the phrase "($100 prior to February 1, 1971)". Subdivision (iii), as redesignated, of subparagraph (5) of §601.401(a) is amended by removing the phrase "(i), (ii), and (iii)" and by adding "(i) and (ii)" in lieu thereof, and by removing the phrase "($100 if return period ends prior to January 1, 1971)" in both places that it appears. Subdivision (iv), as redesignated, is amended by removing the phrase "(i), (ii), (iii), and (iv)" and by adding "(i), (ii), and (iii)" in lieu thereof, and by removing", Withheld Income and FICA Taxes form (Form 501, or Form 511 in the case of Agricultural Employers and by adding "form" in lieu thereof. Subdivision (v), as redesignated, of subparagraph (5) of §601.401(a) is amended by removing "Form 507, Federal Tax Deposit, Railroad Retirement Taxes" and adding "a Federal Tax Deposit form" in lieu thereof. Subdivision (vi), as redesignated, of subparagraph (5) is amended by removing the last sentence thereof.

Par. 26. Subparagraph (1) of paragraph (c) of §601.402, relating to sales taxes collected by return, is amended by removing "Form 504, Federal Tax Deposit, Excise Taxes" and by adding "the Federal Tax Deposit form" in lieu thereof.

Par. 27. Subparagraph (3) of paragraph (c) of §601.403, relating to miscellaneous excise taxes collected by return, is amended by removing "Form 504, Federal Tax Deposit, Excise Taxes," and by adding "Federal Tax Deposit form," in lieu thereof.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917; 26 U.S.C. 7805).

(Approved by the Office of Management and Budget under control number 1545-0257.)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved April 20, 1984.

JOHN E. CHAPOTON
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 8, 1984, 8:45 A.M., and published in the issue of the Federal Register for May 9, 1984, 49 F.R. 19643. Corrected in 49 F.R. 25238)

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26 CFR 31.6302(c)-1: Use of Government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

T.D. 7931

TITLE 26—INTERNAL REVENUE. CHAPTER I, SUBCHAPTER C, PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Deposits of Railroad Retirement Tax

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains regulatory amendments which revise the procedure for remittance of railroad retirement tax by employers to the Railroad Retirement Account. Changes to the applicable tax law were made by the Railroad Retirement Solvency Act of 1983 [Pub. L. 98-76, 1983-2 C.B. 375], which requires, among other things, (a) that certain railroad employers remit railroad retirement tax more rapidly and frequently than before and (b) that payments to the Railroad Retirement Account be allocated more rapidly than before. The amendments will implement the Act's requirements regarding remittance of such tax.

DATES: These amendments are effective with respect to railroad retirement tax withheld or imposed upon compensation actually or constructively paid after December 31, 1983. However, these amendments do not apply with respect to railroad retirement tax withheld or imposed upon compensation deemed to be paid in 1983 under §31.3231(e)-1(d)(3).

FOR FURTHER INFORMATION CONTACT: John A. Tolleris of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C., 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 2, 1983, the FEDERAL REGISTER published proposed amendments to the Employment Taxes and Collection of Income Tax at Source Regulations (26 CFR Part 31) under section 6302(c) of the Internal Revenue Code of 1954 (48 FR 50567) [LR-219-83, 1983-2 C.B. 785]. These amendments conform the regulations to section 226 of the Railroad Retirement Solvency Act of 1983 (Pub. L. 98-76; 97 Stat. 426) [1983-2 C.B. 375]. One written and several oral comments concerning this notice were received, and a public hearing was held on December 14, 1983. After consideration of all comments regarding the proposed amendments, those amendments are adopted by this Treasury decision with several revisions in response to those comments which are discussed below.

PUBLIC COMMENTS

Several technical issues were raised in comments received by the Service concerning the above-mentioned notice of proposed rulemaking. One commentator noted that the proposed amendments appear to require that railroad retirement tax reported on Form CT-1, the annual railroad retirement tax return, in excess of taxes previously deposited must be paid by January 31st even though that return is not required to be filed until the end of February, and urged that some appropriate adjustment be made. After consideration of this comment, it was determined that the proposed amendments be revised to allow the year-end "catch-up" deposit of railroad retirement tax to be made by the end-of-February due date for Form CT-1.

This commentator also wrote that applying the new eighth-monthly deposit requirement would be especially difficult with respect to the section 3221(c) supplemental annuity tax which is computed on the basis of total man-hours compiled from monthly wage form reports required by the Interstate Commerce Commission. He argued that since total man-hours are compiled after the end of the month, railroads would have difficulties making eighth-monthly deposits of supplemental annuity tax which is not computed until the end of each month. After consideration of his comments, the Service determined that requiring eighth-monthly deposits of estimated supplemental annuity tax would create too much paperwork and recordkeeping burdens in comparison with the relatively minor benefit of more frequent deposits to the railroad retirement supplemental annuity fund. Therefore, this Treasury decision adopts his suggestion that railroads be required to deposit their supplemental annuity tax once a month with the first eighth-monthly deposit of railroad retirement tax required to be made after the 15th of the month following the month with respect to which the supplemental annuity tax arises.

Another commentator urged that a $10,000 deposit minimum be established as a threshold for the requirement that a railroad retirement tax deposit be made by a wire transfer instead of through the Federal Tax Deposit system; he proposed this rule to replace the proposed requirement that a railroad make all payments during the year, no matter how small, by wire transfer if it had at least $1 million of railroad retirement tax for the year 2 years earlier. After considering this and other comments on this issue, the Service determined that certainty regarding which payment method must be used for an entire year is preferable to determining on a deposit-by-deposit basis whether a wire transfer of railroad retirement tax must be made. It is noted in this regard that a small railroad subsidiary which files returns of tax under its own employer identification number (E.I.N.) will determine whether it must make wire transfers of its railroad retirement tax payments on the basis of its own total railroad retire-

ment tax liability 2 years earlier under its own E.I.N. rather than the total tax liability under its parent company's E.I.N.

One caller inquired whether the 95 percent "safe-haven" of §31.6302(c)-1(a)(1)(i)(*b*) applicable to employers making eighth-monthly deposits of social security and withheld income tax also applies to employers who make eighth-monthly deposits of railroad retirement tax. Since this Treasury decision generally incorporates the rules of §31.6302(c)-1(a)(1)(i), this 95 percent "safe-haven" does apply to employers who make eighth-monthly deposits of railroad retirement tax.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

It has been determined that this Treasury decision is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Although this document promulgates legislative regulations under section 6302(c) of the Internal Revenue Code of 1954, the Internal Revenue Service has concluded that these amendments do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6) since these these revisions were mandated by section 226 of the Railroad Retirement Solvency Act of 1983.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of these amendments is John A. Tolleris of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations

Accordingly, the proposed amendments to 26 CFR Part 31 are adopted, revised as follows:

Paragraph 1. Section 31.6302(c)-1 is amended by adding a new subdivision (v) to paragraph (a)(1) thereof. The added provisions read as follows:

§31.6302(c)-1 Use of Government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

(a) *Requirement*—(1) *In general.* ***

(v) If the aggregate amount of taxes reportable on Form CT-1, the return relating to an employer's railroad retirement tax payments, for a return period exceeds the total amount deposited by the employer pursuant to paragraph (a)(1)(i) of this section for such return period by $100 or more, the employer shall, on or before the last day of the second calendar month following the return period, deposit with a Federal Reserve bank or authorized financial institution an amount equal to the amount by which the taxes reportable on Form CT-1 exceed the total deposits (if any) of such taxes made pursuant to subdivision (i) of this subparagraph for such period.

* * * * *

Par. 2 Section 31.6302(c)-2 is amended as follows:

1. Paragraphs (a)(2) is redesignated as paragraph (a)(3), and the phrase "beginning after March 31, 1964," in paragraph (a)(3) as so redesignated is removed and the phrase "before January 1, 1984," is inserted in lieu thereof.

2. Paragraph (a)(1) is redesignated as paragraph (a)(2), "*In general; before 1984*" is inserted as the heading of paragraph (a)(2) as so redesignated in lieu of "*In general*", and the phrase "before January 1984" is inserted immediately following the term "any calendar month" therein.

3. A new paragraph (a)(1) is added. The added provisions read as follows:

§31.6302(c)-2 Use of Government depositaries in connection with employee and employer taxes under Railroad Retirement Tax Act.

(a) *Requirement*—(1) *In general; after 1983.* In the case of a calendar month which begins after December 31, 1983, if, at a time prescribed under §31.6302(c)-1(a)(1)(i) or (v) for the deposit of undeposited taxes, the aggregate amount of undeposited employee tax withheld after December 31, 1983, under section 3202 and employer tax imposed after December 31, 1983, under section 3221(a) and (b) equals an amount required to be deposited under §31.6302(c)-1(a)(1)(i) or (v), the employer shall deposit the undeposited railroad retirement taxes described in sections 3202 and 3221 at such time in the manner prescribed in §31.6302(c)-1(a)(1)(i) or (v) (except that undeposited railroad retirement taxes described in section 3221(c) shall in no case be required to be deposited earlier than the first day on which a deposit is otherwise required by §31.6302(c)-1(a)(1)(i) to be made after the 15th day of the month following the month in which the section 3221(c) tax arises).

Notwithstanding the preceding sentence, and notwithstanding subdivision (v) of §31.6302(c)-1(a)(1), if, for the calendar year prior to the calendar year preceding the current calendar year, the aggregate amount of taxes imposed under sections 3202 and 3221 with respect to an employer equalled or exceeded $1 million, such employer shall deposit his undeposited railroad retirement taxes required to be deposited for the current calendar year in accordance with Revenue Procedure 83-90, 1983-2 C.B. 615, (relating to transfers by wire to the Treasury).

* * * * *

This Treasury decision is issued under the authority contained in sections 6302(c) and 7805 of the Internal

Revenue Code of 1954 (68A Stat. 775, 26 U.S.C. 6302(c); 68A Stat. 917; 26 U.S.C. 7805). Approved by the Office of Management and Budget under control number 1545-0001.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 21, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 23, 1983; 12:10 p.m., and published in the issue of the Federal Register for December 29, 1983, 48 F.R. 57273)

Subchapter B.—Receipt of Payment

Section 6312.—Payment by United States Notes and Certificates of Indebtedness

26 CFR 301.6312-1: Treasury certificates of indebtedness, Treasury notes, and Treasury bills acceptable in payment of internal revenue taxes or stamps.
(Also Sections 6151, 6402, 6611, 6621; 20.6151-1, 301.6402-1, 301.6611-1, 301.6621-1.)

Overpayments; treasury bonds. When there is an overpayment of estate tax originally paid by the redemption of flower bonds, the Government may reinstate the flower bonds rather than make a cash refund. In such a case, the Government will pay interest on the overpayments at the rate established by section 6621 of the Code and will calculate the interest on the fair market value of the bonds as of the date they were redeemed.

Rev. Rul. 84-38

ISSUES

1. When there is an overpayment of federal estate tax, may the Government reinstate "flower bonds" previously tendered at par in payment of the tax?

2. If so, what rate of interest should be paid on the overpayment?

3. On what amount should the interest be calculated?

FACTS

D died on May 15, 1980. On February 15, 1981, *EX*, executor of *D*'s estate, filed a federal estate tax return reporting 800x dollars in tax. To pay the tax, the estate redeemed "flower bonds" bearing interest at 3½ percent, due February 15, 1990, with a par (face) value of 800*x* dollars and a fair market of 600*x* dollars. On February 15, 1982 the estate filed a claim for refund for 200*x* dollars. The Internal Revenue Service determined that the claim should be allowed in full.

LAW AND ANALYSIS

Section 6312 of the Internal Revenue Code authorizes the Secretary to receive certain U.S. government indebtedness issued on or before March 3, 1971, at par for payment of internal revenue taxes to the extent and under the conditions provided in the regulations. Section 6312 was repealed by section 4(a)(2) of Pub. L. No. 92-5, 1971-1 C.B. 553, effective with respect to obligations issued after March 3, 1971.

Under section 20.6151-1(c) of the Estate Tax Regulations, "flower bonds" may be used to pay estate tax. Flower bonds are debt instruments of the United States that, although not otherwise redeemable at par before maturity, may be redeemed at par, plus accrued interest, to pay federal estate tax due from the deceased owner's estate. The right of redemption applies only to those bonds which, by their offering circulars, provide for such redemption. See 31 CFR 306.28. Thus, the right of redemption is contractual in nature.

Section 6402(a) of the Code provides that the Secretary may credit the amount of any overpayment against any internal revenue tax liability of the person who made the overpayment and will refund any balance to that person.

Section 6611(a) of the Code provides that interest will be allowed and paid upon any overpayment of any internal revenue tax at an annual rate established under section 6621.

Section 6611(b)(2) of the Code provides that, in the case of a refund, interest will be paid from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days.

Section 6621 of the Code, as amended by the Tax Equity and Fiscal Responsibility Act of 1982, section 345(a), 1982-2 C.B. 462, 579, requires the Secretary to adjust interest rates semiannually according to the adjusted prime rate charged by banks.

In *Fryer v. United States*, 440 F. Supp. 769 (S.D. Iowa, 1977), the question of the authority of the Government to reinstate bonds in lieu of a cash overpayment was not raised. The court held that when the Government reinstates bonds, interest is payable at the contractual rate, not the statutory rate on overpayments established by section 6621 of the Code.

In *Girard Trust Bank v. United States*, 602 F.2d 938 (Ct. Cl. 1979), (*Girard I*) the court held that the Government was not limited, in refunding an overpayment, to making a cash refund or crediting the overpayment against another deficiency. When the Government redeemed flower bonds to satisfy a liability that was found later not to be due, a premature redemption took place, contrary to the offering terms of the bonds. Thus, the Government could refund the overpayment by reinstating a portion of the flower bonds previously surrendered.

Girard I also considered the question of the interest on the overpayment. The Government argued that interest should be paid at the contractual rate of 3½ percent. The court held, however, that because the estate had relinquished use of the funds as of the date the bonds were tendered for payment, an overpayment arose that should be governed by the statutory principles in sections 6611 and 6621 of the Code, rather than by the contractual language in the offering circular. Thus, interest was payable under section 6611 at the rate established by section 6621.

In *Girard Trust Bank V. United States*, 643, F.2d 725 (Ct. Cl., 1981) (*Girard II*), the court further considered the question of the amount of

the overpayment on which the interest would be computed. The court applied the rationale in *Girard I* that interest is payable as compensation for the use of money. The court reasoned that the amount of funds the estate lost the use of for the period after the tendering of the bonds was the fair market value of the bonds, not their par value. Moreover, to allow interest on the par value would create a windfall for the estate beyond that intended by Congress. Thus, the court held that interest should be paid on the fair market value of the bonds.

The Service will follow the decisions in both *Girard I* and *Girard II* and will not follow the decision in *Fryer*. Accordingly, the Government may reinstate bonds with a face value of 200*x* dollars and pay interest at the applicable rate under section 6621 of the Code from February 15, 1981 to the date of reinstatement on 150*x* dollars

$$(600x \times 200x).$$
$$800x$$

HOLDINGS

1. The Government may reinstate flower bonds previously redeemed in settlement of an overpayment of federal estate tax.

2. Interest on such overpayments will be paid at the applicable rate established under section 6621 of the Code. The interest paid will be in lieu of the contractual rate.

3. Interest will be calculated on the fair market value of the bonds at the time they are redeemed from the date of the overpayment to the date reinstatement is made.

Subchapter C.—Lien for Taxes

Section 6324A.—Special Lien for Estate Tax Deferred under Section 6166

26 CFR 20.6324A-1: Special lien for estate tax deferred under section 6166 or 6166A.
(Also Sections 2204; 20.2204-1, 20.2204-3, 301.6324A-1.)

T.D. 7941

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, SUBCHAPTER F, PART 20.—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954; PART 301.—PROCEDURE AND ADMINISTRATION

Special Lien for Estate Taxes Deferred Under Section 6166 or 6166A

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to a special lien under section 6324A for estate taxes deferred under section 6166 or 6166A. Changes to the applicable law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], and the Economic Recovery Tax Act [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations would provide the public with the guidance needed to comply with the law and would affect those estates electing a special lien in favor of the United States on property as security for deferred payments of estate tax.

DATES: These regulations are generally effective for estates of decedents dying after December 31, 1976. The regulations necessitated by the Economic Recovery Tax Act of 1981 are effective for estates of decedents dying after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: Neil W. Zyskind of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W. Washington, D.C. 20224, Attention: CC:LR:T, (202) 566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 11, 1983, the Federal Register published proposed amendments to the Estate Tax Regulations (26 CFR Part 20) and to the Procedure and Administration Regulations (26 CFR Part 301) under section 6324A of the Internal Revenue Code of 1954 (48 FR 21167). No comments were received and no public hearing was requested. Furthermore, no substantive changes have been made to the rules contained in the proposed regulations.

This Treasury decision is issued under the authority contained in sections 6324A(a) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1808, 68A Stat. 917; 26 U.S.C. 6324A(a), 7805).

SUMMARY

Section 6324A permits the executor of a decedent's estate to elect a lien on section 6166 property in favor of the United States in lieu of a bond or personal liability if an election under section 6166 or 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981) was made. The election under section 6324A will not be effective unless all parties having an interest in the property subject to the lien sign an agreement in which they consent to the creation of the lien. Regulations concerning the election of and agreement to the lien may be found in §301.6324A-1.

These regulations define the term "section 6166 lien property" and determine the maximum value of the property which the district director may require as section 6166 lien property. Section 20.6324A-1(b)(3) indicates when the district director may require additional property to be subject to the lien under section 6324A. Section 20.6324A-1(c) discusses the period and priorities of a section 6324A lien.

SPECIAL ANALYSIS

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the

regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 533 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB and have been assigned No. 1545-0754.

DRAFTING INFORMATION

The principal author of these regulations is Neil W. Zyskind of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

LIST OF SUBJECTS IN 26 CFR 20

Estate taxes.

LIST OF SUBJECTS IN 26 CFR 301

Administrative practice and procedure, Bankruptcy, Courts, Crime, Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Investigations, Law enforcement, Penalties, Pensions, Statistics, Taxes, Disclosure of information, Filing requirements.

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 20 and 301 are amended as follows:

§20.2204-1 [Amended]

Paragraph 1. Section 20.2204-1 is amended as follows:

(a) Paragraph (a) is amended by removing the phrases "(1 year with respect to the estate of a decedent dying before January 1, 1974)" and "(1 year if applicable)" wherever they appear.

(b) Paragraph (b) is amended by removing the phrases "(1 year with respect to the estate of a decedent dying before January 1, 1974)" and "(or 1 year period if applicable)" wherever they appear.

Par. 2. A new §20.2204-3 is added immediately following §20.2204-2 to read as set forth below.

§20.2204-3 Special rules for estates of decedents dying after December 31, 1976; special lien under section 6324A.

For purposes of §§20.2204-1(b) and 20.2204-2(b), in the case of a decedent dying after December 31, 1976, if the executor elects a special lien in favor of the United States under section 6324A, relating to special lien for estate taxes deferred under section 6166 or 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981), such lien shall be treated as the furnishing of a bond with respect to the amount for which the time for payment has been extended under section 6166. If an election has been made under section 6324A, the executor may not thereafter substitute a bond pursuant to section 2204 in lieu of that lien. If a bond has been supplied under section 2204, however, the executor may, by filing a proper notice of election and agreement, substitute a lien under section 6324A for any part or all of such bond. See §§20.6324A-1 and 301.6324A-1 for rules relating to a special lien under section 6324A.

Par. 3. Section 20.6324A-1 is revised to read as set forth below.

§20.6324A-1 Special lien for estate tax deferred under section 6166 or 6166A.

(a) *In general.* If the executor of an estate of a decedent dying after December 31, 1976, makes an election under section 6166 or 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981) to defer the payment of estate tax, the executor may make an election under section 6324A. An election under section 6324A will cause a lien in favor of the United States to attach to the estate's section 6166 lien property, as defined in paragraph (b)(1) of this section. This lien is in lieu of the bonds required by sections 2204 and 6165 and in lieu of any lien under section 6324 on the same property with respect to the same estate. The value of the property which the district director may require under section 6324A as section 6166 lien property may not exceed the sum of the deferred amount (as defined in paragraph (e)(1) of this section) and the required interest amount (as defined in paragraph (e)(2) of this section). The unpaid portion of the deferred amount (plus any unpaid interest, additional amount, addition to tax, assessable penalty, and cost attributable to the deferred amount) shall be a lien in favor of the United States on the section 6166 lien property. See §301.6324A-1 of this chapter (Regulations on Procedure and Administration) for provisions relating to the election of and agreement to the special lien for estate tax deferred under section 6166 or 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981).

(b) *Section 6166 lien property.*— (1) *In general.* Section 6166 lien property consists of those interests in real and personal property designated in the agreement referred to in section 6324A(c) (see paragraph (b) of §301.6324A-1 of this chapter). An interest in property may be designated as section 6166 lien property only to the extent such interest can be expected to survive the deferral period (as defined in paragraph (e)(3) of this section). Property designated, however, need not be property included in the decedent's estate.

(2) *Maximum value of required property.* The fair market value of the property required by the district director to be designated as section 6166 lien property with respect to any estate shall not be greater than the sum of the deferred amount and the required interest amount, as these terms are defined in paragraphs (e)(1) and (2) of this section. However, the parties to the agreement referred to in section 6324A(c) may voluntarily designate property having a fair mar-

ket value in excess of that sum. The fair market value of the section 6166 lien property shall be determined as of the date prescribed in section 6151(a) (without regard to any extension) for payment of the estate tax. Such value must take into account any encumberance on the property (such as a mortgage or a lien under section 6324B).

(3) *Additional lien property may be required.* If, at any time, the unpaid portion of the deferred amount and the required interest amount exceeds the fair market value of the section 6166 lien property, the district director may require the addition of property to the agreement in an amount up to such excess. When additional property is required, the district director shall make notice and demand upon the agent designated in the agreement setting forth the amount of additional property required. Property having the required value (or other security equal to the required value) must be added to the agreement within 90 days after notice and demand from the district director. Failure to comply with the demand within the 90-day period shall be treated as an act accelerating payment of installments under section 6166(g) or 6166A(h) (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981).

(4) *Partial substitution of bond.* See paragraph (c) of §301.6324A-1 of this chapter for rules relating to the partial substitution of a bond for the lien where the value of property designated as section 6166 lien property is less than the amount of unpaid estate tax plus interest.

(c) *Special rules.*—(1) *Period of lien.* The lien under section 6324A arises at the earlier of the date—

(i) The executor is discharged from liability under section 2204; or

(ii) Notice of lien is filed in accordance with §301.6323(f)-1 of this chapter.

The section 6324A lien continues until the liability for the deferred amount is satisfied or becomes unenforceable by reason of lapse of time. The provisions of §301.6325-1(c), relating to release of lien or discharge of property, shall apply to this paragraph (c)(1).

(2) *Requirement that lien be filed.* The lien imposed by section 6324A is not valid against a purchaser (as defined in paragraph (f) of §301.6323(h)-1), holder of a security interest (as defined in paragraph (a) of §301.6323(h)-1), mechanic's lienor (as defined in paragraph (b) of §301.6323(h)-1), or judgment lien creditor (as a defined in paragraph (g) of §301.6323(h)-1) until notice of the lien is filed. Once filed, the notice of lien remains effective without being refiled.

(3) *Priorities.* Although a notice of lien under section 6324A has been properly filed, that lien is not valid—

(i) To the extent provided in section 6323(b)(6), relating to real property tax and special assessment liens, regardless of whether such liens came into existence before or after the filing of the notice of Federal tax lien;

(ii) In the case of any real property subject to a lien for repair or improvement, as against a mechanic's lienor, whether or not such lien came into existence before or after the notice of tax lien was filed; and

(iii) As against any security interest set forth in section 6323(c)(3), relating to real property construction or improvement financing agreements, regardless whether such security interest came into existence before or after the filing of the notice of tax lien.

However, paragraphs (c)(3)(ii) and (iii) of this section shall not apply to any security interest that came into existence after the date of filing of notice (in a manner similar to a notice filed under section 6323(f)) that payment of the deferred amount has been accelerated under section 6166(g) or 6166A(h) (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981).

(d) *Release or discharge of lien.* For rules relating to release of the lien imposed by section 6324A or discharge of the section 6166 lien property, see section 6325 and §301.6325-1 of this chapter.

(e) *Definitions.* For purposes of section 6324A of this section—

(1) *Deferred amount.* The deferred amount is the aggregate amount of estate tax deferred under section 6166 or 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981) determined as of the date prescribed by section 6151(a) for payment of the estate tax.

(2) *Required interest amount.* The required interest amount is the aggregate amount of interest payable over the first four years of the deferral period. For purposes of computing the required interest amount, the interest rate prescribed by section 6621 in effect on the date prescribed by section 6151(a) for payment of the estate tax shall be used for computing the interest for the first four years of the deferral period. The 4-percent interest rate prescribed by section 6601(j) shall apply to the extent provided in that section. For purposes of computing interest during deferral periods beginning after December 31, 1982, interest shall be compounded daily.

(3) *Deferral period.* The deferral period is the period for which the payment of tax is deferred pursuant to the election under section 6166 or 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981).

(4) *Application of definitions.* In the case of a deficiency, a separate deferred amount, required interest amount, and deferral period shall be determined as of the due date of the first installment after the deficiency is prorated to installments under section 6166 and 6166A (as in effect prior to its repeal by the Economic Recovery Tax Act of 1981).

PART 301—(AMENDED)

§301.6324A-1 (Amended)

Par. 4. Paragraphs (a), (b)(1)(iv), (b)(4), and (f) of §301.6324A-1 are amended by adding the phrase "(as in effect prior to its repeal by Economic Recovery Tax Act of 1981)" after each time the phrase "6166A" appears.

This Treasury decision is issued under the authority contained in sections 6324A(a) and 7805 of the Internal Revenue code of 1954 (90 Stat. 1808, 68A Stat. 917; 26 U.S.C. 6324A(a), 7805). Approved by the Office of Management and Budget under control number 1545-0754.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

Approved January 20, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury

(Filed by the Office of the Federal Register on February 6, 1984, 8:54 a.m. and published in the issue of the Federal Register for February 7, 1984, 49 F.R. 4467)

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26 CFR 301.6324A-1: Election of and agreement to special tax lien for estate tax deferred under section 6166 or 6166A.

Special lien for estate tax deferred under section 6166 or 6166A. See T.D. 7941, page 251.

Chapter 65.—Abatements, Credits and Refunds
Subchapter A.—Procedures in General

Section 6402.—Authority to Make Credits or Refunds

26 CFR 51.6402-1: Credit or refund of overpayment of windfall profit tax.

Procedures for claiming credit or refund of windfall profit tax by certain partnerships for 1983. See Rev. Proc. 84-4, page 363.

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26 CFR 301.6402-1: Authority to make credits or refunds.

When there is an overpayment of federal estate tax, may the Government reinstate flower bonds previously tendered at par in payment of the tax? See Rev. Rul. 84-38, page 250.

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26 CFR 301.6402-3: Special rules applicable to income tax.
(Also Sections 6153, 6154, 6654, 6655; 1.6153-1, 1.6154-2, 1.6654-1, 1.6655-1.)

Penalties; underpayment of estimated tax; credit offset from preceding year. When an underpayment of estimated tax is satisfied by an overpayment applied from a previous year, the period of underpayment runs from the due date of the installment of estimated tax to the date the overpayment arose. Rev. Rul. 83-111 revoked. Rev. Rul. 77-475 reinstated as modified.

Rev. Rul. 84-58 [1]

FACTS

The Internal Revenue Service has reconsidered Rev. Rul. 83-111, 1983-2 C.B. 245, and Rev. Rul. 77-475, 1977-2 C.B. 476, concerning application of overpayments of income tax against installment payments of estimated tax for the succeeding year.

Rev. Rul. 83-111 holds that such an overpayment will be applied against installment payments due on or after the date the election to apply the overpayment is made. In *Situation 2* of Rev. Rul. 83-111, a taxpayer with an extension of time to file a return for calendar year 1979 filed the return on June 15, 1980. The overpayment shown on the return that arose from estimated tax payments made during 1979 was applied against the June 15 estimated tax installment for 1980 and not against the April 15 installment, as had previousy been the case.

HOLDING

For returns filed after December 31, 1983, the Service will apply overpayments arising on or before the due date of a return against the first installment payment of the next year's estimated tax, unless the taxpayer notifies the Service that the overpayment should be applied against another installment. In *Situation 2* of Rev. Rul. 83-111, the 1979 overpayment would be applied against the April 15, 1980, installment unless the taxpayer notified the Service to the contrary. In order to properly notify the Service that the overpayment should be applied against another installment, taxpayers must attach a statement to the income tax return showing the overpayment, indicating which installment of estimated tax the overpayment should be applied against.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 83-111 is revoked. Rev. Rul. 77-475 is reinstated as modified herein.

[1] Based on News Release IR-84-46, dated March 30, 1984.

Subchapter B.—Rules of Special Application

Section 6413.—Special Rules Applicable to Certain Taxes Under Subtitle C

26 CFR 31.6413(c)-1: Special refunds.

Federal employee with an outside job, paying the hospital insurance tax on both jobs. See Rev. Rul. 84-56, page 184.

Chapter 66.—Limitations
Subchapter A.—Limitation on Assessment and Collection

Section 6501.—Limitations On Assessment and Collection

(Also Section 6653; 301.6653-1.)

Ct. D. 2024

SUPREME COURT
OF THE
UNITED STATES
Nos. 82-1453 and 82-1509

Ernest Badaracco, Sr., et al., Petitioners,
v.
Commissioner of Internal Revenue

Deleet Merchandising Corp., Petitioner,
v.
United States
[464 U.S.]

On Writ on Certiorari to the United States Court of Appeals for the Third Circuit
[January 17, 1984]

Syllabus

Section 6501(a) of the Internal Revenue Code of 1954 establishes a general 3-year period of limitations "after the return was filed" for the assessment of federal income taxes. However, §6501(c)(1) provides that when there is "a false or fraudulent return with the intent

*Together with No. 82-1509, *Deleet Merchandising Corp.* v. *United States*, also on certiorari to the same court.

to evade tax," the tax then may be assessed "at any time." In No. 82-1453, petitioners conceded, for purposes of this litigation, that they had filed fraudulent partnership and individual income tax returns for the years 1965-1969. However, in 1971 they filed nonfraudulent amended returns and paid the additional basic taxes shown thereon. In 1977, the Commissioner of Internal Revenue issued notices of deficiency, asserting liability under §6653(b) of the Code for the addition to tax on account of fraud of 50% of the underpayment in the basic tax. Petitioners sought redetermination in the United States Tax Court of the asserted deficiencies, contending that §6501(c)(1) did not apply because of the filing of the nonfraudulent amended returns, and that the Commissioner's action was barred by §6501(a) because the deficiency notices were issued more than three years from the date of filing of the amended returns. The Tax Court agreed with petitioners. In No. 82-1509, petitioner filed timely corporation income tax returns for the years 1967 and 1968, but in 1973 it filed amended returns disclosing certain receipts that had not been reported on the original returns. In 1979, the Commissioner issued a notice asserting deficiencies in tax and addition under §6653(b) for 1967 and 1968. Petitioner paid the alleged deficiencies and brought suit for refund in Federal District Court, which granted summary judgment for petitioner on the ground that the Commissioner's action was barred by §6501(a), regardless of whether the original returns were fraudulent. The Court of Appeals, consolidating the appeals, reversed in both cases.

Held: Where a taxpayer files a false or fraudulent return but later files a nonfraudulent amended return, §6501(c)(1) applies and a tax may be assessed "at any time," regardless of whether or not more than three years have expired since the filing of the amended return.

(a) The plain and unambiguous language of §6501(c)(1) permits the Commission to assess "at any time" the tax for a year in which the taxpayer has filed "a false or fraudulent return," despite any subsequent disclosure the taxpayer might make. Nothing is present in the statute that can be construed to suspend its operation as a consequence of a fraudulent filer's subsequent repentant conduct. Neither is there anything in the wording of §6501(a) that itself enables a taxpayer to reinstate the section's general 3-year limitations period by filing an amended return. Moreover, the substantive operation of the fraud provisions of the Code itself confirms the conclusion that §6501(c)(1) permits assessment at any time in fraud cases regardless of a taxpayer's later repentance.

(b) Nothing in the statutory language, the structure of the Code, or the decided cases supports petitioners' contention that a fraudulent return is a "nullity" for statute of limitations purposes and that therefore the amended return is necessarily "the return" referred to in §6501(a).

(c) There is no need to twist §6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy, for its literal language is supported by substantial policy considerations—the increased difficulty in investigating fraud cases as opposed to cases marked for routine audits; the fact that the filing of a document styled "amended return" does not fundamentally change the nature of a tax fraud investigation; and the compounding of the difficulties that attend a civil fraud investigation where the Commissioner's initial findings lead him to conclude that the case should be referred to the Department of Justice for criminal prosecution.

(d) Petitioner's argument that a literal reading of §6501(c) would elevate one form of tax fraud over another because it produces a disparity in treatment between a taxpayer who in the first instance files a fraudulent return and one who fraudulently fails to file any return at all, cannot prevail. Section 6501(c)(3)—which provides that in a case of failure to file a return, the tax may be assessed "at any time"—has been construed as ceasing to apply once a return has been filed for a particular year, regardless of whether that return is filed late and even though the failure to file a timely return in the first instance was due to fraud. However, the language employed in the respective subsections of §6501(c)(1). P. 14.

693 F.2d 298, affirmed.

BLACKMUN, J., delivered the opinion of the Court, in which BURGER, C. J., and BRENNAN, WHITE, MARSHALL, POWELL, REHNQUIST, and O'CONNOR, JJ., joined. STEVENS, J., filed a dissenting opinion.

JUSTICE BLACKMUN delivered the opinion of the Court. These cases focus upon §6501 of the Internal Revenue Code of 1954, 26 U.S.C. §6501. Subsection (a) of that statute establishes a general three-year period of limitations "after the return was filed" for the assessment of income and certain other federal taxes. [1] Subsection (c)(1) of §6501, however, provides an exception to the three-year period when there is "a false or fraudulent return with the intent to evade tax." The tax then may be assessed "at any time." [2]

The issue before us is the proper application of §§6501(a) and (c)(1) to the situation where a taxpayer files a false or fraudulent return but later files a nonfraudulent amended return. May a tax then be assessed more than three years after the filing of the amended return?

I

No. 82-1453. Petitioners Ernest Badaracco, Sr., and Ernest Badaracco, Jr., were partners in an electrical contracting business. They filed federal partnership and individual income tax returns for the calendar years 1965-1969, inclusive. "[F]or purposes of this case," these petitioners concede the "fraudulent nature of the original returns." App. 37a.

In 1970 and 1971, federal grand juries in New Jersey subpoenaed books and records of the partnership. On August 17, 1971, petitioners filed nonfraudulent amended returns for the tax years in question and paid the additional basic taxes shown thereon. Three months later petitioners were indicted for filing false and fraudulent returns, in violation of §7206(1) of the code, 26 U.S.C. §7206(1). Each pleaded guilty to the charge with respect to the 1967 returns, and judgments of conviction were entered. *United States v. Badaracco,* Crim. No. 766-71 (DNJ). The remaining counts of the indictment were dismissed.

On November 21, 1977, the Commissioner of Internal Revenue mailed to petitioners notices of deficiency for each of the tax years in question. He asserted, however, only the liability under §6653(b) of the Code, 26 U.S.C. §6653(b), for the addition to tax on account of fraud (the so-called fraud "penalty") of 50% of the underpayment in the basic tax. See App. 5a.

Petitioners sought redetermination in the United States Tax Court of the asserted deficiencies, contending that the Commissioner's action was barred by §6501(a). They claimed that §6501(c)(1) did not apply because the 1971 filing of nonfraudulent amended returns caused the general three-year period of limitations specified in §6501(a) to operate; the deficiency notices, having issued in November 1977, obviously were forthcoming only long after the expiration of three years from the date of filing

[1] Section 6501(a) reads in full:

"Excepts as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period."

[2] Section 6501(c)(1) reads:

"In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time."

of the nonfraudulent amended returns.

The Tax Court, in line with its then-recent decision in *Klemp* v. *Commissioner*, 77 T.C. 201 (1981), appeal pending, (CA9 No. 81-7744), agreed with petitioners.[3] 42 TCM 573, ¶81,404 P-H Memo TC (1981).

No. 82-1509. Petitioner Deleet Merchandising Corp. filed timely corporation income tax returns for the calendar years 1967 and 1968. The returns as so filed, however, did not report certain receipts derived by the taxpayer from its printing supply business. On August 9, 1973, Deleet filed amended returns for 1967 and 1968 disclosing the receipts that had not been reported.[4] Although the taxpayer corporation itself was not charged with criminal tax violations, and although no formal criminal investigation was initiated as to it, there were criminal and civil investigations that centered on certain former officers of the taxpayer. After the completion of those investigations, the Commissioner, on December 14, 1979, issued a notice of deficiency to Deleet. App. 71a. The notice asserted deficiencies in tax and additions under §6653(b) for 1967 and 1968.

Deleet paid the alleged deficiencies and brought suit for their refund in the United States District Court for the District of New Jersey. On its motion for summary judgement, Deleet contended that the Commissioner's action was barred by §6501(a). It claimed that no deficiencies or additions could be assessed more than three years after the amended returns were filed, regardless of whether the original returns were fraudulent.

The District Court agreed and granted summary judgment for Deleet. 535 F. Supp. 402 (1981). It relied on the Tax Court's decision in *Klemp* v. *Commissioner, supra,* and on *Dowell* v. *Commissioner,* 614 F.2d 1263 (CA10 1980), cert. pending, No. 82-1873.

The Appeals. The Government appealed each case to the United States Court of Appeals for the Third Circuit. The cases were heard and decided together. That court, by a 2 to 1 vote, reversed the decision of the Tax Court in *Badaracco* and the judgment of the District Court in *Deleet. Badaracco* v. *Commissioner,* 693 F.2d 298 (1982). The Third Circuit's ruling is consistent with the Fifth Circuit's holding in *Nesmith* v. *Commissioner,* 699 F.2d 712 (1983), cert. pending, No. 82-2008. The Second Circuit has ruled otherwise. See *Britton* v. *United States,* 532 F. Supp. 275 (Vt. 1981), aff'd mem., 697 F.2d 288 (CA2 1982). See also *Espinoza* v. *Commissioner,* 78 T.C. 412 (1982).[5] Because of the conflict, we granted certiorari, ____ U.S. ____ (1983).

II

Our task here is to determine the proper construction of the statute of limitations Congress has written for tax assessment. This Court long ago pronounced the standard: "Statutes of limitation sought to be applied to bar rights of the Government, must receive a strict construction in favor of the Government." *E. I. Dupont de Nemours & Co.* v. *Davis,* 264 U.S. 456, 462 (1924). See also *Lucas* v. *Pilliod Lumber Co.,* 281 U.S. 245, 249 (1930). More recently, Judge Roney, in speaking for the former Fifth Circuit, has observed that "limitations statutes barring the collection of taxes otherwise due and unpaid are strictly construed in favor of the Government." *Lucia* v. *United States,* 474 F.2d, 565, 570 (1973).

We naturally turn first to the language of the statute. Section 6501(a) sets forth the general rule: a three-year period of limitations on the assessment of tax. Section 6501(e)(1)(A) (first introduced as §275(c) of the Revenue Act of 1934, 48 Stat. 745) provides an extended limitations period for the situation where the taxpayer's return nonfraudulently omits more than 25% of his gross income; in a situation of that kind, assessment now is permitted "at any time within 6 years after the return was filed."

Both the three-year rule and the six-year rule, however, explicitly are made inapplicable in circumstances covered by §6501(c). This subsection identifies three situations in which the Commissioner is allowed an unlimited period within which to assess tax. Subsection (c)(1) relates to "a false or fraudulent return with the intent to evade tax" and provides that the tax then may be assessed "at any time." Subsection (c)(3) covers the case of a failure to file a return at all (whether or not due to fraud) and provides that an assessment then also may be made "at any time." Subsection (c)(2) sets forth a similar rule for the case of a "willful attempt in any manner to defeat or evade tax" other than income, estate, and gift taxes.[6]

All these provisions appear to be unambiguous on their face, and it therefore would seem to follow that

[3] In *Klemp*, the Tax Court, in a reviewed decision with five judges dissenting on the issue, departed from its earlier holding in *Dowell* v. *Commissioner,* 68 T.C. 646 (1977), rev'd, 614 F.2d 1263 (CA10 1980), cert. pending, No. 82-1873.

[4] Deleet asserts that the filing of its amended returns was voluntary. The taxpayer's correct tax liability has not yet been determined. Although Deleet has not conceded that its original returns were fraudulent, both the District Court, App. to Pet. for Cert. in No. 82-1509, p. 4d, and the Court of Appeals, see *Badaracco* v. *Commissioner,* 693 F.2d 298, 299, n. 3 (CA3 1982), assumed, for purposes of Deleet's summary judgment motion hereinafter referred to, that they were. We must make the same assumption here.

[5] The Tax Court, in cases concerning several of Deleet's officers, has followed its ruling in *Klemp, supra.* See *Kramer* v. *Commissioner,* 44 TCM 42, ¶82,308 P-H Memo TC (1982); *Elliott Liroff* v. *Commissioner,* 44 TCM 47, ¶82.309 P-H Memo TC (1982); *Derfel* v. *Commissioner,* 44 TCM 45, ¶82,311 P-H Memo TC (1982); *Richard B. Liroff* v. *Commissioner,* 44 TCM 47, ¶82,312 P-H Memo TC (1982). See also *Galvin* v. *Commissioner,* 45 TCM 221, ¶82,689 P-H Memo TC (1982).

[6] Subsection (c)(1) and (c)(3) appeared separately only upon the enactment of the 1954 Code. From 1921 until the 1954 Code, they were combined. See, *e.g.,* Revenue Act of 1921, §250(d), 42 Stat. 265; Internal Revenue Code of 1939, §276(a).

[7] Under every general income tax statute since 1918, the filing of a false or fraudulent return has indefinitely extended the period of limitations for assessment of tax. See Revenue Act of 1918, §250(d), 40 Stat. 1083; Revenue Act of 1921, §250(d), 42 Stat. 265; Revenue Act of 1924, §278(a), 43 Stat. 299; Revenue Act of 1926, §278(a), 44 Stat., pt. 2, p. 59; Revenue Act of 1928, §276(a), 45 Stat. 857; Revenue Act of 1932, §276(a), 47 Stat. 238; Revenue Act of 1934, §276(a), 48 Stat. 745; Revenue Act of 1936, §276(a), 49 Stat. 1726; Revenue Act of 1983, §276(a), 52 Stat. 540; Internal Revenue Code of 1939, §276(a).

the present cases are squarely controlled by the clear language of §6501(c)(1). Petitioners Badaracco concede that they filed initial returns that were "false or fraudulent with the intent to evade tax." Petitioner Deleet, for present purposes, upon this review of its motion for summary judgment, is deemed to have filed false or fraudulent returns with the intent to evade tax. Section 6501(c)(1), with its unqualified language, then allows the tax to be assessed "at any time." Nothing is present in the statute that can be construed to suspend its operation in the light of a fraudulent filer's subsequent repentant conduct.[7] Neither is there anything in the wording of §6501(a) that itself enables a taxpayer to reinstate the section's general three-year limitations period by filing an amended return. Indeed, as this Court recently has noted, *Hillsboro National Bank* v. *Commissioner,* ___ U.S. ___, ___, n. 10 (1983) [1983-1 C.B. 50] (slip op. 8), the Internal Revenue Code does not explicitly provide either for a taxpayer's filing, or for the Commissioner's acceptance, of an amended return; instead, an amended return is a creature of administrative origin and grace. Thus, when Congress provided for assessment at any time in the case of a false or fraudulent "return," it plainly included by this language a false or fraudulent *original* return. In this connection, we note that until the decision of the Tenth Circuit in *Dowell* v. *Commissioner,* 614 F.2d 1263 (1980), cert. pending, No. 82-1873, courts consistently had held that the operation of §6501 and its predecessors turned on the nature of the taxpayer's original, and not his amended, return.[8]

The substantive operation of the fraud provisions of the Code itself confirms the conclusion that §6501(c)(1) permits assessment at any time in fraud cases regardless of a taxpayer's later repentance. It is established that a taxpayer who submits a fraudulent return does not purge the fraud by subsequent voluntary disclosure; the fraud was committed, and the offense completed, when the original return was prepared and filed. See, *e.g., United States* v. *Habig,* 390 U.S. 222 (1968) [1968-2 C.B. 589] *Plunkett* v. *Commissioner,* 465 F.2d 299, 302-303 (CA7 1972). "Any other result would make sport of the so-called fraud penalty. A taxpayer who had filed a fraudulent return would merely take his chances that the fraud would not be investigated or discovered, and then, if an investigation were made, would simply pay the tax which he owed anyhow and thereby nullify the fraud penalty." *George M. Still, Inc.* v. *Commissioner,* 19 T.C. 1072, 1077 (1953), aff'd 218 F.2d 639 (CA2 1955). In short, once a fraudulent return has been filed, the case remains one "of a false or fraudulent return," regardless of the taxpayer's later revised conduct, for purposes of criminal prosecution and civil fraud liability under §6653(b). It likewise should remain such a case for purposes of the unlimited assessment period specified by §6501(c)(1).

We are not persuaded by Deleet's suggestion, Brief for Petitioner in No. 82-1509, p. 15, that §6501(c)(1) should be read merely to suspend the commencement of the limitations period while the fraud remains uncorrected. The Tenth Circuit, in *Dowell* v. *Commissioner, supra,* made an observation to that effect, stating that the three-year limitations period was "put in limbo" pending on further taxpayer action. 614 F.2d, at 1266. The language of the statute, however, is contrary to this suggestion. Section 6501(c)(1) does not "suspend" the operation of §6501(a) until a fraudulent filer makes a voluntary disclosure. Section 6501(c)(1) makes no reference at all to §6501(a); it simply provides that the tax may be assessed "at any time." And §6501(a) itself contains no mechanism for its operation when a fraudulent filer repents. By its very terms, it does not apply to a case, such as one of "a false or fraudulent return," that is "otherwise provided" for in §6501. When Congress intends only a temporary suspension of the running of a limitations period, it knows how unambiguously to accomplish that result. See, *e.g.,* §§6503(a)(1), (a)(2), (b), (c), and (d).

The weakness of petitioners' proposed statutory construction is demonstrated further by its impact on §6501(e)(1)(A), which provides an extended limitations period whenever a taxpayer's return nonfraudulently omits more than 25% of his gross income.

Under petitioners' reasoning, a taxpayer who *fraudulently* omits 25% of his gross income gains the benefit of the three-year limitations period by filing an amended return. Yet a taxpayer who *nonfraudulently* omits 25% of his gross income cannot gain that benefit by filing an amended return; instead he must live with the six-year period specified in §6501(e)(1)(A).[9] We agree with the conclusion of the Court of Appeals in the instant cases that Congress could not have intended to "create a situation in which persons who committed willful, deliberate fraud would be in a better position" than those who un-

[7] The significance of the original, and not the amended, return has been stressed in other, but related, contexts. It thus has been held consistently that the filing of an amended return in a nonfraudulent situation does not serve to extend the period within which the Commissioner may assess a deficiency. See, *e.g., Zellerbach Paper Co.* v. *Helvering,* 293 U.S. 172 (1934); [1934-2 C.B. 347] *National Paper Products Co.* v. *Helvering,* 293 U.S. 183 (1934); [1934-2 C.B. 347] *National Refining Co.* v. *Commissioner,* 1 B.T.A. 236 (1924). It also has been held that the filing of an amended return does not serve to reduce the period within which the Commissioner may assess taxes where the original return omitted enough income to trigger the operation of the extended limitations period provided by §6501(e) or its predecessors. See, *e.g., Houston* v. *Commissioner,* 38 T.C. 486 (1962); *Goldring* v. *Commissioner,* 20 T.C. 79 (1953). And the period of limitations for filing a refund claim under the predecessor of §6511(a) begins to run on the filing of the original, not the amended, return. *Kaltreider Construction, Inc.* v. *United States,* 303 F.2d 366, 368 (CA3), cert. denied, 371 U.S. 877 (1962).

[9] In both *Dowell* and *Klemp,* the Commissioner had issued his deficiency notices more than three years after the amended returns were filed but within the extended six-year period after the original returns were filed. The courts in those cases nonetheless ruled the notices untimely. That result folow necessarily from petitioners' proposed statutory construction. It seems to us, however, to be unacceptably anomalous.

derstated their income inadvertently and without fraud. 693 F.2d, at 302.

We therefore conclude that the plain and unambiguous language of §6501(c)(1) would permit the Commissioner to assess "at any time" the tax for a year in which the taxpayer has filed "a false or fraudulent return," despite any subsequent disclosure the taxpayer might make. Petitioners attempt to evade the consequences of this language by arguing that their original returns were "nullities." Alternatively, they urge a nonliteral construction of the statute based on considerations of policy and practicality. We now turn successively to those proposals.

III

Petitioners argue that their original returns, to the extent they were fraudulent, were "nullities" for statute of limitations purposes. See Brief for Petitioners in No. 82-1453, pp. 22-27; Brief for Petitioner in No. 82-1509, pp. 32-34. Inasmuch as the original return is a nullity, it is said, the amended return is necessarily "the return" referred to in §6501(a). And if that return is nonfraudulent, §6501(c)(1) is inoperative and the normal three-year limitations period applies. This nullity notion does not persuade us, for it is plain that "the return" referred to in §6501(a) is the original, not the amended, return.

Petitioners do not contend that their fraudulent original returns were nullities for purposes of the Code generally. There are numerous provisions in the Code that relate to civil and criminal penalties for submitting or assisting in the preparation of false or fraudulent returns; their presence makes clear that a document which on its face plausibly purports to be in compliance, and which is signed by the taxpayer, is a return despite its inaccuracies. See, *e.g.*, §§7207, 6531(3), 6653(b). Neither do petitioners contend that their original returns were nullities for all purposes of §6501. They contend, instead, that a fraudulent return is a nullity only for the limited purpose of applying §6501(a). See Brief for Petitioners in No. 82-1453, p. 24; Brief for Petitioner in No. 82-1509, pp. 33-34. The word "return," however, appears no less than 64 times in §6501. Surely, Congress cannot rationally be thought to have given that word one meaning in §6501(a), and a totally different meaning in §§6501(b) through (q).

Zellerbach Paper Co. v. *Helvering*, 293 U.S. 172 (1934) [1934-2 C.B. 347] which petitioners cite, affords no support for their argument. The Court in *Zellerbach* held that an original return, despite its inaccuracy, was a "return" for limitations purposes, so that the filing of an amended return did not start a new period of limitations running. In the instant cases, the original returns similarly purported to be returns, were sworn to as such, and appeared on their faces to constitute endeavors to satisfy the law. Although those returns, in fact, were not honest, the holding in *Zellerbach* does not render them nullities. To be sure, current Regulations, in several places, *e.g.*, Treas. Reg. §§301.6211-1(a), 301.6402-3(a), 1.451-1(a) and 1.461-1(a)(3)(i) (1983), do refer to an amended return, as does §6213(g)(1) of the Code itself, 26 U.S.C. §6213(g)(1) (1976 ed., Supp. V). None of these provisions, however, requires the filing of such a return. It does not follow from all this that an amended return becomes "the return" for purposes of §6501(a).

We conclude, therefore, that nothing in the statutory language, the structure of the Code, or the decided cases supports the contention that a fraudulent return is a nullity for statute of limitations purposes.

IV

Petitioners contend that a nonliteral reading should be accorded the statute on grounds of equity to the repentant taxpayer and tax policy. "Once a taxpayer has proviced the information upon which the Government may make a knowledgeable assessment, the justification for suspending the limitations period is no longer viable and must yield to the favored policy of limiting the Government's time to proceed against the taxpayer." Brief for Petitioner in No. 82-1509, p. 12. See, also, Brief for Petitioners in No. 82-1453, p. 17.

The cases before us, however, concern the construction of existing statutes. The relevant question is not whether, as an abstract matter, the rule advocated by petitioners accords with good policy. The question we must consider is whether the policy petitioners favor is that which Congress effectuated by its enactment of §6501. Courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement. See *TVA* v. *Hill*, 437 U.S. 153, 194-195 (1978). This is especially so when courts construe a statute of limitations, which "must receive a strict construction in favor of the Government." *E. I. Dupont de Nemours & Co.* v. *Davis*, 264 U.S., at 462.

We conclude that, even were we free to do so, there is no need to twist §6501(c)(1) beyond the contours of its plain and unambiguous language in order to comport with good policy, for substantial policy considerations support its literal language. First, fraud cases ordinarily are more difficult to investigate than cases marked for routine tax audits. Where fraud has been practiced, there is a distinct possibility that the taxpayer's underlying records will have been falsified or even destroyed. The filing of an amended return, then, may not diminish the amount of effort required to verify the correct tax liability. Even though the amended return proves to be an honest one, its filing does not necessarily "remov[e] the Commissioner from the disadvantageous position in which he was originally placed." Brief for Petitioners in No. 82-1453, p. 12.

Second, the filing of a document styled "amended return" does not fundamentally change the nature of a tax fraud investigation. An amended return, however accurate it ultimately may prove to be, comes with no greater guarantee of trustworthiness than any other submission. It comes carrying no special or significant imprimatur; instead, it comes from a

taxpayer who already has made false statements under penalty of perjury. A responsible examiner cannot accept the information furnished on an amended return as a substitute for a thorough investigation into the existence of fraud. We see no "tax policy" justification for holding that an amended return has the singular effect of shortening the unlimited assessment period specified in §§6501(c)(1) to the usual three years. Fraud cases differ from other civil tax cases in that it is the Commissioner who has the burden of proof on the issue of fraud. See §7454(a) of the Code, 26 U.S.C. §7454(a). An amended return, of course, may constitute an admission of substantial underpayment, but it will not ordinarily constitute an admission of fraud. And the three years may not be enough time for the Commissioner to prove fraudulent intent.

Third, the difficulties that attend a civil fraud investigation are compounded where, as in No. 82-1453, the Commissioner's initial findings lead him to conclude that the case should be referred to the Department of Justice for criminal prosecution. The period of limitations for prosecuting criminal tax fraud is generally six years. See §6531. Once a criminal referral has been made, the Commissioner is under well-known restraints on the civil side and often will find it difficult to complete his civil investigation within the normal three-year period; the taxpayer's filing of an amended return will not make any difference in this respect. See *United States* v. *LaSalle National Bank,* 437 U.S. 298, 311-313 (1978) [1978-2 C.B. 336]; see also Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, §333(a), 96 Stat. 622 [1982-2 C.B. 462, 572]. As a practical matter, therefore, the Commissioner frequently is forced to place a civil audit in abeyance when a criminal presecution is recommended. [10]

We do not find petitioners' complaint of "unfair treatment" persuasive. Petitioners claim that it is unfair "to forever suspend a Sword of Damocles over a taxpayer who at one time may have filed a fraudulent return, but who has subsequently recanted and filed an amended return providing the Government with all the information necessary to properly assess the tax." Brief for Petitioner in No. 82-1509, p. 26. See Brief for Petitioners in No. 82-1453, p. 16. But it seems to us that a taxpayer who has filed a fraudulent return with intent to evade tax hardly is in a position to complain of the fairness of a rule that facilitates the Commissioner's collection of the tax due. A taxpayer who has been the subject of a tax fraud investigation is not likely to be surprised when a notice of deficiency arrives, even if it does not arrive promptly after he files an amended return.

Neither are we persuaded by Deleet's argument that a literal reading of the statute "punishes" the taxpayer who repentantly files an amended return. See Brief for Petitioner in No. 82-1509, p. 44. The amended return does not change the status of the taxpayer; he is left in precisely the same position he was in before. It might be argued that Congress should provide incentives to taxpayers to disclose their fraud voluntarily. Congress, however, has not done so in §6501. That legislative judgment is controlling here.

V

Petitioners contend, finally, that a literal reading of §6501(c) produces a disparity in treatment between a taxpayer who in the first instance files a fraudulent return and one who fraudulently fails to file any return at all. This, it is said, would elevate one form of tax fraud over another.

The argument centers in §6501(c)(3), which provides that in a case of failure to file a return, the tax may be assessed "at any time." It is settled that this section ceases to apply one a return is filed late and even though the failure to file a timely return in the first instance was due to fraud. See *Bennett* v. *Commissioner,* 30 T.C. 114 (1958), acq., 1958-2 Cum. Bull. 3. See also Rev. Rul 79-178, 1979-1 Cum. Bull. 435. This, however, does not mean that §6501 should be read to produce the same result in each of the two situations. From the language employed in the respective subsections of §6501, we conclude that Congress in tended different limitations results. Section 6501(c)(3) applies to a "failure to file a return." It makes no reference to a failure to file a timely return (cf. §§6651(a)(1) and 7203), nor does it speak of a fraudulent failure to file. The section literally becomes inapplicable once a return has been filed. Section 6501(c)(1), in contrast, applies in the case of "a false or fraudulent return." The fact that a fraudulent filer subsequently submits an amended return does not make the case any less one of a false or fraudulent return. Thus, although there may be some initial superficial plausibility to this argument on the part of petitioners, we conclude that the argument cannot prevail. If the result contended for by petitioners is to be the rule, Congress must make it so in clear and unmistakable language. [11]

The judgment of the Court of Appeals in each of these cases is affirmed.

It is so ordered.

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[10] Petitioners contend that these policy considerations favorable to the Commissioner do not apply on the facts of petitioners' cases. Brief for Petitioners in No. 82-1453, pp. 33-34; Brief for Petitioner in No. 82-1509, pp. 35-36. This assertion is irrelevant, for the cases involve construction of a statute of limitations, not a question of laches, a defense to which the Government usually is not subject. See *United States* v. *Summerlin,* 310 U.S. 414, 416 (1940). [1940-2 C.B. 435]

[11] See generally Brennan, The Uncertain Status of Amended Tax Returns, 7 Rev. of Taxation of Individuals 235, 252-264 (1983).

Chapter 67.—Interest
Subchapter B.—Interest on Overpayments

Section 6611.—Interest on Overpayments

26 CFR 301.6611-1: Interest on overpayments.

How is interest on an overpayment computed when the Government reinstates flower bonds previously tendered at par in payment of estate tax? See Rev. Rul. 84-38, page 250.

Subchapter C.—Determination of Interest Rate; Compounding of Interest

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621-1: Interest rate.

Rev. Rul. 84-66 [1]

Section 6621(b) of the Internal Revenue Code provides for semiannual adjustment of the interest rate and requires that any change in the rate be established by October 15 and April 15 and be based on the average prime interest rate for the six-month period ending September 30 and March 31, respectively. The Federal Reserve System has determined that the average prime rate for the period ending March 31, 1984, was 11.03 percent. When rounded to 11 percent, there is no change in the average prime rate from the last determination made. See Rev. Rul. 83-171, 1983-2 C.B. 252. Accordingly, the interest rate established under section 6621 will continue to be 11 percent through December 31, 1984.

Daily rates for compound interest for 11 percent for leap years were published in Table 41 of Rev. Proc. 83-7, 1983-1 C.B. 583, 625.

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26 CFR 301.6621-1: Interest rate.

What rate of interest will be paid on overpayments when the Government reinstates flower bonds previously tendered in payment of estate tax. See Rev. Rul. 84-38, page 250.

Chapter 68.—Additions to the Tax, Additional Amounts, and Assessable Penalties
Subchapter A.—Additions to the Tax and Additional Amounts

Section 6652.—Failure to File Certain Information Returns, Registration Statements, etc.

26 CFR 301.6652-3: Failure to file information with respect to employee retirement benefit plan.
(Also Sections 6057, 6058, 6059, 6692; 301.6057-1, 301.6058-1, 301.6059-1, 301.6692-1.)

Penalties; failure to file Schedules B and SSA (Form 5500). The penalties for failure to file Schedule B (Form 5500), Actuarial Information, and Schedule SSA (Form 5500), Registration Statement Identifying Separated Participants with Deferred Vested Benefits, are imposed by sections 6692 and 6652 (e)(1) of the Code respectively. Penalties imposed by section 6652(f) do not apply to the failure to file these schedules.

Rev. Rul. 84-54

ISSUES

(1) Does section 6652(f) of the Internal Revenue Code impose a penalty for failure to file Schedule B (Form 5500), Actuarial Information?

(2) Does section 6652(f) of the Code impose a penalty for failure to file Schedule SSA (Form 5500), Registration Statement Identifying Separated Participants with Deferred Vested Benefits?

FACTS

A plan administrator for a defined benefit plan timely filed an Annual Return/Report of Employee Benefit Plan (Form 5500 series) for the plan year ending December 31, 1980. However, the administrator did not file a Schedule SSA or a Schedule B, both of which were required to be filed for that year.

LAW AND ANALYSIS

Section 6058(a) of the Code requires that every employer who maintains any pension, annuity, stock bonus, profit-sharing, or other funded plan of deferred compensation, or plan administrator, file a return. An Annual Return/Report of Employee Benefit Plan (Form 5500 series) is used for this purpose.

Section 6652(f) of the Code imposes a penalty on the employer or plan administrator for failure to file a return required under section 6058 unless such failure is due to reasonable cause.

Section 301.6058-1(a)(3) of the Regulations on Procedure and Administration provides that the information required to be furnished on forms prescribed by section 6058(a) of the Code shall include information required by *applicable accompanying schedules*. (Emphasis added.)

Section 6059(a) of the Code requires the plan administrator of each defined benefit plan to which section 412 applies to file an actuarial report described in section 6059(b). Section 301.6059-1(a) of the regulations identifies such actuarial report as Schedule B of Form 5500.

Section 6692 of the Code imposes a penalty on the plan administrator for failure to timely file the actuarial report required by section 6059 unless such failure is due to reasonable cause.

Section 6057(a)(1) of the Code provides that the plan administrator of certain plans must file with the Internal Revenue Service a registration statement concerning certain participants who separated from service covered by the plan. Section 301.6057-1(a)(4) of the regulations identifies such registration statement as Schedule SSA of Form 5500.

Section 6652(e)(1) of the Code imposes a penalty on the person failing to timely file the registration statement required under section 6057(a) unless it is shown that such failure is due to reasonable cause.

Schedule B is required to be filed by the specific provisions of section 6059(a) of the Code and Schedule SSA is required to be filed by the specific provisions of section 6057. In addition, separate penalties for failure to file these forms are imposed under sections 6692 and 6652(e)(1), respectively. Thus, because there are separate statuatory requirements and penalty provisions relating specifically to the filing of Schedule B and SSA of the Form 5500 series, neither schedule is considered an applicable accompanying schedule to Form 5500 within the meaning of section 301.6058-1(a)(3) of the regulations, and failure to file either schedule will not result in imposition of the penalty under section 6652(f).

HOLDINGS

(1) Penalties for failure to file

[1] Also released as News Release IR-84-53, dated April 12, 1984.

Schedule B are imposed only by section 6692 of the Code, not by section 6652(f).

(2) Penalties for failure to file Schedule SSA are imposed only by section 6652(e)(1) of the Code, not by section 6652(f).

Section 6653.—Failure to Pay Tax

26 CFR 301.6653-1: Failure to pay tax.

Whether a 50 percent fraud penalty may be assessed "at any time", even though more than three years have expired since the filing of a nonfraudulent amended return. See Ct. D. 2024, page 254.

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26 CFR 301.6653-1: Failure to pay tax.

Whether a taxpayer claiming a deduction for a contribution to an individual retirement account (IRA) may be subject to penalty where the IRA contribution was not made by the due date of the return. See Rev. Rul. 84-18, page 88.

Section 6654.—Failure by Individuals to Pay Estimated Income Tax

26 CFR 1.6654-1: Addition to the tax in the case of an individual.

The proper application of an overpayment of income tax to estimated tax for the succeeding tax year. See Rev. Rul. 84-58, page 254.

Section 6655.—Failure by Corporation to Pay Estimated Income Tax

26 CFR 1.6655-1: Addition to the tax in the case of a corporation.

The proper application of an overpayment of income tax to estimated tax for the succeeding tax year. See Rev. Rul. 84-58, page 254.

Section 6656.—Failure to Make Deposit of Taxes or Overstatement of Deposits

26 CFR 301.6656-1: Penalty for underpayment of deposits.
(Also Section 6046; 1.6046-1.)

T.D. 7925

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 1—INCOME TAX; PART 301—PROCEDURE AND ADMINISTRATION

Penalties for Underpayment of Deposits and Overstated Deposit Claims, and Time for Filing Information Returns of Owners, Officers and Directors of Foreign Corporations

AGENCY: Internal Revenue Service, Treasury

ACTION: Final regulations

SUMMARY: This document provides final regulations relating to the penalty for underpayment of deposits and the penalty for overstated deposit claims, and to the time for filing information returns of owners, officers and directors of foreign corporations. The penalty for overstated deposit claims was added by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. A change in the time for filing information returns relating to foreign corporations was permitted by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. The regulations provide guidance to officers and employees of the Internal Revenue Service with respect to the application of these civil penalties and filing deadlines. The regulations also provide guidance to the public (1) in obtaining relief from the penalty for overstated deposit claims if the overstatement was due to reasonable cause, and (2) for timely filing information returns required of owners, officers, and directors of foreign corporations. The regulations remove outdated regulation provisions relating to the penalty for underpayment of deposits. The regulations affect taxpayers required to make deposits of any internal revenue tax with government depositaries, and taxpayers required to file an information return as an owner, officer, or director of a foreign corporation.

EFFECTIVE DATE: These Regulations on Procedure and Administration relating to penalties are effective with respect to returns filed after August 13, 1981. These Income Tax Regulations relating to information returns are effective with respect to returns filed after September 3, 1982.

FOR FURTHER INFORMATION CONTACT: Charles C. Saverude of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3323, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 26, 1982, the FEDERAL REGISTER published proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 6656 of the Internal Revenue Code of 1954 (47 FR 22970) [LR-311-81, 1982-1 C.B. 570]. The amendments were proposed to conform the regulations to section 724 of the Economic Recovery Tax Act of 1981 (95 Stat. 344) [Pub. L. 97-34, 1981-2 C.B. 256, 346]. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. The amendments to the Income Tax Regulations (26 CFR Part 1) under section 6046 of the Internal Revenue Code of 1954 will conform the regulations to section 341(a) of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324) [Pub. L. 97-248, 1982-2 C.B. 462, 579].

DISCUSSION

Section 6656(a) of the Code imposes a penalty of 5 percent of the amount of any underpayment of a mandatory deposit. This penalty is imposed if a taxpayer fails to make a required deposit or makes a deposit of an amount less than the amount required to be deposited. Current regulations relating to this penalty contain rules for deposits required to be made before January 1, 1970, based on the law in effect for those deposits. This Treasury decision deletes these outdated provisions.

Section 6656(b) was amended by

section 724 of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 346]. The amendment provides a new penalty for overstated deposit claims made in returns filed after August 13, 1981. Overstated deposit claims are amounts claimed in a return to have been deposited in a government depositary that have not actually been deposited. The penalty of 25 percent of the overstated deposit claim is imposed unless the taxpayer shows that the overstated claim was due to reasonable cause and was not due to willful neglect. The penalty applies in addition to any other penalties, such as the penalty provided by section 6656(a), relating to underpayments of deposits.

These regulations define an overstated deposit claim as the excess of the amount of deposits claimed on a return over the amounts actually deposited in a government depositary on or before the date the return is filed. An overstated deposit claim includes a claim of deposits when no deposits have been made as well as a claim of an amount of deposits in excess of the amount actually deposited. The penalty applies to overstated deposit claims contained in amended returns as well as such claims in original returns. The subsequent filing of a correct amended return for the period will not result in relief from the penalty, although it may in some cases be evidence that the original overstated deposit claim was due to reasonable cause. These regulations also set forth the procedure (which is the same procedure as is available with respect to the penalty imposed by section 6656(a)) by which a taxpayer can assert that the overstated deposit claim was due to reasonable cause and was not due to willful neglect.

A comment was received recommending that the regulation specifically state that section 7502(e) applies in determining the date a deposit is made. This recommendation is adopted in §301.6656-1(a) and §301.6656-2(b).

Section 6046(a) of the Code requires information returns to be filed by a U.S. owner of 5 percent or more in value of stock of a foreign corporation, and by officers and directors of foreign corporations so owned. Information returns are also required when a United States person (1) acquires an additional 5 percent in value of the outstanding stock, (2) owns 5 percent or more in value of the outstanding stock when the corporation is reorganized, or (3) reduces his holdings below the 5 percent level. Section 6046(d) requires that these information returns be filed on or before the 90th day after the date on which the liability to file arises.

Section 6046(d) was amended by section 341(a) of the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462, 579]. The amendment, which applies to returns filed after September 3, 1982, allows the Secretary to provide by forms or regulation a later date for filing the information returns required by section 6046(a). The regulations provide that any change in the time for filing these information returns may be provided by forms.

DRAFTING INFORMATION

The principal author of these regulations is Martha E. Kadue of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The amendment to the regulations proposed by the notice of proposed rulemaking published on May 26, 1982, and adopted by this Treasury decision is interpretative. Therefore, the Regulatory Flexibility Act (5 U.S.C. chapter 6) did not apply to the notice of proposed rulemaking. The Commissioner of Internal Revenue has determined that this final regulation is not subject to Executive Order 12291.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Parts 1 and 301 are amended as follows:

INCOME TAX REGULATIONS

Paragraph 1. Paragraph (j)(1) of §1.6046-1 is revised to read as follows:

§1.6046-1 Returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock, on or after January 1, 1963.

* * * * *

(j) *Time and place for filing return*—(1) *Time for filing.* Any return required by section 6046 and this section shall be filed on or before the 90th day after the date on which a United States citizen, resident, or person becomes liable to file such return under any provision of section 6046(a) and of paragraph (a), (b), or (c) of this section. With respect to returns filed after September 3, 1982, such return shall be filed on or before such later date (if any) as may be authorized by the return form. The Director of the Internal Revenue Service Center where the return is required to be filed is authorized to grant reasonable extensions of time for filing returns under section 6046 and this section in accordance with the applicable provisions of section 6081(a) and §1.6081-1.

* * * * *

REGULATIONS ON PROCEDURE AND ADMINISTRATION

Par. 2. Section 301.6656-1 is revised to read as follows:

§301.6656-1 Penalty for underpayment of deposits.

(a) *General rule.* If any person is required by the Code or regulations prescribed thereunder to deposit any tax in a government depositary that is authorized under section 6302(c) to receive the deposit, and fails to de-

posit the tax within the time prescribed therefor, a penalty shall be imposed on such person unless the failure is shown to be due to reasonable cause and not due to willful neglect. The penalty shall be 5 percent of the amount of the underpayment without regard to the period during which the underpayment continues. For purposes of this section, the term "underpayment" means the amount of tax required to be deposited less the amount, if any, that was deposited on or before the date prescribed therefor. Section 7502(e) applies in determining the date a deposit is made.

(b) *Assertion of reasonable cause.* To show that the underpayment was due to reasonable cause and not due to willful neglect, a taxpayer must make an affirmative showing of all facts alleged as a reasonable cause in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return with respect to the tax is required to be filed. If the district director or the director of the service center determines that the underpayment was due to reasonable cause and was not due to willful neglect, the penalty will not be imposed.

Par. 3. A new §301.6656-2 is added immediately after §301.6656-1, to read as follows:

§301.6656-2 Penalty for overstated deposit claims.

(a) *General rule.* Any person who makes an overstated deposit claim on a return is subject to a penalty equal to 25 percent of such claim, unless it is shown that the overstated deposit claim is due to reasonable cause and not due to willful neglect. This penalty is in addition to any other penalty provided by law, such as the penalty provided by section 6656(a), relating to underpayment of deposits.

(b) *Overstated deposits claim.* An overstated deposit claim is the excess of—

(1) The amount of any internal revenue tax for any period that a person claims, in a return (including an amended return) filed after August 13, 1981, to have deposited in a government depositary authorized under section 6302(c) to receive the deposit, over

(2) The aggregate amount for that period that the person has deposited, on or before the date such return for that period is filed, in a government depositary authorized under section 6302(c) to receive the deposit.

An overstated deposit claim includes a claim that deposits have been made when no deposits have been made in an authorized government depositary. The existence or amount of an overstated deposit claim is not limited even though the amount described in subparagraph (1) of this paragraph (b) or the amount described in subparagraph (2) of this paragraph (b) exceeds the actual tax liability. For purposes of this paragraph (b), the date a return is considered to be filed is the later of the date the return is due to be filed (not including extensions) or the date the return is actually filed. Section 7502(e) applies in determining the date a deposit is made. The application of this paragraph is illustrated by the following examples.

Example 1. On the date a return is due for the taxable period ended December 31, 1982, Z files the return claiming deposits of tax in the amount of $150 for that period. Z actually made deposits of $75 for that period on or before the date the return was due and filed. Z's tax liability for that period is $150. Z has made an overstated deposit claim in the amount of $75, the excess of the amount of tax claimed on the return to have been deposited ($150), over the amount actually deposited ($75) for that period on or before the date the return was due and filed.

Example 2. On the date a return is due for the quarter ended December 31, 1982, X files the return claiming deposits of tax in the amount of $200 for that period. X actually made deposits of $100 for that period on or before the date the return was due and filed. X's tax liability for that period is $100. X has made an overstated deposit claim of $100, the excess of the amount of tax claimed on the return to have been deposited ($200), over the amount actually deposited ($100) for that period on or before the date the return was due and filed.

Example 3. The facts are the same as in example 2. For the quarter ended March 31, 1983, X files a return on the date it is due, claiming $100 (the excess of the quarter's return, $200, over X's liability for the prior quarter, $100) as a deposit for the quarter ended March 31, 1983. X did not actually deposit any amount for the quarter ended March 31, 1983, on or before the date the return was due and filed. X made an overstated deposit claim of $100 for the quarter ended December 31, 1982, as described in example 2. For the quarter ended March 31, 1983, X made an overstated deposit claim of $100, the excess of the amount of tax claimed to have been deposited ($100), over the amount actually deposited (Ø) for that period on or before the date the return was due and filed.

(c) *Assertion of reasonable cause.* To show that an overstated deposit claim was due to reasonable cause and not due to willful neglect, a taxpayer must make an affirmative showing of all facts alleged as a reasonable cause in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return with respect to the tax is required to be filed. If the district director or the director of the service center determines that the overstated deposit claim was due to reasonable cause and was not due to willful neglect, the penalty will not be imposed. The fact that a correct amended return has been filed may in some cases be evidence that an overstated deposit claim on the original return was due to reasonable cause and not due to willful neglect, but is not determinative of that issue.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. §7805). (Approved by the Office of Management and Budget under control number 1545-0794.)

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved May 25, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 12, 1983, 8:45 a.m., and published in the issue of the Federal Register for December 13, 1983, 48 F.R. 55453)

Section 6659.—Addition to Tax in the Case of Valuation Overstatements for Purposes of the Income Tax

Whether a taxpayer who acquires a nonexclusive right to use a master tape sound recording is entitled to claim an investment tax credit with respect to the master tape sound recording. See Rev. Rul. 84-4, page 19.

Section 6661.—Substantial Understatement of Liability

For returns required to be filed and that are actually filed in 1984, circumstances are identified under which the disclosure on a taxpayer's return of an item or position taken, with no specific reference to section 6661 of the Code, is adequate for reducing the understatement of income tax liability on which the penalty is imposed under section 6661. See Rev. Proc. 84-19, page 433.

Subchapter B.—Assessable Penalties

Section 6671.—Rules for Application of Assessable Penalties

26 CFR 301.6671-1: Rules for application of assessable penalties.

Whether a volunteer member of a board of trustees of organizations referred to in section 501(a) of the Code may be considered a responsible person and liable for the penalty under section 6672. See Rev. Rul. 84-83, below.

Section 6672.—Failure to Collect and Pay Over Tax, or Attempt to Evade or Defeat Tax

26 CFR 301.6672-1: Failure to collect and pay over tax, or attempt to evade or defeat tax. (Also Section 6671; 301.6671-1.)

Failure to pay over tax; responsible persons. A volunteer member of a board of trustees of a charitable organization may be liable for unpaid employment and withholding taxes in certain circumstances under section 6672 of the Code.

Rev. Rul. 84-83

ISSUE

Can a volunteer member of a board of trustees of organizations referred to in section 501(a) of the Code can be considered a responsible person and liable for the penalty under section 6672?

LAW AND ANALYSIS

Under section 6672(a) of the Code any person required to collect, truthfully account for, and pay over any internal revenue tax who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat such tax or the payment thereof, shall, in addition to other penalties, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty will be imposed under section 6653 for any offense to which this section is applicable.

Section 6671(b) of the Code defines the term person to include an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

The determination of who is the person under a duty to collect, account for, and pay over the employment and withholding taxes for wages paid to employees is especially dependent upon the facts of the case. See *United States v. Graham*, 309 F. 2d 210 (9th Cir. 1962); *Bauer v. United States*, 543 F. 2d 142 (Ct. Cl. 1976); *Feist v. United States*, 607 F. 2d 954 (Ct. Cl. 1979).

The term "person" includes an officer or employee, but does not exclude others. Its scope is illustrated rather than limited by the examples in section 6671(b) of the Code. Section 6672(a) is addressed to those persons who have responsibility for payment of the withheld taxes, who have knowledge of the tax delinquency and who have authority over the decision to pay or not to pay the taxes, not necessarily persons who have the duty of filling out the forms. Trustees can have this responsibility, knowledge and authority.

HOLDING

The trustee can be liable for unpaid employment and withholding taxes. The fact that a trustee is a volunteer member of the board of trustees does not in and of itself mean the trustee will or will not be deemed liable. The trustee's liability depends on whether he or she is found to meet the tests of responsibility and willfulness under section 6672 of the Code.

Section 6676.—Failure to Supply Identifying Numbers

Requirements for payers of interest, dividends, or patronage dividends that wish to submit magnetic tape files to the Service to verify the names and taxpayer identification numbers of payees. See Rev. Proc. 84-10, page 406.

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26 CFR 301.6676-1: Penalty for failure to supply identifying number.

Proper identifying number to be used by banks in reporting interest payments credited to savings accounts after the death of the account owner. See Rev. Rul. 84-73, page 240.

Section 6692.—Failure in File Actuarial Report

26 CFR 301.6692-1: Failure to file actuarial report.

Whether failure to file an actuarial report results in penalty assessment under both sections 6692 and 6652(f) of the Code. See Rev. Rul. 84-54, page 260.

Section 6695.—Other Assessable Penalties With Respect to the Preparation of Income Tax Returns for Other Persons

26 CFR 1.6695-1: Other assessable penalties with respect to the preparation of income tax returns for other persons.

Return preparers; penalty; signature requirement. Tax consultants who fill out income tax returns, send back statements of necessary information to taxpayers, or review drafts prepared by taxpayers are income tax return preparers for purposes of the penalty for failure to sign returns under section 6695(b) of the Code.

Rev. Rul. 84-3

ISSUE

Does the penalty under section

6695(b) of the Internal Revenue Code for failure to sign an income tax return apply to tax consultants under the following situations?

FACTS

Situation 1. Taxpayer *A* submits books and records to consultant *B*, who fills out an income tax return and presents it to *A*. *A* files the return without making any changes.

Situation 2. *A* submits books and records to *B*, who sends back a statement of all necessary information, making it merely a mechanical process for *A* to fill out the return.

Situation 3. *A* submits a draft of a return to *B* to review in its entirety for both substantive correctness and mechanical accuracy. *B* recommends substantial changes. *A* adopts all the recommendations and fills out a return based on those recommendations.

Situation 4. *A* submits a signed return to *B* who thoroughly reviews it in its entirety for both substantive correctness and mechanical accuracy. Although *B* questioned certain entries, *B* is satisfied that the return was correct as submitted to *B* and makes no changes. *B* mails it to the Internal Revenue Service, pursuant to *A*'s instructions to do so if no changes were recommended.

In all situations, *B* does not sign *A*'s return as the preparer.

LAW AND ANALYSIS

Section 6695(b) of the Internal Revenue Code imposes a $25 penalty on any income tax return preparer required by regulations to sign a return or claim for refund who fails to do so, unless the failure is due to reasonable cause.

Under section 7701(a)(36) of the Code and section 301.7701-15 of the regulations, an "income tax return preparer" is defined as any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any return of tax or claim for refund under subtitle *A*. Those sections provide further that the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

Section 1.6695-1(b)(1) of the Income Tax Regulations provides that an individual who is an income tax return preparer with respect to a return or claim for refund under subtitle A of the Code must manually sign the return in the appropriate place on the return after it is completed and before it is presented to the taxpayer for signature.

Section 1.6695-1(b)(5) of the regulations provides that the penalty under section 6695(b) of the Code will not be imposed on an individual solely because the individual is a preparer either under section 301.7701-15(a)(2) and (b) of the regulations on account of having given advice on specific issues of law or section 301.7701-15(b)(3) on account of having prepared another return that affects amounts reported on the return in question.

Under section 301.7701-15(a)(1) of the regulations, a person who furnishes to a taxpayer or other preparer sufficient information and advice so that completion of the return or claim for refund is largely a mechanical or clerical matter is considered a preparer, even though that person does not actually place or review placement of information on the return or claim for refund.

Section 301.7701-15(a)(2) of the regulations provides that a person who only gives advice on specific issues of law is not considered a preparer unless the advice is given with respect to events that have occurred at the time the advice is rendered and not given with respect to the consequences of contemplated actions, and the advice is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund.

Section 301.7701-15(b) of the regulations provides that only those persons who prepare all or a substantial portion of a return or claim for refund will be considered preparers of that return or claim for refund. Persons who render advice that is directly relevant to the determination of the existence, characterization, or amount of an entry on a return or claim for refund are regarded as having prepared that entry. Additionally, a preparer of one return may be considered the preparer of another return, if the entries on the prepared return are directly reflected on the other return.

A preparer cannot avoid the requirement to sign a return by, for example, sending "statements" or "drafts" of the return to a taxpayer. However, a preparer who makes a bona fide effort to sign a return will not be penalized for not doing so if the taxpayer disregards the preparer's attempts to present a signed return to the taxpayer.

HOLDINGS

Situation 1. *B* is an income tax return preparer with respect to *A*'s return under the specific language of section 7701(a)(36) of the Code. *B* is subject to the penalty because of the failure to sign the return after it was completed and before it was presented to *A* for signing.

Situation 2. *B* is an income tax return preparer with respect to *A*'s return under section 301.7701-15(a)(1) of the regulations. *B* does not alter his status as a return preparer by sending a "statement" or "draft" to *A*. Accordingly, *B* is required to ask *A* to submit the final form for *B*'s signature and will be subject to the penalty unless it is shown that *A* would not honor *B*'s request to be allowed to sign the return. *B* could discharge this obligation, however, by actually preparing a return, signing it, and then submitting it to *A*.

Situation 3. This is similar to situation 2 in that *B* is an income tax return preparer under section 301.7701-15(a)(1) of the regulations. Accordingly, *B* is required to ask *A* to submit the final form for *B*'s signature and will be subject to the penalty unless it is shown that such a request was made by *B* but not honored by *A*. As in *situation 2*, *B* can discharge this obligation by pre-

paring a return, signing it, and then submitting it to *A*.

Situation 4. *B* is an income tax return preparer with respect to *A*'s return under section 301.7701-15(a)(1) of the regulations. Because of *A*'s instructions to *B* to mail the return if no changes were made, *B* is deemed to have presented the return to *A* before mailing because *B* is obligated to return it to *A* if changes were made. *B* cannot avoid the duty to sign merely because of *A* having signed first. *B* is subject to the penalty for not signing the return.

Section 6698.—Failure to File Partnership Returns

Guidelines are provided under which partnerships with 10 or fewer partners will not be subject to the penalty under section 6698 of the Code for not filing a partnership return. Rev. Proc. 81-11 is superseded. See Rev. Proc. 84-35, page 509.

Chapter 75.—Crimes, Other Offenses, and Forfeitures
Subchapter A.—Crimes
Part I.—General Provisions

Section 7216.—Disclosure or Use of Information by Preparers of Returns

26 CFR 301.7216-2: Disclosure or use without formal consent of taxpayer.

Disclosure of information to grand juries by return preparers. See T.D. 7948, page 238.

Chapter 76.—Judicial Proceedings
Subchapter B.—Proceedings of Taxpayers and Third Parties

Section 7428.—Declaratory Judgments Relating to Status and Classification of Organizations Under Section 501(c)(3), etc.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

Section 7430.—Awarding of Court Costs and Certain Fees

26 CFR 301.7430-1: Exhaustion of administrative remedies.

T.D. 7950

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBTITLE A—PART 301—PROCEDURE AND ADMINISTRATION

Exhaustion of Administrative Remedies

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the circumstances in which a party normally will be considered to have exhausted the administrative remedies available within the Internal Revenue Service for purposes of the recovery of court costs and certain fees in a civil tax proceeding brought in a court of the United States (including the Tax Court). Changes to the applicable tax law were made by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. The regulations apply to parties to civil tax proceedings and provide them with guidance concerning circumstances in which the Internal Revenue Service normally will consider a party's administrative remedies exhausted.

DATES: The regulations are effective on the date this document is published in the FEDERAL REGISTER and apply to civil tax proceedings commenced after February 28, 1983, and before January 1, 1986.

FOR FURTHER INFORMATION CONTACT: C. Scott McLeod of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention, CC:LR:T, 202-566-3288 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On March 25, 1983, the Federal Register published proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7430 of the Internal Revenue Code of 1954 (48 FR 12560) [LR-11-83, 1983-1 C.B. 1066]. The amendments were proposed to reflect the changes made by section 292(a) of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 572) [Pub. L. 97-248, 1982-2 C.B. 462, 546]. After consideration of all comments, the proposed amendments are adopted as revised by this Treasury decision.

In general, the rules in this Treasury decision are the same as those in the notice of proposed rulemaking. Those rules are explained in the preamble of the notice of proposed rulemaking under the heading, "Supplementary Information." Changes to those rules and public comments on the proposed rules are summarized below.

CHANGES AND PUBLIC COMMENTS

Several comments objected to the rule providing that a party's administrative remedies are not exhausted unless the party agrees under section 6501(c)(4) to extend the time for an assessment of tax if necessary to provide the Appeals office with a reasonable time period to consider the tax matter. The comments suggested that taxpayers should not be required to choose between the right to recover costs under section 7430 and the right to be free from assessments after a 3-year period.

The final regulations adopt the rule as proposed. The provisions requiring exhaustion of administrative remedies and permitting extension of the period for assessment of tax are complementary and should be applied in conjunction. The former is "intended to preserve the role that the administrative appeals process plays in the resolution of tax disputes" and to "prevent taxpayers from recovering litigation costs when the litigation might have been avoided or reduced in scope through use of administrative remedies." Technical Explanation of Committee Amendment, 127 Cong. Rec. §15594 (daily ed. Dec. 16, 1981). The latter

makes the administrative resolution of disputes possible when the 3-year limitation period does not provide sufficient time. The Service believes that, in these circumstances, the extension of the period for assessment is an essential part of the administrative appeals process. It is the Service's experience that many disputes are resolved during the extended period of limitations. Accordingly, a taxpayer who refuses to consent to an extension should not be considered to have exhausted administrative remedies.

Some comments expressed concern that the rule might lead to unreasonable delays in the resolution of tax disputes. The prompt resolution of tax disputes is also a concern of the Service and it is the Service's policy to request an extension only in cases involving unusual circumstances and to keep the number of extensions to an absolute minimum. Rev. Proc. 57-6, 1957-1 C.B. 729.

Some comments objected to the definition of participation in an Appeals office conference, which requires disclosure of all relevant information regarding the party's tax matter. The final regulations generally retain this definition, but now require the disclosure only of all information the party knew or should have known was relevant at the time of the Appeals office conference. The Service believes this definition is consistent with the legislative history, which states, "A taxpayer who actively participates in and discloses all relevant information during the administrative stages of the case will be considered to have exhausted the available administrative remedies. Failure to so participate and disclose information may be sufficient grounds for determining that the taxpayer has not exhausted administrative remedies." Technical Explanation of Committee Amendment, 127 Cong. Rec. §15594 (daily ed. Dec. 16, 1981).

Some comments questioned the result provided in example 10 of the regulations in which the issuance of a revenue ruling, private letter ruling or technical advice covering the same fact situation but taking a contrary position did not constitute notification by the Internal Revenue Service that the pursuit of administrative remedies is unnecessary. The final regulations have not changed example 10 as proposed because it is the experience of the Service that some disputes are resolved in Appeals office conferences despite such contrary pronouncements.

Two comments asked for clarification of the treatment given to late requests for an Appeals office conference. In the absence of extenuating circumstances, the Service denies requests for conferences received after the issuance of a statutory notice of deficiency or disallowance. Accordingly, the final regulations provide that an Appeals office conference must be requested prior to the issuance of a statutory notice of deficiency in the case of a petition in the Tax Court or a statutory notice of disallowance in the case of a civil action for refund. In the rare circumstance that an Appeals office conference is granted after the issuance of the statutory notice, however, the party will be considered to have exhausted the administrative remedies available within the Service if the party participates in the conference prior to filing a civil action for refund in a court of the United States or a petition in the Tax Court.

The proposed regulations provided that a party's administrative remedies are considered exhausted if the party did not receive a preliminary notice of proposed deficiency or disallowance before receipt of the statutory notice of deficiency or disallowance. The final regulations adopt this position with three modifications. First, the final regulations change the term "receipt" to "issuance" because a notice of deficiency mailed in accordance with section 6212(b) is sufficient even if it is not received by the taxpayer. Second, the final regulations make it clear that this rule does not apply if the failure of a party to receive a preliminary notice of deficiency (or disallowance) is due to the actions of the party. The final regulations provide that a failure to receive such a preliminary notice is due to the actions of a party if the party fails to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter. Third, the final regulations provide that in the case of a petition in the Tax Court where the party did not receive a preliminary notice of deficiency prior to the issuance of a statutory notice of deficiency, a party's administrative remedies will be considered exhausted only if the party does not refuse to participate in an Appeals office conference while the case is in docketed status.

Finally, a comment requested guidance on matters outside the scope of these regulations, such as the meaning of the terms, "prevailing party," "multiple actions," and "reasonable litigation costs." The final regulations do not address these matters.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although a notice of proposed rulemaking soliciting public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these regulations was Paul H. Weisman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Amendments to the regulations

The amendments to 26 CFR 301

are as follows:

Paragraph. 26 CFR Part 301 is amended by adding a new §301.7430-1 at the appropriate place. The new §301.7430-1 reads as set forth below:

§301.7430-1 Exhaustion of administrative remedies.

(a) *In general.* Section 7430(b)(2) provides that a court shall not award reasonable litigation costs in any civil tax proceeding under section 7430(a) unless the court determines that the prevailing party has exhausted the administrative remedies available to the party within the Internal Revenue Service. This section sets forth the circumstances in which the Internal Revenue Service normally will consider such administrative remedies exhausted.

(b) *Tax, penalty and addition to tax*—(1) *In general.* A party has not exhausted its administrative remedies available within the Internal Revenue Service with respect to any tax matter for which an Appeals office conference is available under §§601.105 and and 601.106 of the Statement of Procedural Rules (26 CFR Part 601) (other than a tax matter described in paragraph (c)) unless—

(i) The party, prior to filing a petition in the Tax Court or a civil action for refund in a court of the United States—

(A) Participates, either in person or through a qualified representative described in §601.502 of the Statement of Procedural Rules, in an Appeals office conference; and

(B) Agrees under section 6501 (c)(4) to extend the time for an assessment of tax if necessary to provide the Appeals office with a reasonable time period to consider the tax matter; or

(ii) If no Appeals office conference is granted, the party, prior to the issuance of a statutory notice of deficiency in the case of a petition in the Tax Court or the issuance of a statutory notice of disallowance in the case of a civil action for refund in a court of the United States—

(A) Requests an Appeals office conference in accordance with §§601.105 and 601.106 of the Statement of Procedural Rules;

(B) Files a written protest if a written protest is required to obtain an Appeals office conference; and

(C) Agrees under section 6501 (c)(4) to extend the time for an assessment of tax if necessary to provide the Appeals office with a reasonable time period to consider the tax matter.

(2) *Participates.* For purposes of this paragraph a party or qualified representative of the party described in §601.502 of the Statement of Procedural Rules participates in an Appeals office conference if the party or qualified representative discloses to the Appeals office all relevant information regarding the party's tax matter to the extent such information and its relevance were known or should have been known to the party or qualified representative at the time of such conference.

(c) *Revocation of a determination that an organization is described in section 501(c)(3).* A party has not exhausted its administrative remedies available within the Internal Revenue Service with respect to a revocation of a determination that it is an organization described in section 501(c)(3) unless, prior to filing a declaratory judgment action under section 7428, the party has exhausted its administrative remedies in accordance with section 7428, and any regulations, rules, and revenue procedures thereunder.

(d) *Actions involving summonses, levies, liens, jeopardy and termination assessments, etc.* (1) A party has not exhausted its administrative remedies available within the Internal Revenue Service with respect to a matter other than one to which paragraph (b) or (c) applies (including summonses, levies, liens and jeopardy and termination assessments) unless, prior to filing an action in a court of the United States—

(i) The party submits to the district director of the district having jurisdiction over the dispute a written claim for relief reciting facts and circumstances sufficient to show the nature of the relief requested and that the party is entitled to such relief; and

(ii) The district director has denied the claim for relief in writing or failed to act on the claim within a reasonable period after such claim is received by the district director.

(2) For purposes of this paragraph, a reasonable period is—

(i) The 5-day period preceding the filing of a petition to quash an administrative summons issued under section 7609;

(ii) The 5-day period preceding the filing of a wrongful levy action in which a demand for the return of property is made;

(iii) The period expressly provided for administrative review of the party's claim by an applicable provision of the Internal Revenue Code that expressly provides for the pursuit of administrative remedies (such as the 16-day period provided under section 7429(b)(1)(B) relating to review of jeopardy assessment procedures); or

(iv) The 60-day period following receipt of the claim for relief in all other cases.

(e) *Tax matter.* For purposes of this section "tax matter" means a matter in connection with the determination, collection or refund of any tax, interest or penalty under the Internal Revenue Code.

(f) *Exception to requirement that party pursue administrative remedies.* A party's administrative remedies within the Internal Revenue Service are considered exhausted for purposes of section 7430 if—

(1) The Internal Revenue Service notifies the party in writing that the pursuit of administrative remedies in accordance with paragraphs (b), (c) and (d) is unnecessary.

(2) In the case of a petition in the Tax Court—

(i) The party did not receive a preliminary notice of proposed deficiency (30-day letter) prior to the issuance of the statutory notice of deficiency and the failure to receive such notice was not due to actions of the party (such as a refusal to sign an extension of time for assessment or failure to supply requested information or a

current mailing address to the district director or service center having jurisdiction over the tax matter); and

(ii) The party does not refuse to participate in an Appeals office conference while the case is in docketed status.

(3) In the case of a civil action for refund involving a tax matter other than a tax matter described in paragraph (4), the party—

(i) Exhausted the administrative remedies available within the Internal Revenue Service with respect to the tax matter prior to issuance of a statutory notice of deficiency with respect to such tax matter.

(ii) Did not receive a preliminary notice of proposed disallowance prior to issuance of a statutory notice of disallowance and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter); or

(iii) Did not receive either written or oral notification that an Appeals office conference had been granted within six months from the date of the filing of the claim for refund and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter).

(4) In the case of a civil action for refund involving a tax matter under sections 6703 and 6694—

(i) The party did not receive a preliminary notice of proposed disallowance prior to issuance of a statutory notice of disallowance and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address to the district director or service center having jurisdiction over the tax matter); or

(ii) During the six-month period following the day on which the party's claim for refund is filed, the party's claim for refund is not denied and there is no Appeals office conference with respect to the claim in which the party could participate (within the meaning of paragraph (b)).

(g) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Taxpayer A exchanges property held for investment for similar property and claims that the gain on the exchange is not recognized under section 1031. The Internal Revenue Service conducts a field examination and determines that there has not been a like-kind exchange. No agreement is reached on the matter and a preliminary notice of proposed deficiency (30-day letter) is sent to A. A does not file a request for an Appeals office conference. A pays the amount of the proposed deficiency and files a claim for refund. A preliminary notice of proposed disallowance is issued by the Internal Revenue Service. A does not request an Appeals office conference and, instead, files a civil action for refund in a United States District Court. A has not exhausted the administrative remedies available within the Internal Revenue Service.

Example (2). Assume the same facts as in example (1) except that, after receiving the preliminary notice of proposed deficiency (30-day letter) A files a request for an Appeals office conference. No agreement is reached at the conference. A pays the amount of the proposed deficiency and files a claim for refund. A preliminary notice of proposed disallowance is issued by the Internal Revenue Service. A does not request an Appeals office conference and files a civil action for refund in a United States District Court. A has exhausted the administrative remedies available within the Internal Revenue Service.

Example (3). Assume the same facts as in example (1) except A first requests an Appeals office conference after A's receipt of the preliminary notice of proposed disallowance. A is granted an Appeals office conference and A participates in such conference. A has exhausted the administrative remedies within the Internal Revenue Service.

Example (4). Taxpayer B receives a preliminary notice of proposed deficiency (30-day letter) after completion of a field examination. B requests and is granted an Appeals office conference. The Appeals office, to obtain a reasonable period of time to consider the tax matter, requests that B sign Form 872 to extend the time for an assessment of tax. B's administrative remedies are exhausted only if B signs Form 872.

Example (5). Taxpayer M receives a preliminary notice of proposed deficiency (30-day letter). M submits a written protest and files a request for an Appeals office conference. The Appeals office sends M a written statement that M will not be granted an Appeals office conference. M is considered to have exhausted the administrative remedies available within the Internal Revenue Service.

Example (6). Taxpayer J receives a preliminary notice of proposed deficiency (30-day letter) and a written statement that J need not file a written protest or request an Appeals office conference since a conference will not be granted. J files a petition in the Tax Court after receiving the statutory notice of deficiency. J's administrative remedies available within the Internal Revenue Service are considered exhausted.

Example (7). On January 2, the Internal Revenue Service serves a summons issued under section 7609 on third-party recordkeeper B to produce records of taxpayer R. On January 5 notice of the summons is given to R. The last day on which R may file a petition in a court of the United States to quash the summons is January 25. Thereafter, R files a written claim for relief with the district director having jurisdiction over the matter together with a copy of the summons. The claim and copy are received by the district director on January 20. On January 25, R files a petition to quash the summons. R's administrative remedies available within the Internal Revenue Service are considered exhausted.

Example (8). A notice of Federal tax lien is filed in County M on March 3, in the name of R. On April 2, R pays the entire liability thereby satisfying the lien. On May 2, R files a written claim with the district director having jurisdiction over the tax matter demanding a certificate of release of lien. Thereafter, R provides the district director with a copy of the notice of Federal tax lien and a copy of the cancelled check in satisfaction of the lien, which are received by the district director on May 15. R's claim is deemed to have been filed on May 15. Accordingly, R is considered to have exhausted R's administrative remedies with respect to an action commenced after July 14 (60 days following the filing of the claim for relief on May 15).

Example (9). A revenue officer seizes an automobile to effect collection of P's liability on January 10. On January 22 R submits a written claim to the district director having jurisdiction over the tax matter claiming that R purchased the automobile from P for an adequate consideration before the tax lien against P arose, and demands immediate return of the automobile. A copy of the title certificate and R's cancelled check are submitted with the claim. The claim is received by the district director on January 25. On January 30, R brings a wrongful levy action. R is considered to have exhausted the administrative remedies available within the Internal Revenue Service.

Example (10). The Internal Revenue Service issues a revenue ruling which holds that ear piercing does not affect a function or structure of the body within the meaning of section 213 and therefore is not deductible. Taxpayer E deducts the costs of ear piercing and following an examination, receives a preliminary notice of proposed deficiency (30-day letter) disallowing the treatment of such costs. Because of the revenue ruling, E believes a conference would not aid in the resolution of the tax dispute. Accordingly, E does not request an Appeals office conference. After receiving a statutory notice of deficiency, E files a petition in the Tax Court. E has not exhausted the administrative remedies available within the Internal Revenue Service. The issuance of a revenue ruling covering the same fact situation but taking a contrary position does not constitute notification by the Internal Revenue Service to E that the pursuit of administrative remedies is unnecessary. Similarly, the issuance to E of a private letter ruling or technical advice does not constitute notification by the Internal Revenue Service that the pursuit of administrative remedies is unnecessary.

Example (11). Taxpayer G is assessed a pen-

alty under section 6701 for siding in the understatement of the tax liability of another person. G pays 15% of the penalty in accordance with section 6703 and files a claim for refund on June 15. G is not issued a preliminary notice of proposed disallowance and thus cannot participate in an Appeals office conference within six months of the filing of the claim for refund. G brings an action on December 23, G has exhausted G's administrative remedies.

Example (12). Taxpayer H receives a preliminary notice of proposed deficiency (30-day letter) and neither requests nor participates in an Appeals office conference. The Service then issues a statutory notice of deficiency (90-day letter). Upon receiving the statutory notice, H requests an Appeals office conference. The Appeals office informs H that an Appeals office conference will not be granted. H files a petition in the Tax Court after receiving notice of the denial of a conference. H has not exhausted the administrative remedies available within the Internal Revenue Service because the request for an Appeals office conference was made after the issuance of the statutory notice.

(h) *Effective date.* Section 7430 and the regulations thereunder apply to civil proceedings described in section 7430 filed in a court of the United States (including the Tax Court) after February 28, 1983, and before January 1, 1986.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved March 13, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 16, 1984, 8:45 a.m., and published in the issue of the Federal Register for April 17, 1984, 49 F.R. 15074)

Subchapter C.—The Tax Court
Part IV.—Declaratory Judgments

Section 7477.—Declaratory Judgments Relating to Transfers of Property from the United States

26 CFR 301.7477-1: Declaratory judgments relating to transfers of property from the United States.

Certain transfers of property by U.S. persons to foreign corporations. See T.D. 7954, page 107.

Section 7478.—Declaratory Judgments Relating to Status of Certain Governmental Obligations

Procedures for requesting letter rulings under section 103 of the Code to which section 7478 applies. See Rev. Proc. 84-48, page 547.

Procedures for persons other than the issuer of a prospective governmental obligation to request a ruling under section 103 of the Code. See Rev. Proc. 84-49, page 548.

Chapter 78.—Discovery of Liability and Enforcement of Title
Subchapter A.—Examination and Inspection

Section 7602.—Examination of Books and Witnesses

26 CFR 301.7602-1: Examination of books and witnesses.
(Also Section 7604; 301.7604-1.)

Ct. D. 2026

SUPREME COURT
OF THE
UNITED STATES
No. 82-687

United States, Petitioner,
v.
Arthur Young & Company et al.
[465 U.S.]

On Writs of Certiorari to the
United States Court of Appeals
for the Second Circuit
[March 21, 1984]

Respondent certified public accountant firm, as the independent auditor for respondent corporation, was responsible for reviewing the corporation's financial statements as required by the federal securities laws. In the course of reviewing these statements, the accounting firm verified the corporation's statement of its contingent tax liabilities, and, in so doing, prepared tax accrual workpapers relating to the evaluation of the corporation's reserves for such liabilities. When a routine audit by the Internal Revenue Service (IRS) to determine the corporation's income tax liability for certain years revealed that the corporation had made questionable payments from a "special disbursement account," the IRS instituted a criminal investigation of the corporation's tax returns. In that process, the IRS, pursuant to §7602 of the Internal Revenue Code of 1954—which authorizes the Secretary of the Treasury to summon and "examine any books, papers, records, or other data which may be relevant or material" to a particular tax inquiry—issued a summons to the accounting firm requiring it to make available to the IRS all of its files relating to the corporation, including its tax accrual workpapers. When the corporation instructed the accounting firm not to comply with the summons, the IRS commenced an enforcement action in Federal District Court, which, upon finding that the tax accrual workpapers were relevant to the IRS investigation within the meaning of §7602 and refusing to recognize an accountant-client privilege that would protect the workpapers, ordered the summons enforced. The Court of Appeals affirmed in part and reversed in part. While agreeing that the workpapers were relevant to the IRS investigation, the court held that the public interest in promoting full disclosure to public accountants, and in turn ensuring the integrity of the securities markets, required protection under a work-product immunity doctrine for the work that independent auditors perform for publicly owned corporations. Accordingly, because it found that the IRS had not made a sufficient showing of need to overcome the immunity and was not seeking to prove fraud on the corporation's part, the court refused to enforce the summons insofar as it sought the tax accrual workpapers.

Held:

1. The tax accrual workpapers are relevant within the meaning of §7602. As §7602's language indicates, an IRS summons is not to be judged by the relevance standards used in deciding whether to admit evidence in court. The language "may be" reflects Congress' intention to allow the IRS to obtain items of even *potential* relevance to the ongoing investigation, without reference to its admissibility. As a discovery tool, a §7602 summons is critical to the IRS's investigative and enforcement functions. That the tax accrual workpapers are not actually used in the preparation of tax returns by the taxpayer or its accountants does not bar a finding of relevance within the meaning of §7602.

2. The tax accrual workpapers are not protected from disclosure under §7602.

(a) While §7602 is subject to traditional privileges and limitations, any other restrictions upon the IRS summons power should be avoided "absent unambiguous directions from Congress." *United States* v. *Bisceglia*, 420 U.S. 141, 150 [1975-1 C.B. 379]. There are no such unambiguous directions that would justify a judicially created work-product immunity doctrine for tax accrual workpapers summoned under §7602. Indeed, §7602 reflects a congressional policy *favoring disclosure* of all information relevant to a legitimate IRS inquiry.

(b) In light of *Couch* v. *United States*, 409 U.S. 322 [1973-1 C.B. 609], which held that no confidential accountant-client privilege exists, the Court of Appeals' creation of a work-product privilege was misplaced and conflicts with Congress' clear intent.

(c) Nor is a work-product immunity for accountants' tax accrual workpapers a fitting analogue to the attorney work-product doctrine. An independent certified public accountant performs a different role from an attorney whose duty, as his client's confidential adviser and advocate, is to present the client's case in the most favorable possible light. In certifying the public reports that depict a corporation's financial status, the accountant performs a *public* responsibility transcending any employment relationship with the client, and owes allegiance to the corporation's creditors and stockholders, as well as to the investing public.

(d) The integrity of the securities markets will not suffer absent some protection for accountants' tax accrual workpapers. The inde-

pendent auditor's obligation to serve the public interest assures that that integrity will be preserved, without the need for a work-product immunity for such workpapers.

(e) Nor does enforcement of an IRS summons for accountants' tax accrual workpapers give the IRS an unfair advantage in negotiating and litigating tax controversies. Since the Securities and Exchange Commission or a private plaintiff in securities litigation would be entitled to obtain the tax accrual workpapers at issue, there is no good reason, in light of §7602's broad congressional command, for conferring lesser authority upon the IRS.

677 F. 2d 211, affirmed in part, reversed in part, and remanded.

BURGER, C. J., delivered the opinion for a unanimous Court.

CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari to consider whether tax accrual workpapers prepared by a corporation's independent certified public accountant in the course of regular financial audits are protected from disclosure in response to an Internal Revenue Service summons issued under §7602 of the Internal Revenue Code of 1954 (Code), 26 U.S.C. §7602.

I

A

Respondent Arthur Young & Co. is a firm of certified public accountants. As the independent auditor for respondent Amerada Hess Corp., Young is responsible for reviewing the financial statements prepared by Amerada as required by the federal securities laws.[1] In the course of its review of these financial statements, Young verified Amerada's statement of its contingent tax liabilities, and, in so doing, prepared the tax accrual workpapers at issue in this case. Tax accrual workpapers are documents and memoranda relating to Young's evaluation of Amerada's reserves for contingent tax liabilities. Such workpapers sometimes contain information pertaining to Amerada's financial transactions, identify questionable positions Amerada may have taken on its tax returns, and reflect Young's opinions regarding the validity of such positions. See *infra*, at ——.

In 1975 the Internal Revenue Service began a routine audit to determine Amerada's corporate income tax liability for the tax years 1972 through 1974. When the audit revealed that Amerada had made questionable payments of $7830 from a "special disbursement account," the IRS instituted a criminal investigation of Amerada's tax returns as well. In that process, pursuant to Code §7602, 26 U.S.C. §7602,[2] the IRS issued an administrative summons to Young, which required Young to make available to the IRS all its Amerada files, including its tax accrual workpapers. Amerada instructed Young not to comply with the summons.

The IRS then commenced this enforcement action against Young in the United States District Court for the Southern District of New York. See 26 U.S.C. §7604.[3] Amerada intervened, as permitted by 26 U.S.C. §7609(b)(1).[4] The District Court found that Young's tax accrual workpapers were relevant to the IRS investigation within the meaning of §7602 and refused to recognize an accountant-client privilege that would protect the workpapers. 496 F. Supp. 1152, 1156-1157 (SDNY 1980). Accordingly, the District Court ordered the summons enforced.

B

A divided United States Court of Appeals for the Second Circuit affirmed in part and reversed in part. 677 F. 2d 211 (1982). The Court of Appeals majority agreed with the District Court that the tax accrual workpapers were relevant to the IRS investigation of Amerada, but held that the public interest in promoting full disclosure to public accountants, and in turn ensuring the integrity of the securities markets, required protection for the work that such independent auditors perform for publicly owned companies. Drawing upon *Hickman* v. *Taylor*, 329 U.S. 495 (1947), and Fed. Rule Civ. Proc. 26(b)(3), the Court of Appeals fashioned a work-product immunity doctrine for tax accrual workpapers prepared by independent auditors in the course of compliance with the federal securities laws. Because the IRS had not demonstrated a sufficient showing of need to overcome the immunity and was not seeking to prove fraud on Amerada's part, the Court of Appeals refused to enforce the summons insofar as it sought Young's tax accrual workpapers.

One judge dissented from that portion of the majority opinion creating a work-product immunity for accountants' tax accrual workpapers. The dissent viewed the statutory sum-

[1] See, *e.g.*, Securities Exchange Act of 1934, §12(b)(1)(J)-(L), 48 Stat. 892, 15 U.S.C. §78*l*(b)(1)(J)-(L); Regulation S-X, 17 CFR §210 *et seq.* (1983). See also n. 5, *infra*.

[2] Section 7602 of the Code, 26 U.S.C. §7692, provides as follows:

"For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—

(1) To examine any books, papers, records, or other data which may be relevant on material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry."

[3] Section 7604 of the Code, 26 U.S.C. §7604, provides that:

"If any person is summoned under the internal revenue laws to appear, to testify, or to produce books, papers, records, or other data, the United States district court for the district in which such person resides or is found shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, records or other data."

[4] The IRS summons served upon Young sought the production of records concerning the business transactions and affairs of Young's client, Amerada. Accordingly, under Code §7609(a)(1), 26 U.S.C. §7609(a)(1), Amerada was entitled to notice of the IRS summons. Section 7609(b)(1) provides that "any person who is entitled to notice of a summons under subsection (a) shall have the right to intervene in any proceeding with respect to the enforcement of such summons under section 7604."

mons authority, 26 U.S.C. §7602, as reflecting a congressional decision in favor of the disclosure of such workpapers. The dissent also rejected the policy justifications asserted by the majority for an accountant work-product immunity, reasoning that such protection was not necessary to ensure the integrity of the independent auditor's certification of a corporation's financial statements.

We granted certiorari, 465 U.S. ____ (1983). We affirm in part and reverse in part.

II

Corporate financial statements are one of the primary sources of information available to guide the decisions of the investing public. In an effort to control the accuracy of the financial data available to investors in the securities markets, various provisions of the federal securities laws require publicly held corporations to file their financial statements with the Securities and Exchange Commission.[5] Commission regulations stipulate that these financial reports must be audited by an independent certified public accountant in accordance with generally accepted auditing standards.[6] By examining the corporation's books and records, the independent auditor determines whether the financial reports of the corporation have been prepared in accordance with generally accepted accounting principles.[7] The auditor then issues an opinion as to whether the financial statements, taken as a whole, fairly present the financial position and operations of the corporation for the relevant period.[8] See n. 13, *infra*.

An important aspect of the auditor's function is to evaluate the adequacy and reasonableness of the corporation's reserve account for contingent tax liabilities. This reserve account, known as the tax accrual account, the noncurrent tax account, or the tax pool, represents the amount set aside by the corporation to cover adjustments and additions to the corporation's actual tax liability. Additional corporate tax liability may arise from a wide variety of transactions.[9] The presence of a reserve account for such contingent tax liabilities reflects the corporation's awareness of, and preparedness for, the possibility of an assessment of additional taxes.

The independent auditor draws upon many sources in evaluating the sufficiency of the corporation's tax accrual account. Initially, the corporation's books, records, and tax returns must be analyzed in light of the relevant Code provisions, Treasury Regulations, Revenue Rulings, and case law. The auditor will also obtain and assess the opinions, speculations, and projections of management with regard to unclear, aggressive, or questionable tax positions that may have been taken on prior tax returns. In exploring the tax consequences of certain transactions, the auditor often engages in a "worst-case" analysis in order to ensure that the tax accrual account accurately reflects the full extent of the corporation's exposure to additional tax liability. From this conglomeration of data, the auditor is able to estimate the potential cost of each particular contingency, as well as the probability that the additional liability may arise.

The auditor's tax accrual workpapers record this process of examination and analysis. Such workpapers may document the auditor's interviews with corporate personnel, judgments on questions of potential tax liability, and suggestions for alternative treatments of certain transactions for tax purposes. Tax accrual workpapers also contain an overall evaluation of the sufficiency of the corporation's reserve for contingent tax liabilities, including an item-by-item analysis of the corporation's potential exposure to additional liability. In short, tax accrual workpapers pinpoint the "soft spots" on a corporation's tax return by highlighting those areas in which the corporate taxpayer has taken a position that may, at some later date, require the payment of additional taxes.

III

In seeking access to Young's tax accrual workpapers, the IRS exercised the summons power conferred by Code §7602, 26 U.S.C. §7602, which authorizes the Secretary of the Treasury to summon and "examine any books, papers, records, or other data which may be relevant or material" to a particular tax inquiry.[10] The Dis-

[5] See Securities Act of 1933, Schedule A (25)-(27), 48 Stat. 88, 15 U.S.C. §77aa (filing of audited financial statement prior to registration of new stock issue); Securities Exchange Act of 1934, §§12(b)(1)(J)-(L), 12(g)(1), 48 Stat. 892, 15 U.S.C. §§78*l*(b)(1)(J)-(L), 78*l*(g)(1) (filing of audited financial statement prior to listing securities on an exchange); Securities Act of 1934, §§13(a)(2), 13(b), 48 Stat. 894, 15 U.S.C. §§78m(a)(2); 17 CFR §§249.310, 249.460 (1983) (filing of annual reports); Securities Exchange Act of 1934, §14, 48 Stat. 895, 15 U.S.C. §78n; Schedule 14A, Item 15, 17 CFR §240.14a-101 (1983) (filing of audited financial statement in connection with proxy and information statements).

[6] Regulation S-X, 17 CFR §210 *et seq.* (1983), prescribes the qualifications of accountants and the contents of the accountants' reports that must be submitted with corporate financial statements. In particular, 17 CFR §210.1-02(d) (1983) requires that the financial statements of a public corporation must be audited by an accountant "in accordance with generally accepted auditing standards." "Generally accepted auditing standards" are promulgated by a committee of the public accounting profession's national organization, the American Institute of Certified Public Accountants (AICPA). See 1 AICPA Professional Standards (CCH) §150.02 (1972).

[7] See 1 AICPA, Statement on Auditing Standards §110.01 (1972). Promulgated by the accounting profession's Financial Accounting Standards Board, "generally accepted accounting principles" are the conventions, rules, and procedures that define accepted accounting practices. See W. Meigs, E. Larsen, & R. Meigs, Principles of Auditing 25-26 (5th ed. 1973); H. Stettler, Auditing Principles 12-16 (5th ed. 1982).

[8] See 1 AICPA Professional Standards (CCH) §509 (1974).

[9] For example, the characterization of the proceeds of a sale as capital gain instead of ordinary income, the claiming of an investment tax credit, and the attribution of a transaction to a future tax year are decisions requiring judgment calls in gray areas of the Code, any one of which might result in a recomputation of the corporation's outstanding tax liability.

[10] In *United States* v. *Powell*, 379 U.S. 48 (1964) [1965-1 C.B. 547], the Court refused to impose a probable cause requirement in connection with the enforcement of an IRS summons under §7602. Instead, the Court held that the IRS need show only "that the investigation will be conducted pursuant to a legitimate purpose, *that the inquiry may be relevant to the purpose*, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed. . . ." *Id.*, at 57-58 (emphasis added).

trict Court and the Court of Appeals determined that the tax accrual workpapers at issue in this case satisfied the relevance requirement of §7602, because they "might have thrown light upon" the correctness of Amerada's tax return.[11] Because the relevance of tax accrual workpapers is a logical predicate to the question whether such workpapers should be protected by some form of work-product immunity, we turn first to an evaluation of the relevance issue.[12] We agree that such workpapers are relevant within the meaning of §7602.

As the language of §7602 clearly indicates, an IRS summons is not to be judged by the relevance standards used in deciding whether to admit evidence in federal court. Cf. Fed. Rule Evid. 401. The language "may be" reflects Congress' express intention to allow the IRS to obtain items of even *potential* relevance to an ongoing investigation, without reference to its admissibility. The purpose of Congress is obvious; the Service can hardly be expected to know whether such data will in fact be relevant until it is procured and scrutinized. As a tool of discovery, the §7602 summons is critical to the investigative and enforcement functions of the IRS, see *United States* v. *Powell*, 379 U.S. 48, 57 (1964) [1965-1 C.B. 547]; the Service therefore should not be required to establish that the documents it seeks are actually relevant in any technical, evidentiary sense.

That tax accrual workpapers are not actually used in the preparation of tax returns by the taxpayer or its own accountants does not bar a finding of relevance within the meaning of §7602. The filing of a corporate tax return entails much more than filling in the blanks on an IRS form in accordance with undisputed tax principles; more likely than not, the return is a composite interpretation of corporate transactions made by corporate officers in the light most favorable to the taxpayer. It is the responsibility of the IRS to determine whether the corporate taxpayer in completing its return has stretched a particular tax concept beyond what is allowed. Records that illuminate any aspect of the return—such as the tax accrual workpapers at issue in this case—are therefore highly relevant to legitimate IRS inquiry. The Court of Appeals acknowledged this: "It is difficult to say that the assessment by the independent auditor of the correctness of positions taken by the taxpayer in his return would not throw 'light upon' the correctness of the return." 677 F.2d, at 219. We accordingly affirm the Court of Appeals' holding that Young's tax accrual workpapers are relevant to the IRS investigation of Amerada's tax liability.

IV

A

We now turn to consider whether tax accrual workpapers prepared by an independent auditor in the course of a routine review of corporate financial statements should be protected by some form of work-product immunity from disclosure under §7602. Based upon its evaluation of the competing policies of the federal tax and securities laws, the Court of Appeals found it necessary to create a so-called privilege for the independent auditor's workpapers.

Our complex and comprehensive system of federal taxation, relying as it does upon self-assessment and reporting, demands that all taxpayers be forthright in the disclosure of relevant information to the taxing authorities. Without such disclosure, and the concomitant power of the Government to compel disclosure, our national tax burden would not be fairly and equitably distributed. In order to encourage effective tax investigations, Congress has endowed the IRS with expansive information-gathering authority; §7602 is the centerpiece of that congressional design. As we noted in *United States* v. *Bisceglia*, 420 U.S. 141, 146 (1975) [1975-1 C.B. 379]:

"The purpose of [§7602] is not to accuse, but to inquire. Although such investigations unquestionably involve some invasion of privacy, they are essential to our self-reporting system, and the alternatives could well involve far less agreeable invasions of house, business, and records."

Similarly, we noted in *United States* v. *Euge*, 444 U.S. 707, 711 (1980) [1980-1 C.B. 310]:

"[T]his Court has consistently construed congressional intent to require that if the summons authority claimed is necessary for the effective performance of congressionally imposed responsibilities to enforce the tax Code, that authority should be upheld absent express statutory prohibition or substantial countervailing policies."

While §7602 is "subject to the traditional privileges and limitations," *id.*, at 714, any other restrictions upon the IRS summons power should be avoided "absent unambiguous directions from Congress." *United States* v. *Bisceglia, supra*, at 150. We are unable to discern the sort of "unambiguous directions from Congress" that would justify a judicially created work-product immunity for tax accrual workpapers summoned under §7602. Indeed, the very language of §7602 reflects precisely the opposite; a congressional policy

[11] The relevance standard employed by the Second Circuit—whether the documents at issue "might have thrown light upon the correctness of the return"—appears to be widely accepted among the Courts of Appeals. See, *e.g.*, *United States* v. *Wyatt*, 637 F. 2d 293, 300 (CA5 1981); *United States* v. *Turner*, 480 F. 2d 272, 279 (CA7, 1973); *United States* v. *Ryan*, 455 F. 2d 728, 733 (CA9 1972); *United States* v. *Egenberg*, 443 F. 2d 512, 515-516 (CA3 1971); *Foster* v. *United States*, 265 F. 2d 183, 187 (CA2), *cert. denied*, 360 U.S. 912 (1959). In *United States* v. *Harrington*, 388 F. 2d 520, 524 (1968), the Second Circuit amplified this test by stating that "the 'might' in the articulated standard, 'might throw light upon the correctness of the return,' is . . . an indication of a realistic expectation rather than an idle hope that something may be discovered." But in *United States* v. *Coopers & Lybrand*, 550 F. 2d 615 (1977), the Court of Appeals for the Tenth Circuit held that tax accrual workpapers not prepared in connection with the filing of a corporate tax return were not relevant within the meaning of §7602.

[12] The petition for certiorari did not question the relevancy of the tax accrual workpapers, and respondents have not filed a cross-petition raising the issue. Respondents have, however, argued before this Court that the Court of Appeals erred in holding that Young's tax accrual workpapers were relevant to the IRS investigation of Amerada within the meaning of §7602. Respondents were clearly entitled to do so, for our precedents establish that a prevailing party may urge any ground in support of the judgment, whether or not that ground was relied upon or even considered by the court below. See, *e.g.*, *United States* v. *New York Telephone Co.*, 434 U.S. 159, 166, n. 8 (1977); *Dandridge* v. *Williams*, 397 U.S. 471, 475-476, n. 6 (1970).

choice *in favor of disclosure* of all information relevant to a legitimate IRS inquiry. In light of this explicit statement by the Legislative Branch, courts should be chary in recognizing exceptions to the broad summons authority of the IRS or in fashioning new privileges that would curtail disclosure under §7602. Cf. *Milwaukee* v. *Illinois*, 451 U.S. 304, 315 (1981). If the broad latitude granted to the IRS by §7602 is to be circumscribed, that is a choice for Congress, and not this Court, to make. See *United States* v. *Euge, supra*, at 712.

B

The Court of Appeals nevertheless concluded that "substantial countervailing policies," *id.*, at 711, required the fashioning of a work-product immunity for an independent auditor's tax accrual workpapers. To the extent that the Court of Appeals, in its concern for the "chilling effect" of the disclosure of tax accrual workpapers, sought to facilitate communication between independent auditors and their clients, its remedy more closely resembles a testimonial accountant-client privilege than a work-product immunity for accountants' workpapers. But as this Court stated in *Couch* v. *United States*, 409 U.S. 322, 335 (1973) [1973-1 C.B. 609], "no confidential accountant-client privilege exists under federal law, and no state-created privilege has been recognized in federal cases." In light of *Couch*, the Court of Appeals' effort to foster candid communication between accountant and client by creating a self-styled work-product privilege was misplaced, and conflicts with what we see as the clear intent of Congress.

Nor do we find persuasive the argument that a work-product immunity for accountants' tax accrual workpapers is a fitting analogue to the attorney work-product doctrine established in *Hickman* v. *Taylor, supra*. The *Hickman* work-product doctrine was founded upon the private attorney's role as the client's confidential advisor and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light. An independent certified public accountant performs a different role. By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust. To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations.

We cannot accept the view that the integrity of the securities markets will suffer absent some protection for accountants' tax accrual workpapers. The Court of Appeals apparently feared that, were the IRS to have access to tax accrual workpapers, a corporation might be tempted to withhold from its auditor certain information relevant and material to a proper evaluation of its financial statements. But the independent certified public accountant cannot be content with the corporation's representations that its tax accrual reserves are adequate; the auditor is ethically and professionally obligated to ascertain for himself as far as possible whether the corporation's contingent tax liabilities have been accurately stated. If the auditor were convinced that the scope of the examination had been limited by management's reluctance to disclose matters relating to the tax accrual reserves, the auditor would be unable to issue an unqualified opinion as to the accuracy of the corporation's financial statements. Instead, the auditor would be required to issue a qualified opinion, an adverse opinion, or a disclaimer of opinion, thereby notifying the investing public of possible potential problems inherent in the corporation's financial reports.[13] Responsible corporate management would not risk a qualified evaluation of a corporate taxpayer's financial posture to afford cover for questionable positions reflected in a prior tax return.[14] Thus, the independent auditor's obligation to serve the public interest assures that the integrity of the securities markets will be preserved, without the need for a work-product immunity for accountants' tax accrual workpapers.[15]

[13] An *unqualified opinion*, the most favorable report an auditor may give, represents the auditor's finding that the company's financial statements fairly present the financial position of the company, the results of its operations, and the changes in its financial position for the period under audit, in conformity with consistently applied generally accepted accounting principles. See 1 AICPA, Statement on Auditing Standards §§510, 511.01 (1973). Alternatively, the auditor may give a *qualified opinion*, which states that the financial statements are fairly presented except for, or subject to, a departure from generally accepted accounting principles, a change in accounting principles, or a material uncertainty. *Id.*, at §512. An *adverse opinion* is a reflection of the auditor's determination that the corporation's financial statements do not fairly present the financial position, results of operations, or changes in financial position of the company in conformity with generally accepted accounting principles; an adverse opinion is issued when the auditor determines that the corporation has materially misstated certain items on its financial statements. *Id.*, at §513. Finally, a *disclaimer of opinion* expresses the auditor's inability to draw a conclusion as to the accuracy of the corporate financial records. A disclaimer of opinion is generally issued when the auditor lacks sufficient information about the financial records to issue an overall opinion. *Id.*, at §514. See generally A. Arens & J. Loebbecke, Auditing: An Integrated Approach 643-660 (1976).

[14] The inclusion in an audited financial statement of anything less than an unqualified opinion could send signals to stockholders, creditors, potential investors, and others that the independent auditor has been unable to give the corporation an unqualified bill of financial health. Such a public auditor's opinion could well have serious consequences for the corporation and its shareholders.

[15] Indeed, rather than protecting the investing public by ensuring the accuracy of corporate financial records, insulation of tax accrual workpapers from disclosure might well undermine the public's confidence in the independent auditing process. The SEC requires the filing of audited financial statements in order to obviate the fear of loss from reliance on inaccurate information, thereby encouraging public investment in the nation's industries. It is therefore not enough that financial statements *be* accurate; the public must also *perceive* them as being accurate. Public faith in the

We also reject respondents' position that fundamental fairness precludes IRS access to accountants' tax accrual workpapers. Respondents urge that the enforcement of an IRS summons for accountants' tax accrual workpapers permits the Government to probe the thought processes of its taxpayer citizens, thereby giving the IRS an unfair advantage in negotiating and litigating tax controversies. But if the SEC itself, or a private plaintiff in securities litigation, sought to obtain the tax accrual workpapers at issue in this case, they would surely be entitled to do so.[16] In light of the broad congressional command of §7602, no sound reason exists for conferring lesser authority upon the IRS than upon a private litigant suing with regard to transactions concerning which the public has no interest.

Congress has granted to the IRS "broad latitude to adopt enforcement techniques helpful in the performance of [its] tax collection and assessment responsibilities." *United States* v. *Euge, supra*, at 716, n. 9. Recognizing the intrusiveness of demands for the production of tax accrual workpapers, the IRS has demonstrated administrative sensitivity to the concerns expressed by the accounting profession by tightening its internal requirements for the issuance of such summonses. See Int. Rev. Manual—Audit (CCH) §4024.4 (May 14, 1981).[17] Although these IRS guidelines were not applicable during the years at issue in this case, their promulgation further refutes respondents' fairness argument and reflects an administrative flexibility that reinforces our decision not to reduce irrevocably the §7602 summons power.

V

Beyond question it is desirable and in the public interest to encourage full disclosures by corporate clients to their independent accountants; if it is necessary to balance competing interests, however, the need of the Government for full disclosure of all information relevant to tax liability must also weigh in that balance. This kind of policy choice is best left to the Legislative Branch. Accordingly, the judgment of the Court of Appeals is affirmed in part and reversed in part, and the case is remanded for proceedings consistent with this opinion.

It is so ordered.

Section 7604.—Enforcement of Summons

26 CFR 301.7604-1: Enforcement of summons.

Whether tax accrual workpapers prepared by a corporation's independent certified public accountant in the course of regular financial audits are subject to summons under section 7602 of the Code. See Ct. D. 2026, page 270.

Chapter 79.—Definitions

Section 7701.—Definitions

26 CFR 301.7701-2: Associations.

Limited Partnerships. A list is provided of state laws that are substantially similar to the Revised Uniform Limited Partnership Act for purposes of section 301.7701-2 of the Procedure and Administration Regulations.

Rev. Rul. 84-80

ISSUE

Whether states that have revised their limited partnership statutes following promulgation of the Revised Uniform Limited Partnership Act ("RULPA") have enacted legislation that corresponds to the Uniform Limited Partnership Act ("ULPA") for purposes of section 301.7701-2 of the Procedure and Administration Regulations.

FACTS

RULPA was adopted by the National Conference of Commissioners on Uniform State Laws in 1976.

On April 26, 1983, final regulations were published which amend section 301.7701-2 of the regulations. T.D. 7889, 1983-1 C.B. 362. As amended, section 301.7701-2(a)(5) provides that references in section 301.7701-2 to the ULPA shall be deemed to refer to the ULPA as originally enacted and as revised in 1976 (RULPA).

LAW AND ANALYSIS

Section 301.7701-2 of the regulations provides that the classification of an entity depends upon the presence or absence of corporate characteristics. That section also includes certain special rules for determining whether an entity organized under a statute corresponding to the ULPA possesses or lacks the corporate characteristics of continuity of life, centralization of management, limited liability, and free transferability of interests.

HOLDING

The Internal Revenue Service has determined that the following states have enacted legislation that, as of the effective date, corresponds to the ULPA for purposes of section 301.7701-2 of the regulations:

CALIFORNIA: Cal. Corp. Code sections 15611 through 15723 (West

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reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional. Endowing the workpapers of an independent auditor with a work-product immunity would destroy the appearance of auditor's independence by creating the impression that the auditor is an advocate for the client. If investors were to view the auditor as an advocate for the corporate client, the value of the audit function itself might well be lost. See generally A. Arens & J. Loebbecke, n. 13, *supra*. 55-58.

[16] See, *e.g.*, Securities Act of 1933, §19.48 Stat. 85, 15 U.S.C. §77s(b) (for purposes of all "necessary and proper" investigations, SEC is empowered to "require the production of any books, papers, or other documents which the Commission deems relevant or material to the inquiry"); Securities Act of 1934, §21, 48 Stat. 899, 15 U.S.C. §78u(b) (same); Fed. Rule Civ. Proc. 26(b)(1) (parties may obtain discovery of "any matter, not privileged, which is relevant to the subject matter involved in the pending action").

[17] The new IRS guidelines provide that access may be had to accountants' tax accrual workpapers only in "unusual circumstances" and only as a "collateral source for factual data." The guidelines require the prior written approval of the Chief of the Examination Division of the IRS before an examining agent may request tax accrual workpapers; in addition, they state that the examiner should first take all reasonable means to secure the information from the corporation itself before issuing a summons to the independent auditor.

Supp. 1984) effective July 1, 1984.

COLORADO: Col. Rev. Stat. sections 7-62-101 through 7-62-1201 (Supp. 1983) effective November 1, 1981.

CONNECTICUT: Conn. Gen. Stat. Ann. sections 34-9 through 34-38 (West Supp. 1983-84) effective October 1, 1979.

DELAWARE: Del. Code Ann. tit. 6, sections 17-101 through 17-1107 (Supp. 1982) effective January 1, 1983.

MASSACHUSETTS: Mass. Ann. Laws ch. 109, sections 1-62 (Law. Co-op. Supp. 1983) effective July 1, 1982.

MONTANA: Mont. Code. Ann. sections 35-12-501 through 1404, effective October 1, 1981.

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26 CFR 301.7701-4: Trusts.

Whether a mortgage "pool" comes within the definition of the term "trust". See Rev. Rul. 84-10, page 155.

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26 CFR 301.7701-13A: Post-1969 domestic building and loan association.

Whether interests in a mortgage pool qualify as "loans secured by an interest in real property". See Rev. Rul. 84-10, page 155.

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26 CFR 305.7701-1: Definition of Indian tribal government.
(Also Section 7871; 305.7871-1.)

T.D. 7952

TITLE 26—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER F, PART 305—TEMPORARY PROCEDURAL AND ADMINISTRATIVE TAX REGULATIONS UNDER THE INDIAN TRIBAL GOVERNMENT TAX STATUS ACT OF 1982

Indian Tribal Governments Treated As States For Certain Purposes

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the treatment of Indian tribal governments as States for certain purposes. Changes to the applicable tax law were made by the Indian Tribal Governmental Tax Status Act of 1982. The regulations provide guidance to Indian tribal governments that are treated as States for certain purposes. In addition, the text of the temporary regulations set forth in this document serves as the text of the proposed rulemaking *** [on page 776, of this Bulletin].

DATES: The regulations are generally effective for taxable years beginning after December 31, 1982, and before January 1, 1985.

FOR FURTHER INFORMATION CONTACT: Linda M. Kroening of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3288) (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to the treatment of Indian tribal governments as States for certain purposes under sections 7701 and 7871 of the Internal Revenue Code of 1954, as added to the Code by sections 202 and 203 of the Indian Tribal Governmental Tax Status Act of 1982 (Pub. L. 97-473, 96 Stat. 2608, 2611). Further, a new Part 305, Temporary Procedural and Administrative Tax Regulations Under the Indian Tribal Governmental Tax Status Act of 1982, is added by this document to Title 26 of the Code of Federal Regulations. The temporary regulations will remain in effect until superseded by final regulations on this subject.

EXPLANATION OF PROVISIONS

Generally, for taxable years 1983 and 1984, the regulations provide that an Indian tribal government may be treated as a State for certain Federal tax purposes. For purposes of the regulations, the governing body of a tribe, band, pueblo, community, village or group of Indians, or Alaska Natives, will qualify as an Indian tribal government upon a determination by the Internal Revenue Service that such governing body exercises governmental functions. Designation of a governing body as an Indian tribal government will be by revenue procedure. If a governing body is not currently designated by the applicable revenue procedure as an Indian tribal government, and such governing body believes that it qualifies for such designation, the governing body may apply for a ruling from the Internal Revenue Service. Such governing body will qualify as an Indian tribal government, for purposes of these regulations, only upon obtaining a favorable ruling from the Internal Revenue Service. The regulations provide instructions for applying for a ruling.

Similarly, a subdivision of a designated Indian tribal government may be treated as a political subdivision of a State for certain Federal tax purposes if the Internal Revenue Service determines that the subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government. Designation of a subdivision of an Indian tribal government as a political subdivision of a State will be by revenue procedure. If a subdivision of an Indian tribal government is not currently designated by the applicable revenue procedure as a political subdivision of a State, the subdivision may apply for a ruling from the Internal Revenue Service. Such subdivision of an Indian tribal government will qualify as a political subdivision of a State, for purposes of these regulations, only upon obtaining a favorable ruling from the Internal Revenue Service.

The regulations set forth the sections of the Internal Revenue Code of 1954 under which designated Indian tribal governments and subdivisions of Indian tribal governments shall be treated as States or political subdivisions of States. In addition, special rules for excise tax exemptions and

tax-exempt bonds are provided, including the requirement that an essential governmental function be exercised.

SPECIAL ANALYSES

The Treasury Department has determined that this temporary regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983. The notice of proposed rulemaking relating to the treatment of Indian tribal governments as States for certain purposes *** on page 776, this Bulletin] describes the applicability of the Executive Order to both the proposed and final regulations.

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and a Regulatory Flexibility Analysis is not required for this rule.

The collection of information requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) under section 3507 of the Paperwork Reduction Act. (Control No. 1545-0823)

DRAFTING INFORMATION

The principal author of these temporary regulations is Linda M. Kroening of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, a new Part 305, Temporary Procedural and Administrative Tax Regulations under the Indian Tribal Government Tax Status Act of 1982, is added to Title 26 of the Code of Federal Regulations, and the following temporary regulations are adopted:

Paragraph. Subchapter F of 26 CFR is amended by adding a new Part 305 to read as follows:

Part 305—TEMPORARY PROCEDURAL AND ADMINISTRATIVE TAX REGULATIONS UNDER THE INDIAN TRIBAL GOVERNMENTAL TAX STATUS ACT OF 1982

Sec.

305.7701-1 Definition of Indian tribal government.

305.7871-1 Indian tribal governments treated as States for certain purposes.

Authority: Section 7805 (68A Stat. 917, 26 U.S.C. 7805) Internal Revenue Code of 1954.

§305.7701-1 Definition of Indian tribal government.

(a) *Definition.* A governing body of a tribe, band, pueblo, community, village, or group of native American Indians, or Alaska Natives, qualifies as an Indian tribal government upon determination by the Internal Revenue Service that the governing body exercises governmental functions. Designation of a governing body as an Indian tribal government will be by revenue procedure. If a governing body is not currently designated by the applicable revenue procedure as an Indian tribal government, and such governing body believes that it qualifies for such designation, the governing body may apply for a ruling from the Internal Revenue Service. In order to qualify as an Indian tribal government, for purposes of section 7701(a)(40) and this section, such governing body must receive a favorable ruling from the Internal Revenue Service. The request for a ruling shall be made in accordance with all applicable procedural rules set forth in the Statement of Procedural Rules (26 CFR Part 601) and any applicable revenue procedures relating to the submission of ruling requests. The request shall be submitted to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention: CC:IND:S, Room 6545, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

(b) *Effective date.* The provisions of this section are effective after December 31, 1982.

§305.7871-1 Indian tribal governments treated as States for certain purposes.

(a) *In general.* An Indian tribal government, as defined in section 7701(a)(40) and the regulations thereunder, shall be treated as a State, and a subdivision of an Indian tribal government, as determined under section 7871(d) and paragraph (e) of this section, shall be treated as a political subdivision of a State, under the following sections and regulations thereunder—

(1) Section 170 (relating to income tax deductions for charitable, etc., contributions and gifts), sections 2055 and 2106(a)(2) (relating to estate tax deductions for transfers of public, charitable, and religious uses), and section 2522 (relating to gift tax deductions for charitable and similar gifts), for purposes of determining whether and in what amount any contribution or transfer to or for the use of an Indian tribal government (or subdivision thereof) is deductible;

(2) Section 164 (relating to deductions for taxes);

(3) Section 511(a)(2)(B) (relating to the taxation of colleges and universities which are agencies or instrumentalities of governments or their political subdivisions);

(4) Section 37(e)(9)(A) (relating to certain public retirement systems);

(5) Section 41(c)(4) (defining "State" for purposes of credit for contributions to candidates for public offices);

(6) Section 117(b)(2)(A) (relating to scholarships and fellowship grants);

(7) Section 403(b)(1)(A)(ii) (relating to the taxation of contributions of certain employers for employee annuities);

(8) Chapter 41 of the Code (relating to tax on excess expenditures to influence legislation); and

(9) Subchapter A of chapter 42 of the Code (relating to private foundations).

(b) *Special rule for excise tax provisions.* An Indian tribal government shall be treated as a State, and a subdivision of an Indian tribal government shall be treated as a political subdivision of a State, for purposes of any exemption from, credit or refund of, or payment with respect to, an excise tax imposed on a transaction under—

(1) Chapter 31 of the Code (relating to tax on special fuels);

(2) Chapter 32 of the Code (relating to manufacturers excise taxes);

(3) Subchapter B of chapter 33 of the Code (relating to communications excise tax); and

(4) Subchapter D of chapter 36 of the Code (relating to tax on use of certain highway vehicles), if, in addition to satisfying all requirements applicable to a similar transaction involving a State (or political subdivision thereof) under the Code, the transaction involves the exercise of an essential governmental function of the Indian tribal government, as defined in paragraph (d) of this section.

(c) *Special rule for tax-exempt bonds.* An Indian tribal government shall be treated as a State and a subdivision of an Indian tribal government shall be treated as a political subdivision of a State for purposes of any obligation issued by such government or subdivision under section 103 (relating to interest on certain governmental obligations) if such obligation is part of an issue substantially all of the proceeds of which are to be used in the exercise of an essential governmental function, as defined in paragraph (d) of this section. For purposes of section 7871 and this section, the "substantially all" test is the same as that provided in §1.103-8(a)(1)(i). An Indian tribal government shall not be treated as a State and a subdivision of an Indian tribal government shall not be treated as a political subdivision of a State, however, for issues of the following private activity bonds—

(1) An industrial development bond (as defined in section 103(b)(2));

(2) An obligation described in section 103(l)(1)(A) (relating to scholarship bonds); or

(3) A mortgage subsidy bond (as defined in section 103A(b)(1), without regard to section 103A(b)(2)).

(d) *Essential governmental function.* For purposes of section 7871 and this section, an essential governmental function of an Indian tribal government (or portion thereof) is a function of a type which is—

(1) Eligible for funding under 25 U.S.C. 13 and the regulations thereunder;

(2) Eligible for grants or contracts under 25 U.S.C. 450(f), (g), and (h) and the regulations thereunder; or

(3) An essential governmental function under section 115 and the regulations thereunder when conducted by a State or political subdivision thereof.

(e) *Treatment of subdivisions of Indian tribal governments as political subdivisions.* A subdivision of an Indian tribal government shall be treated as a political subdivision of a State for purposes of section 7871 and this section if the Internal Revenue Service determines that the subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government. Designation of a subdivision of an Indian tribal government as a political subdivision of a State will be by revenue procedure. If a subdivision of an Indian tribal government is not currently designated by the applicable revenue procedure as a political subdivision of a State, and such subdivision believes that it qualifies for such designation, the subdivision may apply for a ruling from the Internal Revenue Service. In order to qualify as a political subdivision of a State, for purposes of section 7871 and this section, such subdivision must receive a favorable ruling from the Internal Revenue Service. The request for a ruling shall be made in accordance with all applicable procedural rules set forth in the Statement of Procedural Rules (26 CFR Part 601) and any applicable revenue procedures relating to submission of ruling requests. The request shall be submitted to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention: CC:IND:S, Room 6545, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

(f) *Effective dates*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, the provisions of this section are effective after December 31, 1982.

(2) *Specific effective dates.* Specific provisions of this section are effective as follows:

(i) Provisions relating to Chapter 1 of the Internal Revenue Code of 1954 (other than section 103 and section 37(e)(9)(A)) shall apply to taxable years beginning after December 31, 1982, and before January 1, 1985;

(ii) Provisions relating to section 37(e)(9)(A) shall apply to taxable years beginning after December 31, 1982, and before January 1, 1984;

(iii) Provisions relating to section 103 shall apply to obligations issued after December 31, 1982, and before January 1, 1985;

(iv) Provisions relating to chapter 11 of the Code shall apply to estates of decedents dying after December 31, 1982, and before January 1, 1985;

(v) Provisions relating to chapter 12 of the Code shall apply to gifts made after December 31, 1982, and before January 1, 1985; and

(vi) Provisions relating to taxes imposed by subtitle D of the Code shall take effect on January 1, 1983 and shall cease to apply at the close of December 31, 1984.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (b) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved April 16, 1984.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 4, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 7, 1984, 49 F.R. 19302)

Chapter 80.—General Rules
Subchapter A.—Applications of Internal Revenue Laws

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Obsolete ruling. G.C.M. 27026, relating to the treatment of the proceeds derived from public entertainments conducted for the benefit of charitable organizations, is obsolete.

Rev. Rul. 84-39

Periodically, the Internal Revenue Service has obsoleted rulings which, athough not specifically revoked or superseded, are not considered determinative with respect to future transactions because (1) the applicable statutory provisions have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations or a subsequent published position; or (3) the facts set forth no longer exist or are not sufficient to permit application of the current statute.

The following ruling is hereby declared to be obsolete: G.C.M. 27026, 1951-2 C.B. 7.

The applicable principles of the ruling are included in section 1.61-2(c) of the Income Tax Regulations and are illustrated in Rev. Rul. 68-563, 1968-2 C.B. 44, and Rev. Rul. 71-33, 1971-1 C.B. 30.

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26 CFR 301.7805-1: Rules and regulations.

Obsolete revenue rulings. A list is given of pre-ERISA revenue rulings in the employee plans area which are not considered determinative with respect to future transactions and are declared obsolete.

Rev. Rul. 84-50

In light of the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) [Pub. L. 93-406, 1974-3 C.B. 1], the Internal Revenue Service has undertaken a review of certain pre-ERISA Revenue Rulings that are published in the Internal Revenue Bulletin.

The purpose of this Revenue Ruling is to publish a list of pre-ERISA Revenue Rulings having primary application in the employee plans area which, although not specifically revoked or superseded, are not considered determinative with respect to future transactions because (1) the applicable statutory provisions or regulations have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or a subsequent published position; or (3) the facts set forth no longer exist or are not sufficient to permit application of the current statute. Accordingly, the rulings listed below are hereby declared obsolete.

REVENUE RULING
(REV. RUL.) SERIES

Rev. Rul. No.

54-531, 1954-2 C.B. 56
55-436, 1955-2 C.B. 541
56-366, 1956-2 C.B. 976
57-89, 1957-1 C.B. 169
59-29, 1959-1 C.B. 123
62-183, 1962-2 C.B. 143
63-117, 1963-1 C.B. 92
66-218, 1966-2 C.B. 120
68-138, 1968-1 C.B. 183
69-37, 1969-1 C.B. 130
69-250, 1969-1 C.B. 116
69-252, 1969-1 C.B. 128
69-399, 1969-2 C.B. 99
69-570, 1969-2 C.B. 91
70-493, 1970-2 C.B. 93
71-38, 1971-1 C.B. 130
71-392, 1971-2 C.B. 208
72-3, 1972-1 C.B. 105
72-98, 1972-1 C.B. 113
74-420, 1974-2 C.B. 135

The above-listed rulings in the employee plans area are not determinative with respect to future transactions. However, this Revenue Ruling does not determine their applicability to past transactions.

Other published pre-ERISA Revenue Rulings relating to the employee plans area will continue to be reviewed to ascertain those that are inapplicable to future transactions. Therefore, failure to include any particular Revenue Ruling in the above list should not be construed as an indication that the Revenue Ruling necessarily is determinative with respect to future transactions.

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26 CFR 301.7805-1: Rules and regulations.

Whether a jig, described as a cadmium plated hook with an integral lead weight, is an artificial lure withn the meaning of section 4161(a) of the Code. See Rev. Rul. 84-57, page 210.

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26 CFR 301.7805-1: Rules and regulations.

Whether Rev. Ruls. 80-284 and 80-285 are revoked retroactively. See Rev. Rul. 84-71, page 106.

Subchapter C.—Provisions Affecting More Than One Subtitle

Section 7871.—Indian Tribal Governments Treated as States for Certain Purposes

List of subdivisions of Indian tribal governments that are to be treated as political subdivisions of states for specified purposes. See Rev. Proc. 84-36, page 510.

Manner in which a governmental unit of an Indian tribe or a political subdivision of an Indian tribal government can request a determination qualifying it for treatment as a state or a political subdivision of a state. See Rev. Proc. 84-37, page 513.

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26 CFR 305.7871-1: Indian tribal governments treated as States for certain purposes.
(Also Sections 61, 103, 170, 2055, 4041, 4221, 4253, 4483; 1.61-7, 1.103-1, 1.170A-1, 20.2055-1, 48.4041-11, 48.4221-5, 49.4253-12, 41.4483-1.)

Indian tribal governments; treatment as states or political subdivisions. Rev. Rul. 58-610, Rev. Rul. 68-231 and Rev. Rul. 74-179 are suspended as to their respective applications to Indian tribes, or

subdivisions thereof, during the specified two years under section 7871 of the Code.

Rev. Rul. 84-93

The Service has held that for certain federal tax purposes an Indian tribe is neither a state, a territory or a political subdivision. See Rev. Rul. 58-610, 1958-2 C.B. 815, Rev. Rul. 68-231, 1968-1 C.B. 48 and Rev. Rul. 74-179, 1974-1 C.B. 279.

The Indian Tribal Governmental Tax Status Act of 1982, (Title II of Pub. L. No. 97-473, 96 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1983-1 C.B. 510, 511] added certain provisions to the Code that pertain to the status of Indian tribal governments. For two years beginning in 1983, Indian tribal governments (or subdivisions thereof) will be treated as states (or political subdivisions thereof) for specified federal tax purposes. For example, under new section 7871 of the Code interest on public activity bonds issued during the years 1983 and 1984 by a tribal government may be tax exempt, and a tribal government will be entitled to exemption from certain excise taxes. Also, charitable contributions made in 1983 and 1984 to or for the use of a tribal government may be deductible under the federal gift and estate tax laws. Charitable contributions made during a taxpayer's tax years beginning in 1983 and 1984 may be deductible under the federal income tax laws.

The term "Indian tribal government" is defined under section 7701(a)(40) of the Code, as amended, to mean the governing body of any tribe, band, community, village or group of Indians, or (if applicable) Alaska Natives, that is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions. Section 7871(d) of the Code provides that for purposes of section 7871, a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the Secretary of the Treasury determines (after consultation with the Secretary of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-610, Rev. Rul. 68-231 and Rev. Rul. 74-179 are suspended as to their respective applications to Indian tribes, or subdivisions thereof, that qualify during the specified two years under section 7871 of the Code.

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26 CFR 305.7871-1: Indian tribal governments treated as states for certain purposes.

Whether, under various sections of the Code, Indian tribal governments will be treated as states, and subdivisions of Indian tribal governments will be treated as political subdivisions of states. See T.D. 7952, page 276.

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26 CFR 1.9100-1: Extension of time for making certain elections.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 84-46, page 541.

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26 CFR 1.9100-1: Extension of time for making certain elections.

Whether an extension of time may be granted under section 1.9100-1 of the regulations for a failure to satisfy the notification requirement of section 508(a) of the Code. See Rev. Proc. 84-47, page 545.

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26 CFR 1.9200-1: Deduction for motor carrier operating authority.
(Also Section 1502; 1.1502-32.)

T.D. 7947

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART I—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Deduction for motor carrier operating authorities

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to a deduction which is to be taken ratably over a 60-month period for the adjusted basis of motor carrier operating authorities held by taxpayers on July 1, 1980. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], the Highway Revenue Act of 1982 [Pub. L. 97-424, 1983-1 C.B. 405], and the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. These regulations provide guidance to taxpayers who, on July 1, 1980, held one or more motor carrier operating authorities, or later acquired such an authority pursuant to a binding contract in effect on July 1, 1980.

DATES: The regulations are effective for taxable years ending after June 30, 1980.

FOR FURTHER INFORMATION CONTACT: Robert B. Coplan of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention CC:LR:T) 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On June 6, 1983, the FEDERAL REGISTER (48 FR 25224) [LR-203-81, 1983-2 C.B. 707] published proposed amendments to the Income Tax Regulations (26 CFR Part 1) in order to conform the regulations to section 266 of the Economic Recovery Tax Act of 1981 (95 Stat. 265) [Pub. L. 97-34, 1981-2 C.B. 256, 306], section 517 of the Highway Revenue Act of 1982 (Title V of the Surface Transportation Assistance Act of 1982 (96 Stat. 2097)) [Pub. L. 97-424, 1983-1 C.B. 405, 413], and section 102(n) of the Technical Corrections Act of 1982 (96 Stat. 2365) [Pub. L. 97-448, 1983-1 C.B. 451, 456]. After consideration of all comments regarding the proposed amendments, those amend-

ments are adopted as revised by this Treasury decision.

This Treasury decision is issued under the authority contained in section 266 of the Economic Recovery Tax Act of 1981, section 517 of the Highway Revenue Act of 1982, and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

CHANGES IN REGULATIONS IN RESPONSE TO COMMENTS

Several clarifying changes have been made to the proposed regulations in response to comments received.

The preamble to the notice of proposed rulemaking provided that in accordance with the Technical Corrections Act of 1982, the deduction for motor carrier operating authorities may carry over in corporate acquisitions to which section 381 applies. The last sentence of §1.9200-1(b) has been revised to specifically allow the deduction to be claimed by the acquiring corporation in such transactions. One commentator recommended that this rule be extended to provide that if an operating authority is acquired after July 1, 1980 in a transaction to which section 351 or 355 applies, the acquirer would be allowed to claim the deduction. However, in light of the specific reference in the Technical Corrections Act to section 381 transactions, sufficient statutory authority for extending this rule does not exist.

The final regulations have been clarified in §1.9200-1(d) to provide that freight forwarders are not included in the definition of the terms "motor common carrier" and "motor contract carrier." Thus, the deduction allowed under §1.9200-1 may not be claimed with respect to operating authroities issued to freight forwarders.

A minor clarification has been added to the last sentence of §1.9200-1(e)(2)(iv) of the proposed regulations, relating to the portion of stock basis which may be allocated to the basis of an operating authority when a qualified acquiring party acquires the stock of a corporation indirectly holding the authority. The final regulations indicate that one way that the authority could have been transferred to the acquired corporation so that the qualified acquiring party would have received direct ownership of the authority upon the liquidation of the acquired corporation, would have been by liquidating the subsidiary that directly holds the authority.

The formula in §1.9200-1(e)(2)(vi) has been revised to indicate that the decrease in the qualified acquiring party's stock basis should be based only on the additional amount of basis which is allocated to an authority under §1.9200-1(e)(2)(i), and not the total amount of basis in the authority after the allocation.

Section 1.9200-1(e)(2)(v) of the proposed regulations provided that intangible assets of the acquired corporation, such as goodwill and going concern value, must be taken into account when allocating the qualified acquiring party's stock basis to the operating authority under paragraphs (e)(2)(iii) or (iv) of §1.9200-1. The examples contained in §1.9200-1(g) have been revised in order to take into account the value of goodwill when allocating basis among the assets of the acquired corporation.

An example has been added to §1.9200-1(g) to illustrate how basis is to be allocated under a section 334(b)(2) liquidation if the amount a qualified acquiring party paid for the stock of an acquired corporation was less than the fair market value (net of liabilities) of the assets acquired in order to reflect a potential tax liability that would have been triggered in an actual liquidation under section 334(b)(2) (*e.g.* recapture under section 1245). The example indicates that the deemed basis which is to be allocated among the assets of the acquired corporation includes the potential tax liability. In order to take into account the potential tax liability such amount must be based on the same fair market values that are used to determine the amount of the stock basis allocable to the operating authority.

Finally, the proposed regulations under §1.9200-2(a) have been revised to provide more guidance concerning the information which must be included on the statement to be filed in support of the deduction, and the time such statement must be filed. The final regulations require any taxpayer who has claimed a deduction under §1.9200-1 to file the statement by June 4, 1984, unless it has already done so. In addition, paragraph (b) of §1.9200-2 has been revised to indicate that a taxpayer eligible to claim a deduction under §1.9200-1 who has filed returns without claiming the deduction, may file amended returns or claims for refund for the taxable year in which the taxpayer elects to begin the 60-month period, and for subsequent taxable years.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analyis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirement of 5 U.S.C. 533 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this regulation have been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

DRAFTING INFORMATION

The principal author of this regulation is Robert B. Coplan of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel

from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

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Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. The following new §§1.9200-1 and 1.9200-2 are added to read as follows:

§1.9200-1 Deduction for motor carrier operating authority.

(a) *In general.* Section 266 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34, 95 Stat. 265) provides that, for purposes of chapter 1 of the Internal Revenue Code of 1954, an ordinary deduction shall be allowed in computing the taxable income of all taxpayers who either held one or more motor carrier operating authorities on July 1, 1980, or later acquired a motor carrier operating authority pursuant to a binding contract in effect on July 1, 1980. The deduction for each motor carrier operating authority is to be allowed ratably over a 60-month period and is equal to the adjusted basis of the motor carrier operating authority on July 1, 1980. Except as provided in this section, no deduction is allowable for any diminution in value of any motor carrier operating authority caused by administrative or legislative actions to decrease restrictions on entry into the interstate motor carrier business.

(b) *Person entitled to claim deduction.* In general, the deduction provided by this section for a particular motor carrier operating authority may be claimed only by the taxpayer which held the authority on July 1, 1980. However, if another person acquired the motor carrier operating authority after July 1, 1980, pursuant to a binding contract in effect on that date, the deduction for such authority may be claimed only by the acquirer and may not be claimed by the taxpayer which held the authority on July 1, 1980. A taxpayer, otherwise entitled to claim a deduction under this section, who sells a motor carrier operating authority after July 1, 1980 may not claim an amortization deduction for such authority for any month which begins after the date of such sale. In addition, acquisition of a motor carrier operating authority after July 1, 1980, if not pursuant to a binding contract in effect on July 1, 1980, will not entitle the acquirer to a deduction under this section, unless the operating authority is acquired pursuant to a transaction to which section 381 applies.

(c) *Allowance of deduction*—(1) *Determination of period for deduction.*—(i) *General rule.* Except as provided in paragraph (c)(1)(ii) of this section, the 60-month period for taking the deduction provided by this section for a particular motor carrier operating authority begins with the month of July 1980, or, if later, the month in which the motor carrier operating authority was acquired pursuant to a binding contract in effect on July 1, 1980.

(ii) *Election.* In lieu of beginning the 60-month period as provided in paragraph (c)(1)(i) of this section, the taxpayer may elect to begin the 60-month period with the first month of the taxpayer's first taxable year beginning after July 1, 1980. This election, if made, shall apply to the deduction for all motor carrier operating authorities either held by the taxpayer on July 1, 1980, or later acquired by the taxpayer by the end of the first month of the first taxable year beginning after July 1, 1980, pursuant to a binding contract in effect on July 1, 1980. Any such election will not apply to the determination of the period for amortizing the bases of authorities acquired by the taxpayer after the end of the first month of the first taxable year beginning after July 1, 1980.

(2) *Amount of monthly deduction.* In the case of each motor carrier operating authority for which the taxpayer is entitled (under paragraph (b) of this section) to claim a deduction, the deduction for each month during the 60-month period relating to the motor carrier operating authority is equal to the adjusted basis (determined under paragraph (e) of this section) of the motor carrier operating authority divided by 60.

(d) *Definition of motor carrier-operating authority.* For purposes of §1.9200-2 and this section, the term "motor carrier operating authority" means a certificate or permit held by a motor common carrier or motor contract carrier of property and issued pursuant to the Revised Interstate Commerce Act, 49 U.S.C §10921-10933 (Sup. III 1979). The terms "motor common carrier" and "motor contract carrier" shall be defined as in 49 U.S.C. 10102 (Supp. III 1979) and do not include persons meeting the definition of freight forwarder contained in 49 U.S.C. 10102 (Supp. III 1979).

(e) *Adjusted basis of motor carrier operating authority.*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, the adjusted basis of a motor carrier operating authority for which a deduction is allowed under this section is the adjusted basis of the motor carrier operating authority as determined under sections 1012 and 1016 in the hands of the taxpayer who is entitled to claim the deduction under paragraph (b) of this section.

(2) *Special rule in case of certain stock acquisitions*—(i) *Election by holder.* A corporation entitled to claim a deduction under paragraph (b) of this section for a motor carrier operating authority may elect to allocate a portion of the cost basis of a qualified acquiring party in the stock of an acquired corporation, to the basis of the authority. A qualified acquiring party is a corporation (or a noncorporate person or group of noncorporate persons described in paragraph (e)(2)(ii) of this section) that after June 21, 1952, and on or before July 1, 1980 (or after July 1, 1980 under a binding contract in effect on such date) acquired by purchase, within the meaning of section 334(b)(3) and during a period of not more than 12 months, 80 percent or more of the stock (as described in sec-

tion 334(b)(2)(B)) of a corporation (the acquired corporation) which held the authority directly or indirectly on the date which is the end of the period of 12 months or less within which such 80 percent of the acquired corporation's stock was purchased. The election to allocate basis in an acquired corporation's stock to the basis in an authority may be made only if 80 percent of all classes of the acquired corporation's stock (other than nonvoting stock which is limited and preferred as to dividends) was acquired by purchase (within the meaning of section 334(b)(3)) during a period of not more than 12 months, as described in section 334(b)(2)(B). If the qualified acquiring party is a corporation, the taxpayer holding the authority on July 1, 1980, may elect the basis allocation of this paragraph only if it is a member of the affiliated group (as defined in section 1504(a)) of which the qualified acquiring party is a member. If there is more than one acquisition of stock that might permit an election to allocate basis under this paragraph (e)(2)(i), the taxpayer may elect to allocate to the authority only the basis in the acquired corporation's stock held by the qualified acquiring party which became a qualified acquiring party as a result of the last of such acquisitions.

(ii) *Certain noncorporate persons treated as qualified parties.* For purposes of paragraphs (e)(2)(i)-(vi) of this section, the term "qualified acquiring party" shall include a noncorporate person or group of noncorporate persons which, after June 21, 1952 and on or before July 1, 1980, acquired in one purchase, stock in a corporation (the acquired corporation) which at the time of acquisition held, directly or indirectly, a motor carrier operating authority. In order to be treated as a qualified acquiring party under this paragraph, a noncorporate person or group of noncorporate persons must have held stock constituting control (within the meaning of section 368(c)) of the acquired corporation on July 1, 1980. A group of noncorporate persons consists of two or more noncorporate persons who, acting together on the same date, made the required purchase of stock in the acquired corporation.

(iii) *Portion of stock basis allocable to basis of authority when stock of direct holder of authority is acquired.* If the qualified acquiring party acquired the stock of a corporation directly holding the authority, the portion of the stock basis allocable to the basis of the authority is the amount that would have been properly allocable under section 334(b)(2) if the qualified acquiring party were a corporation that had received the authority in a distribution of all the acquired corporation's assets in a complete liquidation of the acquired corporation immediately after the acquisition of the acquired corporation's stock. If the acquired corporation's stock was acquired on more than one date, the date on which the liquidation is deemed to have occurred shall be the date which is the date of the last acquisition by purchase of stock of the acquired corporation within the 12-month period described in section 334(b)(2)(B).

(iv) *Portion of stock basis allocable to basis of authority when stock of indirect holder of authority is acquired.* If the qualified acquiring party acquired the stock of a corporation indirectly holding the authority (such as by owning all of the stock of a subsidiary that directly holds the authority), a portion of the qualified acquiring party's cost basis in the stock of the acquired corporation may be allocated to the basis in the operating authority. The portion allocable is the amount that would have been properly allocable under section 334(b)(2) if, immediately before the liquidation of the acquired corporation on the date of the last acquisition by purchase of stock of the acquired corporation within the 12-month period described in section 334(b)(2)(B), the authority had been transferred in such a way (such as by liquidating the subsidiary that directly holds the authority) that the qualified acquiring party would have received direct ownership of the authority upon the liquidation of the acquired corporation immediately after the acquisition.

(v) *Other assets to be accounted for.* For purposes of paragraphs (e)(2)(iii) or (iv) of this section, in determining the portion of stock basis properly allocable to the operating authority under section 334(b)(2), the portion of the qualified acquiring party's basis in the acquired corporation's stock that would have been allocable following the liquidation to other assets of the acquired corporation, including intangible assets such as goodwill and going concern value, must be taken into account.

(vi) *Adjustments to basis in acquired corporation's stock and other assets.* If a taxpayer makes the election provided by paragraph (e)(2)(i) of this section, the qualified acquiring party's basis in the stock of the acquired corporation shall be decreased, effective as of July 1, 1980, by the amount determined by the following formula:

$$\frac{\text{basis in acquired corporation's stock}}{\text{basis in acquired corporation's stock plus unsecured liabilities of acquired corporation}} \times \text{amount allocated to basis in authority under section 334(b)(2) minus acquired corporation's basis in authority}$$

In addition, if the aggregate basis of the assets of the acquired corporation other than the authority as of July 1, 1980 (reduced by the liabilities secured by such assets) exceeds the qualified acquiring party's basis in the stock of the acquired corporation remaining after application of the preceding sentence, then the bases of such assets shall be reduced proportionately so that their aggregate basis as of such date (minus secured liabilities) is equal to such remaining stock basis. If the acquired corporation held the authority indirectly, appropriate basis reductions shall be made to reflect the transfers deemed to have occurred under paragraph (e)(iv) of this section.

(vii) *Pre-TEFRA law applies.* References made in this section to section

334 of the Code relate to such section as it existed before amendment by the Tax Equity and Fiscal Responsibility Act of 1982.

(f) *Adjustment to basis of motor carrier operating authority.* A taxpayer's basis in a motor carrier operating authority must be reduced by the amount of any amortization deductions allowable to the taxpayer under this section.

(g) *Examples.* The principles of this section may be illustrated by the following examples:

Example (1). (i) Corporation X acquired all the stock of corporation Y for $130,000 in 1970. Y's assets at the time of acquisition consisted of a motor carrier operating authority valued at $180,000 in which it has a basis of $60,000, trucks with a fair market value of $70,000 and an aggregate basis of $30,000, and goodwill valued at $30,000. Y has $50,000 of liabilities secured by the trucks and $100,000 of unsecured liabilities. Both X and Y use a June 30 fiscal year for tax purposes.

(ii) Y is the only taxpayer eligible to claim a deduction under §1.9200-1(b). If X sold its Y stock to Z in October 1980 (other than pursuant to a binding contract in effect on July 1, 1980), Y would continue to be the only taxpayer eligible to claim the deduction. However, if Y sold the operating authority to W in February 1981, neither Y nor W would be eligible to claim the monthly deduction for the remainder of the 60-month period. Also, Y would realize gain or loss on the sale after reducing its basis in the authority by any amortization claimed for the period prior to the sale.

(iii) Y must begin the 60-month period in July 1980 unless it elects under paragraph (c)(1)(ii) of this section to begin the 60-month period with the first month of the first taxable year beginning after July 1, 1980, which in Y's case would be July 1981.

(iv) Y's allowable monthly deduction is equal to its adjusted basis in the operating authority of $60,000, divided by 60, or $1,000. However, Y may elect under §1.9200-1(e)(2) to allocate to its basis in the authority a portion of X's basis in Y stock, since X is a qualified acquiring party under paragraph (e)(2)(i) of this section and Y is a member of an affiliated group of which X is a member. Assuming Y makes the election, Y may allocate to the basis of the authority the amount of X's basis in Y stock that would have been allocable under section 334(b)(2) if X had received the authority in a distribution of all of Y's assets in a complete liquidation of Y immediately after X acquired Y's stock. Therefore, for purposes of the allocation, X's $130,000 cost basis in Y stock is deemed to be increased by Y's $100,000 of unsecured liabilities to $230,000. Of the $230,000 deemed basis, $180,000 is allocated to the authority, $30,000 to goodwill and $20,000 to the trucks. Y's allowable monthly amortization deduction would be $180,000 divided by 60, or $3,000. X's $130,000 cost basis in its Y stock must be decreased to $62,174 as provided in paragraph (e)(2)(vi) of this section. Y's $30,000 aggregate basis in its trucks remains unchanged.

Example (2). Assume the same facts as in Example (1), except that Y's aggregate basis in the trucks is $120,000. If Y makes the election under §1.9200-1(e)(2), the same allocation as in Example (1) would occur. However, in addition to the decrease in X's basis in its Y stock to $62,174, the $120,000 aggregate basis in the trucks must be reduced to $112,174 (so that the $112,174 basis minus secured liabilities of $50,000 is equal to X's $62,174 remaining stock basis).

Example (3). Assume the same facts as in Example (1), except that X pays a negotiated purchase price of $120,000 for the Y stock, in order to take into account an anticipated tax liability of $10,000, relating to potential section 1245 recapture. If Y makes the election under §1.9200-1(e)(2), then for purposes of allocating X's basis in Y stock, X's cost basis is deemed to be increased by Y's $100,000 of unsecured liabilities as well as the $10,000 of potential tax liability resulting from section 1245 recapture, to $230,000. The $10,000 of potential recapture tax is treated as a general liability and the deemed basis is allocated among Y's assets as in Example (1). In order to take into account the potential recapture tax liability, such amount must be based on the same fair market values that are used to determine the amount of the stock basis allocable to the operating authority.

§1.9200-2 Manner of taking deduction.

(a) *In general.* The deduction provided by §1.9200-1 shall be taken by multiplying the amount of the monthly deduction determined under §1.9200-1(c)(2) for each motor carrier operating authority by the number of months in the taxable year for which the deduction is allowable, and entering the resulting amount at the appropriate place on the taxpayer's return for each year in which the deduction is properly claimed. Additionally, any taxpayer who has claimed the deduction provided by §1.9200-1 must (unless it has already filed a statement containing the required information) attach a statement to the next income tax return of the taxpayer which has a filing due date on or after June 4, 1984. The statement shall provide, in addition to the taxpayer's name, address, and taxpayer identification number, the following information for each motor carrier operating authority for which a deduction was claimed:

(1) the taxable year of the taxpayer for which the deduction was first claimed;

(2) whether the taxpayer's deduction was determined using the adjusted basis of the authority under section 1012 or an allocated stock basis under §1.9200-1(e)(2); and

(3) if an allocation of stock basis has been made under §1.9200-1(e)(2), the calculations made in determining the amount of basis to be allocated to the authority.

(b) *Filing and amendment of returns.* A taxpayer who has filed its return for the taxable year that includes July 1, 1980 claiming the deduction allowed under §1.9200-1, may amend its return for such year in order to elect under §1.9200-1(c)(1)(ii) to begin the 60-month period in the subsequent taxable year. A taxpayer eligible to take the deduction under §1.9200-1 who has filed its returns for both the taxable year that includes July 1, 1980 and the following taxable year without claiming the deduction, may claim the deduction by filing amended returns or claims for refund for the taxable year in which the taxpayer elects to begin the 60-month period, and for subsequent taxable years. If a taxpayer first claims the deduction on an amended return under the preceding sentence, the statement required by paragraph (a) of this section must be attached to such amended return.

(c) *Deduction taken for operating authority other than under §1.9200-1.* If a deduction other than the deduction allowed under §1.9200-1 was taken in any taxable year for the reduction in value of a motor carrier operating authority caused by administrative or legislative actions to decrease restrictions on entry into the interstate motor carrier business, the taxpayer should file an amended return for such taxable year which computes taxable income without regard to such deduction.

Approved by the Office of Management and Budget under control number 1545-0767.

Par. 2. Section 1.1502-32 is amended by removing the word "and" at the end of paragraph (d)(1)(i)(*b*), by adding ", and" in lieu of the period at the end of paragraph (d)(1)(i)(*c*), and by adding a new paragraph (d)(1)(i)(*d*) to read as follows:

§1.1502-32 Investment adjustment.

* * * * *

(d) ***

(1) ***

(i) ***

(*b*) ***

(*c*) ***, and

(*d*) In computing the earnings and profits of a member holding one or more motor carrier operating authorities who makes the election under §1.9200-1(e)(2), the annual amortization deduction allowed under §1.9200-1 shall not be taken into account.

This Treasury decision is issued under the authority contained in section 266 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34; 95 Stat. 265), section 517 of the Highway Revenue Act of 1982 (Pub. L. 97-424; 96 Stat. 2097), and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved February 16, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 5, 1984, 8:45 a.m., and published in the issue of the Federal Register for March 6, 1984, 49 F.R. 8246)

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26 CFR 35a.9999-1: Questions and answers concerning the due diligence requirement and the certification requirements in connection with backup withholding and other related issues.

T.D. 7929 [1]

TITLE 26.—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER C, PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983.

Backup Withholding

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to backup withholding. Changes to the applicable tax law were made by the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 369 [1983-2 C.B. 352]. These regulations affect payors and payees of, and brokers with respect to, reportable payments and provide them with the guidance necessary to comply with the law. This document also clarifies A-21 of §35a.9999-2 of the Temporary Employment Tax Regulations.

DATES: The temporary regulations are effective for payments made after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Yerachmiel Weinstein (at 202-566-3289 with respect to the foreign provisions), Bruce Jurist (at 202-566-3238 with respect to broker transactions), and Diane Kroupa (at 202-566-3590 with respect to all other provisions) of the Legislation and Regulations Division of the Office of Chief Counsel, Intrnal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 4, 1983, the FEDERAL REGISTER published Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983 (26 CFR Part 35a) under sections 3406 and 6676 of the Internal Revenue Code of 1954 (48 FR 45362) [T.D. 7916, 1983-2 C.B. 272]. Those amendments were published to conform the regulations to the statutory changes enacted by the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369). Section 3406 was added to the Internal Revenue Code of 1954 by section 104 of the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 371) [1983-2 C.B. 352, 353], and section 6676 of the Code was amended by section 105 of the Act (Pub. L. 98-67, 97 Stat. 380) [1983-2 C.B. 352, 358].

Additional temporary regulations relating to the requirement to impose backup withholding on reportable paymetns and the exercise of due diligence by payors of reportable interest, dividends, and patronage dividends and brokers were published in the FEDERAL REGISTER (48 FR 53104) on November 25, 1983 [T.D. 7922, 1983-2 C.B. 282].

This document, containing additional temporary regulations relating to the requirement to impose backup withholding, adds new §35a.9999-3 to Part 35a, Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983, to Title 26 of the Code of Federal Regulations. Because these provisions are generally effective for payments made after December 31, 1983, there is a need for immediate guidance so that payors and payees can prepare to comply with these provisions.

The Internal Revenue Service intends to publish a notice of proposed rulemaking in the FEDERAL REGISTER in the near future that will provide comprehensive rules regarding backup withholding. All pertinent provisions of the temporary regulations with respect to backup withholding will be incorporated in the notice of proposed rulemaking. The notice of proposed rulemaking will provide the public an opportunity to comment on the regulations. A public hearing will be held. Notice of the time and place of the public hearing will be published in the FEDERAL REGISTER. The temporary regulations contained in this document and §§35a.9999-1 and 35a.9999-2 will remain in effect until superseded by final regulations on this subject.

These temporary regulations, presented in question and answer format, are intended to provide guidelines upon which payors and payees of reportable payments (including reportable interest, dividend, and patronage dividend payments) may rely in order to resolve questions specifically set forth herein. However, no

[1] Also released as News Release IR-83-156, dated December 16, 1983.

inference should be drawn regarding issues not raised herein or reasons certain questions, and not others, are included in these regulations.

EXPLANATION OF PROVISIONS

The regulations provide additional guidance concerning the application of backup withholding to payments subject to reporting under section 6041 (relating to rents, royalties, commissions, etc.) section 6041A(a) (relating to nonemployee compensation), section 6042 (relating to dividends), section 6044 (relating to patronage dividends), section 6045 (relating to brokers and barter exchanges), section 6049 (relating to interest and original issue discount), and section 6050A (relating to certain fishing boat operators). A payment must be subject to information reporting under one of those provisions before backup withholding can apply. Thus, if a payment is not subject to information reporting, backup withholding cannot apply to the payment. With respect to payments subject to reporting under section 6041A(a), these regulations provide that the exceptions currently applicable under section 6041 shall apply until regulations are issued under section 6041A (LR-214-82). For example, payments made to certain corporations engaged in providing medical and health care services are not excepted from information reporting under sections 6041 or 6041A and also are not excepted from backup withholding if a condition for imposing withholding exists with respect to the payee.

In addition, these regulations provide that certain amounts that are subject to information reporting are not subject to backup withholding. For example, a premature withdrawal penalty with respect to a time savings account, a certificate of deposit, or similar deposit, does not reduce the amount of interest that is subject to information reporting, but, in the payor's discretion, only the net payment is subject to backup withholding. In addition, the regulations describe certain categories of dividends that are not subject to backup withholding.

Payments of interest to a mortgage escrow account at a financial institution and interest earned on certain premiums paid with respect to an insurance policy are reportable payments and thus may be subject to backup withholding. While such payments were exempt from 10 percent withholding on interest and dividends, the underlying purpose of backup withholding is to ensure that payees' taypayer identification numbers are provided on information returns in order to match the information with the payee's income tax return. Thus, such payments will be subject to backup withholding.

These regulations define "an obviously incorrect number", delineate how often withholding applies, and describe the penalties associated with backup withholding.

Special rules are provided with respect to readily tradable instruments. When a readily tradable instrument is acquired in a transaction between parties unrelated to the payor and without the assistance of a broker, no certification is required.

These regulations also provide special rules when an account is established directly with, or an instrument is acquired directly from, the payor. If acquisition is effected by means of electronic transfer, the payee, at the payor's option, is given 30 days after such acquisition to provide the required certifications before the payor is obligated to impose backup withholding on any reportable interest and dividends, provided that the payee furnishes a taxpayer identification number to the payor at the time of the acquisition. The payor must, however, withhold 20 percent of the reportable amount if the payee withdraws any funds before the certifications are recieved. If the acquisition is by means of mail communication, the special rule applies with respect to acquisitions before January 1, 1985.

The amount subject to backup withholding is generally the amount subject to information reporting. The amount subject to backup withholding with respect to patronage dividends and payments of certain fishing boat operators is limited generally to the amount paid in cash (or paid by qualified check in the case of patronage dividends). Special rules are provided to show the amount subject to backup withholding with respect to short sales, futures contracts, margin accounts, and foreign currency contracts.

In addition, the regulations explain that while withholding from an alternative source generally is not available to payors as under the now repealed provisions of 10 percent withholding on interest and dividends, payors of payments in property may withhold from an alternative source if the payee is subject to backup withholding.

The regulations prescribe rules governing the confidentiality of the information the payor receives in connection with backup withholding. In addition, the penalty associated with wrongful disclosure is described.

The regulations explain when withholding under section 3406(a)(1)(A) and (D) is required to stop. In general, if a payor is withholding because he has not received a taxpayer identification number or a required certification, the payor must stop withholding on the date that the payor receives a taxpayer identification number from the payee in the manner required or the date that the payor receives the required certification, as applicable. Under A-17 of §35a.9999-2 a payor has 30 days in which to treat a taxpayer identification number or required certification as having been received.

The regulations also explain the circumstances in which erroneously withheld amounts may be refunded to the payee. In general, a payor may refund taxes to the payee if, due to the payor's error, the payor improperly withholds. A payor may not refund taxes withheld due to a payee's error or failure to provide a taxpayer identification number or a required certification. For example, if a payor withholds because no taxpayer

identification number has been received by the payment date, the payor may not refund the tax to the payee even though the payee subsequently furnishes the taxpayer identification number in the manner required to the payor before an information return is required to be made. In this situation, the payor properly withheld. A payor may only refund the tax if the payor has made an error in withholding.

The regulations provide that if a payor is required to withhold, the payor is required to make an information return and is required to furnish a statement to the recipient showing the amount paid and the amount of tax withheld. Thus, the payor is required to make an information return whenever the payor imposes backup withholding even though the amount of the payment is less than the minimum amount that generally must be paid before an information return is required to be made.

The regulations also provide rules for determining whether a payor has exercised due diligence with respect to an account opened or an instrument acquired after December 31, 1983.

Several persons questioned whether various types of interest payments which are not subject to information reporting under section 6049 are, nevertheless, subject to backup withholding. If a payment is not subject to information reporting, it is not subject to backup withholding. These regulations generally do not change any information reporting responsibilities under section 6049. For example, interest which is exempt from taxation under section 103 (relating to certain governmental obligations) is not a reportable payment. If the holder of a tax exempt obligation provides written certification to the payor that the interest payment is exempt from taxation, the payor is not required to make an information return under §1.6049-5(b)(1)(ii). Because such a payment is not subject to information reporting, the payor is not required to impose backup withholding. Similarly, interest paid by an individual on its own obligation (*i.e.*, a mortgage) is not a reportable payment under §1.6049-5(b)(1)(i) and, accordingly, the individual has no backup withholding responsibilities. The result is the same irrespective of whether such interest is collected on behalf of the holder of the obligation by a middleman. Amounts paid with respect to repurchase agreements, however, are reportable under section 6049 and accordingly backup withholding applies to such reportable interest amounts. Thus, as with any account that is not a pre-1984 account, the payee is required to make the certifications described in A-32 of §35a.9999-1 with respect to repurchase agreements.

Clarification has also been requested with respect to the application of backup withholding to original issue discount. Answer 15 of §35a.9999-2 restates that the amount of original issue discount includible in the holder's gross income is treated as a payment of interest under section 6049(d)(6) and §1.6049-5(c). Original issue discount is, therefore, subject to backup withholding. Answer 15 of §35a.9999-2 also provides that the rules of 10 percent withholding on interest and dividends shall apply for purposes of determining the amount of original issue discount subject to backup withholding. Thus, backup withholding only applies to original issue discount when a cash payment is made to the payee, such as a payment of stated interest, or at redemption of the obligation at maturity. When interest payments are made on a long-term registered obligation with original issue discount, backup withholding applies to the stated interest plus the amount of original issue discount includible in the gross income of the holder during the calendar year (although the amount to be withheld cannot exceed the cash paid). In the case of a short-term obligation or a long-term obligation in bearer form, backup withholding with respect to original issue discount applies only at maturity of the obligation. At maturity of a long-term original issue discount obligation in bearer form, backup withholding applies only with respect to the amount of original issue discount includible in gross income of the holder for the calendar year in which the obligation matures.

If a person purchases an original issue discount obligation from another holder, the purchaser generally does not have to impose backup withholding. If, however, a broker was involved with respect to the sale of the obligation and was required to make an information return under section 6045, the broker would be required to impose backup withholding on the gross proceeds of the sale of the obligation. Similarly, if a person purchases a bond between interest payment dates, backup withholding generally only applies when the interest is paid. If, however, a broker was involved with respect to the sale of the obligation and was required to make an information return under section 6045, the broker would be required to impose backup withholding on the gross proceeds of the sale of the obligation.

Clarification has also been requested with respect to readily tradable instruments. A payor may assume that the taxpayer identification number received from a broker with respect to a readily tradable instrument is furnished in the manner required unless and until the broker notifies the payor otherwise as required in A-41 of §35a.9999-1. If the broker notifies the payor that the payee is subject to backup withholding, the payor generally is required to impose backup withholding and is required to notify the payee as provided in A-39 of §35a.9999-1 and A-18 of §35a.9999-2 that backup withholding has commenced, or will commence. For purposes of backup withholding, the term readily tradable instrument includes shares in a mutual fund. For purposes of A-41 of §35a.9999-1, the term "transfer instructions" includes account registration instructions transmitted by a broker with respect to acquisitions of shares in a mutual fund.

With respect to the manner of delivery of Forms 1099 of reportable interest or dividend payments made in

1984 and in subsequent years, a payor of such payments is required either to deliver personally an official Form 1099 or to mail the form in a separate first-class mailing to the payee. If a payor of reportable interest or dividends made in 1984 does not personally deliver or mail the Form 1099 in a separate first-class mailing to the payee, the payor shall be considered to have failed to furnish the required statement to the payee, and the payor will be subject to a $50 penalty for each failure under section 6678. The only material that may be included in the separate mailing of Form 1099 is information relating to solicitation of the payee's correct taxpayer identification number. Payors may not include Form 1099 in the same envelope used to mail a payment, such as where a United States savings bond is redeemed by mail. Payors are not required to send a separate Form 1099 for each interest or dividend payment but may aggregate payments made to a payee during a calendar year on one Form 1099. Payors will be allowed to use a substitute Form 1099 provided the specifications of the applicable Revenue Procedure are followed.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal authors of these regulations are Diane Kroupa, Bruce Jurist, Pam Olson, and Yerachmiel Weinstein of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

Adoption of amendments to the regulations.

Accordingly, Part 35a is amended as follows:

Paragraph 1. Section 35a.9999-3 is added immediately after §35a.9999-2 to read as follows:

§35a.9999-3 Questions and answers concerning backup withholding.

The following questions and answers principally concern the backup withholding requirement with respect to reportable payments. These requirements are issued under the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 369):

In general

Q-1. Who has the legal obligation to withhold on reportable payments made to a payee who is subject to backup withholding?

A-1. The person required to withhold (the payor) is the person who is required by the applicable provision to make an information return with respect to a payment under section 6041, 6041A(a), 6042, 6044, 6045, 6049, or 6050A. For example, in the case of a person who has a paying agent making a reportable payment to a payee, the paying agent is not the payor but is merely an agent for the principal (payor). In the case of a payment which is collected on behalf of, or for the account of, a payee, the payor ("middleman") is the person collecting or receiving the payment, irrespective of whether he is acting as the agent of the payee, or as agent for the issuer of the instrument. For example, a payee may establish a custodial account with a financial institution or brokerage firm where instruments are held for the benefit of the payee. The interest or dividends may be paid to a nominee of the financial institution or brokerage firm. The financial institution or brokerage firm will, in turn, credit the payee's custodial account. The financial institution or brokerage firm is the payor since it receives and credits payment to the payee's account and is required to make an information return showing such payment to the payee. See A-20 of §35a.9999-2 for special rules related to grantor trusts.

Q-2. What consequences result if a payor fails to withhold on payments made to a payee who is subject to backup withholding?

A-2. A payor is subject to the same requirements and penalties for failing to impose backup withholding as an employer making a payment of wages. Consequently, under section 3403 and §31.3403-1 of the Employment Taxes and Collection of Income Tax at Source Regulations, a payor is liable for the tax whether or not the payor withholds the tax from a payee who is subject to backup withholding. A payor may be relieved of liability for the tax which was required to be withheld if the payor can show that the tax has been paid by the payee, as provided in section 3402(d) and §31.3402(d)-1 of the Employment Taxes and Collection of Income Tax at Source Regulations. In addition to liability for the tax, a payor who fails to withhold when required may be subject to civil penalties under section 6651 (addition to the tax for failure to pay any tax required to be shown on the payor's return), section 6656 (penalty for failure to make deposit of taxes), and section 6672 (penalty for failure to collect and pay over tax) and to criminal penalties under section 7201 (penalty for willfully attempting to evade or defeat any tax or the payment of any tax), section 7202 (penalty for willful failure to collect or pay over any tax), and section 7203 (penalty for willful failure to pay tax). The fact that a payor shows that the tax has been paid by the payee will not relieve the payor of liability for any civil or criminal penalty. The payor is not liable to any person for any withheld amount. The payor will only be liable to the United States for the tax which

was required to be withheld as provided in §31.3403-1 of the Employment Taxes and Collection of Income Tax at Source Regulations.

Requirement to withhold

Q-3. Is a payor required to withhold if the taxpayer identification number furnished by a payee is an "obviously incorrect number"?

A-3. Yes. As provided in A-28 of §35a.9999-1, a payee shall be treated as having failed to furnish a taxpayer identification number to the payor if the number furnished is obviously incorrect. An obviously incorrect number is any taxpayer identification number that does not contain nine digits or a number that includes one or more alpha characters.

Q-4. When are payments considered to be paid and thus subject to backup withholding?

A-4. With respect to reportable interest or dividends, backup withholding applies when the payor pays interest, dividends, or patronage dividends to a payee who is subject to backup withholding. Amounts are paid when they are credited to the account of or set apart for the payee. Amounts are not considered paid solely because they may be withdrawn by the payee, so long as they are not credited to the payee's account, until either actual withdrawal or a specified crediting date.

Amounts are considered paid, however, upon withdrawal or crediting. If a bank credits interest on savings accounts only on the last day of each month or when the account is closed, then backup withholding applies at the time interest is paid on the last day of each month and when the account is closed.

When bonds are sold between interest payment dates, the portion of the sales price representing interest accrued to the date of sale is not considered to be a payment of interest for purposes of section 6049, but will be considered a reportable payment under section 6045. Therefore, if the gross proceeds of the sale are subject to backup withholding under A-12 of §35a.9999-2, 20 percent of the sales price, including the portion representing accrued interest, will be subject to backup withholding.

In the case of stock for which the record date is earlier than the payment date, the dividend is considered paid on the payment date. For example, if a corporation declares a dividend on September 1 to the record holders as of September 12, and the dividends are payable on October 12, backup withholding applies on October 12 (the payment date). In the case of a corporate reorganization, if a payee is required to exchange stock held in the former corporation for stock in the new corporation before the dividends which have been paid with respect to the stock in the new corporation will be provided to the payee, the dividend is considered paid on the payment date without regard to when the payee actually exchanges the stock and receives the dividend.

If a payor (such as a money market fund) computes interest or dividends daily but credits the interest or dividends on the last day of each month, then backup withholding applies on the last day of each month. If a payor computes *and* credits interest or dividends daily, backup withholding applies daily.

With respect to any reportable payment other than reportable interest or dividends, backup withholding applies at the time the payment is made or in the case of a transaction reportable under section 6045 when the amount subject to backup withholding is determined. Except in the case of forward contracts, regulated futures contracts, and security short sales, the amount subject to backup withholding in the case of a transaction reportable under section 6045 is determined on the date of the sale or exchange. See §1.6045-1(d)(4) and (f)(3) of the Income Tax Regulations for the applicable sale or exchange date and A-23 through A-25 and A-27 for special rules applicable to forward contracts, regulated futures contracts, security short sales, and issuer payment of debt securities. The date by which the payor is required to make an information return is irrelevant for purposes of determining when the payment is made and thus subject to backup withholding.

In the case of a middleman required to withhold tax, rules similar to §31.3453(b)-1(b) of the Employment Taxes and Collection of Income Tax at Source Regulations shall apply. In the case of a United States savings bond, see §1.6049-4(d)(9) of the Income Tax Regulations.

Payments and amounts subject to backup withholding

Q-5. Is interest paid on a mortgage escrow account with a financial institution or interest earned on certain premiums paid with respect to an insurance policy, subject to backup withholding?

A-5. Yes. Both a payment of interest to a mortgage escrow account with a financial institution and a payment that represents an increment in value of "advance premiums," "prepaid premiums," or "premium deposit funds" which is applied to the payment of premiums due on an insurance policy, or is made available for withdrawal by the policyholder, are subject to reporting under section 6049 and thus are subject to backup withholding.

Q-6. If a payor imposes a penalty for premature withdrawal of funds deposited in a time savings account, certificate of deposit, or similar class of deposit, is the payor required to calculate the tax to be withheld on the amount of the reportable interest payment (not reduced by any penalty)?

A-6. No. A payor may, at its option, take into account any penalty it actually imposes on a payee when it calculates the amount to be withheld. If the payor chooses to take the penalty into account, the amount subject to backup withholding would be the amount of interest the payee actually receives. The gross amount of the payment, however, is subject to information reporting.

Q-7. If a payor is able to estimate the portion of a distribution which is not a dividend, is the payor nevertheless required to impose backup with-

holding on the gross amount of the distribution?

A-7. If the payor is unable to determine the portion of a distribution which is a dividend, backup withholding applies to the entire amount of the distribution. If a payor is able reasonably to estimate the portion of the distribution which is not a dividend, however, backup withholding does not apply to such portion. A payor making a payment all or a portion of which may not be a dividend may use previous experience to estimate the portion of such payment which is not a dividend. An estimate of the portion of a distribution which is not a dividend shall be considered reasonable if the estimate does not exceed the proportion of the distributions made by the payor during the most recent calendar year for which Forms 1099 and 1087 were required to be filed which was not reported by the payor as a dividend.

Q-8. Are dividends which are reinvested in stock of the company subject to backup withholding?

A-8. Dividends which are reinvested pursuant to a qualified plan in stock of a public utility are not subject to backup withholding. For this purpose, the amount of the reinvested dividend paid to any person, the identity of the recipient, and whether the recipient makes the election required by section 305(e)(2)(B) are irrelevant. All other reinvested dividends are subject to backup withholding.

Backup withholding shall apply to the amount of any dividend available to the shareholder, or credited to the shareholder's account. At the discretion of the payor, backup withholding need not be applied (1) to any excess of the fair market value of the shares of stock received by the shareholder or credited to the shareholder's account over the purchase price of such shares (including additional shares acquired by the shareholder at a discount in connection with the dividend distribution) or (2) to any fee which is paid by the payor in the nature of a broker's fee for purchase of the stock or service charge for maintenance of the shareholder's account. The payor must, however, treat such excess amounts and fees on a consistent basis for each calendar year. Thus, the payor is not required to impose backup withholding on any amount in excess of the actual cash value of the dividend declared which the payee would have received had the payee not been a participant in the dividend reinvestment plan.

Q-9. Are there any payments of dividends that are not subject to backup withholding?

A-9. Yes. Backup withholding does not apply to—

(i) Any amount treated as a taxable dividend by reason of section 302 (relating to redemptions of stock).

(ii) Any amount treated as a taxable dividend by reason of section 306 (relating to disposition of certain stock).

(iii) Any amount treated as a taxable dividend by reason of section 356 (relating to receipt of additional consideration in connection with certain reorganizations).

(iv) Any amount treated as a taxable dividend by reason of section 1081(e)(2) (relating to certain distributions pursuant to an order of the Securities and Exchange Commission).

(v) Any amount which is an exempt-interest dividend, as defined in section 852(b)(5)(A), of a regulated investment company.

(vi) Any amount paid or treated as paid during a year by a regulated investment company, provided that the payor reasonably estimates, as provided in A-7, that 95 percent or more of all dividends paid or treated as paid during the year are exempt-interest dividends.

(vii) Any dividend that is reinvested pursuant to a qualified plan in stock of a public utility as provided in A-8.

The foregoing exceptions do not apply to backup withholding on gross proceeds reportable under section 6045.

Q-10. What amount of a payment reportable under section 6044 is subject to backup withholding?

A-10. If a payee fails to provide his taxpayer identification number or, for relationships with or memberships in a cooperative that are established after December 31, 1983, fails to provide a taxpayer identification number under penalties of perjury, the amount subject to backup withholding is any amount subject to reporting under section 6044, but only to the extent that the payment is made in money or by qualified check (as defined in section 1388(c)(4)). Thus, the payor shall withhold 20 percent of the amount paid in money or by qualified check to a payee who has failed to provide a taxpayer identification number in the manner required. For example, if a cooperative pays a patronage dividend of $2,000, consisting of $200 in cash, $300 by a qualified check and $1,500 in a qualified written notice of allocation, the amount subject to backup withholding is $500 (the amount paid in money and by qualified check). Thus, if the payee failed to provide a taxpayer identification number in the manner required, the cooperative would be required to withhold 20 percent of the $500.

If a payee (whose relationship with or membership in a cooperative was established after December 31, 1983) fails to certify that the payee is not subject to backup withholding due to notified payee underreporting, the amount subject to backup withholding is the amount of any payment reportable under section 6044 that is paid in money or by qualified check, but only if 50 percent or more of the reportable amount is paid in money or by qualified check. Therefore, in the case where there has been a payee certification failure, if a payment is made 50 percent or more in cash and by qualified check, the payor is required to withhold 20 percent of the amount of the cash and qualified check. If less than 50 percent of the payment is paid in cash or by qualified check, no amount is subject to backup withholding. For example, if a cooperative pays a patronage divi-

dend consisting of $350 in cash, $250 by a qualified check, and $400 in a qualified written notice of allocation, 20 percent of $600 (the amount paid in money and by qualified check) is required to be withheld if there is a payee certification failure. If $100 were paid in cash, $250 by a qualified check, and $650 in a qualified written notice of allocation, however, the payment would not be subject to backup withholding even though there is a payee certification failure because less than 50 percent of the patronage dividend is paid in cash or by qualified check.

Q-11. If a payor makes a reportable payment in property (other than money), is the payor required to impose backup withholding?

A-11. Yes. In the case of a payment that is made in property, backup withholding applies to the fair market value of the property determined on the date of payment except in the case of certain payments subject to reporting under section 6050A.

Q-12. If the payor is required to withhold on a payment made in property, in what manner may the payor withhold?

A-12. The payor may withhold on the principal amount being deposited with the payor, or the payor may withhold from another account or source maintained by the payor for the payee. The account or source from which such tax is withheld must be payable to at least one of the persons listed on the account subject to backup withholding. If the account or source is not payable solely to the same person or persons listed on the account subject to backup withholding, then the payor must obtain a written statement from all other persons to whom the account or source is payable authorizing the payor to withhold the tax from such account or source. The payor electing to withhold from an alternative source may determine the account or source from which the tax is to be withheld. The payor is liable for any tax that is required to be withheld if the recipient of the payment is subject to backup withholding. A payor may not withhold from an alternative source except with respect to payments in property.

Amounts subject to reporting under section 6041 or 6041A(a)

Q-13. Under what circumstances will a payment of a type subject to information reporting under section 6041 be exempt from backup withholding?

A-13. An information return is not required to be made with respect to payments described in §1.6041-3 of the Income Tax Regulations and, therefore, such payments are not subject to backup withholding. In addition, payments otherwise reportable under section 6041 that are made to the following persons will not be subject to backup withholding:

(i) An organization exempt from taxation under section 501(a), or an individual retirement plan,

(ii) The United States,

(iii) A State, the District of Columbia, a possession of the United States, or any political subdivision of any of the foregoing,

(iv) A foreign government or political subdivision of a foreign government,

(v) An international organization,

(vi) Any wholly owned agency or instrumentality of any person described in (ii), (iii), (iv), or (v), or

(vii) A foreign central bank of issue.

The provisions of §31.3452(c)-1 of the Employment Taxes and Collection of Income Tax at Source Regulations shall apply for the purpose of determining whether a payee to whom a payment is made is subject to information reporting and backup withholding. For example, during 1984, payor K, in the course of its trade or business makes a payment of rent of $700 to R Inc. for the use of premises owned by R Inc. Under §1.6041-3(c) of the Income Tax Regulations payments to a corporation are not subject to information reporting (except in the case of certain payments not relevant here). Under §31.3452(c)-1(b)(2) of the Employment Taxes and Collection of Income Tax at Source Regulations, K may treat R Inc. as a corporation because its name contains the unambiguous expression of corporate status, "Inc." Because the payment of rent to R Inc. is not subject to information reporting, it is not subject to backup withholding. If, however, K made the payment of rent to S Company, K would not be authorized to treat S Company as a corporation because "company" is not an unambiguous expression of corporate status. *See* §31.3452(c)-1(b)(2) of the Employment Taxes and Collection of Income Tax at Source Regulations. Accordingly, K would be required to make an information return with respect to the payment under secton 6041 and withhold 20 percent of the payment to S Company, if S Company did not furnish a taxpayer identification number to K.

Q-14. Do the exceptions under section 6041 and the regulations thereunder apply to payments subject to reporting under section 6041A(a)?

A-14. For purposes of both information reporting and backup withholding, the exceptions under section 6041 shall apply to payments of a type reportable under section 6041A until regulations are issued under section 6041A; the rules of A-13 shall apply to such payments. Thus, in general, payments of the type reportable under section 6041A(a) that are made to corporations or general agents are not subject to information reporting or backup withholding. (See A-15 relating to payments to certain medical corporations.)

Q-15. Does backup withholding apply to a payment reportable under section 6041 or section 6041A(a) that is paid to a corporation engaged in providing medical and health care services or engaged in the billing and collection of payments in respect of medical and health care services (other than certain tax-exempt or governmental facilities described in §1.6041-3(c)(1) and (2) of the Income Tax Regulations)?

A-15. Yes. Such amounts are subject to information reporting under

section 6041 and 6041A(a) and thus are subject to backup withholding. The exception from backup withholding for payments to exempt recipients (described in A-21 of §35a.9999-2) does not apply in the case of payments that are subject to reporting under sections 6041, 6041A(a) or 6050A.

Q-16. Does backup withholding apply to oil royalty payments that are subject to reporting under section 6041?

A-16. Backup withholding does not apply to an oil royalty payment if windfall profit tax is actually withheld under section 4986. If windfall profit tax is not actually withheld from the oil royalty payment (because, for example, payment is made with respect to "exempt royalty oil" (as defined in section 4993(f)), the oil royalty payment is subject to backup withholding. The amount subject to backup withholding is the amount the payee receives (*i.e.*, the gross proceeds less production related taxes such as State severance tax). The payor shall not be liable to any person other than the United States for the amount of tax withheld.

Q-17. Does backup withholding apply to net commissions paid to an unincorporated special agent with respect to insurance policies that are subject to reporting under section 6041?

A-17. Backup withholding does not apply to commissions reportable with respect to such an unincorporated special agent, provided that no cash is actually paid by the payor to the special agent.

Q-18. Does backup withholding apply to "designated distributions" (as defined in section 3405(d)(1)) if the distribution is not subject to reporting under section 6041?

A-18. No. As specified in A-30 of §35a.9999-1, backup withholding applies only to distributions from pensions, annuities, or other plans of deferred compensation that are subject to reporting under section 6041. Thus, the following distributions are among those exempt from backup withholding because they are not subject to reporting under section 6041: (1) distributions from an individual retirement account subject to reporting under sections 408(i) and 6047(d)); (2) distributions from an owner-employee plan (subject to reporting under section 6047(b)); (3) certain surrenders of life insurance contracts (subject to reporting under section 6047(e)); and (4) distributions from a qualified bond purchase plan (subject to reporting under section 6047(c)).

Q-19. Does backup withholding apply to payments of gambling winnings that are subject to reporting under section 6041?

A-19. Backup withholding does not apply to any portion of reportable gambling winnings with respect to which tax is actually withheld under section 3402(q). In any case in which the reportable gambling winnings are not withheld upon under section 3402(q), backup withholding applies. Thus, gambling winnings reportable under section 6041 are subject to backup withholding if the payee does not furnish a taxpayer identification number and the payment is not withheld upon under section 3402(q). Answer 11 of §35a.9999-2 does not apply to gambling winnings. Thus, the payor is not required to determine whether any of the three conditions specified therein applies with respect to the payee.

For purposes of information reporting and backup withholding, (1) the reportable gambling wnnings is the amount paid with respect to the amount of the wager reduced, at the option of the payor, by the amount of the wager, and (2) amounts paid with respect to identical wagers are treated as paid with respect to a single wager for purposes of calculating the amount of proceeds from a wager. The determination of whether amounts paid with respect to a single wager are identical shall be made under the rules of §31.3402(g)-1(c)(1)(ii) of the Employment Taxes and Collection of Income Tax at Source Regulations. In addition, until further regulations are issued, gambling winnings in excess of $600 are reportable only if the payout is based on betting odds of 300 to 1, or higher. The applicability of the odds requirement to information reporting and backup withholding is being studied by the Service and is subject to change in further regulations. Notwithstanding the odds requirement, winnings from bingo, keno, or slot machines are subject to backup withholding if reportable under §7.6041-1 of the temporary Income Tax Regulations.

Definition of a pre-1984 account

Q-20. Under what circumstances is an account or instrument treated as a pre-1984 account?

A-20. Answer 34 of §35a.9999-1 describes generally the accounts and instruments that are treated as a pre-1984 account. In addition, the purchase of additional shares in a credit union, where a prime account existed before 1984, shall be considered a pre-1984 account. If funds taken from one account, in existence prior to January 1, 1984, are used to create a new account on or after such date, however, the new account generally does not constitute a pre-1984 account. For example, with respect to a disposition of shares in a mutual fund and the purchase of shares of another fund within a group of mutual funds which occurs after December 31, 1983, the shares acquired in the second fund are not reated as a pre-1984 account unless the payee owned shares in the second fund prior to January 1, 1984.

If a shareholder is enrolled before January 1, 1984, in a dividend reinvestment program to purchase additional shares of the corporation sponsoring the program, the shares acquired through the program are considered a pre-1984 account, in the discretion of the payor. In the case of a qualified employee trust that distributes instruments in kind, any instrument distributed from the trust will be considered a pre-1984 account with respect to employees who were participants in the plan before January 1, 1984. Similarly, when a payor

offers participants in a plan the opportunity to purchase stock of the payor after a specified time using the money that the payee invested during that period of time, the stock so purchased after December 31, 1983, shall be considered a pre-1984 account with respect to participants in the plan who either owned shares or invested money in the plan before January 1, 1984.

An instrument with respect to which a broker is the payor is a pre-1984 account if the brokerage account in which the instrument is held is not a "post-1983 account." Answer 41 of §35a.9999-1 describes generally the manner of determining whether a brokerage relationship is a post-1983 account. In addition, a brokerage relationship will not be treated as a post-1983 account if (1) a broker redeems or repurchases securities which were acquired by the seller prior to January 1, 1984, and (ii) either (A) the issuer of the securities is the broker obligated to make an information return under section 6045 or (B) the broker was obligated during 1983 to redeem the securities.

Brokerage accounts and transactions

Q-21. Does backup withholding apply to bonds the interest from which is exempt from taxation under section 103?

A-21. Interest on a tax-exempt obligation is not reportable under section 6049 if the payee provides a written certification to the payor (other than the issuer) that interest on the obligation is exempt from tax. See §1.6049-5(b)(1)(ii) of the Income Tax Regulations. If the interest is not reportable under section 6049, it is not subject to backup withholding. A broker, however, is required to report the gross proceeds of a sale of a tax-exempt bond (including redemption of the bond at maturity) under section 6045. Thus, the gross proceeds from the sale of such a bond are subject to backup withholding. Any accrued and unpaid tax-exempt interest included in the sales proceeds is not reportable under §1.6045-1(d)(3) of the Income Tax Regulations. Accordingly, backup withholding is not required with respect to the portion of the proceeds of the sale that represents accrued tax-exempt interest.

Q-22. Does backup withholding apply to a redemption of a share in a mutual fund?

A-22. Generally, yes. A redemption of shares of a mutual fund (other than a redemption at an issue price described in §1.6045-1(c)(3)(iv) of the Income Tax Regulations) is a reportable payment under section 6045, and thus the gross proceeds are subject to backup withholding if the fund is considered a broker or a broker is otherwise involved.

Q-23. What amounts are subject to backup withholding upon the disposition of forward contracts or regulated futures contracts?

A-23. If a customer is subject to backup withholding with respect to an account containing forward contracts or regulated futures contracts, the broker must withhold 20 percent of the following amounts:

(i) All cash or property withdrawn from the account by the customer during the year. A withdrawal includes the use of money or property in the account to purchase any property other than property acquired in connection with the closing of a contract. For this purpose, the acceptance of a warehouse receipt or other taking delivery to close a contract is in connection with the closing of a contract only if the property acquired is disposed of by the close of the seventh trading day following the trading day that the customer takes delivery under the contract. In addition, the making delivery to close a contract is in connection with the closing of a contract only if the broker is able to determine that the property used to close the contract was acquired no earlier than the seventh trading day prior to the trading day on which delivery is made. Cash withdrawals do not include repayments of debt incurred in connection with a making or taking delivery that meets the requirements of the preceding three sentences. A withdrawal also does not include payments of variation margin, commissions, fees, a transfer of cash from the account to another futures account that is subject to the rules of this A-23, or cash withdrawals traceable to dispositions of property other than futures (not including profit on the contract separately reportable under §1.6045-1(c)(5)(i)(*b*) of the Income Tax Regulations).

(ii) The amount of cash in the account available for withdrawal by the customer at the relevant year-end (as described in §1.6045-1(c)(5) of the Income Tax Regulations).

The payor must include the amount withheld and the amounts subject to withholding, in addition to the amounts otherwise reportable under section 6045, on the Form 1099-B filed with respect to a customer who is subject to backup withholding. The determination of whether the customer is subject to backup withholding should be made at the time of (1) the cash or property withdrawals or (2) the relevant year end, whichever is applicable.

Q-24. What amount is subject to backup withholding with respect to security sales made through a margin account?

A-24. The amount subject to backup withholding in the case of a security sale made through a margin account (as defined in 12 CFR section 220 (Regulation T)) is the gross proceeds (as defined in §1.6045-1(d)(5) of the Income Tax Regulations) on such sale. The amount required to be withheld with respect to such a sale, however, is limited to the amount of cash available for withdrawal by the customer immediately after the settlement of the sale. For this purpose, the amount available for withdrawal by the customer does not include amounts required to satisfy margin maintenance under: Regulation T, rules and regulations of the National Association of Securities Dealers and national securities exchanges, and generally applicable self-imposed rules of the margin account carrier. Thus, for example, if the broker forces a customer sale to meet the requirements of Regulation T (a

maintenance call), none of the proceeds of such a sale are subject to backup withholding (except to the extent of the fractional amount of the last share sold which exceeds the amount needed to meet the Regulation T margin requirement).

Q-25. What amount is subject to backup withholding with respect to security short sales?

A-25. The amount subject to backup withholding with respect to a short sale of securities is ordinarily the gross proceeds (as defined in §1.6045-1(d)(5) of the Income Tax Regulations) on such short sale. At the option of the broker, however, the amount subject to backup withholding may be in the gain upon the closing of the short sale (if any) and the obligation to withhold can be deferred until the closing. A broker may use this alternative method of determining the amount subject to backup withholding with respect to a short sale only if at the time the short sale is initiated the broker expects that the amount of gain realized upon the closing of the short sale will be determinable from the broker's records. If, due to events unforeseen at the time the short sale was initiated, the broker is unable to determine the basis of the property used to close the short sale, the property shall be assumed to have a basis of zero. The determination of whether a short sale is subject to backup withholding shall be made on the date (1) of the initiation or closing, as the case may be, or (2) that the initiating or closing, as the case may be, is entered on the broker's books and records.

Q-26. How does backup withholding apply to foreign currency contracts (as defined in section 1256(g))?

A-26. In general, brokers shall report with respect to foreign currency contracts in accordance with the rules for reporting with respect to regulated futures contracts (see §1.6045-1(c)(5)). For purposes of §1.6045-1(c)(5)(i)(*b*) of the Income Tax Regulations realized profit (or loss) from a foreign currency contract is determined—

(1) In the case of making or taking delivery, by comparing the contract price to the spot price for the contract currency at the time and place specified in the contract, and

(2) In the case of a closing by entry into an offsetting contract, by comparing the contract price to the price of the offsetting contract.

For purposes of §1.6045-1(c)(5)(i)(*c*) and (*d*), unrealized profit in a foreign currency contract is determined by comparing the contract price to the broker's price for similar contracts at the close of business of the relevant year. Appropriate additions will be made to §1.6045-1(c) of the Income Tax Regulations in the near future. For rules determining the amount subject to backup withholding under §1.6045-1(c)(5), see A-23.

Q-27. When does backup withholding apply to payments arising as a result of the retirement or redemption of a debt security subject to reporting under section 6045?

A-27. In general, backup withholding applies on the sale date under §1.6045-1(d)(4) of the Income Tax Regulations. Additionally, a broker that is also the obligor on a debt security may elect to apply backup withholding on the payment date. Such a broker must determine whether backup withholding applies on the same date (either sale date or payment date) with respect to all similarly situated payees.

Special rules with respect to readily tradable instruments

Q-28. Do special rules apply if an account or instrument is acquired directly from the payor of reportable interest or dividends after December 31, 1983?

A-28. Yes. Special rules apply depending on the manner in which the instrument is acquired. In the case of a readily tradable instrument acquired directly from the payor by means of electronic transmission (*e.g.*, telephone or wire transfer), the payee, at the payor's option, shall be given 30 days after such acquisition to provide the certifications required in A-32 of §35a.9999-1, before the payor is required to impose backup withholding on the reportable interest or dividends, *provided* that the payee furnishes a taxpayer identification number to the payor at the time of the acquisition. If the payee withdraws any of the interest or dividends before the certifications are received, however, the payor must withhold 20 percent of the reportable amounts. For purposes of the preceding sentence, all cash withdrawals in an amount up to the reportable amounts are assumed to be interest or dividends. In addition, the payor must commence withholding on all reportable interest or dividends in connection with the instrument or account 30 days after the acquisition, if the payee has not provided the required certifications to the payor by such date.

The special rule described in the preceding paragraph shall also apply to acquisitions that are effected before January 1, 1985, by mail communication. With respect to accounts or instruments acquired by mail on or after January 1, 1985, the payor is required to impose backup withholding on the reportable interest or dividend payments if the payee has not provided the required certifications at the time that the first reportable payment is made.

Q-28A. Do special rules apply if a broker sells securities for a customer pursuant to a telephone instruction, in circumstances in which the customer failed to provide a certified taxpayer identification number as required by A-12 of §35a.9999-2?

A-28A. Yes. The customer, at the payor's option, shall be given 30 days after the date of the sale to furnish a certification as required by A-12 of §35a.9999-2, provided that (1) the payee furnishes his taxpayer identification number before the sale and (2) the customer does not withdraw the proceeds of the sale prior to the time the required certification is provided (or backup withholding is applied). For purposes of the preceding sentence, an investment of the cash proceeds of the sale in other property shall be considered a withdrawal by the customer; however, investment in other property shall be permitted if,

at all times, at least 20 percent of all gross proceeds reportable under section 6045 are held in cash by the broker. If the customer does not provide the required certification within 30 days after the date of the sale, the broker must withhold 20 percent of all reportable gross proceeds on the 31st day after the date of the sale.

Q-29. If a readily tradable instrument is transferred in a transaction between parties unrelated to the payor of the instrument without the assistance of a broker, is the transferee required to certify either the correctness of the taxpayer identification number or that the transferee is not subject to backup withholding due to notified payee underreporting?

A-29. No. Certification is not required in the case of a transfer of a readily tradable instrument between parties unrelated to the payor if the parties act without the assistance of a broker.

Q-30. If a bond in bearer form is redeemed by the obligor after December 31, 1983, is the payee required to certify under penalties of perjury the correctness of the payee's taxpayer identification number?

A-30. Yes. The redemption of such an obligation is subject to reporting under section 6045 if a broker is otherwise involved. However, the redemption of an interest coupon is considered a window transaction as provided in A-42 of §35a.9999-1, so the payee is not required to certify the correctness of the taxpayer identification number.

Foreign transactions

Q-31. What representations must a person make, on a certificate signed under penalties of perjury, to establish that he is an exempt foreign person under §1.6045-1(g)(1) of the Income Tax Regulations and, consequently, that the gross proceeds of his broker transactions are not section 6045 reportable payments which may be subject to backup withholding?

A-31. In order to be treated as an exempt foreign person under §1.6045-1(g)(1) of the Income Tax Regulations with respect to transactions effected by a broker during a calendar year, a customer will only be required to certify to the broker the following: (1) that the foreign person is neither a citizen nor a resident of the United States, (2) that the foreign person has not been, and at the time the statement is furnished reasonably expects not to be, present in the United States for a period aggregating 183 or more days during the calendar year, and (3) that the foreign person is not, and at the time the statement is furnished reasonably expects not to be, engaged in a United States trade for business with respect to which any gain derived from transactions effected by the broker during that calendar year is effectively connected. In lieu of making the certifications in (2) or (3) of the preceding sentence, the person may instead certify that he is a beneficiary of an income tax treaty to which the United States is a party and pursuant to which gains from his broker transactions are exempt from Federal income taxation. A person may make this latter certification only if all conditions to the exemption provided by the treaty are actually satisfied.

In accordance with the foregoing, the Service will amend §1.6045-1(g) of the Income Tax Regulations to indicate that a foreign person need make no express representations to a broker concerning the application of section 877 or section 6013(g) or (h) (although a person with respect to whom a section 6013(g) or (h) election is in effect may not make the representation in (1) above that he is not a resident of the United States). These amendments will apply with respect to substitute forms prepared by the broker, as well as to the Form W-8 (which is being developed by the Service for use under the requirements both of §1.6049-5(b)(2)(iv) and §1.6045-1(g)(1) of the Income Tax Regulations). Subject to A-32, all other provisions of §1.6045-1(g) of the Income Tax Regulations will remain in effect.

Q-32. Must a foreign office of a United States broker obtain the statement described in §1.6045-1(g)(1) of the Income Tax Regulations and A-31 from a foreign person having an account at that office in order to treat such person as an exempt foreign person under §1.6045-1(g)(1) of the Income Tax Regulations?

A-32. As currently provided in §1.6045-1(g)(1) of the Income Tax Regulations, a foreign office of a United States broker may treat a customer as an exempt foreign person if it receives a certificate, signed under penalties of perjury, in accordance with §1.6045-1(g)(1) of the Income Tax Regulations. However, the Service will also permit a person to be treated as an exempt foreign person with respect to transactions effected on his behalf by a foreign office of the broker if either of the following conditions is satisfied: (1) during the calendar year in which such transactions are effected, the broker withholds tax on any amount, including interest and dividends, paid to such person under subchapter A of chapter 3 of the Code in accordance with the provisions of chapter 3; or (2) the broker, in accordance with §1.1441-6(b) or (c) of the Income Tax Regulations, has received from such person a Form 1001 (Ownership, Exemption or Reduced Rate Certificate) or special variation thereof that is in effect with respect to any amounts (including interest) that are or may be paid to such person during the calendar year in which the transactions are effected. These alternatives to obtaining the certificate described in §1.6045-1(g)(1) of the Income Tax Regulations only apply, however, if payments the broker makes with respect to transactions effected on behalf of such person are made only outside the United States and if such person has no account with a branch of the broker in the United States. Section 1.6045-1(g) of the Income Tax Regulations will be amended to reflect this modification.

Q-33. With respect to payments of United States source original issue discount on obligations having maturities of six months or less from the date of original issue, must a payor obtain the statement described in

§1.6049-5(b)(2)(iv) of the Income Tax Regulations from a payee who is neither a citizen nor a resident of the United States in order to avoid section 6049 information reporting and the possible application of backup withholding?

A-33. Generally, when making payments of United States source interest or original issue discount to a payee who is a foreign person, the payor need not obtain the certificate described in §1.6049-5(b)(2)(iv) of the Income Tax Regulations since the payor usually either withholds tax on the amounts paid in accordance with subchapter A of chapter 3 of the Code or obtains a Form 1001 from the payee with respect to such payments. See §1.6049-5(b)(2)(i) and (ii) of the Income Tax Regulations. However, as original issue discount on obligations having maturities of six months or less from the date of original issue is not subject to United States tax when paid to a foreign person, there is neither withholding under subchapter A of chapter 3 of the Code nor the receipt of a Form 1001 with respect to such amount. In order to treat original issue discount on obligations having maturities of six months or less from the date of original issue the same under §1.6049-5(b)(2) of the Income Tax Regulations as interest and original issue discount on other obligations, the Service will allow a payee who is a foreign person to substitute a Form 1001 for the statement described in §1.6049-5(b)(2)(iv) of the Income Tax Regulations with respect to original issue discount on obligations having maturities of six months or less from the date of original issue. Despite the substitution of the Form 1001 for the Form W-8 or substitute form prepared by the payor, all other procedures of §1.6049-5(b)(2)(iv) of the Income Tax Regulations will apply.

Section 1.6049-5(b)(2) of the Income Tax Regulations will be amended to reflect the modifications made by this A-33.

Q-34. Are payments of foreign source interest made on deposits outside the United States by a foreign branch of a United States bank reportable payments that may be subject to backup withholding?

A-34. As provided in §1.6049-5(b)(1)(ix) of the Income Tax Regulations, such payments are not required to be reported under section 6049. However, except to the extent such payments are less than $600 in a taxable year or are made to persons who are neither citizens nor residents of the United States, they are subject to information reporting under section 6041(a).

For purposes of section 6041(a), a foreign branch of a United States bank may treat a person as being neither a citizen nor a resident of the United States if the bank has evidence in its records to such effect (provided it does not have actual knowledge that the evidence is false). Such evidence may include a written indication from the payee (*e.g.*, appearing on an account application form) that the payee is neither a citizen nor a resident of the United States or an affidavit from an employee of the United States bank stating that the employee knows that, or that the payee has represented orally that, he is neither a citizen nor a resident of the United States. The mere fact, however, that the payee has provided an address outside the United States is insufficient evidence to establish for this purpose that the payee is neither a citizen nor a resident of the United States.

Foreign source interest payments made on deposits outside the United States by foreign branches of United States banks to United States persons, although reportable payments under section 6041(a), will not be subject to backup withholding beginning January 1, 1984. However, the issue of whether backup withholding should be applied with respect to such payments is presently under further consideration. If backup withholding is subsequently determined to be appropriate, such will be provided in future regulations. Backup withholding, in that case, would apply no earlier than July 1, 1984, and would apply on a prospective basis only. Payments of interest on deposits of United States persons with foreign branches of foreign banks similarly will not be subject to backup withholding beginning January 1, 1984.

Q-35. In the case of a payment to joint payees, must a payor obtain the statement described in §1.6049-5(b)(2)(iv) of the Income Tax Regulations (or other verification of foreign status described in §1.6049-5(b)(2)(ii) or (iii) of the Income Tax Regulations) with respect to each payee in order for such payment to be exempt from information reporting under §1.6049-5(b)(1)(vi) of the Income Tax Regulations and from the possible application of backup withholding?

A-35. Yes. In order for a payment to be exempt from information reporting under §1.6049-5(b)(1)(vi) of the Income Tax Regulations (and in order not to constitute a reportable payment to which backup withholding may apply), the payor must ascertain in accordance with the provisions of §1.6049-5(b)(2) of the Income Tax Regulations that each payee is a foreign person. A broker similarly must verify the independent status of each person on a joint account as an exempt foreign person in accordance with the provisions of §1.6045-1(g)(1) of the Income Tax Regulations, and of A-31 and A-32, in order to exempt transactions effected on behalf of such account from section 6045 information reporting and from the possible application of backup withholding.

If the first payee named on the account, but not every joint payee, provides the verification of foreign status referred to in this A-35, backup withholding shall commence unless any one of the joint payees has provided a taxpayer identification number to the payor in the manner otherwise required in §§35a.9999-1 and 35a.9999-2. This is contrary to the general rule of section 3406(h)(3), which would require backup withholding to commence unless a taxpayer identification number is obtained from the first payee listed in the payment.

Q-36. In order to avoid information reporting under section 6042 and

the possible application of backup withholding, must a payor of United States source dividends to a person having an address outside the United States obtain from such a person a statement, signed under penalties of perjury, that the person is neither a citizen nor a resident of the United States?

A-36. No. The regulations under section 6042 exempt from information reporting any United States source dividends that are subject to withholding under section 1441 or section 1442 or that would be subject to such withholding either but for the provisions of a treaty or but for the fact of the application of §1.1441-4(a) or (f) of the Income Tax Regulations (relating to income effectively connected with a United States trade or business). See §1.6042-3(b)(2) of the Income Tax Regulations. The regulations under section 1441 indicate that, absent definite knowledge of the status of a payee, a payor of United States source dividends may determine whether withholding is required under section 1441 (absent the receipt of a Form 4224 evidencing effectively connected income) or whether a payee is entitled to exemption from such withholding under the applicable provisions of a treaty by reference to the address of the payee. See §1.1441-3(b)(3) of the Income Tax Regulations. Therefore, provided a payor does not have definite knowledge that a payee is a United States person, the payor may treat payments of United States source dividends to a payee with a foreign address as exempt from information reporting under section 6042 and from the possible application of backup withholding. (Note, however, that the use of the address method of purposes of section 1441 is under reconsideration in accordance with the provisions of section 342 of the Tax Equity and Fiscal Responsibility Act of 1982. Future elimination of such a method could impact prospectively on the requirement of backup withholding with respect to dividends).

Payments of dividends to United States persons by a foreign corporation which are not exempt from information reporting under §1.6042-3(b)(1) (relating to payments by a foreign corporation that is not engaged in business in the United States and that does not have an office or place of business or a fiscal or paying agent in the United States) will nevertheless not be subject to backup withholding beginning January 1, 1984. However, the issue of whether backup withholding should be applied with respect to such payments is presently under further consideration. If backup withholding is determined to be appropriate, such will be provided in future regulations. Backup withholding, in that case, would apply no earlier than July 1, 1984, and would apply on a prospective basis only.

Q-37. With respect to a payment of interest that would be subject to information reporting under section 6049 but for the fact that it is made outside the United States, how is the place of payment to be determined?

A-37. For purposes of the reporting requirements of section 6049 and backup withholding, the place of payment of interest is considered to be the place where the payor or middleman completes the acts necessary to effect payment. The fact that payment is made from an account with a United States office of a United States or foreign bank by means of a draft drawn on the bank or by a wire or other electronic transfer from an account with the United States office of the bank is not alone determinative of the place of payment. Similarly, the fact that payment is made by means of a transfer into an account of the payee with a United States office of a United States or foreign bank, whether by means of a wire or other electronic transfer, is not determinative of the place of payment, unless such office is expressly authorized by the payee to act as agent for collection of the interest or unless the records of such office otherwise reasonably evidence the nature of the funds transferred as interest and the amount of such interest.

Subject to the foregoing provisions concerning the receipt of wire and other electronic transfers, a bank or similar financial institution is generally considered to complete the acts necessary to effect payment of interest on its deposits at the branch or office at which it credits the interest to the account of the payee or at which payment is made in cash. However, in no event shall interest be considered to be paid for purposes of section 6049 at a branch or office of the financial institution unless all the following conditions are met: (1) the branch or office is a permanent place of business which is regularly maintained, occupied, and used to carry on a banking or similar financial business, (2) the business is conducted by at least one employee of the branch or office who is regularly in attendance at such place of business during normal business hours, and (3) the branch or office receives deposits of funds from the public and in addition also engages in one or more of the other activities listed in §1.864-4(c)(5)(i) of the Income Tax Regulations.

In the case of a coupon bond (including a certificate of deposit with detachable interest coupons), the acts necessary to effect payment of interest are considered to be completed within the United States either if: (1) a coupon is presented to a payor or middleman within the United States (regardless of whether the funds paid are credited to an account of the payee maintained outside the United States); or (2) the coupon is presented at an office of a payor or middleman outside the United States but the interest on the coupon is credited to an account of the payee maintained with another office of the payor or middleman within the United States. The application of the provisions of this A-37 will be illustrated by examples to be published in future regulations.

Refund of erroneously withheld amounts

Q-38. What action should a payor take if the payor erroneously imposes backup withholding?

A-38. If a payor, through its own error, withholds tax or withholds more than the proper amount of the tax, the payor may refund the amount erroneously withheld as provided in section 6413 and A-39. A payor shall be considered to have withheld erroneously only if the amount is withheld because of an error by the payor (*e.g.*, an error in "flagging" or identifying an account that is subject to backup withholding). If the payor requires a payee described in §31.3452(c)-1(b) through (p) of the Employment Taxes and Collection of Income Tax at Source Regulations (*e.g.*, a corporation) to certify as to its status as exempt from backup withholding, the payee fails to make the required certification, and the payor subsequently withholds the tax from a payment to such payee, the payor may, in its discretion, treat the amount withheld as an amount erroneously withheld and refund it to the payee. The result is the same if the payor does not require such a payee to certify as to its status and the payor withholds.

If a payor withholds from a payee after the payee provides a taxpayer identification number or required certification to the payor but before the payor has processed the number or required certification (*i.e.*, prior to the time that the payor is treated as having received the number or certification under A-17 of §35a.9999-2), the payor may, at its discretion, treat the amount withheld as an amount erroneously withheld and refund it to the payee. If a payor withholds, however, because the payor has not received a taxpayer identification number or required certification and the payee subsequently provides a taxpayer identification number or the required certification to the payor, the payor may not refund the tax to the payee because the payor properly imposed backup withholding. The amount withheld is a credit against tax that the payee may take into account in computing estimated tax payments and may claim on the payee's income tax return.

Q-39. In what manner should a payor treat erroneously withheld tax?

A-39. If a payor withholds from a payee in error or withholds more than the correct amount of tax, the payor may refund the amount improperly withheld to the payee so long as the refund is made prior to the end of the calendar year and prior to the time the payor furnishes a Form 1099 to the payee with respect to the payment for which the improper withholding occurred. If the amount of the improper withholding is refunded to the payee, the payor shall keep as part of its records a receipt showing the date and amount of refund. For this purpose, a cancelled check or an entry in a statement, a copy of which is provided to the payee by the payor, will suffice for a receipt showing the refund of tax improperly withheld provided that the check or statement contains a specific notation that it is a refund of tax improperly withheld.

If the payor has not deposited the amount of the tax prior to the time that the refund is made to the payee, the payor shall not deposit the amount of the tax improperly withheld. If the amount of the improperly withheld tax has been deposited prior to the time that the refund is made to the payee, the payor may adjust any subsequent deposit of tax collected under chaper 24 of the Code which the payor is required to make in the amount of the tax which has been refunded to the payee. A payor shall not report on a Form 1099 as tax withheld any amount of tax which the payor has refunded to a payee.

Q-40. If a "middleman" payor of reportable interest or dividends (*e.g.*, a broker holding stock in "street name") receives a payment a portion of which was improperly withheld upon prior to payment to the "middleman" payor, what action may the "middleman" take?

A-40. A middleman who receives a payment (referred to as a "receiving payor") from which tax has been improperly withheld may seek a refund of the tax withheld by the payor from whom the receiving payor received the payment (referred to as the "upstream payor") or, alternatively may obtain a refund of the tax by claiming a credit for the amount of tax withheld by the upstream payor against the deposit of any tax collected under chapter 24 of the Code which the receiving payor is required to withhold and deposit. The receiving payor shall make or credit the gross amount of the payment (including the tax withheld) to its payee as though it had received the gross amount of the payment from the upstream payor and shall withhold the tax if any of the conditions for imposing backup withholding exist with respect to its payee.

When backup withholding stops

Q-41. When may a payor stop withholding?

A-41. If a payee is subject to backup withholding because the payee failed to furnish a taxpayer identification number in the manner required, the payor is required to withhold until a taxpayer identification number is received from the payee in the manner required. Once the payor receives the payee's taxpayer identification number in the manner required, the payor must stop withholding. See A-17 of §35a.9999-2 for determining when a payor is treated as having received a taxpayer identification number. The same rule applies with respect to a payee certification failure under section 3406(a)(1)(D). If more than one condition applies for imposing backup withholding, a payor is required to withhold until all of the conditions for imposing backup withholding cease to apply.

Confidentiality

Q-42. What use may a payor make of information obtained under the backup withholding rules?

A-42. A payor may use information obtained under the backup withholding rules (including any information with respect to any payee certification failure other than failure to certify the payee's taxpayer identification number) only for the purposes of complying with the backup withholding and information reporting requirements, or to the extent otherwise

permitted by the Code. Any other use of this information may subject the payor to civil damages under section 7431 of at least $1,000 plus the cost of the action.

Q-43. May a payor impose a surcharge to cover the cost of backup withholdng on an account?

A-43. No. If the payor imposes a surcharge on such an account, the payor is liable to the payee under section 7431 for an unauthorized use of information obtained by the payor under section 3406.

Q-44. If a payor imposes backup withholding on a payee, may the payor use this information in determining whether to extend credit to the payee?

A-44. No. If the payor uses this information in making its decision, the payor is liable to the payee under section 7431 for an unauthorized use of information obtained pursuant to section 3406.

Q-45. If a payor is notified to begin withholding on payments made with respect to a payee and the payor provides notice to the payee of the withholding, has the payor made an unauthorized disclosure under section 7431?

A-45. No. If, for example, a payor receives a notice from a broker of the requirement to withhold with respect to a payee and the payor, pursuant to A-39 of §35a.9999-1 and A-18 of §35a.9999-2, provides notice to the payee of such withholding, the payor has no liability to the payee under section 7431.

Miscellaneous

Q-46. If a payor withholds on any payment and the payment is less than the minimum amount for which an information return is required, is the payor required to make an information return and furnish a statement to the recipient?

A-46. Yes. Whenever the payor imposes backup withholding, the payor is required to make an information return regardless of the amount of the payment. The information return shall show the payee's name, address, and taxpayer identification number, the amount of the payment (or aggregate payments to the payee during the calendar year), and the amount of tax withheld. The information return must be provided to the Service no later than February 28 of the year following the calendar year of payment. In addition, the payor is required to furnish a statement to the payee showing the same information, including the amount of tax withheld no later than January 31 of the year following the calendar year of payment.

Q-47. Does backup withholding apply to partnerships?

A-47. Backup withholding generally will apply to a payment to a partnership if the partnership does not provide its correct employer identification number to the payor in the manner required. In addition, the partnership will be required to withhold on all reportable payments that a partnership makes to a payee who is subject to backup withholding. Distributions by a partnership to its partners of their distributive share of partnership income, however, are not reportable payments, so that backup withholding does not apply to such distributions, except to the extent such distributions are reportable under section 6045.

Q-48. May payors require that a separate Form W-9 be filed for each account or instrument held by a payee?

A-48. Yes. See A-29 of §35a.9999.1. However, a payor at its option, may require a payee to file only one Form W-9 for all accounts or instruments of the payee. For example, a bank may permit a payee to file one Form W-9 for all savings, interest-bearing checking, or other accounts the payee has with the bank. In addition, a payee of a mutual fund that has a common investment advisor or common principal underwriter with other mutual funds will be permitted, in the discretion of the mutual fund, to provide one Form W-9 with respect to shares acquired or owned in any of the funds.

Q-49. Do the general rules for deposit, payment, penalties, and reporting of taxes withheld from wages apply to backup withholding?

A-49. Yes. Section 3406(h)(1) provides generally that payments subject to backup withholding shall be treated as wages. Thus, the general procedures for withholding, deposit, payment, and reporting of Federal tax withheld shall apply to payments subject to backup withholding. For example, section 6205 provides that an employer (payor) who makes an undercollection of income tax required to be withheld shall correct such error for the return period in which the undercollection is ascertained. Accordingly, section 6205 requires the employer (payor) to withhold amounts from subsequent payments to the employee (payee) that should have been withheld from prior payments, whether or not such subsequent payments are subject to withholding. Thus, a payor who does not impose backup withholding when required must withhold from subsequent payments to the payee even though the conditions for imposing backup withholding may not exist at the time the subsequent payment is made to the payee.

Q-50. If a payor uses a single employer identification number to report the tax withheld by all its subsidiaries, must all tax withheld with respect to reportable payments by its subsidiaries be aggregated for purposes of determining when tax withheld by them with respect to reportable payments must be deposited under section 6302?

A-50. Yes. All tax withheld under a single emplyer identification number with respect to reportable payments must be aggregated for purposes of determining when such tax must be deposited.

Q-51. In order for a payor of a reportable interest or dividend payment to be considered to have exercised due diligence in furnishing the correct taxpayer identification number of a payee with respect to an account opened or an instrument acquired after December 31, 1983, what actions must the payor take?

A-51. In general, the payor of an

account or instrument that is not a pre-1984 account (as defined in A-34 of §35a.9999-1 and A-19) must use a taxpayer identification number provided by the payee under penalties of perjury to satisfy the due diligence requirement. Therefore, if, after 1983, a payor permits a payee to open an account without providing proper certification that the taxpayer identification number furnished is correct, and a Form 1099 is filed by the payor with a missing or incorrect number, the payor will be liable for the $50 penalty.

A payor also will be considered to have exercised due diligence with respect to a readily tradable instrument that is not a pre-1984 account if the payor (1) uses a taxpayer identification number furnished by a broker or (2) records on its books a transfer to which the payor was not a party. In addition, a payor with respect to an account or instrument that is not a pre-1984 account wll be considered to have exercised due diligence if the payee has compiled with the requirements of A-18 of §35a.9999-2 (exception for a payee who is waiting for receipt of a taxpayer identification number), provided that the payor imposes backup withholding if the payee fails to provide a taxpayer identification number in the manner and within the period required by A-18 of §35a.9999-2.

When a broker notifies the payor that a payee failed to certify or furnish a taxpayer identification number, the payor will be considered to have exercised due diligence if the payor: (1) imposes backup withholding if the payee did not certify his taxpayer identification number to the payor, (2) provides notice to the payee as provided in A-39 of §35a.9999-1 and A-18 of §35a.9999-2, and (3) encloses a postage paid reply envelope.

In addition, to have exercised due diligence, a payor must use the same care in processing a certified taxpayer identification number provided by a payee that a reasonably prudent payor would use in the course of the payor's business in handling account information, such as account numbers and account balances. With respect to window transactions (as defined in A-42 of §35a.9999-1 and A-9 of §35a.9999-2), a payor shall be considered to have exercised due diligence only if it uses the taxpayer identification number provided by the payee. If no number is provided, the payor will not be considered to have exercised due diligence.

Q-52. Does the rule of A-5 of §35a.9999-2 which allows a payor to deliver the mailings described in A-5 and A-6 of §35a.9999-1 in person or by intra-office mail, apply with respect to mailings requesting a penalties of perjury statement from foreign payees described in A-52 and A-55 of §35a.9999-1?

A-52. Yes. A payor or broker may deliver the mailings requesting the penalties of perjury statement from foreign payees described in A-52 and A-55 of §35a.9999-1 provided the mailings are delivered by the same method used by the payor or broker in sending account activity and balance information and other correspondence to the payee.

Par. 2. The second sentence of A-21 of §35a.9999-2 is amended to provide as follows: Backup withholding also is not required with respect to any other reportable payment made to an exempt recipient described in §31.3452(c)-1(b) through (p) of the Employment Taxes and Collection of Income Tax at Source Regulations, except in the case of (1) payments with respect to barter exchange transactions reportable under section 6045, and (2) payments reportable under sections 6041, 6041A, and 6050A.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 3406(a), (b), (c), (e), (g), (h), and (i), section 6041, section 6041A(a), section 6042(a), section 6044(a), section 6045, section 6049(a), (b), and (d), section 6103(q), section 6109, section 6302(c), section 6676, and section 7805 of the Internal Revenue Code of 1954 (97 Stat. 371, 372, 373, 376, 377, 378, 379, 26 U.S.C. 3406(a), (b), (c), (e), (g), (h), and (i); 68A Stat. 745, 26 U.S.C. 6041; 96 Stat. 601, 26 U.S.C. 6041A(a); 96 Stat. 587, 26 U.S.C. 6042(a); 96 Stat. 587, 26 U.S.C. 6044(a); 96 Stat. 600, 26 U.S.C. 6045; 96 Stat. 592, 594, 26 U.S.C. 6049(a), (b), and (d); 90 Stat. 1685, 26 U.S.C. 6103(q); 75 Stat. 828, 26 U.S.C. 6109; 68A Stat. 775, 26 U.S.C. 6302(c); 68A Stat. 917, 26 U.S.C. 7805) and in sections 104, 105, and 108 of the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369, 371, 380, and 383).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 16, 1983.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury

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26 CFR 35a.9999-3: Questions and answers concerning the due diligence requirement and the certification requirements in connection with backup withholding and other related issues.

T.D. 7933

TITLE 26.—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER C, PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Backup Withholding.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document supple-

ments the temporary regulations relating to backup withholding. Changes to the applicable tax law were made by the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 369) [1983-2 C.B. 352]. These regulations affect brokers with respect to reportable gross proceeds and provide them with the guidance necessary to comply with the law.

DATE: The temporary regulations are effective for payments made after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Diane Kroupa of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3590, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 4, 1983, the FEDERAL REGISTER published Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983 (26 CFR Part 35a) and under sections 3406 and 6676 of the Internal Revenue Code of 1954 (26 CFR Part 35a.9999-1; 48 FR 45362) [T.D. 7916, 1983-2 C.B. 272]. Additional temporary regulations were published in the FEDERAL REGISTER on November 25, 1983 (26 CFR Part 35a.9999-2; 48 FR 53104) [T.D. 7922, 1983-2 C.B. 282] and on December 20, 1983 (26 CFR Part 35a.9999-3; 48 FR 56330) [T.D. 7929, page 285, this Bulletin]. Those regulations were published to conform the regulations to the statutory changes enacted by the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369). These regulations supplement 26 CFR Part 35a.9999-3 (December 20, 1983), by adding Question (Q) and A-28B.

These temporary regulations, presented in question and answer format, are intended to provide guidelines upon which brokers may rely in order to resolve questions specifically set forth herein. However, no inference should be drawn regarding issues not raised herein or reasons certain questions, and not others, are included in these regulations.

EXPLANATION OF PROVISIONS

These regulations provide transition rules applicable to backup withholding on gross proceeds reportable by brokers under section 6045. In summary, the regulations provide that, for purposes of backup withholding on gross proceeds, the written certification requirement for post-1983 accounts may be delayed, at the broker's option, until March 31, 1984. Thus, a customer who opens an account after December 31, 1983, and who consummates a sale prior to April 1, 1984, will not be subject to backup withholding, provided that he furnishes a taxpayer identification number to the broker prior to the sale.

In addition, until March 31, 1984, a broker may give customers with pre-1984 accounts, who have not furnished taxpayer identification numbers, 30 days after a sale to provide their numbers, without being subject to backup withholding. Until such a customer provides a number, however, the customer is not permitted to withdraw the cash proceeds from the account. If no number is furnished within 30 days after the sale, the broker must withhold 20 percent of the reportable gross proceeds on the 31st day.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal author of these regulations is Diane Kroupa of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, 26 CFR Part 35a is amended as follows:

Section 35a.9999-3 is amended by adding new Question (Q) and A-28B immediately after A-28A of that section. These added provisions read as follows:

§35a.9999-3 Questions and answers concerning backup withholding.

* * * * *

Q-28B. Will transition rules apply to backup withholding on gross proceeds reportable by brokers under section 6045?

A-28B. Yes. The following transition rules will apply until April 1, 1984. First, for purposes of backup withholding on gross proceeds reportable by brokers, the penalties of perjury certification required by A-12 of §35a.9999-2 (for post-1983 accounts) may be waived, at the broker's option, until April 1, 1984. A customer who opens an account after December 31, 1983, and who consummates a sale prior to April 1, 1984, will not be subject to backup withholding, provided that the customer furnishes a taxpayer identification number to the broker prior to the sale. The gross proceeds from sales made through post-1983 accounts after March 31, 1984, however, will be subject to backup withholding if the customer does not provide a taxpayer identification number certified under penalties of perjury. See A-28A for special rules applicable when a sale is made

pursuant to a telephone instruction. Second, until April 1, 1984, the gross proceeds from a sale made through a pre-1984 account, by a customer who has not provided a taxpayer identification number, will not be subject to backup withholding, at the broker's option, provided that (1) the customer furnishes his number to the broker within 30 days after the date of the sale, and (2) the customer does not withdraw the proceeds of the sale prior to the time his taxpayer identification number is furnished to the broker (or backup withholding is applied). For purposes of the preceding sentence, an investment of the cash proceeds shall be considered a withdrawal by the customer; however, investment of the proceeds in other property shall be permitted if, at all times during the 30-day period, at least 20 percent of all gross proceeds reportable under section 6045 are held in cash within the customer's account by the broker. If the customer does not furnish his taxpayer identification number within 30 days after the date of sale, the broker must withhold 20 percent of all reportable gross proceeds on the 31st day after the date of the sale.

If, with respect to forward contracts, regulated futures contracts, security short sales, or issuer payment of debt securities, the broker applies backup withholding on a date other than the sale date (see A-23 through A-25 and A-27), the rules of this A-28B shall apply as if any date on which the broker determines whether backup withholding applies were a sale date.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 3406(a), (b), (c), (e), (g), (h), and (i) and section 6045 of the Internal Revenue Code of 1954 (97 Stat. 371, 372, 373, 376, 377, 378, 379, 26 U.S.C. 3406(a), (b), (c), (e), (g), (h), and (i); 96 Stat. 600, 26 U.S.C. 6045) and in section 104 of the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369, 371).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved December 29, 1983.

RONALD A. PEARLMAN,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 29, 1983; 4:48 p.m., and published in the issue of the Federal Register for January 3, 1984, 49 F.R. 62)

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26 CFR 35a.9999-3A: Question and answer relating to exemption from backup withholding for certain principal payments made outside the United States by brokers on certain obligations.

T.D. 7946

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C—PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Backup withholding of principal payments made outside the United States by brokers on obligations the interest payments on which are foreign source income

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the exemption from backup withholding for principal payments made outside the United States by brokers on obligations the interest payments on which are foreign source income. These temporary regulations are intended to modify, amend, and clarify temporary regulations on backup withholding published in the FEDERAL REGISTER for December 20, 1983 (§35a.9999-3; 48 FR 56330). [T.D. 7929, page 285, this Bulletin]. These regulations affect brokers making principal payments on obligations outside the United States and provide the public with the guidance necessary to comply with the law.

DATES: The Temporary regulations are effective for payments made after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Yerachmiel Weinstein of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (202-566-3289, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 20, 1983, the FEDERAL REGISTER published Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983 (26 CRF Part 35a) [Pub. L. 98-67, 1983-2 C.B. 352] under section 3406 of the Internal Revenue Code of 1954 (48 FR 56330) [T.D. 7929, page 285, this Bulletin] (December 20 regulations). Among the provisions contained in the December 20 regulations were provisions dealing with the treatment of payments of interest and of the proceeds of broker transactions made to foreign persons.

The regulations under section 6049 exempt foreign source interest payment made outside the United States from information reporting. The regulations prescribe this result for such payments without regard to whether they are made to foreign persons. The regulations under section 6045, however, presently contain no such exemption for payments made outside the United States of the proceeds of broker transactions.

This disparity in treatment can lead to anomalous results, particularly since transactions subject to information reporting are potentially subject to backup withholding. This anomaly becomes most apparent in the case of obligations the interest on which constitutes foreign source income and the

principal on which is paid outside the United States. In such a situation, the regulations under section 6049 assure that the interest payments made outside the United States will be exempt from information reporting and backup withholding, while the regulations under section 6045 do not similarly exempt the principal payments on the same obligation.

The Treasury Department has determined that this inconsistency of treatment of payments on a single obligation should be subjected to further study and should be eliminated for the present. The Treasury Department is providing for the time being in this temporary regulation that payments of principal made outside the United States on an obligation will be exempt from information reporting under section 6045 and from backup withholding if the interest on that obligation is from foreign sources. In making the determination of whether interest on an obligation is from foreign sources, rules similar to those contained in §1.6049-5(b)(3)(i) will apply. This exemption applies whether the payments are made to a foreign person or to a United States person. Any future change to this rule will apply no earlier than July 1, 1984, and will apply on a prospective basis only.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 20, 1983.

REGULATORY FLEXIBILITY ACT

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for this regulation. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal author of this regulation is Yerachmiel E. Weinstein of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

* * * * *

Adoption of amendments to the regulations.

Accordingly, Part 35a is amended by the addition of a new section 35a.9999-3A immediately after §35a.9999-3 to read as follows:

Part 35a—Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983

§35a.9999-3A Question and answer relating to exemption from backup withholding for certain principal payments made outside the United States by brokers on certain obligations.

The following question and answer concerns the exemption from information reporting and backup withholding for certain principal payments on obligations made outside the United States. The question and answer is issued under the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 369):

Q. Are payments of principal on obligations subject to information reporting under section 6045 or to backup withholding if made outside the United States?

A. Such payments are not subject to section 6045 information reporting or backup withholding if made with respect to obligations the interest on which would be from sources outside the United States. The determination of whether a payment of principal is made outside the United States for this purpose shall be determined under rules similar to those contained in A-37 of §35a.9999-3 of the regulations.

The issue of whether information reporting and backup withholding should apply with respect to these payments remains under consideration by the Treasury Department. If information reporting and backup withholding are subsequently determined to be appropriate, such will be provided in future regulations. Information reporting and backup withholding will apply in that case no earlier than July 1, 1984, and will apply on a prospective basis only.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. Taxpayers have communicated to the Department of the Treasury an urgent need for a rule providing certainty in the treatment of payments they will be obligated to make in the immediate future in the ordinary course of their trade or business. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 3406(b), (g), (h), and (i), section 6045, and section 7805 of the Internal Revenue Code of 1954 (97 Stat. 372, 377, 378, 379, 26 U.S.C. 3406(b), (g), (h), and (i); 96 Stat. 600, 26 U.S.C. 6045; 68A Stat. 917, 26 U.S.C. 7805) and in section 104 of the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

Approved February 22, 1984.

JOHN E. CHAPOTON,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 27, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 28, 1984, 49 F.R. 7226)

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Subpart A.—Tax Conventions

United States-Austria Income Tax Convention

1957-2 C.B. 985

U.S.-Austria Income Tax Convention; exemption for interest paid to Austrian bank. Payments of interest by U.S. citizens on mortgage loans secured by personal property are exempt from United States income taxation under Article VII of the United States-Austria Income Tax Convention.

Rev. Rul. 84-84

ISSUE

Whether payments of interest to *BK* by United States citizens on mortgage loans secured by personal property are exempt from United States income taxation under Article VII of the United States-Austria Income Tax Convention (the Convention), 1957-2 C.B. 985?

FACTS

BK is an Austrian corporation engaged in the business of commercial banking in Austria. During 1982 and in the ordinary course of its business, *BK* made interest-bearing mortgage loans to United States citizens. These loans were secured by the borrowers' personal property located in the United States.

BK has neither a branch office nor any other fixed place of business within the United States. *BK* is not engaged in a trade or business in the United States through an agent or employee who has full power to negotiate and conclude contracts in the United States. Under the Convention, *BK* is not considered to have a permanent establishment in the United States.

LAW AND ANALYSIS

Section 894(a) of the Code states that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from U.S. taxation.

Article VII of the Convention states that interest received from sources within one of the contracting States, on bonds, notes, debentures, securities or any other form of indebtedness (exclusive of interest on debts secured by mortgages) by a resident or corporation or other entity of the other contracting State shall be exempt from tax by the former State if such resident, corporation, or other entity has no permanent establishment in such former State.

Article IX(1) of the Convention states that income from real property (including gains derived from the sale or exchange of such property and interest on mortgages secured by such property) and royalties in respect of the operation of mines, oil wells, or other natural resources shall be taxable in the contracting State in which such property, mines, oil wells, or other natural resources are situated.

Under the taxing structure of the Convention, Article VII is the general provision covering interest. Article VII, however, excludes from its application interest on debts secured by mortgages. Under Article IX(1), which encompasses income derived from real property, "interest on mortgages secured by such [real] property" is taxable where the property is located. Articles VII and IX complement each other and provide, among other things, for the tax treatment of all interest paid to Austrian entities that do not have permanent establishments in the United States. Therefore, the scope of the Article VII exemption for interest applies to all interest except for interest on mortgages secured by real property that, pursuant to Article IX, is specifically subject to tax in the contracting state in which the mortgaged real property is situated. That is, the parenthetical mortgages exception appearing in Article VII includes only interest on loans secured by *real* property mortgages. Under the facts of this revenue ruling, the loans are secured by *personal* property and, thus, the parenthetical mortgages exception in Article VII is inapplicable.

HOLDING

Payments of interest to *BK* by United States citizens on mortgage loans secured by personal property are exempt from United States income taxation under Article VII of the Convention.

United States-France Income Tax Convention 1968-2 C.B. 691.

Rate of tax for a dividend paid by a United States corporation to its French corporate shareholder. A dividend received from a U.S. corporation by a French corporate shareholder that owns, directly, at least ten percent of the outstanding shares of the voting stock of the U.S. corporation during the part of the paying corporation's taxable year that precedes the date of payment of the dividend and during the whole of its prior taxable year (if any) is subject to a tax not exceeding 5 percent of the amount actually distributed in accordance with Article 9(2)(b) of the U.S.-France Income Tax Convention.

Rev. Rul. 84-21

ISSUE

Whether a dividend paid by a United States corporation to its French corporate shareholders is subject to the reduced rate of tax of five percent of the amount actually distributed as provided by Article 9(2)(b) of the Income Tax Convention between the United States and France (the French Convention), 1968-2 C.B. 691.

FACTS

FX, *FY* and *FZ* are French corporations that own all of the outstanding stock of *X*, a domestic corporation. *FX* and *FY* each own 3 percent and *FZ* owns 94 percent of the voting stock of *X*. *FZ* also owns 99 percent of the outstanding stock of both *FX* and *FY*. The stock ownership of *FX*, *FY*, *FZ* and *X* has remained the same for 3 years prior to July 1, 1983.

On July 1, 1983, *X* paid a cash dividend to *FX*, *FY* and *FZ*. *X* uses the

calendar year as its taxable year. *X*'s gross income for the 1982 taxable year did not include any dividend or interest income. *FX*, *FY* and *FZ* do not have a permanent establishment in the United States.

LAW AND ANALYSIS

Article 9(2)(a) of the French Convention provides that dividends derived from sources within a Contracting State by a resident of the other Contracting State may be taxed by the former Contracting State, but the tax imposed on such dividends shall not exceed 15 percent of the amount actually distributed. Article 9(2)(b) of the French Convention provides, in part, that when the recipient of the dividend is a corporation, the rate of tax imposed by the former Contracting State shall not exceed 5 percent of the amount actually distributed if— During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least ten percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation.

The term "owned" as used in Article 9(2)(b) of the French Convention is not defined in the Convention. There is nothing in the language of Article 9 or in the history of the French Convention to indicate that the term "owned" should be interpreted to include any type of ownership other than direct ownership.

Article 2(2) of the Convention provides, in part, that any term not otherwise defined shall, unless the context otherwise requires, have the meaning that it has under the laws of the Contracting State relating to the taxes that are the subject of the Convention. Generally, when the federal income tax laws require ownership of a certain percentage of voting stock, they mean "own" in the ordinary, common sense understanding of the term; namely, actual or outright ownership. *See*, for example, *Trotz v. Commissioner*, 361 F.2d 927 (10th Cir. 1966). Rev. Rul. 81-132, 1981-1 C.B. 603, holds that in a comparable provision of the U.S. - Netherlands Tax Convention the terms "owning" and "owned" mean direct ownership. Therefore, indirect ownership such as parent-subsidiary stock attribution, will not be considered in determining whether the stock ownership requirements of Article 9(2)(b) of the French Convention have been met.

In the present case, *FX* and *FY* each owned directly only 3 percent of the voting stock of *X* during the part of *X*'s taxable year preceding payment of the dividend and during the whole of its prior taxable year. *FZ* owned directly 94 percent of the voting stock of *X* during the same period.

HOLDING

The dividends paid to *FX* and *FY* are subject to a rate of tax not exceeding 15 percent of the amount actually distributed in accordance with Article 9(2)(a) of the French Convention. The dividend paid to *FZ* is subject to a rate of tax not exceeding 5 percent of the amount actually distributed in accordance with Article 9(2)(b) of the French Convention.

1977-1 C.B. 416
(Also Part I, Sections 864, 894; 1.864-4, 1.894-1.)

Poland; election; gain and loss; business activities of permanent and nonpermanent establishment. A taxpayer cannot elect the provisions of the United States-Polish People's Republic Income Tax Convention with respect to the taxability of business gain that is in part attributable to a permanent establishment and in part not attributable thereto, while in the same taxable year elect the provisions of the Code with respect to a nonattributable business loss. Rev. Rul. 81-78 amplified.

Rev. Rul. 84-17

ISSUE

Whether a taxpayer can elect the provisions of the United States-Polish People's Republic Income Tax Convention (the Convention), 1977-1 C.B. 416, with respect to the taxability of business gain that is in part attributable to a permanent establishment and in part not attributable thereto, while in the same taxable year elect the provisions of the Internal Revenue Code with respect to a nonattributable business loss under the circumstances described below.

FACTS

In Rev. Rul. 81-78, 1981-1 C.B. 604, a Polish corporation (the taxpayer) markets two entirely different products in the United States through separate and unrelated business activities. One business activity, the manufacturing and marketing of product *a* both in the United States and abroad, constitutes a permanent establishment in the United States within the meaning of Article 6 of the Convention. The profits attributable to the activity of the permanent establishment are taxable by the United States under Article 8(1) of the Convention. The profits attributable to the second business activity, the manufacturing of the product *b* in Poland and the sale of the product through an independent contractor in the United States and abroad, are not taxable under the Convention by the United States since the activity does not constitute a permanent establishment in the United States.

Assume that the facts of Rev. Rul. 81-78 apply in the subsequent taxable year. In addition to the manufacture and sale of products *a* and *b*, the taxpayer manufactures product *c* in its home office in Poland and sells the product through another independent contractor in the United States. The manufacture and sale of product *c* are wholly independent of the taxpayer's operations through the permanent establishment in the United States and from the sale of product *b* in the United States through an independent contractor. In the taxable year in question, the taxpayer has gain from the manufacture and sale of product *a* through the permanent establishment, gain on the sale of product *b*, and a loss from the sale of product *c* in the United States. The gain or loss from the sale of products *b* and *c* in the United States is not attributable to a permanent establishment in the United States, but, like the income

from the sale of product *a*, is effectively connected with the conduct of a trade or business in the United States within the meaning of sections 882(a) and 864(c)(3) of the Internal Revenue Code.

The taxpayer claimed the provisions of the Convention with respect to the gain-producing activities, involving products *a* and *b*, so that the gain from the permanent establishment was subject to United States income taxation and the gain from the sale of product *b* was exempt from United States income taxation. The taxpayer claimed the provisions of the Code with respect to the loss producing activity so that the loss from the sale of product *c* was used to offset the product *a* gain from the permanent establishment in determining the taxpayer's United States income tax liability.

LAW AND ANALYSIS

Section 882(a) of the Code provides that a foreign corporation engaged in a trade or business within the United States during the taxable year shall be taxable as provided in section 11 or 1201(a) on its taxable income that is effectively connected with the conduct of a trade or business within the United States.

Section 864(c)(3) of the Code provides that all income, gain, or loss from sources within the United States (other than income, gain, or loss to which section 864(c)(2) applies) shall be treated as effectively connected with the conduct of a trade or business within the United States.

Section 894(a) of the Code provides that income, to the extent required by any treaty obligation of the United States, shall be exempt from taxation under subtitle A.

Article 5(2)(a) of the Convention prevents the United States from construing the Convention to restrict in any manner any deduction allowed by the laws of the United States in the determination of the tax that the United States imposes.

The Technical Explanation of the Convention, 1977-1 C.B. 427, states that the rule of Article 5(2)(a) reflects the principle that a convention should not increase the tax burden on residents of the Contracting States.

Article 8(1) of the Convention provides that the profits of an enterprise of a Contracting State, in this case Poland, will be taxable only by Poland unless the enterprise carries on business in the other Contracting State, in this case the United States, through a permanent establishment situated therein; if the enterprise carries on business as aforesaid, only the profits of the enterprise that are attributable to the permanent establishment may be taxed by the United States.

The provisions of the Convention dealing with business profits indicate an intent to subject Polish businesses to United States income taxation only on profits attributable to a permanent establishment in the United States. All nonattributable profits are to be taxed only by Poland. This intent is further evidenced by a statement in the report of the Senate Foreign Relations Committee describing the general objectives of the Convention. The Committee stated that ordinarily business income is not taxable in the source country, in this case the United States, unless the taxpayer has a fixed place of business there; if there is only a temporary or minimal presence in the source country, the conventions typically provide for taxation exclusively by the residence country, in this case Poland. S. Ex. Rep. No. 94-15, 94th Cong., 1st Sess. 1 at 7-8 (1975), 1977-1 C.B. 425.

The intent under the Convention—that the United States will only tax business profits of a Polish enterprise that are attributable to a trade or business conducted by such enterprise in the United States—would be thwarted if losses not attributable to a permanent establishment in the United States are offset against gain attributable to a permanent establishment in the United States. Further, such an offset would require the inconsistent treatment (during a taxable year) of nonattributable gain and loss—such gain being exempt under the Convention and such loss being deductible under the Code. Accordingly, the product *c* nonattributable loss cannot be used to offset the product *a* gain attributable to the United States permanent establishment because the provisions of the Convention have been claimed with respect to the product *a* and product *b* gain.

However, Article 5(2)(a) allows the taxpayer the option to use the provisions of the Code to determine the tax liability with respect to the sales activities for products *a*, *b*, and *c* if this results in a lower tax liability than that obtained using the provisions of the Convention with respect to all of those sales activities. If the Code provisions are used, the effectively connected product *c* loss can be used to offset the effectively connected gain from products *a* and *b* in determining the taxpayer's United States income tax liability.

HOLDING

The taxpayer must use the provisions of the Convention with respect to the taxability of the product *c* nonattributable loss for the taxable year in question because those provisions are used with respect to the taxability of the gain from products *a* and *b*.

If, for the taxable year, the taxpayer desires to use the provisions of the Code with respect to the taxability of the product *c* loss, the provisions of the Code must also be used with respect to the taxability of the gain from products *a* and *b*.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 81-78 is amplified.

Subpart B.—Legislation and Related Committee Reports

Public Law 98-129
98th Congress, H.R. 2840 [1]
October 14, 1983

An Act to provide for the orderly termination of Federal management of the Pribilof Islands, Alaska.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Fur Seal Act Amendments of 1983".

[1] This publication of the law is restricted to excerpts involving tax matters. House Report No. 98-213 and Senate Report 98-212 are not published.

SEC. 2. The Act of November 2, 1966 (Public Law 89-702; 16 U.S.C. 1151-1187), known as the Fur Seal Act of 1966, is amended to read as follows:

"TITLE I—FUR SEAL MANAGEMENT

* * * * *

(1) 'Secretary' means the Secretary of Commerce.

* * * * *

TITLE II—ADMINISTRATION OF THE PRIBILOF ISLANDS

* * * * *

SEC. 205. (a) Any provision of law relating to the transfer and disposal of Federal property to the contrary notwithstanding, the Secretary, after consultation with the Secretary of the department in which the Coast Guard is operating, is authorized to bargain, grant, sell, or otherwise convey, on such terms as he deems to be in the best interests of the United States and in furtherance of the purposes of this Act, any and all right, title, and interest of the United States in and to the property, both real and personal, held by the Secretary on the Pribilof Islands: *Provided*, That such property is specified in a document entitled 'Transfer of Property on the Pribilof Islands: Descriptions, Terms and Conditions,' which is submitted to the Congress on or before October 31, 1983.

* * * * *

(g) The Secretary shall submit to Congress a report, no later than October 1, 1983, providing information on the status of the negotiations for concluding the documents described in subsections (a) and (d) of this section.

"SEC. 206. (a)(1) In order to promote the development of a stable, self-sufficient enduring and diversified economy not dependent on sealing, the Secretary shall cause to be established a Trust for the benefit of the Natives of the Pribilof Islands, to be known as the 'Pribilof Islands Trust' (hereinafter referred to as the 'Trust').

* * * * *

(e) The grant, sale, transfer or conveyance of any real or personal property pursuant to this section shall not be subject to any form of Federal, State or local taxation. The basis for computing gain or loss on subsequent sale or disposition of such real or personal property for purposes of any Federal, State or local tax imposed on, or measured by revenue shall be the fair market value of such real or personal property at the time of receipt.

* * * * *

Approved October 14, 1983.

Public Law 98-134
98th Congress, H.R. 982 [1]
October 18, 1983

An Act to settle certain claims of the Mashantucket Pequot Indians.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Mashantucket Pequot Indian Claims Settlement Act".

CONGRESSIONAL FINDINGS

SEC. 2. The Congress finds that—

(a) there is pending before the United States District Court for the District of Connecticut a civil action entitled "Western Pequot Tribe of Indians against Holdridge Enterprises Incorporated, et al., Civil Action Numbered H76-193 (D. Conn.)," which involves Indian claims to certain public and private lands within the town of Ledyard, Connecticut;

* * * * *

DEFINITIONS

SEC. 3. For the purposes of this Act—

(1) The term "Tribe" means the Mashantucket Pequot Tribe (also known as the Western Pequot Tribe) as identified by chapter 832 of the Connecticut General Statutes and all its predecessors and successors in interest. The Mashantucket Pequot Tribe is represented, as of the date of the enactment of this Act, by the Mashantucket Pequot Tribal Council.

* * * * *

(3) The term "private settlement lands" means—

(A) the eight hundred acres, more or less, of privately held land which are identified by a red outline on a map filed with the secretary of the State of Connecticut in accordance with the agreement referred to in section 2(d) of this Act, and

(B) the lands known as the Cedar Swamp which are adjacent to the Mashantucket Pequot Reservation as it exists on the date of the enactment of this Act. Within thirty days of the enactment of this Act, the secretary of the State of Connecticut shall transmit to the Secretary a certified copy of said map.

(4) The term "settlement lands" means—

(A) the lands described in sections 2(a) and 3 of the Act To Implement the Settlement of the Mashantucket Pequot Indian Land Claims as enacted by the State of Connecticut and approved on June 9, 1982, and

(B) the private settlement lands.

(5) The term "Secretary" means the Secretary of the Interior.

* * * * *

(2) Not less than $600,000 of the Fund shall be available until January 1, 1985, for the acquisition by the Secretary of private settlement lands. Subsequent to January 1, 1985, the Secretary shall determine whether and to what extent an amount less than $600,000 has been expended to acquire private settlement lands and shall make that amount available to the Tribe to be used in accordance with the economic development plan approved pursuant to paragraph (3).

* * * * *

(9) Notwithstanding the provisions of the first section of the Act of August 1, 1888 (25 Stat. 357, chapter 728), as amended, and the first section of the Act of February 26, 1931 (46 Stat. 1421, chapter 307), the Secretary may acquire land or natural resources under this section from the ostensible owner of the land or natural resources only if the Secretary and the ostensible owner of the land or natural resources have agreed upon the identity of the land or natural resources to be sold and upon the pur-

[1] This publication of the law is restricted to excerpts involving tax matters. Senate Report No. 98-222 is not published.

chase price and other terms of sale. Subject to the agreement required by the preceding sentence, the Secretary may institute condemnation proceedings in order to perfect title, satisfactory to the Attorney General, in the United States and condemn interests adverse to the ostensible owner.

(c) For the purpose of subtitle A of the Internal Revenue Code of 1954, any transfer of private settlement lands to which subsection (b) applies shall be deemed to be an involuntary conversion within the meaning of section 1033 of such Code.

* * * * *

Approved October 18, 1983.

Public Law 98-135
98th Congress, H.R. 3929 [1]
October 24, 1983

An Act to extend the Federal Supplemental Compensation Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462], and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Federal Supplemental Compensation Amendments of 1983".

TITLE I—EXTENSION OF FEDERAL SUPPLEMENTAL COMPENSATION PROGRAM

SEC. 101. EXTENSION OF FEDERAL SUPPLEMENTAL COMPENSATION PROGRAM.

(a) GENERAL RULE.—Paragraph (2) of section 602(f) of the Federal Supplemental Compensation Act of 1982 is amended to read as follows:

"(2) No Federal supplemental compensation shall be payable to any individual under an agreement entered into under this subtitle for any week beginning after March 31, 1985."

(b) TECHNICAL AMENDMENT.—Paragraph (2) of section 605 of such Act is amended by striking out "October 19, 1983 (except as otherwise provided in section 602(f)(2))" and inserting in lieu thereof "April 1, 1985".

SEC. 102. NUMBER OF WEEKS FOR WHICH BENEFITS ARE PAYABLE.

(a) GENERAL RULE.—Subsection (e) of section 602 of the Federal Supplemental Compensation Act of 1982 is amended by striking out paragraphs (2) and (3) and inserting in lieu thereof the following:

"(2)(A)(i) Except as provided in subparagraph (B), the amount established in such account shall be equal to the lesser of—

"(I) 55 per centum of the total amount of regular compensation (including dependents' allowances) payable to the individual with respect to the benefit year (as determined under the State law) on the basis of which he most recently received regular compensation, or

"(II) the applicable limit times his average weekly benefit amount for his benefit year.

"(ii) For purposes of clause (i)—

"(I) in the case of an account from which Federal supplemental compensation was payable to an individual for a week beginning before October 19, 1983, the applicable limit shall be the applicable limit in effect in the State under this paragraph (as in effect on the day before the date of the enactment of the Federal Supplemental Compensation Amendments of 1983) for the last week beginning before October 19, 1983, or

"(II) in the case of an account from which Federal supplemental compensation is first payable for a week beginning after October 18, 1983, the applicable limit shall be the applicable limit determined under the following table with respect to the first week for which Federal supplemental compensation is payable from such account:

"In the case of weeks during a:	The applicable limit is:
6-percent period	14
5-percent period	12
4-percent period	10
Low-unemployment period	8.

"(B) In the case of any account from which Federal supplemental compensation was first payable for a week which begins after March 31, 1983, and before October 19, 1983, the amount established in such account under subparagraph (A) shall be increased by the individual's additional entitlement. In no event shall such increase result in the individual's receiving more Federal supplemental compensation for weeks beginning after October 18, 1983, than the subparagraph (A) entitlement.

"(C) For purposes of subparagraph (B) and this subparagraph—

"(i) The term 'additional entitlement' means the lesser of—

"(I) ¾ of the subparagraph (A) entitlement, or

"(II) the individual's average weekly benefit amount for the benefit year multiplied by the applicable limit determined under clause (ii).

"(ii) The applicable limit determined under this clause is—

"(I) 5 if all of the amount in the individual's Federal supplemental compensation account (determined without regard to subparagraph (B)) is payable to the individual for weeks beginning before October 18, 1983, and

"(II) in the case of an individual not described in subclause (I), 4 (2 if the State is in a 4-percent period or a low-unemployment period for the first week beginning after October 18, 1983).

"(iii) The term 'subparagraph (A) entitlement' means the amount which would have been established in the account if Federal supplemental compensation were first payable from such account for the first week beginning after October 18, 1983.

"(3)(A) For purposes of this subsection, the terms '6-percent period', '5-percent period', '4-percent period', and 'low-unemployment period', mean, with respect to any State, the period which—

"(i) begins with the third week after the first week for which the applicable trigger is on, and

"(ii) ends with the second week after the first week for which the applicable trigger is off.

"(B)(i) In the case of a 6-percent period, 5-percent period, 4-percent period, or low-unemployment period, as the case may be, the applicable trigger is on for any week if—

[1] This publication of the law is restricted to excerpts involving tax matters. House Reports Nos. 98-377 and 98-428 and Senate Report No. 98-240 are not published herein.

"(I) the rate of insured unemployment in the State for the period consisting of such week and the immediately preceding 12 weeks falls within the applicable range, or

"(II) the rate of insured unemployment in the State for the period consisting of the last week beginning in the second calendar quarter ending before the week for which the trigger determination is being made and all weeks preceding such last week which began on or after January 1, 1982, equals or exceeds 5.5 percent in the case of a 6-percent period (or, in the case of a 5-percent period, equals or exceeds 4.5 percent but is less than 5.5 percent).

Subclause (II) shall not apply in the case of a 4-percent period or low-unemployment period.

"(ii) In the case of a 6-percent period, 5-percent period, 4-percent period, or low-unemployment period, as the case may be, the applicable trigger is off for any week if subclause (I) of clause (i) is not satisfied (or in the case of a 6-percent period or a 5-percent period, both subclauses (I) and (II) of clause (i) are not satisfied).

"(iii) In the case of any 5-percent period, 4-percent period, or low-unemployment period, as the case may be, notwithstanding clauses (i) and (ii), the applicable trigger shall be off for any week if the applicable trigger for a period with a higher applicable limit in on for such week.

"(C) For purposes of this paragraph, the applicable range is as follows:

"In the case of a:	The applicable range is:
6-percent period...	A rate equal to or exceeding 6 percent.
5-percent period...	A rate equal to or exceeding 5 percent but less than 6 percent.
4-percent period...	A rate equal to or exceeding 4 percent but less than 5 percent.
Low-unemployment period	A rate less than 4 percent.

"(D)(i) No 6-percent period, 5-percent period, 4-percent period, or low-unemployment period, as the case may be, which is in effect for the first week beginning after October 18, 1983, or any week thereafter, shall last for a period of less than 13 weeks beginning after October 18, 1983.

"(ii) The applicable limit in any State shall not be reduced or increased by more than 2 during any 13-week period beginning with the week for which such a reduction (or increase) would otherwise take effect. The preceding sentence shall not apply to any increase (or decrease) which takes effect for the first week beginning after October 18, 1983.

"(E) For purposes of this subsection—

"(i) The rate of insured unemployment for any period shall be determined in the same manner as determined for purposes of section 203 of the Federal-State Extended Unemployment Compensation Act of 1970; except that, for purposes of determining the rate of insured unemployment for the period described in subparagraph (B)(i)(II), the rate of insured unemployment shall be determined by reference to the average monthly covered employment under the State law for so much of such period as does not fall in the last 6 months thereof.

"(ii) The amount of an individual's average weekly benefit amount shall be determined in the same manner as determined for purposes of section 202(b)(1)(C) of such Act."

(b) TECHNICAL AMENDMENT.—Paragraph (3) of section 602(d) of such Act is amended by striking out "or (D)(ii)".

SEC. 103. EFFECTIVE DATES.

(a) GENERAL RULE.—The amendments made by this title shall apply to weeks beginning after October 18, 1983.

(b) TRANSITIONAL RULE.—In the case of any eligible individual who exhausted his rights to Federal supplemental compensation (by reason of the payment of all of the amount in his Federal supplemental compensation account) before the first week beginning after October 18, 1983, such individual's eligibility for additional weeks of compensation by reason of the amendments made by this title shall not be limited or terminated by reason of any event, or failure to meet any requirement of law relating to eligibility for unemployment compensation, occurring after the date of such exhaustion of rights and before the beginning of the first week beginning after October 18, 1983 (and the period after such exhaustion and before the beginning of such first week shall not be counted for purposes of determining the expiration of the two years following the end of his benefit year for purposes of section 602(b) of the Federal Supplemental Compensation Act of 1982).

(c) MODIFICATION OF AGREEMENTS.—The Secretary of Labor shall, at the earliest practicable date, after the date of the enactment of this Act, propose to each State, with which he has in effect an agreement under section 602 of the Federal Supplemental Compensation Act of 1982 a modification of such agreement designed to provide for the payment of Federal supplemental compensation under such Act in accordance with the amendments made by this title. Notwithstanding any other provision of law, if any State fails or refuses within the three-week period beginning on the date the Secretary of Labor proposes such modification to such State, to enter into such modification of such agreement, the Secretary of Labor shall terminate such agreement effective with the end of the last week which ends on or before the close of such three-week period.

(d) NEW PERIODS BEGIN WITH FIRST WEEK AFTER OCTOBER 18, 1983.—For purposes of determining whether any 6-percent period, 5-percent period, 4-percent period, or low-unemployment period is in effect during weeks beginning after October 18, 1983, the amendments made by this title shall be treated as in effect during all periods before the first week beginning after October 18, 1983.

TITLE II—OTHER PROVISIONS

PAYMENT TO SURVIVORS OF DECEASED EMPLOYEES

SEC. 201. (a) Subsection (b) of section 3306 of the Internal Revenue Code of 1954 (defining wages) is amended by striking out "or" at the end of paragraph (13), by striking out the period at the end of paragraph (14) and inserting in lieu thereof "; or", and by inserting after paragraph (14) the following new paragraph:

"(15) any payment made by an employer to a survivor or the estate of a former employee after the calendar year in which such employee died."

(b) The amendments made by subsection (a) shall apply to remuneration paid after the date of the enactment of this Act.

TREATMENT OF CERTAIN AGRICULTURAL LABOR

SEC. 202. Subparagraph (B) of section 3306(c)(1) of the Internal Revenue Code of 1954 (relating to agricultural labor) is amended by striking out "January 1, 1984" and inserting in lieu thereof "January 1, 1986".

* * * * *

DIRECT REPAYMENT OF GENERAL REVENUE ADVANCES

SEC. 205. (a) Section 1203 of the Social Security Act is amended by inserting after the first sentence the following: "Amounts appropriated as repayable advances shall be repaid, without interest, by transfers from the Federal unemployment account to the general fund of the Treasury, at such times as the amount in the Federal unemployment account is determined by the Secretary of the Treasury, in consultation with the Secretary of Labor, to be adequate for such purpose. Any amount transferred as a repayment under this section shall be credited against, and shall operate to reduce, any balance of advances repayable under this section.".

(b) Any amounts transferred from the Federal unemployment account to the employment security administration account as of September 30, 1983, shall be transferred back to the Federal unemployment account.

* * * * *

Approved October 24, 1983.

Public Law 98-259
9th Congress, H.R. 4206 [1]
April 10, 1984

An Act to amend the Internal Revenue Code of 1954 to exempt from Federal income taxes certain military and civilian employees of the United States dying as a result of injuries sustained overseas.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. INCOME TAXES OF CERTAIN MILITARY AND CIVILIAN EMPLOYEES OF THE UNITED STATES DYING AS A RESULT OF INJURIES SUSTAINED OVERSEAS.

(a) GENERAL RULE.—Section 692 of the Internal Revenue Code of 1954 (relating to income taxes of members of the Armed Forces on death) is amended by adding at the end thereof the following new subsection:

"(c) CERTAIN MILITARY OR CIVILIAN EMPLOYEES OF THE UNITED STATES DYING AS A RESULT OF INJURIES SUSTAINED OVERSEAS.—

"(1) IN GENERAL.—In the case of any individual who dies while a military or civilian employee of the United States, if such death occurs as a result of wounds or injury incurred outside the United States in a terroristic or military action, any tax imposed by this subtitle shall not apply—

"(A) with respect to the taxable year in which falls the date of his death, and

"(B) with respect to any prior taxable year in the period beginning with the last taxable year ending before the taxable year in which the wounds or injury were incurred.

"(2) TERRORISTIC OR MILITARY ACTION.—For purposes of paragraph (1), the term 'terroristic or military action' means—

"(A) any terroristic activity directed against the United States or any of its allies, and

"(B) any military action involving the Armed Forces of the United States and resulting from violence or aggression against the United States or any of its allies (or threat thereof). For purposes of the preceding sentence, the term 'military action' does not include training exercises.

"(3) TREATMENT OF MULTINATIONAL FORCES.—For purposes of paragraph (2), any multinational force in which the United States is participating shall be treated as an ally of the United States.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply with respect to all taxable years (whether beginning before, on, or after the date of enactment of this Act) of individuals dying after December 31, 1979, as a result of wounds or injuries incurred after such date.

(2) STATUTE OF LIMITATIONS WAIVED.—Notwithstanding section 6511 of the Internal Revenue Code of 1954, the time for filing a claim for credit or refund of any overpayment of tax resulting from the amendment made by subsection (a) shall not expire before the date 1 year after the date of the enactment of this Act.

Approved April 10, 1984.

Senate Report No. 98-364
2d Session

[Bracketed numerals indicate official report page number]

Federal Income Tax Forgiveness for Certain U.S. Military and Civilian Employees Killed Overseas

March 12, 1984

Mr. Dole, from the Committee on Finance, submitted the following report to accompany H.R. 4206.[2]

* * * * *

The Committee on Finance, to which was referred the bill (H.R. 4206) to provide special Federal income tax rules for certain individuals who die while in active service as a member of the Armed Forces or as a civilian employee of the U.S. Government as a result of wounds or injuries incurred overseas, having considered the same, reports favorably thereon, without amendment, and recommends that the bill do pass.

I. SUMMARY

The bill provides special Federal income tax rules for certain individuals who die while in active service as a

[1] Senate Rept. No. 98-364, this page.

[2] Public Law 98-259, this page.

member of the Armed Forces of the United States or as a civilian employee of the United States as a result of wounds or injuries incurred overseas.

Generally, if such individual's death occurs as a result of wounds or injuries incurred (after 1979) outside the United States in a terroristic or military action, then no U.S. income tax will apply with respect to the income of such individual for the year of death or for any earlier year in the period beginning with the last year ending before the year in which the wound or injuries were incurred.

II. EXPLANATION OF THE BILL

Present law

The Federal income tax does not apply to the income of U.S. military personnel in active service who die while serving in a combat zone, or as a result of wounds, disease, or injury incurred while serving in a combat zone, for the year of death and for any prior year ending on or after the first day such individual served in a combat zone after June 24, 1950 (Code sec. 692(a)). The Congress has delegated the designation of combat zones to the President (sec. 112(c)(2)).[1]

In addition, if a serviceperson is reported in a missing status for a number of years, and it is subsequently determined that he or she actually died at an earlier time, there is no Federal income tax on income for years after the year of actual death. This exclusion for individuals who were in a missing status applies to the year of death and to years after death that precede and include the year of determination of death, but only for years beginning (1) on or before December 31, 1982, in the case of the combat zone designated for purposes of the Vietnam conflict,[2] or (2) within 2 years after termination of any other combat zone designation (sec. 692(b)).

Prior Legislation

In 1970, the Congress enacted legislation treating individuals who had been removed from a U.S. vessel and who died while being illegally detained by the Democratic People's Republic of Korea during 1968 as serving in a combat zone (Public Law 91-235). Thus, service personnel who were members of the crew of the U.S.S. *Pueblo*, illegally detained in 1968 by North Korea, and who died during the detention were eligible for the income tax exclusion (and other special tax rules) available for service personnel who die in combat zones.

Under legislation enacted in 1980, if any American hostage held captive in Iran between November 4, 1979, and December 31, 1981, died as a result of injury or disease or physical or mental disability incurred or aggravated while in captive status, no Federal income tax would have applied with respect to the year in which the individual died or any prior year ending on or after the first day the individual was in captive status (sec. 202 of Public Law 96-449). This treatment would have applied to military and civilian personnel of the United States and to certain other individuals, as well as to certain other U.S. taxpayers taken captive outside Iran on or before December 31, 1981. Moreover, if there had been any unpaid income tax liability of such an individual from years prior to captivity, the liability would have been forgiven. This total income tax exemption for American hostages who died as a result of captive status would have been available only if death had occurred within 2 years after the individual ceased to be in captive status.

Reasons for Change

Recent events in Lebanon and Grenada have focused the attention of the Nation on the sacrifice that members of the U.S. Armed Forces and other U.S. Government employees must be prepared to make for our country when they leave our borders. The committee believes that Federal income taxes should not be imposed on the income of U.S. military or civilian employees who in the course of duty lose their lives at the hands of foreign enemies of the United States. The committee believes that the families of these employees of the United States have withstood sufficient burdens, and they should not have the additional burden of Federal income tax imposed on the employee's income.

The committee concluded that a forgiveness of income tax only for the period from the year of the death-causing injuries or wounds to the year of death would have inequitable results. Under such a limitation, a soldier killed in a terroristic attack on a U.S. base in a foreign country on January 31 of a year would be exempt from income tax only on 1 month's income, which a soldier killed in an attack on December 31 of the prior year would be exempt from income tax on an entire year's income. Accordingly, the committee concluded that it is more equitable to extend the tax forgiveness under the provision to income for the year preceding the year of injury. For example, if on January 21, 1985, a soldier is killed in a terroristic attack overseas, the forgiveness applies under the bill with respect to income of the soldier for both 1984 and 1985.

Explanation of Provision

The bill provides special Federal income tax rules for certain individuals who die while in active service as a member of the Armed Forces of the United States or while in the civilian employment of the Government of the United States.

If death occurs as a result of wounds or injuries incurred outside the United States in a terroristic or military action, then no Federal income tax applies with respect to income of the individual for the year or death or for any earlier year in the period beginning with the last year ending before the year in which the wounds or injuries were incurred. The term "terroristic or military ac-

[1] Presidential designation of a combat zone entails other Federal tax consequences, including (1) exclusion from gross income of certain amounts of military pay of personnel serving there (sec. 112), (2) reduced estate taxes for personnel dying as a result of service there (sec. 2201), and (3) postponement of deadlines for filing returns, paying tax, and performing other acts for personnel serving there (sec. 7508).

[2] Vietnam was designated a combat zone as of Jan. 1, 1964.

tion'' means any terroristic activity directed against the United States or any of its allies, or any military action (not including training exercises) involving U.S. Armed Forces and resulting from violence or aggression against the United States or any of its allies (or the threat of such violence or aggression). The term ''military action'' includes a military accident, such as a military helicopter crash. The term ''allies of the United States'' includes any multinational force in which the United States is participating.

The committee is aware of several circumstances in which the bill is intended to apply. The bill is to apply with respect to U.S. military or civilian employees who die (or who have died) as a result of the bombing of the U.S. Embassy in Beirut, Lebanon, or as a result of the bombing of U.S. Marine headquarters there. Similarly, the bill is to apply with respect to other U.S. personnel who were participating in a United Nations peacekeeping force when killed in Lebanon by land mines or snipers in 1982 or 1983 (or thereafter). The bill also applies with respect to the U.S. service personnel who died as a result of the Government's attempt to rescue the American hostages in Iran, inasmuch as that rescue attempt constituted a military action involving U.S. Armed Forces within the meaning of the bill. The bill also is to apply to U.S. service personnel who died (or who have died) in a military action in Grenada.

For the bill to apply, the injury or wound which causes death must be incurred in a terroristic or military action. Thus, for example, the bill does not apply with respect to a U.S. serviceperson stationed in Lebanon who dies as a result of an accidental fall; that is, if not caused by hostile forces, since such an injury is not incurred in a terroristic or military action. Also, the bill does not apply if the wound or injury causing death occurs within the United States. Where otherwise applicable, the bill does apply even if the individual dies within the United States (for example, in a military hospital) from a wound or injury incurred in a terroristic or military action outside the United States.

The rules of the bill do not apply to the extent that the combat zone rules of current law apply to the individual.

Effective Date

The bill applies with respect to all taxable years (whether beginning before or after the date of the enactment of the bill) of individuals dying as a result of wounds or injury incurred after December 31, 1979. The bill extends (to the extent necessary) the statute of limitations for filing claims for credit or refund of any overpayment of tax that results from the bill until 1 year after the date of enactment.

* * * * *

Part III. Administrative, Procedural, and Miscellaneous

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Part III. Administrative, Procedural, and Miscellaneous

Delegation Order 11 (Rev. 14)

(Effective April 13, 1984)

[Authority To Accept or Reject Offers in Compromise]

The authority vested in the Commissioner of Internal Revenue by Treasury Department Order Nos. 150-25 and 150-36 [1954-2 C.B. 733], 26 CFR 301.7122-1 and 26 CFR 301.7701-9, and Treasury Department Order No. 150-60 is hereby delegated as follows:

1. Regional Commissioners of Internal Revenue and Regional Counsel are delegated authority, under Section 7122 of the Internal Revenue Code to accept offers in compromise in cases in which, the unpaid liability (including any interest, penalty, additional amount or addition to tax) is $250,000 or more. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco and firearms taxes. This authority may not be redelegated.

2. District Directors, Assistant District Directors, Regional Counsel, Regional Directors of Appeals, Chiefs and Associate Chiefs, Appeals Offices, are delegated authority, under Section 7122 of the Internal Revenue Code to accept offers in compromise in cases in which the liability sought to be compromised (including any interest, penalty, additional amount or addition to tax) is less than 250,000, to accept offers involving specific penalties, and to reject offers in compromise regardless of the amount of the liability sought to be compromised. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. The authority delegation to District Directors and Assistant District Directors may not be redelegated, except that the authority to reject offers in compromise may be redelegated, but not lower than to Division Chief. The District Director in a streamlined district may not redelegate this authority. The authority delegated to Regional Counsel may not be redelegated, except that the authority to reject offers in compromise may be redelegated, but not lower than to District Counsel. Regional Director of Appeals, Chiefs and Associate Chiefs, Appeals Offices, may not redelegate this authority.

3. Service Center Directors and Assistant Service Center Directors are delegated authority, under Section 7122 of the Internal Revenue Code, to accept offers in compromise, limited to penalties based solely on doubt as to liability, in cases in which the unpaid liability, is less than $250,000, and to reject offers in compromise, limited to penalties, regardless of the amount of the liability sought to be compromised. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. This authority may be redelegated, but not lower than to Division Chief.

4. Delegation Order No. 11 (Rev. 13), effective March 21, 1982 [1982-1 C.B. 333], is superseded.

Approved:

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on April 23, 1984, 8:45 a.m., and published in the issue of the Federal Register for April 24, 1984, 49 F.R. 17666)

Delegation Order No. 156 (Rev. 5) Chief Counsel Order No. 1031.3D

(Effective March 15, 1984)

Authority to Permit Disclosure of Tax Information and to Permit Testimony or the Production of Documents

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37 and in the Chief Counsel by General Counsel Order No. 4 and by Treasury Department Order No. 190 (as revised), authority to act in matters officially before their respective functions is hereby delegated.

The authority to disclose returns and or return information under certain provisions of the IR Code, such as IRC 6103(h)(1) and (k)(6) is not delegated herein as the language of these provisions themselves permits officers and employees of the Internal Revenue Service and the Office of the Chief Counsel to disclose such information. The authority to disclose returns and return information under IRC 6103(k)(4) is also not delegated herein as Delegation Order 114 (as revised, governs these disclosures.

(1) The Deputy Commissioner; Associate Commissioners; Assistant Commissioners; Deputy Assistant Commissioners; Division Directors (or equivalent level position); Assistant Director, Disclosure and Security Division; Deputy Chief Counsel; Associates Chief Counsel; Deputy Associates Chief Counsel; Chief Counsel Division Directors; Regional Commissioners; Regional Inspectors; Regional Counsels; Deputy Regional Counsels; District Counsels; District and Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized.

(a) To disclose or, in specific instances, authorize the disclosure of returns or return information to such persons as the taxpayer may designate in a written request, subject to the conditions prescribed in IRC 6103(c) and the Treasury Regulations thereunder. The authority to withhold return information upon a determination that such disclosure would seriously impair Federal tax administration is also delegated. The authority delegated in this paragraph to disclose returns or return information may be redelegated to Internal Revenue of Service employees and employees of the Office of Chief Counsel to the extent necessary within the exercise of their official duties. The authority delegated in this paragraph to withhold return information may be redelegated not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Offices; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(b) To disclose or, in specific instances, authorize the disclosure of returns, upon the written request of an individual taxpayer, partner, corporate officer, shareholder, administrator, executor, trustee, or other person having a material interest subject to the conditions prescribed in IRC 6103(e). The authority to disclose or, in specific instances, authorize the disclosure of return information to such persons, upon a determination that disclosure would not seriously impair Federal tax administration, as prescribed in IRC 6103(e)(7), is also delegated. The authority to withhold return information upon a determination that disclosure would seriously impair Federal tax administration is also delegated. The authority delegated in this paragraph to disclose or authorize the disclosure of returns or return information may be redelegated to Internal Revenue Service employees and employees of the Office of Chief Counsel to the extent necessary within the exercise of their official duties. In the event a disclosure of return information would seriously impair Federal tax administration, the decision to withhold such return information will be referred to officials not lower than Chiefs, Special Procedures function; Group Managers (or their equivalent); Chiefs, Appeals Offices; Chiefs, Criminal Investigation Branch; and Disclosure Officers.

(c) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the Department of Justice including United States attorneys, in a matter involving tax administration, subject to the conditions prescribed in IRC 6103(h)(2), the Treasury Regulations thereunder, and (h)(3)(A). The authority delegated in this paragraph may be redelegated not lower than Chiefs, Special Procedures function; and Group Managers (or their equivalent including Disclosure Officers). The authority delegated in this paragraph to Chief Counsel employees may be redelegated not lower than Chiefs, Appeals Officers; and to attorneys of the Office of Chief Counsel directly involved in such matters. (See paragraph (17) below.)

(d) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the Department of Treasury, as specified in IRC 6103(l)(4)(B) or, upon written request, to employees and other persons specified in IRC 6103(l)(4)(A) for use in personnel or claimant representative matters, and to make relevancy and materiality determinations as provided in section 6103(1)(4)(A), subject to the conditions prescribed in IRC 6103(1)(4). The authority delegated in this paragraph may be redelegated only to Assistant Division Directors (or equivalent level position); Assistant Regional Commissioners; Regional Director of Appeals; Assistant Regional Inspectors; Regional Chief, Personnel Branch; Assistant District and Service Center Directors; Division Chiefs; National Office Branch Chiefs, Internal Security Division; Staff Assistants to Regional Counsels; and to attorneys of the Office of Chief Counsel and Inspectors directly involved in such matters. (See paragraph 13(e).)

(e) To disclose or, in specific instances, authorize the disclosure of returns or return information to the extent necessary in connection with contractual procurement by the Service or Office of the Chief Counsel of equipment or other property or services, subject to the conditions prescribed in IRC-6103(n) and the Treasury Regulations thereunder. The authority delegated in this paragraph may be redelegated only to Assistant Division Directors (or equivalent level position); Assistant Regional Commissioners; Regional Director of Appeals; Assistant Regional Inspectors; Assistant District and Service Center Directors; Division Chief; Chief Counsel Assistant Division Directors; Associated Regional Counsel; and Disclosure Officers.

(f) To disclose, or in specific instances, authorize the disclosure of return information (other than taxpayer return information) which may constitute evidence of a violation of any Federal criminal law (not involving tax administration) or to disclose return information under circumstances involving a threat or other imminent danger of death or other physical injury, which is directed against the President or other government official, to the U.S. Secret Service, subject to the conditions prescribed in IRC 6103(i)(3). The authority delegated in this paragraph is also delegated to Assistant District and Service Center Directors. This does not limit the authority granted in paragraph 6(d) of this order.

(g) To determine whether a disclosure of standards used or to be used for selection of returns for examination, or data used or to be used for determining such standards will seriously impair assessment, collection or enforcement under the internal revenue laws pursuant to IRC 6103(b)(2). The authority delegated in this paragraph may be redelegated to Disclosure Officers.

(2) The Deputy Commissioner; Associate Commissioners; Assistant Commissioners; Deputy Assistant Commissioners; Division Directors (or equivalent level position); Assistant Director, Disclosure and Security Division; Regional Commissioners; Regional Inspectors; District and Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to determine whether a disclosure of returns or return information in a Federal or State judicial or administrative proceeding pertaining to tax administration would identify a confidential informant or seriously impair a civil or criminal tax investigation, subject to the conditions prescribed in IRC 6103(h)(4). The authority delegated in this paragraph may not be redelegated.

(3) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; Director, Disclosure and Security Division; Assistant Director, Disclosure and Security Division; and District and Service Center Directors are authorized:

(a) To furnish an affirmative or negative response to a written inquiry from an attorney of the Department

of Justice (including a United States Attorney) involved in a judicial proceeding pertaining to tax administration, or any person (or his/her legal representative) who is a party to such proceeding, as to whether a prospective juror has or has not been the subject of any audit or other tax investigation by the Internal Revenue Service, subject to the conditions prescribed in IRC 6103(h)(5). The authority delegated in this paragraph may be redelegated only to Assistant District and Service Center Directors; Division Chiefs, and Disclosure Officers.

(b) To disclose or, in specific instances, authorize the disclosure of:

(i) Accepted offers-in-compromise to members of the general public, subject to the conditions prescribed in IRC 6103(k)(1).

(ii) The amount of an outstanding obligation secured by a lien, notice of which has been filed pursuant to section 6323(f), to any person who furnishes satisfactory written evidence establishing a right in or intent to obtain a right in property subject to such lien, subject to the conditions prescribed in IRC 6103(d)(2). The authority to disclose or, in specific instances, authorize the disclosure of the amount of such outstanding obligation is also delegated to the Associate Commissioner (Operations); Assistant Commissioner (Collection); and Deputy Assistant Commissioner (Collection).

(iii) Taxpayer identity information with respect to any income tax return preparer and information as to whether any penalty has been assessed against such preparer to officers and employees of any agency charged under State or local law with the regulation of such preparers, upon written request and subject to the conditions prescribed in IRC 6103(k)(5);

(iv) Returns or return information with respect to taxes imposed by IRC chapters 2, 21, and 24 to the Social Security Administration, upon written request and subject to the conditions prescribed in IRC 6103(l)(1)(A);

(v) Returns or return information with respect to taxes imposed by IRC chapter 22 to the Railroad Retirement Board, upon written request and subject to the conditions prescribed in IRC 6103(l)(1)(C).

(vi) Returns or return information with respect to taxes imposed by IRC subtitle E (relating to taxes on alcohol, tobacco and firearms) to officers and employees of the Bureau of Alcohol, Tobacco and Firearms, upon written request and pursuant to IRC 6103(o)(1).

The authority delegated in subparagraphs (iv) and (v) is also delegated to the Associate Commissioner (Operations); the Associate Chief Counsel (Technical); and the Assistant Commissioner (Examination). The authority delegated in this paragraph may be redelegated only to Assistant District and Service Center Directors; Division Chiefs; and Disclosure Officers. In addition, the authority delegated in subparagraph (i) may also be redelegated only to Chiefs, Special Procedures function; Special Procedures function Advisor Reviewers; and Group Managers (or their equivalent). The authority delegated in subparagraph (ii) may also be redelegated only to Chiefs, Special Procedures function; Special Procedures function Advisor Reviewers; Group Managers (or their equivalent); and Revenue Officers. The authority delegated in subparagraph (iv) may be redelegated not lower than Branch Chief.

(4) The Deputy Commissioner; Regional Commissioner; District and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of returns or return information to designated State tax officials, upon written request by the head of a State tax agency, for the purpose of and to the extent necessary in the administration of State tax laws, pursuant to the provisions of IRC 6103(d) and subject to the conditions prescribed in IRC 6103(h)(4) and (p)(8). The authority to withhold return information pursuant to IRC 6103(d) and (h)(4) upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph does not extend to the entry into Federal/State Agreements on the Coordination of Tax Administration. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate, but such redelegation shall not extend to the authority to withhold return information.

(5) The Deputy Commissioner; Regional Commissioners; District and Service Center Directors; and Director, National Computer Center are authorized to disclose or, in specific instances, authorize the disclosure of returns or return information pursuant to Federal/State Agreements on the Coordination of Tax Administration entered into between the head of any State tax agency and the Commissioners of Internal Revenue, pursuant to the provisions of IRC 6103(d) and subject to the conditions prescribed in IRC 6103(h)(4) and (p)(8). The authority to withhold return information pursuant to IRC 6103(d) and (h)(4) upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate, but such redelegation shall not extend to the authority to withhold return information.

(6) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Director, Disclosure and Security Division; and Assistant Director, Disclosure and Security Division are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns and return information to Congressional committees and other persons, upon written request and subject to the conditions prescribed in IRC 6103(f). The authority delegated in this paragraph is also delegated to the Assistant to the Commissioner (Legislative Liaison). The authority delegated in this paragraph may not be redelegated.

(b) To disclose or, in specific in-

stances, authorize the disclosure of returns or return information to officers and employees of a Federal agency pursuant to an *ex parte* order by a Federal District Court judge or magistrate when needed for use in the enforcement of a Federal criminal statute (not involving tax administration), or to locate a fugitive from justice subject to the conditions prescribed in IRC 6103(i)(1) or (i)(5) and the Treasury Regulations thereunder. The authority to withhold any return or return information, pursuant to IRC 6103(i)(6), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. This authority may not be redelegated.

(c) To disclose or, in specific instances, authorize the disclosure of return information (other than taxpayer return information) to officers and employees of a Federal agency upon written request by the head of such agency or the Inspector General thereof, or in the case of the Department of Justice, the Attorney General, the Deputy Attorney General, the Associate Attorney General, any Assistant Attorney General, the Director of the Federal Bureau of Investigation, the Administrator of the Drug Enforcement Administration, any United States attorney, any special prosecutor appointed under section 593 of title 28, United States Code, or any attorney in charge of a criminal division organized crime strike force established pursuant to section 510 of title 28, United States Code, when needed for use in the enforcement of a Federal criminal statute (not involving tax administration), subject to the conditions prescribed in IRC 6103(i)(2). The authority to withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(6), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation is also delegated. The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. This authority may not be redelegated.

(d) To disclose or, in specific instances, authorize the disclosure of:

(i) return information (other than taxpayer return information) which may constitute evidence of a violation of Federal criminal law (not involving tax administration) to the extent necessary to apprise the head of the appropriate Federal agency pursuant to IRC 6103(i)(3)(A);

(ii) return information to the extent necessary to apprise appropriate officers or employees of a Federal or State law enforcement agency of circumstances involving an imminent danger of death or physical injury to any individual pursuant to IRC 6103(i)(3)(B)(i);

(iii) return information to the extent necessary to apprise appropriate officers or employees of a Federal law enforcement agency of circumstances involving the imminent flight of an individual from Federal prosecution pursuant to IRC 6103(i)(3)(B)(ii);

With respect to subparagraph (i), the authority to withhold any return information pursuant to IRC 6103(i)(6) upon a determination that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation is also delegated.

The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. The authority delegated in this paragraph may be redelegated only to the Assistant Director, Disclosure and Security Division; and Branch Chiefs and Section Chiefs, Disclosure and Security Division, but such redelegation shall not extend to the authority to withhold return information (other than taxpayer return information). This authority is in addition to the authority previously delegated in paragraph (1)(f).

(e) To notify the Attorney General or his delegate or the head of a Federal agency that certain returns or return information obtained pursuant to IRC 6103(i)(1), (2) or (3)(A) shall not be admitted into evidence under IRC 6103(i)(4)(A)(i) or (B), upon a determination, in accordance with IRC 6103(i)(4)(C), that such admission would identify a confidential informant or seriously impair a civil or criminal tax investigation. The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. This authority may not be redelegated.

(f) To disclose or, in specific instances, authorize the disclosure of returns or return information to officers and employees of the General Accounting Office, upon written request by the Comptroller General of the United States and subject to the conditions prescribed in IRC 6103(i)(7). The authority to withhold any return or return information, pursuant to IRC 6103(i)(6), upon a determination that such disclosure would impair any civil or criminal tax investigation or reveal the identity of a confidential informant is also delegated. The authority delegated in this paragraph may not be redelegated.

(g) To disclose or, in specific instances, authorize the disclosure of:

(i) the mailing address of taxpayer to officers and employees of an agency when needed in connection with a Federal claim against such taxpayer, upon written request and subject to the conditions prescribed in IRC 6103(m)(2). The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. Upon approval of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Returns and Information Processing); Deputy Assistant Commissioner (Returns and Information Processing); Director, Returns Processing and Accounting

Division; and Director National Computer Center. The authority delegated in this paragraph may be redelegated only as set forth below. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division may be redelegated only to the Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Regional Commissioners; Director, National Computer Center; District and Service Center Directors; and Assistant District and Service Center Directors may be redelegated only to the Disclosure Officer, National Computer Center and Regional, District and Service Center Disclosure Officers. The authority delegated in this order does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(ii) whether or not an applicant for a loan under an included Federal loan program has a tax delinquent account to the head of the Federal agency administering such program, upon written request and subject to the conditions prescribed in IRC 6103(1)(3). The authority delegated in this paragraph is also delegated to Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors. Upon approval of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Returns and Information Processing); Deputy Assistant Commissioner (Returns and Information Processing); Director, Returns Processing and Accounting Division; and Director, National Computer Center. The authority delegated in this paragraph may be redelegated only as set forth below. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division may be redelegated only to the Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Regional Commissioners; Director, National Computer Center; District and Service Center Directors; and Assistant District and Service Center Directors may be redelegated only to the Disclosure Officer, National Computer Center and Regional, District and Service Center Disclosure Officers. The authority delegated in this order does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(h) To disclose or, in specific instances, authorize the disclosure of the mailing address of taxpayers to officers and employees of the National Institute for Occupational Safety and Health, upon written request and subject to the conditions prescribed in IRC 6103(m)(3). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division, may be redelegated only to Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors may not be redelegated. The authority delegated in this paragraph does not include authority to enter into a contractual agreement, which is contained in Delegated Order No. 100, as revised

(i) To disclose, or in specific instances, authorize the disclosure of the mailing address of any taxpayer who has defaulted on a loan made from the student loan fund established under part B or E of title IV of the Higher Education Act of 1965 or a loan made to a student at an institute of higher education pursuant to section 3(a)(1) of the Migration and Refugee Assistance Act of 1962, to the Secretary of Education upon written request and subject to the conditions prescribed in IRC 6103(m)(4). Upon approval by the Director, Disclosure and Security Division or his/her delegate of a contractual agreement for such disclosures, the authority delegated in this paragraph is also delegated to the following officials: Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center; and Service Center Directors. The authority delegated in this paragraph to the Director, Disclosure and Security Division and the Assistant Director, Disclosure and Security Division, may be redelegated only to Branch Chiefs and Section Chiefs, Disclosure and Security Division. The authority delegated to the Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Director, Software Division; Director, National Computer Center, and Service Center Directors may not be redelegated. The authority delegated in this paragraph does not include authority to enter into a contractual agreement, which is contained in Delegation Order No. 100, as revised.

(7) The Deputy Commissioner; Associate Commissioner (Data Processing); and Assistant Commissioner (Returns and Information Processing) are authorized:

(a) To disclose or, in specific instances, authorize the disclosure of returns or return information for statistical use to officers and employees of the Department of Commerce, Bureau of Census, upon the written request of the Secretary of Commerce or to officers and employees of the Department of the Treasury, subject to the conditions prescribed in IRC 6103(j)(1)(A) and the Treasury Regulations thereunder and (j)(3). The authority delegated in this paragraph may be redelegated only to the Director, Statistics of Income Division.

(b) To disclose or, in specific instances, authorize the disclosure of return information for statistical use to officers and employees of the De-

partment of Commerce, Bureau of Economic Analysis, upon the written request of the Secretary of Commerce, or to officers and employees of the Federal Trade Commission, upon written request of the Chairman, subject to the conditions prescribed in IRC 6103(j)(1)(B) and (l)(2) and the Treasury Regulations thereunder. The authority delegated in this paragraph may be redelegated only to the Director, Statistics of Income Division.

(8) The Deputy Commissioner; Assistant to the Commissioner (Public Affairs); Director and Assistant Director, Public Affairs Division; Regional Commissioners; and District Directors are authorized to disclose or, in specific instances, authorize the disclosure of taxpayers' names and the city, state and zip code of their mailing addresses to the press and other media for purposes of notifying persons entitled to undelivered tax refunds, subject to the conditions prescribed in IRC 6103(m)(1). The authority delegated in this paragraph may be redelegated to Assistant District Directors and Public Affairs Officers.

(9) The Deputy Commissioner; Associate Commissioner (Policy and Management); and Assistant Commissioner (Support and Services) are authorized:

(a) Upon written request of the President, to disclose, or in specific instances, authorize the disclosure of return information (other than return information that is adverse to the taxpayer) of an individual who is under consideration for appointment to a position in the executive or judicial branch of the Federal Government to the authorized representative of the Executive Office of the President or to the Federal Bureau of Investigation on behalf of the President, subject to the conditions prescribed in IRC 6103(g)(2) and (g)(4). Authority is also delegated to disclose or, in specific instances, authorize the disclosure of return information with respect to the categories of individuals discussed above to the heads of Federal agencies upon written request, or the Federal Bureau of Investigation on behalf of and upon the written request of such agency heads, subject to the conditions described in IRC 6103(g)(2) and (g)(4). Upon receipt of any request for return information under IRC 6103(g)(2), authority to notify the individuals with respect to whom the request has been made is also delegated. The authority delegated in this paragraph may be redelegated but not lower than:

(i) Deputy Assistant Commissioner (Support and Services), in the case of requests by or on behalf of the President where the return information to be disclosed is not adverse to the taxpayer,

(ii) Assistant Director, Disclosure and Security Division, in the case of requests by or on behalf of the heads of Federal agencies where the return information to be disclosed is adverse to the taxpayer,

(iii) Branch Chiefs, Disclosure and Security Division, in the case of requests by or on behalf of the heads of Federal agencies where the return information to be disclosed is not adverse to the taxpayer, and

(iv) Section Chiefs, Disclosure and Security Division, concerning the notification of individuals with respect to whom a request has been made.

(b) To make the determination that an agency, body or commission or the General Accounting Office has failed to or does not meet the requirements of IRC 6103(p)(4). Subject to the administrative review applicable to State tax agencies described in IRC 6103(p)(7), authority to withhold returns and return information from any agency, body or commission or the General Accounting Office until a determination is made that the requirements of IRC 6103(p)(4) have been or will be met is also delegated. The authority delegated in this paragraph may not be redelegated.

(10) The Deputy Commissioner; Associate Commissioner (Operations); Assistant Commissioner (Employee Plans and Exempt Organizations); Deputy Assistant Commissioner (Employee Plans and Exempt Organizations); Director, Disclosure and Security Division; Assistant Director, Disclosure and Security Division; Regional Commissioners; District Directors of Key Districts for Employee Plans and Exempt Organizations matters; Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to disclose, or in specific instances, authorize the disclosure of:

(a) Statements, notifications, reports, or other return information described in IRC 6057(d) to officers and employees of the Social Security Administration for the administration of section 1131 of the Social Security Act, upon written request and subject to the conditions prescribed in IRC 6103(1)(1)(B). The authority delegated in this paragraph to the Assistant Commissioner and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) may be redelegated, but not lower than Branch Chiefs, Employee Plans Technical and Actuarial Division. The authority delegated in this paragraph to the Director and Assistant Director, Disclosure and Security Division may not be redelegated. The authority delegated in this paragraph to Regional Commissioners may be redelegated not lower than Assistant Regional Commissioner. The authority delegated in this paragraph to the District Directors of Key Districts may be redelegated, but not below Chiefs, Technical Review Staffs, Employee Plans and Exempt Organizations Division. The authority delegated in this paragraph to Service Center Directors may be redelegated, but not lower than Section Chiefs (or their equivalent). The authority delegated in this paragraph to the Director, National Computer Center and Director Data Center may be redelegated, but not lower than Branch Chiefs (or their equivalent).

(b) Returns or return information, including compensation information, to officers and employees of the Department of Labor and Pension Benefit Guaranty Corporation for the administration of Titles I and IV of the Employee Retirement Income Security Act of 1974, upon written request and subject to the conditions prescribed in IRC 6103(1)(2) and the Treasury Regulations thereunder. The returns or return information which may be disclosed under this

paragraph include:

(i) Upon specific written request, the information specified in 26 CFR 301.6103(1)(2)-1(a), 2(a), 3(b)(1), and 3(b)(2);

(ii) Upon receipt by the Commissioner of Internal Revenue of an annual written request, the information specified in 26 CFR 301.6103(1)(2)-3(a),

(iii) Upon receipt by the Commissioner of Internal Revenue of a general written request, information specified in 26 CFR 301.6103(1)(2)-3(d).

The authority delegated in this paragraph to the Assistant Commissioner and Deputy Assistant Commissioner (Employee Plans, and Exempt Organizations) may be redelegated, but not lower than Branch Chiefs, Employee Plans Technical and Actuarial Division. The authority delegated in this paragraph to the Director and Assistant Director, Disclosure and Security Division may not be redelegated. The authority delegated in this paragraph to Regional Commissioners may be redelegated not lower than Assistant Regional Commissioner. The authority delegated in this paragraph to District Directors of the Key Districts may be redelegated, but not lower than Chiefs, Technical Review Staff, Employee Plans and Exempt Organizations Division; Group Managers, Employee Plans and Exempt Organizations Division, and Employee Plans Specialist. The authority delegated in this paragraph to Service Center Directors may be redelegated, but not lower than Section Chiefs (or their equivalent). The authority delegated in this paragraph to the Director, National Computer Center and Director, Data Center may be redelegated but not lower than Branch Chiefs (or their equivalent). The authority delegated in this paragraph is also delegated to the Director, Appeals Division, Regional Director of Appeals; Chief Appeals Office; and Associate Chief, Appeals Office and may not be redelegated.

(11) The Deputy Commissioner; Associate Commissioner (Operations); Assistant Commissioner (Employee Plans and Exempt Organizations); and Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) are authorized to disclose or, in specific instances, authorize the disclosure of drafts of proposed exemptions or of proposed denials of exemption requests, denial letters, and copies of information submitted by taxpayers requesting exemptions to the proper officers of the Department of Labor for consultation and coordination as required by IRC 4975(c)(2). The authority delegated in this paragraph may be redelegated not lower than Branch Chiefs, Employee Plans Technical and Actuarial Division.

(12) Disclosure of information to appropriate Federal, State or local law enforcement officials may be made by Internal Revenue Service employees, and employees of the Office of Chief Counsel, concerning non-tax crimes which do not involve return information or the income or other financial information of an individual or entity, in accordance with the provisions of Chapter (35)00 of the Disclosure of Official Information Handbook, IRM 1272. In situations where there is a question as to whether the information to be disclosed is or is not return information, such as those described in IRM 1272, the Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors are authorized to approve or deny such requests for disclosure. The Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordination with the Disclosure Litigation Division, Office of Chief Counsel, Regional Commissioners; District and Service Center Directors; and Assistant District and Service Center Directors should act in all such matters only after coordination with the Office of Regional or District Counsel, as appropriate. The authority delegated in this paragraph may not be redelegated.

(13) The authority vested in the Commissioner of Internal Revenue by 26 CFR 301.9000-1 is delegated by this Order to the Deputy Commissioner. It is also delegated to the following officials to the extent described below. [No authorization is needed in cases referred to the Department of Justice which are discussed in paragraph (1)(c) where the testimony or disclosure is made on behalf of the government.]

(a) Regional Commissioners are authorized to determine whether officers and employees of the Internal Revenue Service assigned to their regions, including employees of the Office of the Regional Counsel, but not including employees of the Regional Inspector, will be permitted to testify or produce Service records because of a request or demand for the disclosure of such records or information. The Regional Commissioners should act in all such matters only after coordination with the Office of Regional Counsel. However, the personal testimony of a Regional Commissioner shall require authorization in accordance with (b) below. The authority delegated in this paragraph may not be redeledated. (See (d) and (e) below.) The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 Federal Register 58017 (1979), which provides the authority for disclosure of Internal Revenue Service records and information in tax court proceedings.)

(b) The Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) are authorized to determine whether Regional Commissioners, officers and employees of the Internal Revenue Service assigned to the National Office, including employees of the Office of Chief Counsel, and employees assigned to Regional Inspectors will be permitted to testify or produce Service records because of a request or demand for the disclosure of such records or information. The Assistant Commissioner (Support and Services) or the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after coordina-

tion with the Disclosure Litigation Division, Office of Chief Counsel. The authority delegated in this paragraph may not be redelegated. (See (d) and (e) below.) The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 Federal Register 58017 (1979).)

(c) The District Directors and Service Center Directors are authorized to determine whether officers and employees of the Internal Revenue Service assigned to their district or service center (including regional appellate employees located in the district) will be permitted to testify or produce Service records because of a request or demand for disclosure of such records or information. For purposes of this paragraph, employees of the Office of the District Counsel come under the authority of the District Director. Employees of the Regional Inspector are covered under paragraph (b), above. The District and Service Center Directors should act in all such matters only after coordination with the Office of the District Counsel. However, the personal testimony of a District Director or Service Center Director shall require authorization in accordance with (a) above. The authority in this paragraph may not be redelegated. (See (d) and (e) below.) The authority delegated in this paragraph shall not extend to the disclosure of Internal Revenue Service records and information in response to a subpoena or request or other order of the Tax Court. (See General Counsel Order No. 4, 44 Federal Register 58017 (1979).)

(d) The authority delegated in paragraphs (a), (b) and (c) shall not extend to testimony on the production of Service records because of a request or demand for the disclosure of such records or information:

(i) By a Congressional Committee;

(ii) Involving a disclosure to the President or certain other persons pursuant to IRC 6103(g);

(iii) Involving a disclosure to the Comptroller General pursuant to IRC 6103(i)(7); or

(iv) Involving a disclosure to correct a misstatement of fact pursuant to IRC 6103(k)(3).

(e) The Director, General Legal Services Division and Assistant Regional Counsel (GLS), with the concurrence of the Director, General Legal Services Division are authorized to determine whether officers and employees of the Internal Revenue Service, including employees of the Office of Chief Counsel, will be permitted to testify or produce internal revenue records or information because of a request or demand for the Disclosure of such records or information, if the request or demand is made in connection with personnel or claimant representative matters under the jurisdiction of the General Legal Services Division for which they have been delegated authority to disclose returns or return information as described in paragraph 1(d). The authority delegated above in this paragraph to the Director, General Legal Services Division may be redelegated only to the Assistant Director, General Legal Services Division and to Branch Chiefs and attorneys of the Office of Chief Counsel directly involved in such matters. This paragraph does not limit the authority granted in (a), (b), or (c) above.

(f) The authority delegated to Regional Commissioners and District and Service Center Directors in paragraphs (a) and (c) shall not extend to testimony or the production of Service records because of a request or demand for the disclosure of such records or information which may require a disclosure to a competent authority under a tax convention, whether or not such records or information were previously disclosed pursuant to such convention. The Associate Commissioner (Policy and Management), Assistant Commissioner (Support and Services) and the Deputy Assistant Commissioner (Support and Services) should act in all such matters only after authorization by the appropriate United States competent authority. (See Delegation Order 114, as revised).

(g) In addition to paragraphs (a), (b), (c) and (e) above, authority is further delegated to Regional Commissioners; Assistant Regional Commissioners (Resources Management); Regional Inspectors; Regional and District Counsel; District and Service Center Directors; and Director, Data Center, to release or, in specific instances, authorize the release of information from the leave and payroll records of employees under their jurisdiction, and to the Fiscal Management Officer to release or, in specific instances, authorize the release of information from the leave and payroll records of all employees of the National Office, when such information is requested or subpoenaed in connection with private litigation, upon determination that release of the information would not be detrimental to the Internal Revenue Service. This delegation does not include authority to release or authorize the release of information contained in official personnel folders, which is covered by IRM 0293. When any uncertainty exists as to the availability of furnishing leave and pay information in a particular case, the matter should be referred to the National Office, Attention: PM:PFR:F, with a complete report of the circumstances. The authority delegated in this paragraph may not be redelegated.

The provisions of this paragraph (13(a)-(g)) are limited to the authorization of testimony or the production of documents pursuant to a request or demand as referred to in paragraphs (d)(1)(i) and (ii) of 26 CFR 301.9000-1 and does not extend to or affect other disclosure authority previously delegated in paragraphs (6) and (9) of this order. Furthermore, in instances where it is anticipated that the testimony or production of Service records by a Chief Counsel attorney will involve matters which may fall within the attorney-client privilege, the determination of whether to waive the privilege, as well as the authority to authorize the testimony or production shall lie with the Assistant Commissioner (Support and Services) and Deputy Assistant Commissioner (Support and Services) who will act in these matters only after coordination

with the Disclosure Litigation Division. In instances involving Regional or District Counsel attorneys and the attorney-client privilege, authority shall lie with the Regional Commissioner who will act in these matters only after coordination with the Regional Counsel.

(14) The Deputy-Commissioner; Associate Commissioner (Data Processing); Assistant Commissioner (Computer Services); Deputy Assistant Commissioner (Computer Services); Regional Commissioners; Director, Software Division; Director, National Computer Center; and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of individual master file information to the head of a Federal, State or local child support enforcement agency or an authorized supervisory official under a contractual agreement entered into pursuant to Delegation Order 100, as revised, Revenue Procedure 78-10, and subject to the conditions prescribed in IRC 6103(1)(6)(A)(i). Such contractual agreement should be entered into only after coordination with the Director or Assistant Director, Disclosure and Security Division. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate.

(15) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners, and Service Center Directors are authorized to disclose or, in specific instances, authorize the disclosure of return information to the head of a Federal, State or local child support enforcement agency or an authorized supervisory official under a contractual agreement entered into pursuant to Delegation Order 100, as revised, Revenue Procedure 78-10, and subject to the conditions prescribed in IRC 6103(1)(6)(A)(ii). Such contractual agreement should be entered into only after coordination with the Director, Disclosure and Security Division. The authority delegated in this paragraph may be redelegated to any supervisory level deemed appropriate.

(16) The Deputy Commissioner; Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Deputy Assistant Commissioner (Support and Services); Regional Commissioners; Service Center Directors; Director, National Computer Center; and Director, Data Center are authorized to disclose or, in specific instances, authorize the disclosure of information returns filed pursuant to part III of subchapter A of IRC chapter 61 to designated personnel of the Social Security Administration for the purpose of carrying out an effective return processing program in accordance with section 232 of the Social Security Act and pursuant to IRC 6103(1)(5). The authority delegated in this paragraph may not be redelegated.

(17) The Deputy Commissioner, Deputy Chief Counsel and Associate Chief Counsel (Litigation) are authorized to disclose or, in specific instances, authorize the disclosure of returns and return information to the designated officers and employees of the Department of Justice pursuant to a written request from the Attorney General, the Deputy Attorney General, or an Assistant Attorney General in a matter involving tax administration, subject to the conditions prescribed in IRC 6103(h)(3)(B). The authority delegated in this paragraph may not be redelegated.

(18) The Deputy Commissioner; Associate Commissioner (Data Processing); Assistant Commissioner (Computer Services); Assistant Commissioner (Returns and Information Processing); Director, Disclosure and Security Division; Assistant Director, Disclosure and Security Division; Service Center Directors and Director, National Computer Center are authorized upon written request to disclose, or in specific instances, authorize the disclosure of return information pursuant to IRC 6103 (h)(6) with respect to the address and status of an individual as a nonresident alien, citizen or resident of the United States to the Social Security Administration or the Railroad Retirement Board for purposes of carrying out responsibilities for withholding tax from social security benefits under IRC 1441.

(19) At the request of the Commissioner of Internal Revenue and with the approval of the Joint Committee on Taxation, the following officials may disclose information with respect to a specific taxpayer pursuant to IRC 6103(k)(3): Deputy Commissioner; Regional Commissioners; District and Service Center Directors; Associate Commissioner (Operations); Associate Commissioner (Policy and Management); Assistant Commissioner (Support and Services); Assistant Commissioner (Examination); Assistant Commissioner (Collection); Assistant Commissioner (Criminal Investigation); Assistant Commissioner (Employee Plans and Exempt Organizations); Director, Disclosure and Security Division; any individual who is specifically designated by the Commissioner of Internal Revenue. The authority delegated in this paragraph may not be redelegated.

(20) To the extent that authority previously exercised consistent with this Order may require ratification, it is hereby affirmed and ratified.

(21) Delegation Order No. 156 (Rev. 4) and Chief Counsel Order 1031.3c, effective November 27, 1983, are superseded.

Approved JOEL S. GERBER,
Acting Chief Counsel.

Approved JAMES OWENS,
Deputy Commissioner.

Delegation Order No. 159 (Rev. 1) (Effective November 27, 1983)

Authority to Waive Minimum Funding Standards and to Perform Corresponding Duties under ERISA

1. Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order 150-37, there is hereby delegated to the Assistant Commissioner (Employee Plans/Exempt Organizations) and the Director, Employee Plans Technical and Actuarial Division, the authority to:

a. Waive the minimum funding standards under IRC 412 in accordance with subsection (d), thereof, and

b. Perform the corresponding duties of the Secretary of the Treasury under section 303 of the Employee Retirement Income Security Act of 1974 (ERISA) with respect to the minimum funding standards under ERISA section 302.

2. For purposes of this Order, a substantial waiver is a waiver with respect to a plan's minimum funding requirements for a plan year which, based on information reported to the Internal Revenue Service, exceeds one million dollars.

3. Authority delegated in this Order may not be redelegated except that the Director, Employee Plans Technical and Actuarial Division may redelegate the authority contained in paragraph 1 to Branch Chiefs, Employee Plans Technical and Actuarial Division, for such waivers which are not determined substantial as defined in paragraph 2.

4. Delegation Order No. 159, effective October 8, 1976, is superseded.

Dated: November 22, 1983.

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on December 12, 1983; 8:45 a.m., and published in the issue of the Federal Register for December 13, 1983, 48 F.R. 55531)

Delegation Order No. 172 (Rev. 1) (Effective November 27, 1983)

Authority to Waive the 100% Excise Tax Imposed Under Section 4971(b) of the Code

1. Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order 150-37, there is hereby delegated to the Assistant Commissioner (Employee Plans and Exempt Organizations) and the Director, Employee Plans Technical and Actuarial Division, the authority to waive all or part of the additional tax imposed under IRC 4971(b) in accordance with subsection (b) of section 3002 of the Employee Retirement Income Security Act of 1974 (ERISA).

2. For purposes of this Order, a substantial waiver is a waiver of the additional tax liability resulting from a computation based on an accumulated funding deficiency in excess of one million dollars.

3. This authority may not be redelegated except that the Director, Employee Plans Technical and Actuarial Division may redelegate the authority contained in paragraph 1 to Branch Chiefs, Employee Plans Technical and Actuarial Division, for a waiver not deemed substantial, as defined in paragraph 2.

4. Delegation Order No. 172, effective October 25, 1978, is superseded.

Dated: November 22, 1983.

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on December 12, 1983; 8:45 a.m., and published in the issue of the Federal Register for December 13, 1983, 48 F.R. 55532)

Delegation Order No. 182 (Rev. 3)

(Effective December 14, 1983)

Authority to Execute Returns

The authority granted to the Commission of Internal Revenue, by 26 CFR 301-6020-1(b) and 26 CFR 301.7701-9 to execute returns required by any internal revenue law or regulation made thereunder when the person required to file such return fails to do so, is delegated to:

1. Revenue Agents;
2. Tax Auditors;
3. Revenue Officers, GS-9 and above;
4. Collection Office function managers, GS-9 and above;
5. Automated Collection Branch managers, GS-9 and above; and
6. Service Center Collection Branch managers, GS-9 and above.

The authority delegated herein may not be redelegated.

Delegation Order No. 182 (Rev 2) [1983-2 C.B. 409], effective March 7, 1983, is superseded.

Dated: November 29, 1983.

Approved:

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on December 29, 1983, 8:45 a.m., and published in the issue of the Federal Register for December 29, 1983, 48 F.R. 57400)

Delegation Order 204

(Effective December 5, 1983)

Authority To Approve Rewards for Information Relating to Violations of Internal Revenue Laws

The authority vested in the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701-9 and 301.7623-1 to approve rewards for information relating to violations of internal revenue laws is hereby delegated to Service Center Directors.

This authority may be redelegated not lower than Chief, Examination Branch.

Dated: October 30, 1983.

Approved:

JAMES I. OWENS,
Deputy Commissioner.

(Filed by the Office of the Federal Register on December 12, 1983, 8:45 a.m., and published in the issue of the Federal Register for December 13, 1983, 48 F.R. 55532)

Boycott Provisions (Section 999) of the Internal Revenue Code; Additional Boycott Guidelines

Notice 84-1

AGENCY: Office of the Secretary, Treasury.

ACTION: Notice of additional guidelines.

SUMMARY: This document contains proposed additional guidelines relating to those provisions of the Tax Reform Act of 1976 [1976-3 C.B. (Vol. 1) 1] found in section 999 of the Internal Revenue Code, which deny certain tax benefits for participation in or cooperation with international boycotts. These proposed guidelines consist of corrections or clarifications of earlier guidelines and new guidelines which will elaborate on the Department of the Treasury's enforcement of section 999, primarily in the areas of compliance with local laws and the use of vessel eligible clauses.

DATE: Comments must be received on or before Jan 23, 1984.

ADDRESS: Send comments to: Office of the General Counsel, Department of the Treasury, 15th & Pennsylvania Avenue, NW., Washington, DC 20220. Attention: David D. Joy.

FOR FURTHER INFORMATION CONTACT: David D. Joy, Office of the General Counsel, Department of the Treasury, 15th & Pennsylvania Avenue, NW., Washington, DC 20220, (202)-566-5569—not a toll-free call).

SUPPLEMENTARY INFORMATION:

This document contains proposed additional guidelines relating to the Department of the Treasury's enforcement of section 999 of the Internal Revenue Code. Section 999 incorporates provisions of the Tax Reform Act of 1976 (90 Stat. 1649-54), specifically sections 1061-1064 (known as the "Ribicoff Amendment") [1976-3 C.B. (Vol. 1) 1, 126-129] which deny certain tax benefits for participation or cooperation with international boycotts. Published guidelines which are still in effect today are found at 44 FR 66272 (November 19, 1979) [1979-2 C.B. 495] and 43 FR 3454 (January 25, 1978) [1978-1 C.B. 521]

EXECUTIVE ORDER 12291

The Department of the Treasury has determined that these guidelines are not a major rule as defined in Executive Order 12291, and that a Regulatory Impact Analysis is therefore not required.

COMMENTS

Before these proposed guidelines are adopted, consideration will be given to any written comments that are timely submitted to the Office of the General Counsel. All written comments will be available for public inspection and copying at the Department of the Treasury Library, 5th Floor, Department of the Treasury, 15th and Pennsylvania Avenue NW., Washington, D.C.

DRAFTING INFORMATION

The principal author of these proposed guidelines is Leonard Santos, formerly of the Office of the General Counsel, Department of the Treasury. David Joy from the Office of the General Counsel also participated in developing the proposed guidelines.

It Is Proposed To Amend the Guidelines as Follows:

* * * * *

A-9 (correction). Q: Section 999(b)(4) permits a person to agree to comply with certain laws without being treated as having agreed to participate in or cooperate with an international boycott. In the course of its operations in or related to a boycotting country, a person agrees to comply with a prohibition on importation and exportation that is described in section 999(b)(4)(B) and section 999(b)(4)(C). Is that person required to report the operations on Form 5713?

A: Yes. Although agreements described in section 999(b)(4)(B) and (C) do not constitute participation in or cooperation with an international boycott, the operations in or related to a boycotting country must be reported on Form 5713. However, requests to enter into agreements described in section 999(b)(4)(B) and (C) are not reportable on Form 5713.

* * * * *

J-3 (correction). Q: Company C competes for an industrial plant construction contract for which Company P of Country W is inviting international tenders. The contract is to be financed by Country X which maintains a blacklist of companies. Country X requires contracts for projects which it finances to state that the contractor is required to refrain from making any purchase for project from any blacklisted company. Country W does not boycott those companies. Company C wins the tender and signs the contract with Company P with the blacklist provision. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)(A)(ii)?

A: Generally, yes (see Guideline H-1A). Although the boycott is not implemented by Country W, but by Country X, and the project is being carried out in Country W, Company C has agreed not to do business with blacklisted U.S. companies as a condition of doing business indirectly with Country X. Similarly, if the contract financed by Country X in Country W precluded the use of Country Y goods in connection with the project in Country W, the exception reflected in section 999(b)(4)(B) would apply to Company C's agreement and that agreement would not constitute participation in or cooperation with an international boycott.

* * * * *

M-5 (correction). Q: Company C enters into a contract to export goods to or from Country X. The contract requires Company C not to ship the goods on a Country Y flag vessel or on a vessel owned, controlled, operated or chartered by Country Y or by companies or nationals of Country Y, or on a ship which during the voyage calls at Country Y enroute to or from Country X. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)?

A: No. The requirement in the contract is not a restrictive boycott practice. Rather, the contract provision is presumed to arise from the need to protect goods from damage or loss. However, this answer would not cover a restriction on the choice or route of a vessel when it carries no goods destined for or originating in Country X. The presumption described in this answer arises in every case where such clauses are used in connection with countries which are hostile to each other.

* * * * *

M-7 (correction). Q: Company C signs a contract to export goods to Country X. The contract provides that the goods may not be shipped on a vessel that has been blacklisted by Country X because it has called at Country Y in the past. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)(b)?

A: Yes.

* * * * *

It is proposed to add the following Guidelines

* * * * *

C-2. Q: Company C is engaged in

the sale of machinery to Country W. Company C has no knowledge or reason to know that Country W requires participation in or cooperation with an international boycott as a condition of doing business within Country W or with its government, companies or nationals, except that Company C is asked to sign a contract with Country W of the type described in Guideline M-5. Does Company C have knowledge that Country W is a boycotting country such that its operations with Country W are reportable?

A: No. Where the only Country W requirements of which Company C knows or has reason to know involve requests which, if agreed to, are not defined to constitute participation in or cooperation with an international boycott, Company C has no reason to treat Country W as a boycotting country.

* * * * *

H-37. Q: Company C signs a contract which provides that in connection with its performance Company C acknowledges that the import and customs laws and regulations of Country X shall apply to the furnishing and shipment of any products or components thereof to Country X, and that Company C acknowledges that such import and customs laws and regulations prohibit, among other things, the importation into Country X of products or components: (1) originating in Country Y; (2) manufactured, produced or furnished by companies organized under the laws of Country Y; and (3) manufactured, produced or furnished by nationals or residents of Country Y. Does Company C's contract constitute an agreement under section 999(b)(3)?

A: No. (see Guideline H-3). Company C has merely acknowledged that such import and customs laws shall apply to the furnishing of goods under the contract. However, an agreement by Company C to comply with Country X's restriction on the importation of goods furnished either by companies organized under Country Y's laws or by nationals of Country Y would constitute an agreement under section 999(b)(3).

H-38. Q: Company C signs a contract in which it agrees to comply with the laws, rules and regulations of Country X, except to the extent such compliance is penalized under laws of the United States. Does Company C's contract constitute an agreement under section 999(b)(3)?

A: No. An agreement to comply with the laws, rules and regulations of Country X does not constitute an agreement under section 999(b)(3) when such a commitment is qualified by excepting out compliance penalized by U.S. law, including section 999. Any phrase which effectively excludes the agreements described in section 999 from the requirements of a contract with Country X would support the same result. For example, a compliance clause qualified by "except to the extent inconsistent with U.S. law" would also suffice to take the contract out of the coverage of section 999. However, a compliance clause qualified by the phrase "except to the extent *prohibited* by U.S. law" would not defeat the presumption that the contractual provision requires agreements penalized under section 999, since section 999 does not prohibit anything, but merely penalizes certain agreements.

H-39. Q: Company C signs a contract to construct an industrial plant in Country X. The contract states that the laws, regulations, requirements or administrative practices of Country X shall govern Company C's performance of the contract in Country X. The laws, regulations, requirements or administrative practices of Country X prohibit the importation into Country X of goods manufactured by any company engaged in trade in Country Y or with the government, companies or nationals of Country Y. Does Company C's action constitute an agreement under section 999(b)(3)?

A: No. (see Guideline H-3). The answer would be the same if the contract had instead stated that Company C would be "subject to" the laws, regulations, requirements or administrative practices of Country X.

H-40. Q: Company A signs a contract to export goods to Country X. The contract provides that payment will be made by means of a letter of credit confirmed by Bank C. The letter of credit requires Company A to provide Bank C a certificate stating that the ship on which the goods are to be shipped is eligible to enter the ports of Country X in conformity with its laws and regulations, and that the insurer of the goods has a duly qualified and appointed agent or representative in Country X. Country X's laws and regulations prohibit, *inter alia*, black listed vessels from calling at its ports and blacklisted insurance companies from qualifying or appointing an agent in Country X. Bank C confirms the letter of credit requiring the shipping and insurance certificates. Does Bank C's action constitute an agreement under section 999(b)(3)?

A: Yes. Unless Country X has offered the kind of explanation described in Guidelines M-12 and M-13, Bank C's confirmation of the letter of credit constitutes an agreement to refrain from doing business with a U.S. person under section 999(b)(3)(A)(ii). The answer would be the same under section 999(b)(3)(A)(i), if the beneficiary of the letter of credit were organized under the laws of Country Y, and under section 999(b)(3)(A)(iii), if Bank C had reason to know that it would not be able to obtain the required certificate because of the nationality, race, or religion of the beneficiary's ownership, management, or directors. See Guideline H-29 A.

* * * * *

L-6. Q: Company C signs a construction contract that provides that Company C is not to employ individuals or nationals of any country not diplomatically recognized by Country X. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)(A)(iv)?

A: To the extent that Country Y is only one of several countries not recognized by Country X, the exclusion of nationals from unrecognized countries under the contract is not, on its face, boycott related. In those circumstances, agreement to the clause in question would not constitute an agreement to participate in or cooperate with an international boycott un-

der section 999(b)(3). However, where Country Y is the only country not recognized by Country X, agreement to such a clause will constitute an agreement to participate in or cooperate with an international boycott under section 999(b)(3).

* * * * *

M-15. Q: Company C signs a contract to export goods to Country X. The contract provides that payment will be made by means of a letter of credit confirmed by Bank C. The letter of credit requires Company C to provide to Bank C a certificate stating that the goods are being shipped on a U.S. or Country X flag carrier *or*, alternatively, that the ship on which the goods are being shipped is eligible to enter the ports of Country X. Company C provides a certificate stating that the goods have been shipped on a U.S. or Country X flag carrier. Does Company C's acceptance of the letter of credit constitute an agreement under section 999(b)(3)?

A: No. Where the letter of credit requires alternative certifications, one of which is acceptable within the terms of section 999(b)(3), and Company C performs in accordance with that acceptable alternative (i.e., shipping on a U.S. or Country X flag carrier), it is presumed that Company C's agreement included only the acceptable alternative. If Company C were to utilize a ship "eligible to enter the ports of Country X," Guideline M-10 would apply.

Dated: November 16, 1983.

JOHN E. CHAPOTON,
Assistant Secretary
(Tax Policy).

(Filed by the Office of the Federal Register on November 22, 1983, 8:45 a.m., and published in the issue of the Federal Register for November 23, 1983, 48 F.R. 53003)

Exempt Organizations Filing Requirements

Notice 84-2

Section 6033(a)(1) of the Internal Revenue Code generally requires all tax-exempt organization to file an annual information return on Form 990.

Section 6033(a)(2)(A) provides for certain mandatory exceptions from filing such a return, specifically including churches, their integrated auxiliaries, and conventions or associations of churches.

Section 6033(a)(2)(B) provides that organizations may be relieved from filing annual information returns (Form 990s) where the filing is not necessary to the efficient administration of the internal revenue laws. Pursuant to section 6033(a)(2)(B), the following classes of organizations have been relieved from filing effective for tax years ending on or after December 31, 1976:

1. Section 501(c)(3) organizations which are operated, supervised, or controlled by one or more churches, integrated auxiliaries, or conventions or associations of churches, and

(a) which are exclusively engaged in financing, funding the activities of, or managing the funds of

(1) a church, integrated auxiliary, or convention or association of churches, or

(2) a group of organizations substantially all of which are described in (a)(1), if substantially all of its assets are provided by, or held for the benefit of, organizations described in (a)(1); or

(b) which maintain retirement insurance programs primarily for organizations described in (a)(1), so long as

(1) more than 50 percent of the individuals covered by the programs are directly employed by those organizations, or

(2) more than 50 percent of the assets are contributed by, or held for the benefit of, employees of those organizations.

2. Section 501(c)(3) organizations which are operated, supervised, or controlled by one or more religious orders and which are engaged in financing, funding, or managing assets used for exclusively religious activities.

These changes were made because these organizations are vehicles that churches, integrated auxiliaries, conventions or associations of churches, and religious orders use to finance their activities or manage their funds. In addition, some of these organizations engage in the more limited activity of providing retirement benefits primarily to church employees. Requiring these organizations to file annual information returns would be equivalent to requiring churches, integrated auxiliaries, conventions or associations of churches and religious orders to file annual information returns when they are not otherwise required to do so.

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 84-3

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the April-June quarter of 1984, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.3511
Tier 3 oil	0.4780

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service

Notice 84-4

AGENCY: Department of the Treasury.

ACTION: Final rule.

SUMMARY: This document contains final regulations governing practice before the Internal Revenue Service (IRS) to set standards for providing opinions used in the promotion of tax shelter offerings. The final regulations reflect the Treasury Department's concern about the prolif-

eration of abusive tax shelters in recent years and the role of the IRS practitioner's opinion in the promotion of such shelters. The regulations address the problem by imposing duties upon IRS practitioners who furnish opinions for use in connection with tax shelter offerings.

DATES: These final regulations are effective with respect to tax shelter opinions provided after May 23, 1984.

FOR FURTHER INFORMATION CONTACT: Mr. Leslie S. Shapiro, Director of Practice, Department of the Treasury, Washington, D.C. 20220, (202) 634-5135 (non toll free).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 4, 1980, the *Federal Register* (45 FR 58594) published for public comment a proposed rule that would amend the regulations governing practice before the IRS contained in 31 CFR, Part 10 (Treasury Department Circular No. 230). Among other things, the proposed rule would have required an IRS practitioner to comply with certain standards when providing a tax shelter opinion.

In addition, on November 17, 1980, the *Federal Register* (45 FR 75835) published a notice inviting comments from the public on the desirability of establishing an advisory committee to advise the Treasury Department on issues arising out of the standards proposed in the regulations for tax shelter opinions.

On January 29, 1982, the American Bar Association (ABA) issued a revised Formal Opinion 346 relating to the obligations of an attorney in issuing a tax shelter opinion. Unless otherwise noted, references herein to "ABA Opinion 346" refer to the Opinion in its revised form.

On December 15, 1982, a modified proposed rule was published in the *Federal Register* (47 FR 56144) (hereinafter referred to as the "proposed rule") which substantially modified the 1980 proposal in order to follow standards more nearly consistent with those set forth in ABA Opinion 346. The proposed rule required a practitioner who renders a tax shelter opinion to exercise responsibility with respect to the accuracy of the relevant facts; apply the law to the particular facts of the tax shelter offering; ascertain that all material Federal tax issues have been considered; where possible, provide an opinion as to the likely outcome on the merits of each material tax issue; provide an evaluation of the extent to which the material tax benefits in the aggregate will be realized; and assure that the nature and extent of the tax shelter opinion is described correctly in the offering materials.

Approximately fifteen written comments on the proposed rule were received from bar associations, accounting groups, individual attorneys, and accountants. After consideration of all comments regarding the proposed rule, it is hereby adopted as modified for clarification.

EXPLANATION OF CHANGES

The final rule adopted herein continues to follow the general guidelines of ABA Opinion 346, as did the proposed rule, and the "Supplementary Information" contained in the December 15, 1982, Notice of Proposed Rulemaking. However, various changes of a clarifying and stylistic nature have been made in the final rule. The more important changes, and the reasons for not making certain other suggested changes, are discussed below.

GENERAL COMMENTS

A number of comments were received which generally supported the proposed rule, while others suggested that the proposed rule should be withdrawn. Some of the reasons given to withdraw the proposal included the contention that the proposed rule exceeded Treasury's statutory authority; that the rule is unnecessary in light of the publication of ABA Opinion 346 and recent statutory provisions directed at tax shelters added to the tax law; and that it would have little effect on persons who wish to participate in abusive tax shelters.

Treasury determined that the proposed rule should be finalized for several reasons. First, the legal profession has, by publication of ABA Opinion 346, recognized that attorneys have unique ethical responsibilities when they render tax shelter opinions to persons who are not their clients. This action by the ABA reinforces Treasury's belief that tax practitioners must meet minimum standards of conduct with respect to tax shelter opinions, and that those who do not may be subject to suspension or disbarment from practice before Treasury.

Treasury has independent statutory authority to discipline incompetent and unethical conduct by practitioners,[1] while the ABA lacks such authority. State regulatory bodies may choose not to exercise their authority to regulate tax shelter opinions, or they may fail to follow uniform regulatory standards. In addition, certified public accountants, enrolled agents and enrolled actuaries also my practice before the IRS. For these reasons, action by Treasury is needed.

Finally, rules relating to tax shelter opinions complement the new penalties and other tax law changes made by Congress relating to tax shelters. For example, the new penalty for substantial understatements of tax liability under Internal Revenue Code section 6661 has increased the significance of determining whether there is sufficient legal authority for a position taken on a tax return. Thus, it is even more important than before that a prospective investor receive accurate and complete tax advice in the opinion as to the merits of the tax shelter offering. The final rule should help to improve the quality of this advice.

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[1] 31 U.S.C. 330(b), relating to suspension or disbarment from practice before Treasury, provides:

(b) After notice and opportunity for a proceeding, the Secretary [of the Treasury] may suspend or disbar from practice before the Department [of the Treasury] a representative who—

(1) Is incompetent;

(2) Is disreputable;

(3) Violates regulations prescribed under this section; or

(4) With intent to defraud, willfully and knowingly misleads or threatens the person being represented or a prospective person to be represented.

However, the regulations in this final rule are not intended to preclude local law and regulation from governing the preparation, issuance and dissemination of tax shelter opinions. However, regardless of the existence of local authority on the subject, the tax practitioner must observe and comply with the Treasury Department's regulations in order to avoid Treasury sanctions for misconduct thereunder.

Several commenters requested clarification of Treasury's position regarding "negative opinions" as set forth in the Supplementary Information accompanying the proposed rule. The final rule does not prohibit negative opinions, provided that all of the other requirements of the tax shelter opinion rules are met. However, it should be noted that a negative opinion may subject a practitioner to discipline under the final rule if it is not correctly, fairly and clearly described in the offering materials.

SPECIFIC COMMENTS

1. Due Diligence as to Factual Matters

The proposed rule required a practitioner to exercise a degree of diligence with respect to the accuracy of factual matters relevant to a tax shelter opinion. Several comments stated that the proposed rule on this subject was unclear as to the scope of the practitioner's responsibility to verify the facts.

The Supplementary Information for the proposed rule stated that the applicable standards in this area generally were the same as those set forth in ABA Formal Opinion 346 and ABA Formal Opinion 335 (dealing with assumed fact opinions in connection with sale of unregistered securities). The final rule has been modified to incorporate a statement of the appropriate standards directly into the rule. Section 10.33(a)(1) now provides that a practitioner generally need not conduct an independent verification of the facts unless he knows, or should know, that the facts provided to him by the promoter or another person are untrue. Furthermore, a practitioner may accept without further inquiry an asserted valuation of property, an appraisal, or a projection, as support for the matters claimed therein only if they make sense on their face, and, in the case of an appraisal or projection, the practitioner reasonably believes that the person providing the appraisal or projection is competent to do so. Finally, if a valuation of purchased property is based on its stated purchase price, the practitioner must examine the circumstances surrounding the purchase to determine whether the stated purchase price reasonably may be considered to be the fair market value of the property.

2. Opinion on Each Material Tax Issue

Under the proposed rule, practitioners were required to render an opinion on each material tax issue in the offering. The final rule clarifies that an opinion is necessary only with respect to material issued that involve a reasonable possibility of a challenge by the IRS.

Under the rule, opinions are required only "where possible." Treasury will give cases in which practitioners conclude that opinions are not possible special scrutiny to prevent recurrence of the practice of rendering tax shelter "opinions" that do not truly express any opinion at all. Such "opinions" may be issued to mislead investors, who may believe that the practitioner's participation in the shelter offering is an endorsement of the shelter.

3. Overall Evaluation

The proposed rule required a practitioner to make an overall evaluation of the extent to which the tax benefits of the tax shelter in the aggregate were likely to be realized. The final rule has been clarified to provide that such an overall opinion need be rendered only where it is possible to do so. As with opinions on material tax issues, Treasury expects that it will be possible to render an overall evaluation in the great majority of cases (a view shared by ABA Opinion 346).

The final rule specifically requires that the existence of an unfavorable overall evaluation, or an opinion that concludes that an overall evaluation is not possible, must clearly be disclosed in the offering materials.

One comment suggested that reference to "aggregate" tax benefits is ambiguous since no guidelines were provided for making the evaluation. The final rule clarifies the purported ambiguity by defining a favorable overall evaluation as one concluding that substantially more than half of the material tax benefits of the tax shelter, in terms of their financial impact on a typical investor, more likely than not will be realized. Any other conclusion should be viewed as a less than favorable overall evaluation and should be set forth prominently in the opinion as such. Further, several examples of how the overall evaluation requirement is to be applied in typical tax shelter situations are provided.

4. Partial Opinions

The proposed rule permitted a practitioner to render an opinion on less than all the material tax issues if certain conditions were met. In particular, a partial opinion could be given only if the practitioner had no reason to believe that the overall evaluation of the tax shelter provided by another practitioner was incorrect.

Several comments expressed concern that the duty to examine the correctness of the overall evaluation is unduly burdensome to a practitioner hired to render only a partial opinion. The proposed rule was not intended to impose unreasonable burdens on practitioners who give partial opinions. The final rule now provides that the practitioner giving the partial opinion must have no reason to believe that the overall evaluation is incorrect on its face. It is anticipated that practitioners will meet this requirement by reviewing the overall evaluation to determine if it makes sense on its face, based on the practitioner's knowledge and experience, and if it is internally consistent with the opinions rendered on each material tax issue of the shelter.

In addition, comments by certified public accountants have requested clarification of the applicability of the final rule to practitioners who are associated with financial forecasts or projections included in tax shelter offering materials. The final rule states

that practitioners who provide such forecasts or projections must comply with the general rules applicable to partial tax shelter opinions.

Financial forecasts or projections often include assumptions as to the tax return reporting positions to be taken with respect to material tax issues. Tax shelter forecasts or projections therefore could mislead investors by implicitly suggesting that the tax return positions they reflect are proper. For this reason, the final rule treats forecasts or projections involving any tax assumptions as "tax shelter" opinions. If the forecasts or projections themselves do not address all of the material tax issues in the required manner, all material tax issues that form the basis for such forecasts or projections must be fully addressed by the practitioner or some other practitioner in a tax opinion (or elsewhere in the offering materials) that meets the criteria set forth in the rules. Furthermore, the practitioner associated with the forecasts or projections will be responsible for rendering an opinion on any material tax issue not addressed in the tax opinion by the other practitioner. Finally, the nature and extent of the forecasts or projections must be described correctly in the offering materials.

5. Definitions

The definition of a tax shelter generated the greatest number of comments. Some comments suggested that the definition used (patterned after that in ABA Opinion 346) was overbroad, and that it should be made consistent with the definition of a tax shelter in Internal Revenue Code section 6661 (penalty for substantial understatements of tax liability). The final rule does not incorporate this suggestion because section 6661 is intended to identify a relatively narrow category of transactions that should be subject to more stringent penalty requirements because their principal purpose is tax avoidance. In contrast, the tax shelter opinion rules serve a different purpose. Merely because an investment has a business or profit objective and is not principally tax motivated does not mean that it does not also have substantial tax shelter features in the eyes of potential investors, or that a full and complete tax opinion is not necessary.

The tax shelter definition in the final rule provides that the tax shelter effect of a transaction must be both substantial and intended. The reason for this modification is to avoid "retroactive" reclassification of an investment as a tax shelter if unintended losses exceed income in a year (for example, when an unsuccessful investment is disposed of or terminated). The offering materials will be given significant weight to determine whether tax shelter benefits are an intended result of the transaction.

The tax shelter definition also was modified to negate an erroneous interpretation by some that real estate investments are not considered tax shelters unless they produce tax losses in every year. If net losses are foreseeable in any year, a real estate investment is a tax shelter. The exclusion from the tax shelter definition for "family trusts" also was amended so that it applied only to family trusts provided in direct practitioner-client relationships, and not to trust schemes that are publicly marketed by promoters.

The definition of "tax shelter opinion" was changed to clarify the fact that an opinion letter or a tax description in a tax shelter offering circular is a tax shelter opinion even if the practitioner's name is not used.

6. Disciplinary Standards, Firm Opinions

In response to several comments, the standards of culpability required to discipline a practitioner for failing to comply with the tax shelter opinion rules or the prohibition against false opinions have been conformed. A violation of the tax shelter opinion rules or the rule relating to false opinions will be subject to discipline if the practitioner violates the rules willfully (or knowingly), recklessly, through gross incompetence, or if the violation is part of a pattern of repeated violations.

The proposed rule provided that in certain circumstances an entire firm could be disciplined for firm opinions that violated the tax shelter opinion standards. In light of comments pointing to the difficulty of imposing sanctions on firms rather than on individual practitioners, this provision has been deleted from the final rule.

7. Advisory Committee

The provision authorizing formation of an Advisory Committee for the Director of Practice has been modified to provide that action by the Committee is to be taken at the request of the Director of Practice.

One comment questioned the ability of the Director of Practice to enforce the tax shelter opinion rules in an impartial manner. Although the Director of Practice is now an official of the Internal Revenue Service, assessment of individual cases is made on an independent basis. Further, the administrative and judicial appeals described in the Supplementary Information accompanying the proposed rule continue to be applicable to disciplinary actions. Treasury believes that these safeguards are sufficient to assure that the tax shelter opinion rules will be administered in a fair and equitable manner.

8. Return Preparation

In order to clarify §10.7 of the regulations, the heading is being changed to address its full scope.

EXECUTIVE ORDER 12291

It has been determined that this rule is not a major rule as defined in Executive Order 12291. This rule relates solely to practice before the IRS and is not expected to have any significant economic consequences.

REGULATORY FLEXIBILITY ACT

This rule is not subject to the provisions of the Regulatory Flexibility Act since the initial Notice of Proposed Rulemaking was published before January 1, 1981, the effective date of the Act.

DRAFTING INFORMATION

The principal author of these regulations is Mr. Leslie S. Shapiro, Director of Practice, Department of the Treasury. Other present and former personnel in the Treasury Department participated in the development of the regulations, both as to substance and style.

LIST OF SUBJECTS IN 31 CFR PART 10

Administrative rules and procedures, Lawyers, Accountants, Enrolled agents, and Enrolled actuaries.

Authority: These final rules are issued under authority of Sec. 3. 23 Stat. 258, secs. 2-12, 60 Stat. 237 et seq.; 5 U.S.C. 301; 31 U.S.C. 330; 31 U.S.C. 321 (Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949-53 Comp., p. 1017).

ADOPTION OF AMENDMENTS TO REGULATIONS

Accordingly, 31 CFR Part 10 is amended as follows:

§10.2 [Amended]

1. In §10.2, paragraph (a) is amended by removing the third sentence.

2. Section 10.7 is amended by revising the heading and by adding paragraph (c), to read as follows:

§10.7 Limited practice; special appearances; return preparation and furnishing information.

* * * * *

(c) *Preparation of tax returns and furnishing information.* Any person may prepare a tax return, may appear as a witness for the taxpayer before the Internal Revenue Service, or furnish information at the request of the Internal Revenue Service or any of its officers or employees.

3. Section 10.33 is added to read as follows:

§10.33 Tax shelter opinions.

(a) *Tax shelter opinions and offering materials.* A practitioner who provides a tax shelter opinion analyzing the Federal tax effects of a tax-shelter investment shall comply with each of the following requirements:

(1) *Factual matters.* (i) The practitioner must make inquiry as to all relevant facts, be satisfied that the material facts are accurately and completely described in the offering materials, and assure that any representations as to future activities are clearly identified, reasonable and complete.

(ii) A practitioner may not accept as true asserted facts pertaining to the tax shelter which he/she should not, based on his/her background and knowledge, reasonably believe to be true. However, a practitioner need not conduct an audit or independent verification of the asserted facts, or assume that a client's statement of the facts cannot be relied upon, unless he/she has reason to believe that any relevant facts asserted to him/her are untrue.

(iii) If the fair market value of property or the expected financial performance of an investment is relevant to the tax shelter, a practitioner may not accept an appraisal or financial projection as support for the matters claimed therein unless:

(A) The appraisal or financial projection makes sense on its face;

(B) The practitioner reasonably believes that the person making the appraisal or financial projection is competent to do so and is not of dubious reputation; and

(C) The appraisal is based on the definition of fair market value prescribed under the relevant Federal tax provisions.

(iv) If the fair market value of purchased property is to be established by reference to its stated purchase price, the practitioner must examine the terms and conditions upon which the property was (or is to be) purchased to determine whether the stated purchase price reasonably may be considered to be its fair market value.

(2) *Relate law to facts.* The practitioner must relate the law to the actual facts and, when addressing issues based on future activities, clearly identify what facts are assumed.

(3) *Identification of material issues.* The practitioner must ascertain that all material Federal tax issues have been considered, and that all of those issues which involve the reasonable possibility of a challenge by the Internal Revenue Service have been fully and fairly addressed in the offering materials.

(4) *Opinion on each material issue.* Where possible, the practitioner must provide an opinion whether it is more likely than not that an investor will prevail on the merits of each material tax issue presented by the offering which involves a reasonable possibility of a challenge by the Internal Revenue Service. Where such an opinion cannot be given with respect to any material tax issue, the opinion should fully describe the reasons for the practitioner's inability to opine as to the likely outcome.

(4) *Overall evaluation.* (i) Where possible, the practitioner must provide an overall evaluation whether the material tax benefits in the aggregate more likely than not will be realized. Where such an overall evaluation cannot be given, the opinion should fully describe the reasons for the practitioner's inability to make an overall evaluation. Opinions concluding that an overall evaluation cannot be provided will be given special scrutiny to determine if the stated reasons are adequate.

(ii) A favorable overall evaluation may not be rendered unless it is based on a conclusion that substantially more than half of the material tax benefits, in terms of their financial impact on a typical investor, more likely than not will be realized if challenged by the Internal Revenue Service.

(iii) If it is not possible to give an overall evaluation, or if the overall evaluation is that the material tax benefits in the aggregate will not be realized, the fact that the practitioner's opinion does not constitute a favorable overall evaluation, or that it is an unfavorable overall evaluation, must be clearly and prominently disclosed in the offering materials.

(iv) The following examples illustrate the principles of this paragraph:

Example (1). A limited partnership acquires real property in a sale-leaseback transaction. The principal tax benefits offered to investing partners consist of depreciation and interest deductions. Lesser tax benefits are offered to investors by reason of several deductions under Internal Revenue Code section 162 (ordinary and necessary business expenses). If a practitioner concludes that it is more likely than not that the partnership will not be treated as the owner of the property for tax purposes (which is required to allow the interest and depreciation deductions), then he/she may not opine to the effect that it is more likely than not that the material tax benefits in the aggregate will be realized, regardless of whether favorable opinions may be given with respect to the deductions claimed under Code section 162.

Example (2). A corporation electing under subchapter S of the Internal Revenue Code is formed to engage in research and development activities. The offering materials forecast that deductions for research and experimental expenditures equal to 75% of the total investment

in the corporation will be available during the first two years of the corporation's operations, other expenses will account for another 15% of the total investment, and that little or no gross income will be received by the corporation during this period. The practitioner concludes that it is more likely than not that deductions for research and experimental expenditures will be allowable. The practitioner may render an opinion to the effect that based on this conclusion, it is more likely than not that the material tax benefits in the aggregate will be realized, regardless of whether he/she can opine that it is more likely than not that any of the other tax benefits will be achieved.

Example (3). An investment program is established to acquire offsetting positions in commodities contracts. The objective of the program is to close the loss positions in year one and to close the profit positions in year two. The principal tax benefit offered by the program is a loss in the first year, coupled with the deferral of offseting gain until the following year. The practitioner concludes that the losses will not be deductible in year one. Accordingly, he/she may not render an opinion to the effect that it is more likely than not that the material tax benefits in the aggregate will be realized, regardless of the fact that he/she is of the opinion that losses not allowable in year one will be allowable in year two, because the principal tax benefit offered is a one-year deferral of income.

Example (4). A limited partnership is formed to acquire, own and operate residential rental real estate. The offering material forecasts gross income of $2,000,000 and total deductions of $10,000,000, resulting in net losses of $8,000,000 over the first six taxable years. Of the total deductions, depreciation and interest are projected to be $7,000,000, and other deductions $3,000,000. The practitioner concludes that it is more likely than not that all of the depreciation and interest deductions will be allowable, and that it is more likely than not that the other deductions will not be allowed. The practitioner may render an opinion to the effect that it is more likely than not that the material tax benefits in the aggregate will be realized.

(6) *Description of opinion.* The practitioner must assure that the offering materials correctly and fairly represent the nature and extent of the tax shelter opinion.

(b) *Reliance on other opinions* —(1) *In general.* A practitioner may provide an opinion on less than all of the material tax issues only if:

(i) At least one other competent practitioner provides an opinion on the likely outcome with respect to all of the other material tax issues which involve a reasonable possibility of challenge by the Internal Revenue Service, and an overall evaluation whether the material tax benefits in the aggregate more likely than not will be realized, which is disseminated in the same manner as the practitioner's opinion; and

(ii) The practitioner, upon reviewing such other opinions and any offering material, has no reason to believe that the standards of paragraph (a) of this section have not been complied with. Notwithstanding the foregoing, a practitioner who has not been retained to provide an overall evaluation whether the material tax benefits in the aggregate more likely than not will be realized may issue an opinion on less than all the material tax issues only if he/she has no reason to believe, based on his/her knowledge and experience, that the overall evaluation given by the practitioner who furnishes the overall evaluation is incorrect on its face.

(2) *Forecasts and projections.* A practitioner who is associated with forecasts or projections relating to or based upon the tax consequences of the tax shelter offering that are included in the offering materials, or are disseminated to potential investors other than the practitioner's clients, may rely on the opinion of another practitioner as to any or all material tax issues, provided that the practitioner who desires to rely on the other opinion has no reason to believe that the standards of paragraph (a) of this section have not been complied with by the practitioner rendering such other opinion, and the requirements of paragraph (b)(1) of this section are satisfied. The practitioner's report shall disclose any material tax issue not covered by, or incorrectly opined upon, by the other opinion, and shall set forth his/her opinion with respect to each such issue in a manner that satisfies the requirements of paragraph (a) of this section.

(c) *Definitions.* For purposes of this section:

(1) "Practitioner" is any person authorized under §10.3 of this part to practice before the Internal Revenue Service.

(2) A "tax shelter," as the term is used in this section, is an investment which has as a significant and intended feature for Federal income or excise tax purposes either of the following attributes: (i) Deductions in excess of income from the investment being available in any year to reduce income from other sources in that year, or

(ii) Credits in excess of the tax attributable to the income from the investment being available in any year to offset taxes on income from other sources in that year. Excluded from the term are municipal bonds; annuities; family trusts (but not including schemes or arrangements that are marketed to the public other than in a direct practitioner-client relationship); qualified retirement plans; individual retirement accounts; stock option plans; securities issued in a corporate reorganization; mineral development ventures, if the only tax benefit would be percentage depletion; and real estate where it is anticipated that in no year is it likely that deductions will exceed gross income from the investment in that year, or that tax credits will exceed the tax attributable to gross income from the investment in that year. Whether an investment is intended to have tax shelter features depends on the objective facts and circumstances of each case. Significant weight will be given to the features described in the offering materials to determine whether the investment is a tax shelter.

(3) A "tax shelter opinion," as the term is used in this section, is advice by a practitioner concerning the Federal tax aspects of a tax shelter either appearing or referred to in the offering materials, or used or referred to in connection with sales promotion efforts, and directed to persons other than the client who engaged the practitioner to give the advice. The term includes the tax aspects or tax risks portion of the offering materials prepared by or at the direction of a practitioner, whether or not a separate opinion letter is issued or whether or not the practitioner's name is referred to in the offering materials or in connection with the sales promotion efforts. In addition, a financial forecast or projection prepared by a practitioner is a tax shelter opinion if it is predicated on assumptions regarding Federal tax aspects of the investment and it meets the other requirements of the first sentence of this subparagraph. The term does not, however, include rendering advice solely to the offeror or reviewing parts of the offering materials, so long as neither the

name of the practitioner, nor the fact that a practitioner has rendered advice concerning the tax aspects is referred to in the offering materials or in connection with the sales promotion efforts.

(4) A "material" tax issue as the term is used in this section is (i) any Federal income or excise tax issue relating to a tax shelter that would make a significant contribution toward sheltering from Federal taxes income from other sources by providing deductions in excess of the income from the tax shelter investment in any year, or tax credits available to offset tax liabilities in excess of the tax attributable to the tax shelter investment in any year; (ii) any other Federal income or excise tax issue relating to a tax shelter that could have a significant impact (either beneficial or adverse) on a tax shelter investor under any reasonably foreseeable circumstances (e.g., depreciation or investment tax credit recapture, availability of long-term capital gain treatment, or realization of taxable income in excess of cash flow, upon sale or other disposition of the tax shelter investment); and (iii) the potential applicability of penalties, additions to tax, or interest charges that reasonably could be asserted against a tax shelter investor by the Internal Revenue Service with respect to the tax shelter. The determination of what is material is to be made in good faith by the practitioner, based on information available at the time the offering materials are circulated.

(4) Section 10.51 is amended by adding new paragraph (j) to read as follows:

§10.51 Disreputable conduct.

* * * * *

(j) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph include those which reflect or result from a knowing misstatement of fact or law; from an assertion of a position known to be unwarranted under existing law; from counseling or assisting in conduct known to be illegal or fraudulent; from concealment of matters required by law to be revealed; or from conscious disregard of information indicating that material facts expressed in the tax opinion or offering material are false or misleading. For the purpose of this paragraph, reckless conduct is highly unreasonable omission or misrepresentation, involving not merely simple or inexcusable negligence, but an extreme departure from the standards of ordinary care that is either known or is so obvious that the competent practitioner must or should have been aware of it. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(5) In §10.52, (a) introductory text is added, the rest of the existing paragraph is designated as paragraph (a), and new pragraph (b) is added to read as follows:

§10.52 Violation of regulations.

(a) *In General.****

(b) *Tax shelter opinions.* An attorney, certified public accountant, enrolled agent or enrolled actuary may be disbarred or suspended from practice before the Internal Revenue Service for violating any part of §10.33 of this part, if such violation is willfull, reckless or through gross incompetence (within the meaning of §10.51(j) of this part); or if the violation is part of a pattern of providing tax shelter opinions that fail to comply with §10.33 of this part.

(6) Section 10.76 is added to read as follows:

§10.76 Advisory committee.

For purposes of advising the Director of Practice whether an individual may have violated §10.33 of this part, the Director of Practice is authorized to establish an Advisory Committee, composed of at least five individuals authorized to practice before the Internal Revenue Service. Under precedures established by the Director of Practice, such Advisory Committee shall, at the request of the Director of Practice, review and make recommendations with regard to alleged violations of §10.33 of this part.

(Filed by the Office of the Federal Register on February 22, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 23, 1984, 49 F.R. 6719; and a correction filed by the Office of the Federal Register on February 24, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 27, 1984, 49 F.R. 7116)

Nonconventional Source Fuel Credit; Publication of Inflation Adjustment Factor and Reference Price for Calendar Year 1983

Notice 84-5

AGENCY: Internal Revenue Service, Treasury.

ACTION: Publication of inflation adjustment factor and reference price for calendar year 1983 as required by section 44D(d)(2)(A) of the Internal Revenue Code (26 U.S.C. 44D(d)(2)(A)).

SUMMARY: The inflation adjustment factor and reference price are used in determining the availability of the tax credit for production of fuel from nonconventional sources under section 44D of the Internal Revenue Code.

DATE: The 1983 inflation adjustment factor and reference price apply to qualified fuels produced and sold during calendar year 1983.

INFLATION FACTOR: The inflation adjustment factor for calendar year 1983 is 1.3197.

PRICE: The reference price for all qualified fuels is $26.19 per equivalent barrel for the 1983 calendar year.

The special reference price for gas produced from Devonian shale expired on December 31, 1982. For calendar year 1983 the credit for gas produced from Devonian shale is to be figured from the reference price shown above which is based on the price of crude oil is defined in section 44D(d)(2)(C) of the Internal Revenue Code.

Because the above reference price does not exceed $23.50 multiplied by the inflation adjustment factor, the phaseout of credit provided for in

section 44D(d)(1) of the Internal Revenue Code does not occur for any qualified fuel based on the above reference price.

FOR FURTHER INFORMATION CONTACT:

For the inflation factor—Robert O'Keefe, PM:PFR:R, Room 3144, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C., 20224, Telephone Number (202) 566-7541 (not a toll-fee number)

For the reference price—Noel J. Sheehan, CC:C:E:E:2, Room 5232, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C., 20224, Telephone Number (202) 566-4463 (not a toll-free number).

WILLIAM H. CONNETT,
Associate Chief Counsel (Technical)

(Filed by the Office of the Federal Register on March 15, 1984, 8:45 a.m., and published in the issue of the Federal Register for March 16, 1984, 49 F.R. 9992)

Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service; Clarification of Effective Date

Notice 84-6

AGENCY: Department of the Treasury.

ACTION: Clarification of effective date.

SUMMARY: This notice clarifies the effective date of the final regulations governing practice before the Internal Revenue Service in 31 CFR Part 10 to set standards for providing opinions used in the promotion of tax shelters. Such regulations were published in the Federal Register on February 23, 1984 (49 FR 6719) [page 331, this Bulletin].

FOR FURTHER INFORMATION CONTACT:

Mr. Leslie S. Shapiro, Director of Practice, Department of the Treasury, Washington, D.C. 20220, (202) 535-6787 (non toll free).

SUPPLEMENTARY INFORMATION:

Clarification

A number of inquiries have been received concerning the effective date of the final tax shelter opinion regulations. The final rule states the following:

These final regulations are effective with respect to tax shelter opinions provided after May 23, 1984. This is interpreted to mean that the regulations will apply only to tax shelter opinions provided by practitioners to clients after May 23, 1984. Opinions furnished clients before that time will not be subject to the provisions of the regulations. However, any tax shelter offering material or sales promotion effort used before May 24, 1984 and modified on or after that date will require compliance with the regulations by a practitioner if the modification relates to a matter which is required to be included in any tax shelter opinion issued after May 23, 1984.

Date: April 13, 1984.

PETER J. WALLISON,
General Counsel, Department of the Treasury.

(Filed by the Office of the Federal Register on April 17, 1984, 8:45 a.m., and published in the issue of the Federal Register for April 18, 1984, 49 F.R. 15188)

Boycott Provisions (Section 999) of the Internal Revenue Code; Additional Boycott Guidelines

Notice 84-7[1]

AGENCY: Office of the Secretary, Treasury.

ACTION: Notice of additional guidelines.

SUMMARY: The Treasury Department today issued additional guidelines relating to those provisions of the Tax Reform Act of 1976, found in section 999 of the Internal Revenue Code, which deny certain tax benefits for participation in or cooperation with international boycotts. These guidelines consist of clarifications of earlier guidelines and new guidelines which will elaborate on the Department of the Treasury's enforcement of section 999, primarily in the areas of compliance with local laws and the use of vessel eligible clauses. These guidelines were published in proposed form on November 23, 1983 at 48 FR 53003 [page 328, this Bulletin].

FOR FURTHER INFORMATION CONTACT: David D. Joy, Office of the General Counsel, Department of the Treasury, 15th & Pennsylvania Avenue, NW, Washington, DC 20220, (202-566-5569—not a toll-free call).

SUPPLEMENTARY INFORMATION: This document contains additional guidelines relating to the Department of the Treasury's enforcement of section 999 of the Internal Revenue Code. Section 999 incorporates provisions of the Tax Reform Act of 1976 (90 Stat. 1649-54), specifically sections 1061-1064 (known as the "Ribicoff Amendment") [1976-3 C.B. (Vol. 1) 1, 126-129], which deny certain tax benefits for participation in or cooperation with international boycotts. Published guidelines which are still in effect today are found at 44 FR 66272 (November 19, 1979) [1979-2 C.B. 495] and 43 FR 3454 (January 25, 1978) [1978-1 C.B. 521].

Executive Order 12291

The Department of the Treasury has determined that these guidelines are not a major rule as defined in Executive Order 12291, and that a Regulatory Impact Analysis is therefore not required.

Analysis of Comments

These guidelines were published in proposed form for comment on November 23, 1983, at 48 FR 53003. The Department of the Treasury received three letters offering comments on these guidelines. Two of the letters focused on Guideline H-38, arguing that the Department of Treasury should permit the use of the clause "except to the extent prohibited by

[1]Filed by the Office of the Federal Register on April 25, 1984, 8:45 a.m. and published in the issue of the Federal Register for April 26, 1984, 49 F.R. 18061.

U.S. law" to take a compliance clause out of the coverage of section 999. The third letter stated that the presumption that "vessel eligible" and "shall comply with local law" clauses are boycott-related should be reversed to give such causes a presumption that they are not boycott-related.

After considering these comments, the Department of Treasury has decided not to implement these recommendations. The Department, however, has changed the word "Similarly" in Guideline J-3 to "On the other hand", substituted the word "clarification" for "correction" after Guidelines A-9, J-3, M-5, and M-7, and changed the number of "proposed" Guideline M-15 to Guideline M-14.

Drafting Information

The principal author of these guidelines is Leonard Santos, formerly of the Office of the General Counsel, Department of the Treasury. David Joy from the Office of the General Counsel also participated in developing the guidelines.

The Guidelines are amended as follows:

* * * * *

A-9 (clarification). Q: Section 999(b)(4) permits a person to agree to comply with certain laws without being treated as having agreed to participate in or cooperate with an international boycott. In the course of its operations in or related to a boycotting country, a person agrees to comply with a prohibition on importation and exportation that is described in section 999(b)(4)(B) and section 999(b)(4)(C). Is that person required to report the operations on Form 5713?

A: Yes. Although agreements described in section 999(b)(4)(B) and (C) do not constitute participation in or cooperation with an international boycott, the operations in or related to a boycotting country must be reported on Form 5713. However, requests to enter into agreements described in section 99(b)(4)(B) and (C) are not reportable on Form 5713.

* * * * *

J-3 (clarification). Q: Company C competes for an industrial plant construction contract for which Company P of Country W is inviting international tenders. The contract is to be financed by Country X which maintains a blacklist of companies. Country X requires contracts for projects which it finances to state that the contractor is required to refrain from making any purchase for the project from any blacklisted company. Country W does not boycott those companies. Company C wins the tender and signs the contract with Company P with the blacklist provision. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)(A)(ii)?

A: Generally, yes (see Guideline H-1A). Although the boycott is not implemented by Country W, but by Country X, and the project is being carried out in Country W, Company C has agreed not to do business with blacklisted U.S. companies as a condition of doing business indirectly with Country X. On the other hand, if the contract financed by Country X in Country W precluded the use of Country Y goods in connection with the project in Country W, the exception reflected in section 999(b)(4)(B) would apply to Company C's agreement and that agreement would not constitute participation in or cooperation with an international boycott.

* * * * *

M-5 (clarification). Q: Company C enters into a contract to export goods to or from Country X. The contract requires Company C not to ship the goods on a Country Y flag vessel or on a vessel owned, controlled, operated or chartered by Country Y or by companies or nationals of Country Y, or on a ship which during the voyage calls at Country Y enroute to or from Country X. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)?

A: No. The requirement in the contract is not a restrictive boycott practice. Rather, the contract provision is presumed to arise from the need to protect goods from damage or loss. However, this answer would not cover a restriction on the choice or route of a vessel when it carries no goods destined for or originating in Country X. The presumption described in this answer arises in every case where such clauses are used in connection with countries which are hostile to each other.

* * * * *

M-7 (clarification). Q: Company C signs a contract to export goods to Country X. The contract provides that the goods may not be shipped on a vessel that has been blacklisted by Country X because it has called at Country Y in the past. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)(B)?

A: Yes.

* * * * *

The following guidelines are added:

* * * * *

C-2. Q: Company C is engaged in the sale of machinery to Country W. Company C has no knowledge or reason to know that Country W requires participation in or cooperation with an international boycott as a condition of doing business within Country W or with its government, companies or nationals, except that Company C is asked to sign a contract with Country W of the type described in Guideline M-5. Does Company C have knowledge that Country W is a boycotting country such that its operations with Country W are reportable?

A: No. Where the only Country W requirements of which Company C knows or has reason to know involve requests which, if agreed to, are not defined to constitute participation in or cooperation with an international boycott, Company C has no reason to treat Country W as a boycotting country.

* * * * *

H-37. Q: Company C signs a contract which provides that in connection with its performance Company C acknowledges that the import and customs laws and regulations of Country X shall apply to the furnishing and shipment of any products or components thereof to Country X,

and that Company C acknowledges that such import and customs laws and regulations prohibit, among other things, the importation into Country X of products or components: (1) originating in Country Y; (2) manufactured, produced or furnished by companies organized under the laws of Country Y; and (3) manufactured, produced or furnished by nationals or residents of Country Y. Does Company C's contract constitute an agreement under section 999(b)(3)?

A: No. (see Guideline H-3). Company C has merely acknowledged that such import and customs laws shall apply to the furnishing of goods under the contract. However, an agreement by Company C to comply with Country X's restriction on the importation of goods furnished either by companies organized under Country Y's laws or by nationals of Country Y would constitute an agreement under section 999(b)(3).

H-38. Q: Company C signs a contract in which it agrees to comply with the laws, rules and regulations of Country X, except to the extent such compliance is penalized under laws of the United States. Does Company C's contract constitute an agreement under section 999(b)(3)?

A: No. An agreement to comply with the laws, rules and regulations of Country X does not constitute an agreement under section 999(b)(3) when such a commitment is qualified by excepting out compliance penalized by U.S. law, including section 999. Any phrase which effectively excludes the agreements described in section 999 from the requirements of a contract with Country X would support the same result. For example, a compliance clause qualified by "except to the extent inconsistent with U.S. law" would also suffice to take the contract out of the coverage of section 999. However, a compliance clause qualified by the phrase "except to the extent *prohibited* by U.S. law" would not defeat the presumption that the contractual provision requires agreements penalized under section 999, since section 999 does not prohibit anything, but merely penalizes certain agreements.

H-39. Q: Company C signs a contract to construct an industrial plant in Country X. The contract states that the laws, regulations, requirements or administrative practices of Country X shall govern Company C's performance of the contract in Country X. The laws, regulations, requirements or administrative practices of Country X prohibit the importation into Country X of goods manufactured by any company engaged in trade in Country Y or with the government, companies or nationals of Country Y. Does Company C's action constitute an agreement under section 999(b)(3)?

A: No. (see Guideline H-3). The answer would be the same if the contract has instead stated that Company C would be "subject to" the laws, regulations, requirements or administrative practices of Country X.

H-40. Q: Company A signs a contract to export goods to Country X. The contract provides that payment will be made by means of a letter of credit confirmed by Bank C. The letter of credit requires Company A to provide to Bank C a certificate stating that the ship on which the goods are to be shipped is eligible to enter the ports of Country X in conformity with its laws and regulations, and that the insurer of the goods has a duly qualified and appointed agent or representative in Country X. Country X's laws and regulations prohibit, *inter alia*, blacklisted vessels from calling at its ports and blacklisted insurance companies from qualifying or appointing an agent in Country X. Bank C confirms the letter of credit requiring the shipping and insurance certificates. Does Bank C's action constitute an agreement under section 999(b)(3)?

A: Yes. Unless Country X has offered the kind of explanation described in Guidelines M-12 and M-13, Bank C's confirmation of the letter of credit constitutes an agreement to refrain from doing business with a U.S. person under section 999(b)(3)(A)(ii). The answer would be the same under section 999(b)(3)(A)(i), if the beneficiary of the letter of credit were organized under the laws of Country Y, and under section 999(b)(3)(A)(iii), if Bank C had reason to know that it would not be able to obtain the required certificate because of the nationality, race, or religion of the beneficiary's ownership, management, or directors. See Guideline H-29A.

* * * * *

L-6. Q: Company C signs a construction contract that provides that Company C is not to employ individuals or nationals of any country not diplomatically recognized by Country X. Does Company C's action constitute participation in or cooperation with an international boycott under section 999(b)(3)(A)(iv)?

A: To the extent that Country Y is only one of several countries not recognized by Country X, the exclusion of nationals from unrecognized countries under the contract is not, on its face, boycott related. In those circumstances, agreement to the clause in question would not constitute an agreement to participate in or cooperate with an international boycott under section 999(b)(3). However, where Country Y is the only country not recognized by Country X, agreement to such a clause will constitute an agreement to participate in or cooperate with an international boycott under section 999(b)(3).

* * * * *

M-14. Q: Company C signs a contract to export goods to Country X. The contract provides that payment will be made by means of a letter of credit confirmed by Bank C. The letter of credit requires Company C to provide to Bank C a certificate stating that the goods are being shipped on a U.S. or Country X flag carrier *or*, alternatively, that the ship on which the goods are being shipped is eligible to enter the ports of Country X. Company C provides a certificate stating that the goods have been shipped on a U.S. or Country X flag carrier. Does Company C's acceptance of the letter of credit constitute an agreement under section 999(b)(3)?

A: No. Where the letter of credit requires alternative certifications, one of which is acceptable within the terms of section 999(b)(3), and Company C performs in accordance with that acceptable alternative (i.e., ship-

ping on a U.S. or Country X flag carrier), it is presumed that Company C's agreement included only the acceptable alternative. If Company C were to utilize a ship "eligible to enter the ports of Country X," Guideline M-10 would apply.

Dated: April 9, 1984.

JOHN E. CHAPOTON,
Assistant Secretary,
(Tax Policy).

Percentage To Be Used by Foreign Life Insurance Companies in Computing Income Tax for the Taxable Year 1983 and Estimated Tax for the Taxable Year 1984

Notice 84-8

(Also Part I, Section 819; 1.819-2.)

AGENCY: Department of the Treasury.

ACTION: Final rule; proclamation.

SUMMARY: This proclamation announces the percentage to be used to compute the income tax liability of foreign corporations carrying on life insurance business in the United States.

EFFECTIVE DATE: March 15, 1984.

FOR FURTHER INFORMATION CONTACT: Mr. Hudson Milner, Office of Tax Analysis, U.S. Treasury Department, Washington, D.C. 20220, (202-566-2705), not a toll free call.

SUPPLEMENTARY INFORMATION:

This proclamation, issued each year by the Secretary of the Treasury, announces the percentage to be used to compute the income tax liability of foreign corporations carrying on life insurance business in the United States.

PROCLAMATION

For purposes of computing the 1983 income tax of foreign corporations carrying on a life insurance business, a percentage of 17.9 shall be used in determining the "minimum figure" under section 819. The same percentage shall be used for purposes of computing the estimated tax and the installment payments of estimated tax for the taxable year 1984. No additions to tax shall be made because of any underpayment of estimated tax for the taxable year 1984 which results solely from the use of this percentage.

This proclamation is issued without notice and public procedure because the public cannot effectively participate in the determination of the percentage. It is computed from information contained in income tax returns that are not open to the public. The proclamation was not published prior to its effective date because the percentage is computed on the basis of data which was not then available.

RONALD A. PEARLMAN,
Deputy Assistant Secretary
(Tax Policy).

March 23, 1984.

(Filed by the Office of the Federal Register on April 10, 1984, 11:39 a.m. and published in the issue of the Federal Register for April 13, 1984, 49 F.R. 14729)

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 84-9

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the July-September quarter of 1984, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.3625
Tier 3 oil	0.4979

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

Merchant Marine and Fisheries Capital Construction Fund—Applicable Rate of Interest on Nonqualified Withdrawals

Notice 84-10

Under the authority in section 607 (h)(4)(B) of the Merchant Marine Act, 1936, as amended (46 U.S.C. 1177(h)(4)(B)), we hereby determine and announce that the applicable rate of interest on the amount of additional tax attributable to any nonqualified withdrawals from a capital construction fund established under section 607 of the Act shall be 11.69 percent, with respect to nonqualified withdrawals made in the taxable year beginning in 1984.

The determination of the applicable rate of interest with respect to nonqualified withdrawals was computed, according to the joint regulations issued under the Act (46 CFR 391.7(e)(2)(ii)), by multiplying 8 percent by the ratio which (a) the average yield on 5-year Treasury securities for the calendar year immediately preceding the beginning of such taxable year bears to (b) the average yield on 5-year Treasury securities for the calendar year 1970. The applicable rate so determined was computed to the nearest one-hundredth of 1 percent.

Dated: May 4, 1984.

H. E. SHEAR,
Maritime Administrator.

ANTHONY J. CALIO,
Acting Administrator,
National Oceanic And
Atmospheric Administration.

JOHN E. CHAPOTON,
Assistant Secretary
for Tax Policy.

So ordered by: Maritime Administrator, Maritime Administration, Administrator, National Oceanic and Atmospheric Administration, Assistant Secretary for Tax Policy Department of Treasury.

GEORGE P. STANNIS,
Secretary,
Maritime Administration.

(Filed by the Office of the Federal Register on May 14, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 15, 1984, 49 F.R. 20591)

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-1

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 83-1, 1983-1 C.B. 545, which provides procedures for issuing rulings, determination letters and information letters, and for entering into closing agreements on specific issues involving the interpretation or application of the federal tax laws. It also tells taxpayers and their representatives where to send requests for rulings, determination letters and information letters. It gives the steps to follow so that requests may be handled more efficiently. Changes to this revenue procedure will be incorporated annually in a new revenue procedure published as the first revenue procedure of the year.

SEC. 2. SCOPE

This revenue procedure applies only to ruling requests, information letters, and closing agreements under the jurisdiction of the Associate Chief Counsel (Technical), and to requests for determination letters under the jurisdiction of field offices that relate to Code sections under the jurisdiction of the Associate Chief Counsel (Technical). The Chief Counsel through the Associate Chief Counsel (Technical) provides basic principles and rules for the uniform interpretation and application of the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical). The procedures for obtaining rulings, etc., that apply specifically to federal firearms taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms. The procedures for obtaining rulings, determination letters, etc., on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). See Rev. Proc. 83-36, 1983-1 C.B. 763. However, the jurisdiction of the Associate Chief Counsel (Technical) includes section 521 of the Code, on exemption of farmer's cooperatives from tax; section 526, on shipowners' protection and indemnity associations; section 527(a),(b),(c),(d),(e), and (g), on political organizations, and section 528, on certain homeowners' associations.

SEC. 3. CHANGES

.01 Section 1 has been amended to state that changes to this revenue procedure will be incorporated annually in a new revenue procedure published as the revenue procedure of the year. This will enable taxpayers, practitioners, and Service personnel to find future updates of this revenue procedure easily.

.02 Section 9.05, which contains a list of revenue procedures that provide specific guidelines for requesting rulings, has been revised by updating the list.

.03 Section 9.06, which set forth certain statements that must be made in a request by the taxpayer, has been amended to require a statement whether the identical issue has previously been submitted to the Service, but withdrawn by the taxpayer before a ruling was issued.

.04 Sections 9.19 and 9.20, which relate to the protest or delay of the disclosure of a ruling, have been amended by providing that the address to which a protest or a request for delay should be sent is the address in the notice of intention to disclose that is furnished with the ruling or determination letter. The address will differ depending on whether the written determination is a ruling letter or a determination letter.

SEC. 4. GENERAL PRACTICE AND DEFINITIONS

.01 The Service answers inquiries of individuals and organizations, when appropriate in the interest of sound tax administration, about their status for tax purposes and the tax effects of their acts or transactions. The National Office issues rulings in such matters.

.02 District Directors of Internal Revenue apply the statutes and tax treaties, regulations, revenue rulings, and other precedents published in the Internal Revenue Bulletin in determining tax liability, collecting taxes, and issuing information letters and determination letters in answer to taxpayers' inquiries or requests. For purposes of this revenue procedure, any reference to District Director or district office includes their respective offices or, when appropriate, the director of an Internal Revenue Service Center.

.03 The word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, when first appropriate, their representatives. Any reference to National Office means only the Office of the Associate Chief Counsel (Technical).

.04 A "ruling" is a written statement issued to a taxpayer by the National Office that interprets and applies the tax laws to that taxpayer's specific set of facts. Rulings are issued only by the National Office, under the general supervision of the Associate Chief Counsel (Technical). Issuing rulings has been largely delegated to the Directors of the Corporation Tax Division and the Individual Tax Division.

.05 A "determination letter" is a written statement issued by a District Director in response to a written inquiry by a taxpayer that applies the principles and precedents previously announced by the National Office to a specific set of facts. A determination letter is issued only when a determination can be made on the basis of clearly established rules in the statute or regulations, or by a position in a ruling, opinion, or court decision published in the Internal Revenue Bulletin that specifically answers the question presented. A determination letter will not be issued if a determination cannot be made, for example, when the question presents a novel issue, or if the matter is excluded from the jurisdiction of a District Director under section 7 of this revenue procedure.

.06 An "information letter" is a statement issued either by the National Office or by a District Director that calls attention to a well-established interpretation or principle of tax law, without applying it to a specific set of facts. It may be issued if the request indicates that the taxpayer is seeking general information. If the request does not meet the require-

ments of section 9 of this revenue procedure, but the Service thinks that the general information may help the individual or organization, it may issue an information letter.

.07 A "revenue ruling" is an interpretation by the Service that has been published in the Internal Revenue Bulletin. It is the conclusion of the Service on how the law is applied to an entire set of facts. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and other interested parties.

.08 A "closing agreement" is an agreement between the Commissioner of Internal Revenue or the Commissioner's delegate and a taxpayer on a specific issue or issues or liability that is entered into under the authority in section 7121 of the Code. A closing agreement prepared in an office under the responsibility of the Associate Chief Counsel (Technical) is based on a ruling that has been signed by the Commissioner, or the Commissioner's delegate, that says that a closing agreement will be entered into on the basis of the holding of the ruling letter. Closing agreements are final, unless fraud, malfeasance, or misrepresentation of a material fact can be shown. Closing agreements may be entered into when it is advantageous to have the matter permanently and conclusively closed, or when a taxpayer can show good and sufficient reasons for an agreement and the government will sustain no disadvantage by its consummation. In appropriate cases, taxpayers may be asked to enter into a closing agreement as a condition to the issuing of a ruling. If, in a single case, closing agreements are requested for each of a number of taxpayers, such agreements are entered into only if the number of taxpayers is 25 or less. However, if the issue and holding are identical for all the taxpayers and they number more than 25, a "mass closing agreement" will be entered into with the taxpayer who is authorized by the others to represent the entire group.

SEC. 5. RULINGS ISSUED BY THE NATIONAL OFFICE

.01 *In income and gift tax matters*, the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for them. However, the National Office will issue rulings after the return is filed if a ruling is required by section 367 of the Code and the ruling request is filed on time under that section. Further, see Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief under section 1.9100-1 of the regulations. If a request for an extension of time under section 1.9100-1 is submitted after the return is filed but before the return is examined, the procedures under Rev. Proc. 84-1 are applicable. If an examination of the return has begun, or is being considered by an Appeals Office, the procedures of Rev. Proc. 84-2, page 354, this Bulletin, are applicable. The National Office issues rulings on the exempt status of organizations under section 521. See Rev. Proc. 80-25, 1980-1 C.B. 667. The National Office ordinarily does not issue rulings if, at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period, and (1) that issue is being examined by a District Director or is being considered by an Appeals Office, or (2) that issue had been examined by a District Director or considered by an Appeals Office and the statutory period of limitation on either assessment or, for filing a claim for refund, or credit of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals Office. If a return dealing with an issue for a particular year is filed while a request for ruling on that issue is pending, the National Office will issue the ruling unless it is notified by the taxpayer that an examination of that issue or the identical issue on an earlier year's return has been started by a District Director. See section 9.06. However, even if an examination has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued. The National Office does not issue rulings on the replacement of involuntarily converted property, whether or not replacement has been made, if the taxpayer has already filed a return for the tax year in which the property was converted. See section 7.05 on the District Director's authority to issue determination letters in this connection. In addition, the National Office does not issue rulings on the classification of an organization if a return has been filed for the organization for an earlier period. The National Office also does not issue rulings on only part of an integrated transaction.

.02 *In estate tax matters*, the National Office issues rulings with respect to transactions affecting the estate tax of a decedent before the estate tax return is filed. If the estate tax return is due to be filed before the ruling is issued, the taxpayer should secure an extension of time for filing the return for the maximum period of six months, and notify the National Office Branch considering the request for ruling that an extension has been secured. If the return is filed before the ruling is issued, the taxpayer must disclose on the return that a ruling has been requested, attach a copy of the pending ruling request to the return, and notify the National Office that the return has been filed. The National Office will make every effort to issue the ruling within three months of the day on which the return was filed. If the ruling cannot be issued within that three month period, the National Office will notify the District Director having jurisdiction of the return who may, by memorandum to the National Office, grant an additional period for the issuance of the ruling. The National Office will not rule on matters relating to the application of the estate tax to property or the estate of a living person.

1 *In generation-skipping transfer tax matters*, the National Office issues rulings on transactions that affect the generation-skipping transfer tax before the return is filed. Rulings are not issued until after the generation-skipping trust, or trust equivalent, has been established. Rulings are not issued on a generation-skipping transfer tax matter before the distri-

bution or termination takes place. Notwithstanding the foregoing, the National Office will issue rulings regarding the application of the generation skipping transfer tax effective date rules (section 2006(c) of the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 365, as amended by section 702(n)(1) of the Revenue Act of 1978, Pub. L. 95-600 1978-3 C.B. (Vol. 1) 1, 169) to wills, trusts, and trust equivalents in existence on June 11, 1976.

2 *In matters involving additional tax under section 2032A(c)*, the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for those transactions.

.03 *In employment and excise tax matters*, the National Office issues rulings on prospective transactions and on completed transactions either before or after the return is filed for those transactions. In employment tax matters, generally the taxpayer is the employer. However, if the worker asks for the ruling, both the worker and the employer are considered to be the taxpayer and both are entitled to the ruling. The National Office usually will not issue rulings if, at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is under examination by a District Director or under consideration by an Appeals Office, or (2) that issue has been examined by a District Director or considered by an Appeals Office and the statutory period of limitation either on assessment or filing a claim for refund or credit of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals Office. However, if a District Director began an examination of the issue involved in the ruling request, the National Office usually will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued.

.04 *In administrative provisions matters*, the National Office issues rulings on issues arising under the Internal Revenue Code, and related statutes, and the regulations thereunder, that relate primarily to the time, place, manner, and procedures, for reporting and paying taxes; assessing and collecting taxes (including interest and penalties); abating, crediting, or refunding overassessments or overpayments of tax; and filing information returns. Rulings ordinarily are not issued, if, at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being considered by a District Director or (2) that the issue has been considered and the statutory period of limitation on either assessment or for filing a claim for refund, or credit of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into. If a return involving an issue for a particular year is filed while a request for a ruling on that issue is pending, the National Office will issue the ruling unless an examination of that issue or an examination of the identical issue on a earlier year's return has been started by a District Director. But, even if consideration has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued. Rulings ordinarily are not issued if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being considered by an Appeal Office, or (2) that issue has been considered by an Appeals Office and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into.

.05 The National Office does not issue rulings to business, trade, or industrial associations or to similar groups concerning the application of the tax laws to members of the group. It may, however, issue rulings to these groups or associations on their own tax status or liability if the request meets the requirements of this section.

.06 Pending the adoption of regulations (either temporary or final) that interpret the provisions of any act, the issuing of rulings will be considered under the following conditions.

1 If the ruling request presents an issue on which the answer seems clear by applying the statute to the facts, a ruling will be issued under the usual procedures.

2 If the ruling request presents an issue on which the answer seems reasonably certain but not entirely free from doubt, a ruling will be issued only if it is established that a business emergency requires a ruling or that unusual hardship will result from failure to obtain a ruling. If the taxpayer believes that a business emergency exists or that an unusual hardship will result from failure to obtain a ruling, the taxpayer should submit with the request a separate letter stating the facts necessary for the Service to reach a conclusion. In this connection, the Service will not consider a "business emergency" to result from circumstances under the taxpayer's control, such as scheduling within an inordinately short time the closing date for a transaction or a meeting of the board of directors or the shareholders of a corporation. However, if the ruling request presents an issue that cannot be readily resolved before regulations are issued, a ruling will not be issued.

SEC. 6. DETERMINATIONS UNDER SECTION 999(d) OF THE CODE

Under Rev. Proc. 77-9, 1977-1 C.B. 542, the National Office issues determinations under section 999(d) of the Code that may deny certain benefits of the foreign tax credit, deferral of earnings of foreign subsidiaries and domestic international sales corporations (DISC) to a person, if that person, or a member of a controlled group (within the meaning of section 993(a)(3)) that includes that person, or a foreign corporation of which a member of the controlled group is a United States shareholder, agrees to participate in, or cooperate with, an international boycott.

SEC. 7. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTOR

.01 *In income and gift tax matters*, District Directors issue determination

letters in response to taxpayers' written requests on completed transactions that affect returns over which they have examination jurisdiction. This applies only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion or court decision published in the Internal Revenue Bulletin. A determination letter usually is not issued for a question concerning a return to be filed by the taxpayer if the same question is involved in a return already filed. District Directors do not issue determination letters on the tax consequences of prospective or proposed transactions, except as provided in section 7.05.

.02 *In estate tax matters*, District Directors issue determination letters in response to written requests affecting the estate tax returns over which they have examination jurisdiction, but only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. District Directors do not issue determination letters on matters concerning the application of the estate tax to property or the estate of a living person.

1 *In generation-skipping transfer tax matters*, District Directors issue determination letters in response to written requests affecting the generation skipping transfer tax returns over which they have examination jurisdiction, but only if the questions presented are specifically answered by statute or regulation, or by a position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. District Directors do not issue determination letters or matters concerning the application of the generation-skipping transfer tax before the distribution or termination takes place.

.03 *In employment and excise tax matters*, District Directors issue determination letters on completed transactions in response to written requests from taxpayers over which they have examination jurisdiction, but only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin.

.04 Notwithstanding the provisions of section 7.01, 7.02, and 7.03, a District Director will not issue a determination letter in response to a request that presents a question specifically answered by statute or regulation, or by the position stated in rulings, etc., published in the Internal Revenue Bulletin, if (1) it appears that the taxpayer has directed a similar inquiry to the National Office, (2) the same issue involving the same taxpayer is pending in a case before an Appeals Office, (3) the determination letter is requested by an industry, trade association, or similar group, or (4) the request involves an industry-wide problem. Under no circumstances will a District Director issue a determination letter unless it is clearly shown that the request concerns a return that has been filed or is required to be filed over which the District Director has or will have examination jurisdiction. Notwithstanding the provisions of section 7.03, a District Director will not issue a determination letter on an employment tax question if the specific question for the same taxpayer has been or is being considered by the Central Office of the Social Security Administration or the Railroad Retirement Board. Nor will District Directors issue determination letters for determination of a constructive sales price under section 4216(b) or 4218(e) of the Code. The National Office, however, will issue rulings in this area. See section 8.03.

.05 District Directors issue determination letters on the replacement of involuntarily converted property under section 1033 even though the replacement has not been made, if the taxpayer has filed an income tax return for the year in which the property was involuntarily converted.

.06 A request received by a District Director on a question concerning an income, estate, or gift tax return already filed will be, in general, considered in connection with the examination of the return. If a response is made to such a request before the return is examined, it will be considered a tentative finding in any later examination of that return.

SEC. 8. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS

.01 The Service ordinarily will not issue rulings or determination letters in certain areas because of the factual nature of the problem involved, or for other reasons. Rev. Proc. 83-22, 1983-1 C.B. 680, provides a list of these areas. This list is not all inclusive, since the Service may decline to issue a ruling or a determination letter on other grounds, whenever warranted by the facts or circumstances of a particular case. The National Office and District Directors may, when it is considered appropriate and in the best interest of the Service, issue information letters calling attention to well-established principles of tax law.

.02 A ruling or a determination letter is not issued on alternative plans of proposed transactions or on hypothetical situations.

.03 The National Office will issue rulings in all cases on prospective or future transactions if the law or regulations require a determination of the effect of a proposed transaction for tax purposes, as in a transfer under sections 1491 and 1492 of the Code. The National Office will issue rulings on all transfers described in section 367(a)(1) if the request is filed within 183 days after the beginning of the transfer. The request must meet the minimum filing standards required under section 7.367(a)-1(e) of the Temporary Income Tax Regulations. The National Office also will issue rulings in all cases on the determination of a constructive sales price under section 4216(b) or 4218(e).

SEC. 9. INSTRUCTIONS TO TAXPAYER

.01 The taxpayer should submit a request for a ruling or a determination letter in duplicate if (1) more than one issue is presented in the request, or if (2) a closing agreement is requested on the issue presented. It is not necessary to submit requests in duplicate under other circumstances except as set forth in section 9.09.

.02 A request for a ruling or determination letter and any factual information submitted at a later time must be accompanied by a declaration in the following form: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete." The declaration may not be made by the taxpayer's representative. It must be signed by the person or persons on whose behalf the request is made. The person who must sign for a corporate taxpayer must be an officer of the corporate taxpayer who has personal knowledge of the facts. The officer must be one whose duties are not limited to obtaining a ruling or determination letter from the Service. The person signing for a trust or partnership must be a trustee or partner who has personal knowledge of the facts.

.03 If more than one issue is presented in a request for a ruling, the Service generally will issue a single ruling letter. However, the taxpayer may request a separate ruling letter on any of the issues. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with such a request, it will issue separate ruling letters.

.04 When multiple issues are involved in a single factual situation and separate letters requesting rulings are submitted, a statement to this effect must be included in each ruling letter request. The Service in issuing each ruling will state that separate rulings have been issued or requests for rulings are pending.

.05 Each request for a ruling or a determination letter must contain a complete statement of all of the facts relating to the transaction. Such facts include: names, addresses, and taxpayer identification numbers of all interested parties; the location of the District Office that has or will have examination jurisdiction over the return, not the Service Center where the return is filed; a full and precise statement of the business reasons for the transaction; and a carefully detailed description of the transaction. (The term "all interested parties" does not mean that a list is required of all shareholders of a widely-held corporation requesting a ruling relating to a reorganization, or a list of employees where a large number may be involved.) In addition, true copies of all contracts, wills, deeds, agreements, instruments, and other documents in the transaction must be submitted with the request. Original documents, such as contracts, wills, etc., should not be submitted because they become part of the Service's file and will not be returned. All material facts in documents must be included in the taxpayer's letter requesting a ruling or in supplemental letters, and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the provisions that apply. Material facts furnished to the Service by telephone or orally at a conference must be promptly confirmed by letter to the Service with a declaration in the form described in section 9.02. This confirmation must be furnished within 21 calendar days to be considered part of the request. An extension of the 21-day period will be granted only if justified in writing by the taxpayer and approved by the Chief or Assistant Chief of the Branch to which the case is assigned. A request for extension should be submitted before the end of the 21-day period. If unusual circumstances close to the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told of the problem and that the written request for extension will be coming soon. Such a request must be sent promptly. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right of appeal to a denial of an extension request. Because the purpose of these procedures is to speed up the ruling process, the taxpayer is encouraged to submit the required relevant material promptly. Therefore, requests for extension should be justified by compelling facts and circumstances. If the Service is not made aware, as provided above, of problems in meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems in meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

Specific guidelines for requesting rulings under certain Code sections follow: Rev. Proc. 79-4, 1979-1 C.B. 483, as amplified by Rev. Proc. 79-12, 1797-1 C.B. 492, and Rev. Proc. 80-1, 1980-1 C.B. 579 (guidelines for submitting requests for rulings under sections 103 and 7478); Rev. Proc. 80-36, 1980-2 C.B. 769, as amended by Rev. Proc. 83-73, 1983-2 C.B. 593 (certification of manufacturers under section 44C); Rev. Proc. 68-11, 1968-1 C.B. 761 (guidelines for a ruling request under section 117); Rev. Proc. 81-62, 1981-2 C.B. 684 (guidelines concerning a request for a ruling under section 302 or 311); Rev. Proc. 81-68, 1981-2 C.B. 723 (guidelines concerning a request for a ruling under section 332, 334(b)(1) or 334(b)(2)); Rev. Proc. 81-52, 1981-2 C.B. 625 (guidelines concerning a request for a ruling under sections 331 and 337); Rev. Proc. 81-42, 1981-2 C.B. 611 (guidelines concerning a request for a ruling under section 346); Rev. Proc. 83-59, 1983-2 C.B. 575 (guidelines concerning a request for a ruling under section 351); Rev. Proc. 81-41, 1981-2 C.B. 605 (guidelines concerning a request for a ruling under section 355); Rev. Proc. 68-23, 1968-1 C.B. 821, as modified by Rev. Proc. 77-17, 1977-1 C.B. 577, and as amplified by Rev. Proc. 76-20, 1976-1 C.B. 560 and Rev. Proc. 80-14, 1980-1 C.B. 617, Rev. Proc. 69-19, 1969-2 C.B. 301, as amplified by Rev. Proc. 74-36, 1974-2 C.B. 491, Rev. Proc. 77-5, 1977-1 C.B. 536, Rev. Proc. 78-27, 1978-2 C.B. 526, and Rev. Proc. 78-28, 1978-2 C.B. 526 (guidelines concerning a request for a ruling under section 367). However, see section 7.367 of the Temporary Income Tax Regulations under the Tax Reform Act of 1976, which superseded the previously mentioned revenue procedures relating to section 367, to the extent of overlapping rules; Rev. Proc. 81-70, 1981-2 C.B. 729 (guide-

lines for estimating the basis of stock acquired in a section 368(a)(1)(B) reorganization); Rev. Proc. 81-60, 1981-2 C.B. 680 (guidelines concerning a request for a ruling under section 368(a)(1)(E)). See, however, Rev. Proc. 83-22, 1983-1 C.B. 680, which provides that a ruling whether a transaction constitutes a corporate recapitalization within the meaning of section 368(a)(1)(E) will not be issued except when the recapitalization is an integral part of a larger transaction and it is impossible to determine the tax consequences of the larger transaction without making a determination with regard to the recapitalization; Rev. Proc. 77-30, 1977-2 C.B. 539, as clarified by Rev. Proc. 78-18, 1978-2 C.B. 491 and Rev. Proc. 78-23, 1978-2 C.B. 503, and Rev. Proc. 77-37, 1977-2 C.B. 568, as amplified by Rev. Proc. 77-41, 1977-2 C.B. 574, Rev. Proc. 82-23, 1982-1 C.B. 474 and Rev. Proc. 83-62, 1983-2 C.B. 581 (certain other guidelines concerning requests for rulings handled by the Reorganization Branch of the Corporation Tax Division); Rev. Proc. 72-13, 1972-1 C.B. 735, Rev. Proc. 74-17, 1974-1 C.B. 438, and Rev. Proc. 75-16, 1975-1 C.B. 676 (guidelines on classification of limited partnerships); Rev. Proc. 82-58, 1982-2 C.B. 847 (guidelines on classification of organizations as liquidating trusts); Rev. Proc. 82-36, 1982-1 C.B. 490 (guidelines concerning requests for consent to elect not to defer gain or loss on deferred intercompany transactions); Rev. Proc. 79-63, 1979-2 C.B. 578 (factors considered and information needed for granting extensions under section 1.9100-1 of the Income Tax Regulations).

If the request concerns a corporate distribution, reorganization, or similar transaction, the corporate balance sheet and profit and loss statement closest to the date of the transaction should be submitted. (If the request relates to a prospective transaction, the most recent balance sheet and profit and loss statement should be submitted).

.06 The request must contain a statement of whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), if any, the identical issue is in a return of the taxpayer (or of a related taxpayer within the meaning of section 267 of the Code, or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504) and, if so, whether the issue (1) is being examined by a District Director, (2) has been examined and the statutory period of limitations on either assessment or for filing a claim for refund or credit of tax has not expired or a closing agreement covering the issue or liability has not been entered into by a District Director, (3) is being considered by an Appeals Office in connection with the taxpayer's return for an earlier period, or has been considered by an Appeals Office and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired or a closing agreement covering the issue or liability has not been entered into by an Appeals Office, or (4) is pending in litigation in a case involving the taxpayer or a related taxpayer. The request must also contain a statement whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), the identical or similar issue has been (i) submitted to the Service, but withdrawn before a ruling was issued, or (ii) ruled on by the Service to the taxpayer or to the taxpayer's predecessor and, if so, when and with what results. If, after the request is filed but before a ruling is issued, the taxpayer knows that an examination of the issue by a District Director has been started, the taxpayer must notify the National Office of such action. If a return is filed before a ruling is received from the National Office concerning the issue, a copy of the request must be attached to the return. This alerts the District Office and avoids premature District action on the issue.

If the request deals with only one step of a larger integrated transaction, the facts, circumstances, etc. relating to the entire transaction must be submitted.

.07 As an alternative procedure (known as the "two-part" ruling request procedure) for the issuance of rulings on prospective transactions, the taxpayer may submit a summary of the facts considered to be controlling the issue, in addition to the complete statement required for ruling requests by section 9.05. If the National Office agrees with the summary, the National Office will use it as the basis for the ruling. To use this procedure, the taxpayer should submit the following with the request for a ruling:

1 A complete statement of facts about the transaction, together with related documents, as required by section 9.05; and

2 A summary statement of the facts believed to be controlling in reaching the requested conclusion. When the taxpayer's statement of controlling facts is accepted, the Service will base its ruling on these facts and only this statement will ordinarily be incorporated in the ruling letter. It is emphasized, however, that:

(a) The taxpayer may elect this procedure for a "two-part" ruling request. It is not to be considered a required substitute for the regular procedures provided by this revenue procedure;

(b) The taxpayer's rights and responsibilities are the same under the "two-part" ruling request procedure as those provided in this revenue procedure;

(c) The Service reserves the right to rule on the basis of a more complete statement of facts it considers controlling and to seek more information in developing facts and restating them; and

(d) The "two-part" ruling request procedure will not apply if it is inconsistent with other procedures, such as those dealing with requests for permission to change accounting methods or periods; applications for recognition of exempt status under section 521 of the Code; or rulings on employment tax status.

.08 If the taxpayer advocates a particular conclusion, an explanation of the grounds for the assertion must be furnished, together with a statement of relevant authorities in support of the taxpayer's views. Even though the taxpayer is urging no particular tax treatment of a proposed or prospective transaction, the tax-

payer's views on the tax results of the proposed action and a statement of relevant authorities to support those views must be furnished. In addition, the taxpayer is encouraged to inform the Service, and discuss the implications of any legislation, tax treaties, court decisions, regulations, revenue rulings or revenue procedures that the taxpayer determines to be contrary to the position advanced. If the taxpayer determines that there are no contrary authorities, a statement to this effect would be helpful in the ruling request. Identification and discussion of contrary authorities will generally enable Service personnel to arrive more quickly at a full understanding of the issue and the relevant authorities. There is a further advantage to the taxpayer. When Service personnel receive the request, they will have before them the taxpayer's thinking on the effect and applicability of contrary authorities. Such information should, therefore, make research easier and lead to earlier action by the Service. Conversely, failure to disclose and distinguish significant contrary authorities may result in requests for additional memoranda which will delay action on the ruling request.

.09 To assist the Service in making the deletions required by section 6110(c) of the Code from the text of rulings and determination letters, to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted or, if more information is proposed to be deleted, the statement must indicate the deletions proposed by the person requesting the ruling or determination letter. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of the request for a ruling or determination letter and supporting documents, on which must be shown by the use of brackets, the material that the person making the request believes should be deleted pursuant to section 6110(c). The statement of proposed deletions must indicate the statutory basis, under service 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for a ruling or determination letter. If the person making the request decides to ask for additional deletions before the ruling or determination letter is issued, additional statements may be submitted. The procedures in this paragraph also apply to additional information that is submitted after the initial request.

.10 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative, or if the representative is to appear before the Service in connection with the request, the representative must be:

1 an attorney who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as an attorney and is authorized to represent the taxpayer;

2 a certified public accountant who is qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the taxpayer; or

3 a person, other than an attorney or certified public accountant who is currently enrolled to practice before the Service, and who files with the Service a written declaration that he or she is currently enrolled (including in the declaration either the enrollment number or the expiration date of the enrollment card) and is authorized to represent the taxpayer. (See Treasury Department Circular No. 230 (31 CFR Part 10), revised 1966-2 C.B. 1171, amended 1967-1 C.B. 433, and 1970-2 C.B. 644, for the rules on who may practice before the Service.) These requirements do not apply to an individual representing his or her full-time employer, or to a bona fide officer, administrator, administratrix, trustee, etc., representing a corporation, trust, estate, association, or organized group. An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in (1) and (2) above) who is not a full-time employee or a bona fide officer, administrator, administratrix, trustee, etc., may not represent a taxpayer in connection with a ruling or a determination letter. Any authorized representative, whether or not enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney, and Form 2848-D, Authorization and Declaration, may be used with regard to rulings, closing agreements, and determination letters requested under this revenue procedure.

.11 If a taxpayer has more than one representative, it is sufficient to send a copy of the ruling to any one of them. Copies of rulings will be sent to no more than two representatives, provided that they are located at different mailing addresses. If a taxpayer does not designate which representative is to receive a copy of the ruling, a copy of the ruling will be sent to the first representative named on the latest power of attorney. If the original of the ruling is to be sent to a representative, the power of attorney should contain a statement to that effect and designate the mailing address of the representative.

.12 A request for a ruling letter by the National Office should be sent to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, Room 6545, 1111 Constitution Avenue, N.W., Washington, DC 20224. A request for a determination letter should be sent to the District Director of Internal Revenue whose office has or will have examination jurisdiction over the taxpayer's return.

.13 If a request for a ruling or determination letter does not comply with all the provisions of this revenue procedure, the request will be acknowledged, and the requirements that have not been met will be pointed out. If a request for a ruling lacks essential information, the taxpayer will

be told that if the information is not received within 30 calendar days, the request will be closed. If the information is received after the request is closed, it will be reopened and treated as a new request as of the date the essential information is received. A request for a ruling letter sent to the District Director that does not comply with the provisions of this revenue procedure will be returned by the District Director for corrections before it is sent directly to the National Office.

.14 A taxpayer who wants to have a conference on the issue or issues involved should indicate this in writing when, or soon after, filing the request.

.15 The Service processes requests for ruling and determination letters in regular order and as expeditiously as possible. Consideration of a request for processing ahead of its regular order, or by a specified time, delays the processing of other matters. Requests for processing ahead of the regular order must be made in writing, preferably in a separate letter sent with, or soon after, the request. If the request is not made in a separate letter, then the letter in which the request is made should say, at the top of the first page: "Expeditious Handling Is Requested. See page of this letter." The request should give a compelling need for such treatment. The Service cannot give assurance that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the board of directors or shareholders of a corporation, without regard for the time it may take to obtain a ruling or determination letter, will not be considered sufficient reason for handling a request ahead of its regular order. Nor will the possible effect of fluctuation in the market price of stocks on a transaction be considered sufficient reason for handling a request out of order. Requests by telegram will be treated in the same manner as requests by letter. Ruling and determination letters ordinarily are not issued by telegram. A request for expeditious handling will not cause the Communications and Records Group to route the case to the Ruling Branch ahead of normal processing; and a request for expeditious handling will not be considered until the underlying ruling request has been found to satisfy the section 6110 requirements.

.16 The Director, Individual Tax Division, has primary responsibility for providing basic principles for uniform interpretation and application of the federal tax laws in those areas involving: income taxes of noncorporate taxpayers (including individuals, partnerships, estates, and trusts); political organizations under section 527 (except subsection (f)); employment taxes and taxes on self-employment income; estate, gift, generation-skipping transfer, and certain excise taxes; and procedure and administration provisions of the Internal Revenue Code, except those that apply specifically to employee plans, exempt organizations, and actuarial determinations.

.17 The Director, Corporation Tax Division, has primary responsibility for providing basic principles of and rules for uniform interpretation and application of the federal tax laws in those areas involving: income taxes and earnings and profits of corporate taxpayers; changes in methods and periods of accounting, depreciation, depletion, valuation and other engineering issues; the taxable status of exchanges and distributions in connection with corporate organizations, reorganizations, and liquidations; and the exemption of farmers' cooperatives (under section 521), shipowners' protection and indemnity associations (under section 526), and certain homeowners associations (under section 528).

.18 A taxpayer may obtain information regarding the status of a request by calling the person whose name and telephone number is shown on the acknowledgement of receipt of the request.

.19 If, after receiving the notice under section 6110(f)(1) of the Code of intention to disclose the ruling or determination letter (including a copy of the version proposed to be open to public inspection and notation of third-party communications under section 6110(d)), the person requesting the ruling or determination letter wants to protest the disclosure of certain information in the ruling or determination letter, that person must within 20 calendar days send a written statement to the Internal Revenue Service office indicated on the notice of intention to disclose, identifying those deletions that the Service has not made and that the person requesting the ruling or determination letter believes should have been made. That person must also submit a copy of the version of the ruling or determination letter proposed to be open to public inspection on which the person indicates, by use of brackets, the deletions proposed by the taxpayer that have not been made by the Service. Generally, the Service will not consider the deletion under this subparagraph of any material that the taxpayer did not propose to be deleted before the ruling or determination letter was issued. Within 20 days after it receives the response to the notice under section 6110(f)(1), the Service will mail to that person its final administrative conclusion regarding the deletions to be made. The taxpayer does not have the right to a conference to resolve any disagreements concerning material to be deleted from the text of the ruling. However, these matters may be taken up at any conference that is otherwise scheduled regarding the request.

.20 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose (but no later than 60 calendar days after the notice is mailed), the person requesting a ruling or determination letter may send a request for delay of public inspection under either section 6110 (g)(3) or section 6110(g)(3) and (4). The request for delay must be sent to the Internal Revenue Service office indicated on the notice of intention to disclose. A request for delay must contain the date on which it is expected that the underlying transaction will be completed. The request for delay under section 6110(g)(4) must contain a statement from which the Commissioner may determine that there are good reasons for the delay.

.21 A taxpayer who receives a ruling or determination letter before filing a return about any transaction

that has been consummated and that is relevant to the return being filed should attach a copy of the ruling or determination letter to the return when it is filed.

.22 Protests to adverse rulings under section 367 will be processed as follows:

Under Rev. Proc. 77-5, 1977-1 C.B. 536, a taxpayer may protest an adverse, or terms and conditions, ruling letter issued on or after January 31, 1977 under section 367(a)(1) of the Code. The protest may not be made later than the close of the 45th calendar day after the date of the ruling letter. A protest is considered made on the date of the postmark of a letter of protest sent to the Associate Chief Counsel (Technical), or the date that the letter is hand delivered to the Service. The letter must include: (1) a copy of the ruling letter; (2) the reasons for the protest including, if applicable, (a) the grounds for asserting that none of the principal purposes for the exchange is the avoidance of federal income tax, (b) the grounds for asserting that the terms and conditions in the ruling letter pursuant to which an exchange to which section 367 applies will be considered not to be in pursuance of tax avoidance are not reasonable, and (c) the arguments supporting a protest of the validity of a ruling position published by the Service, such as a position in the guidelines announced in Rev. Proc. 68-23, 1968-1 C.B. 821 (factual material not previously submitted and considered by the Service should not be included in the protest); (3) a statement of whether a conference is desired; and (4) names of persons (including authorized representatives) expected to attend the conference, if a conference is granted. The Associate Chief Counsel (Technical) will establish an ad hoc advisory board to consider each protest, whether or not a conference is requested. The taxpayer will be granted one conference upon request. Whether or not such a request is made, the board may ask for one or more conferences or for written submissions. The taxpayer will be notified of the time, date, and place of the conference, and of the names of the members of the board. The board will consider all materials submitted in writing by the taxpayer and oral arguments presented at the conference. The board will make its recommendation to the Associate Chief Counsel (Technical) who will make a decision in the matter. Any oral arguments made at a conference by the taxpayer, which have not previously been submitted to the Service in writing, may, if desired, be submitted to the Service in writing if postmarked no later than the end of the 7th calendar day after the day of the conference. The taxpayer will be informed of the decision of the Associate Chief Counsel (Technical) by certified or registered mail.

.23 For appeal procedures with regard to adverse determination letters under section 521 of the Code and revocation or modification of exemption rulings and determination letters under section 521, see Rev. Proc. 80-25, 1980-1 C.B. 667, as amplified by Rev. Proc. 80-28, 1980-1 C.B. 680.

SEC. 10. HANDLING OF RULING REQUESTS

.01 Within 21 calendar days after a ruling request is received in the branch, Service personnel will contact the taxpayer to discuss informally the procedural and substantive issues in the ruling request.

.02 The following subject matters are included in the 21 calendar day procedure:

1 Individual Income Tax Branch

(a) Patnerships and trusts

(b) Real estate investment trusts

(c) Stock options

(d) Employment and self-employment taxes (except ruling requests from individuals for employment status submitted on Forms SS-8)

(e) Credit for employment of certain new employees

(f) Rental value of parsonages

2 All matters within the jurisdiction of the Corporation Tax Branch, except cases

(a) involving a request for change in accounting methods or periods,

(b) relating to the last-in, first-out method of computing inventory,

(c) concerning insurance issues on contracts with reserves based on segregated asset acounts,

(d) concerning insurance issues requiring actuarial computations.

3 All matters within the jurisdiction of the Specialty Tax Branch.

4 All matters within the jurisdiction of the Engineering and Valuation Branch (except cases involving a request for a change in accounting methods), and the Reorganization Branch.

.03 Procedures to be followed regarding ruling requests are:

1 Within 21 calendar days after a ruling request has been received in the branch having jurisdiction, a representative of the branch will contact the taxpayer to discuss the procedural issues in the ruling requests covered by this procedure. Considering the complexity of some cases or the number of issues involved, it may not be possible for the branch representative to discuss the substantive issues in the ruling request during this initial contact. However, when possible, as to each issue coming within the jurisdiction of the branch, the branch representative will tell the taxpayer:

(a) whether the branch representative will recommend the Service rule as the taxpayer requested, rule adversely on the matter, or not rule;

(b) whether the taxpayer should submit additional information or representations to enable the Service to rule on the matter; or

(c) whether because of the nature of the transaction, or the issue presented, a tentative conclusion on the issue cannot be reached.

2 When the rulings requested involve matters within the jurisdiction of more than one branch or more than one office in the same branch, a representative of the branch that received the original ruling request will tell the taxpayer within the initial 21 calendar day contact period: (1) that the rulings requested involving matters within the jurisdiction of another branch or another office in the same branch have been referred to the other branch or office for consideration; and (2) that a representative of the other branch or office will contact the taxpayer within 21 calendar days after receiving the referral to informally discuss the procedural and, to the extent possible, the substantive is-

sues if covered by this procedure.

3 If something less than a fully favorable ruling is indicated, the branch representative will tell the taxpayer if minor modifications of the transaction or adherence to certain published positions will warrant the issuing of a favorable ruling. In addition, the branch representative may tell the taxpayer what representations must be furnished in a document to comply with the requirements of the Service. However, the branch representative will not suggest precise changes that would materially alter the form of the proposed transaction. If, at the conclusion of the discussion, the branch representative determines that a meeting in the National Office would better serve the purpose of developing or exchanging information, a meeting will be offered and an early meeting date arranged. This meeting will not be the taxpayer's conference of right, as described in this revenue procedure.

4 The Service will not be bound by the informal opinion expressed by the branch representative or any other authorized Service representative under this procedure, and such an opinion cannot be relied upon as a basis for granting retroactive relief under the provisions of section 7805(b) of the Code.

5 The ruling request will then be processed under present procedures.

SEC. 11. CONFERENCES IN THE NATIONAL OFFICE

.01 A taxpayer may request a conference only in connection with a ruling request. Normally, a conference is scheduled only when the National Office considers it to be helpful in deciding the case or when an adverse decision is indicated. If conferences are being arranged for more than one request for a ruling involving the same taxpayer, they will be scheduled so as to cause the least inconvenience to the taxpayer. If a conference has been requested, the taxpayer will be notified by telephone, if possible, of the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 9.05.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 11.06 develops. This conference normally will be held at the branch level of the appropriate division in the office of the Associate Chief Counsel (Technical) and will be attended by a person who, at the time of the conference, has authority to sign the ruling letter for the branch chief in the case being discussed. When more than one branch has taken an adverse position on an issue within its jurisdiction presentted in a ruling request, or when the position ultimately adopted by one branch will affect another branch's determination, a representative from each branch with the authority to sign for the branch chief will attend the conference. If more than one subject is to be discussed at the conference, the discussion will constitute a conference on each subject. In order to promote a free and open discussion of the issues, the conference usually will be held after the branch has had an opportunity to study the case. However, at the request of the taxpayer or representative, the conference of right may be held at an earlier stage in the consideration of the case than the Service ordinarily would designate. No taxpayer has a "right" to appeal the action of a branch to a division director or to any other official of the Service.

.03 In employment tax matters, only the party entitled to the ruling is entitled to a conference.

.04 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

.05 The senior Service representative present at the conference insures that the taxpayer has full opportunity to present views on all of the issues that are in question. The Service representative explains the Service's tentative decision on the substantive issues and the reasons for that decision. If the taxpayer advances prospective application under section 7805(b) of the Code, the Service representative will discuss the tentative recommendation concerning the request for relief and the reasons for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.06 An invitation to an additional conference will be extended if, after the conference of right, an adverse holding is proposed but on a new issue or on the same issue but on different grounds from those discussed at the first conference. There is no right to another conference when a proposed holding is reversed at a higher level with a result less favorable to the taxpayer if the ground or arguments on which the reversal is based were discussed at the conference of right. The provisions of this revenue procedure limiting the number of conferences a taxpayer is entitled to will not prevent a taxpayer from attending further conferences when, in the opinion of National Office personnel, such conferences are necessary. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.07 It is the responsibility of the taxpayer to furnish in writing to the National Office any additional data, lines of reasoning, precedents, etc., that are proposed by the taxpayer and discussed at the conference but that were not previously or adequately presented in writing. The taxpayer must furnish the additional information within 21 calendar days. If the additional information is not received within that time, a ruling will be issued on the basis of the information on hand or, if appropriate, no ruling will be issued. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 9.05.

SEC. 12. REFERRAL OF MATTERS TO THE NATIONAL OFFICE

.01 Request for determination letters received by District Directors that, under the provisions of this revenue procedure, may not be acted upon by a District Office, will be for-

warded to the National Office for reply. The District Office will let the taxpayer know that this action has been taken. District Directors also refer to the National Office any request for a determination letter that in their judgment should have the attention of the National Office.

.02 If the request involves an issue on which the Service will not issue a ruling or determination letter, the request will not be forwarded to the National Office. The District Office will let the taxpayer know that the Service will not issue a ruling or a determination letter on the issue. See section 8.01 of this revenue procedure.

SEC. 13. REFERRAL OF MATTERS TO DISTRICT OFFICES

Requests for rulings received by the National Office that, under section 5 of this revenue procedure, may not be acted upon by the National Office will be forwarded to the District Office that has examination jurisdiction over the taxpayer's return. The taxpayer will be notified of this action. If the request is on an issue or in an area of the type discussed in section 8.01 and it is decided not to issue a ruling or an information letter, the National Office will let the taxpayer know and the request will then be forwarded to the appropriate District Office for association with the related return.

SEC. 14. REVIEW OF DETERMINATION LETTERS

Determination letters issued under section 7.01, 7.02, and 7.03 are not reviewed by the National Office before they are issued. If a taxpayer believes that a determination letter of this type is in error, the taxpayer may ask the District Director to reconsider the matter. The taxpayer may also ask the District Director to request technical advice from the National Office. In such an event the procedures in Rev. Proc. 84-2 must be followed.

SEC. 15. WITHDRAWAL OF REQUESTS

A request for a ruling or determination letter may be withdrawn at any time before the signing of the letter of reply. If a request for a ruling is withdrawn, the National Office may give its views on the subject matter of the request to the District Director whose office will have examination jurisdiction over the taxpayer's return for consideration in connection with any later examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be kept by the Service and will not be returned to the taxpayer. In appropriate cases, the Service may publish its findings in a revenue ruling or revenue procedure.

SEC. 16. ORAL ADVICE TO TAXPAYERS

.01 The Service does not issue rulings or determination letters on oral requests. National Office officials and employees ordinarily do not discuss a substantive tax issue with a taxpayer before written request for ruling is received, since oral opinions or advice are not binding on the Service. This does not prevent a taxpayer from asking whether the Service will rule on a particular issue. In such cases, however, the name of the taxpayer and identifying number must be disclosed. The Service also will discuss questions relating to procedural matters about submitting a request for a ruling, including the application of the provisions of section 9 to a particular case.

.02 A taxpayer may seek oral technical assistance from a Taxpayer Service Representative in a District Office or Service Center when preparing a return or report, under other established procedures. Oral advice is advisory only and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 17. EFFECT OF RULINGS

.01 A taxpayer may not rely on a ruling issued to another taxpayer. A ruling, except to the extent incorporated in closing agreement, may be revoked or modified at any time under appropriate circumstances. See section 4.08 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all years open under the statutes, unless the Commissioner or the Commissioner's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which this authority generally is exercised is given later in this section. For information on rulings relating to the sale or lease of articles subject to the manufacturer's excise tax and the retailer's excise tax, see section 17.08.

.02 When determining a taxpayer's liability, the District Director must ascertain whether (1) any ruling previously issued to the taxpayer has been properly applied, (2) the representations upon which the ruling was based reflected an accurate statement of the material facts, and (3) the transaction actually was carried out substantially as proposed. If, in the course of determining the tax liability, the District Director finds that a ruling should be modified or revoked, the findings and recommendations of the District Director will be forwarded to the National Office for consideration before further action. Such a referral to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 84-2 will be followed. Otherwise the ruling is to be applied by the District Office in its determination of the taxpayer's liability.

.03 Appropriate coordination with the National Office will be undertaken if any field official having jurisdiction over a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.04 A ruling found to be in error or not in accord with the current views of the Service may be modified or revoked. Modification or revocation of a ruling may be made by (1) a notice to the taxpayer to whom the ruling was issued, (2) an enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) the issuing of temporary or final regulations, or (5) the issuing of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin. Consistent with these provisions, if a ruling relates to a continuing action or a series of actions, the ruling will ordinarily be applied until

any one of the actions described above has taken place, or until specifically withdrawn.

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively to the taxpayer for whom the ruling was issued or to a taxpayer whose tax liability was directly involved in the ruling if (1) there has been no misstatement or omission of material facts, (2) the facts developed later are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment. For example, the tax liability of each shareholder is directly involved in a ruling on the reorganization of a corporation. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the holding in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of the industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client. If a ruling is revoked by letter with retroactive effect, the letter will, except in fraud cases, state the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

.06 A ruling issued on a particular transaction represents a holding of the Service on that transaction only. However, the application of that ruling to the transaction will not be affected by the later issuing of regulations (either temporary or final), if the conditions specified in section 17.05 are met. If the ruling is later found to be in error or no longer in accord with the position of the Service, it will not give the taxpayer protection for a like transaction in the same or later year.

.07 However, if a ruling is issued covering a continuing action or a series of actions and it is determined that the ruling was in error, or no longer in accord with the position of the Service, the Associate Chief Counsel (Technical) ordinarily will limit the retroactivity of the revocation or modification to a date that is not earlier than that on which the ruling is modified or revoked. To illustrate, if a taxpayer receives a ruling that certain payments are excludable from gross income for federal income tax purposes and it is later determined that the ruling is in error or no longer in accord with the position of the Service, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling. If a taxpayer rendered service or provided a facility that is subject to the excise tax on services or facilities, and in reliance on a ruling issued to the same taxpayer did not pass the tax on to the user of the service or the facility, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling. If an employer incurred liability under the Federal Insurance Contributions Act, but in reliance on a ruling made to the same employer, neither collected the employee tax nor paid the employee and employer taxes under the Act, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling for both the employer tax and the employee tax. In the last situation, however, the restriction of retroactive application ordinarily will be conditioned on the furnishing by the employer of wage data, as may be required by section 31.6011(a)-1 of the Employment Tax Regulations. Publication of a notice of proposed rulemaking will not affect the application of any ruling issued under the procedures stated in this revenue procedure.

.08 A ruling holding that the sale or lease of a particular article is subject to the manufacturer's excise tax or the retailer's excise tax may not retroactively revoke or modify an earlier ruling holding that the sale or lease of such an article was not taxable, if the taxpayer to whom the ruling was issued, in reliance upon the earlier ruling, parted with possession or ownership of the article without passing the tax on to the customer. Section 1108(b) Revenue Act of 1926.

.09 For rulings involving completed transactions, other than those described in sections 17.07 and 17.08, taxpayers will not be given the protection against retroactive revocation provided in section 17.05, since they will not have entered into the transactions in reliance on the ruling.

SEC. 18. EFFECT OF DETERMINATION LETTERS

A determination letter issued by a District Director has the same effect as a ruling issued to a taxpayer under section 17 of this revenue procedure. However, if the District Director is of the opinion that a conclusion contrary to that expressed in the determination letter is indicated, the matter need not be referred to the National Office. A District Director may not limit the modification or revocation of a determination letter but may refer the matter to the National Office for the possible exercise by the Commissioner or the Commissioner's delegate of the authority to limit the modification or revocation.

SEC. 19. EFFECT OF INFORMATION LETTERS

An information letter issued by the National Office or by a District Director is advisory only and the provisions of section 17 do not apply.

SEC. 20. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS AND DETERMINATION LETTERS

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including determination letters) will be applied without retroactive effect.

A taxpayer to whom a ruling or determination letter has been issued may request that the Associate Chief Counsel (Technical), the Commis-

sioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any subsequent revocation or modification of the ruling or determination letter.

.02 In the case of a ruling, a request to limit the retroactive effect of the revocation or modification of a ruling must be in the form of, and meet the requirements for, a ruling request generally. These requirements are set forth in section 9 of this revenue procedure. Specifically, the request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 17.05 of this revenue procedure as they relate to the taxpayer's particular situation.

A request for the application of section 7805(b) of the Code may take the form of a separate request for ruling when, for example, a revenue ruling has the effect of modifying or revoking a ruling previously issued to the taxpayer or when the Service notifies the taxpayer of a change in position that will have the effect of revoking or modifying such a ruling. However, when such notice is given by the District Director during the course of an examination of the taxpayer's return, or during consideration by the Chief, Appeals Office, a request to limit the retroactive effect of the modification or revocation of a ruling must be made in the form of a request for technical advice. See section 12.03 of Rev. Proc. 84-2. When germane to a pending ruling request, a request for the application of section 7805(b) may be made as part of the request, either initially or at any time before the ruling is issued. When a ruling that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the ruling must be made before a return is examined that contains the transaction that is the subject of the request for ruling.

.03 When a request for the application of section 7805(b) of the Code is made in a separate ruling request, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 11 of this revenue procedure. If the request is made initially as part of a pending ruling request or is made before the conference of right is held on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. (See section 11.05 of this revenue procedure). If the request for the application of 7805(b) is made as part of a pending ruling request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

.04 In the case of a determination letter that the District Director proposes to modify or revoke, a request to limit the modification or revocation of the determination letter must be made by requesting the District Director who issued the determination letter to seek technical advice from the National Office, since a District Director has not been delegated authority under section 7805(b) of the Code to limit the modification or revocation of a determination letter. See section 12.03 of Rev. Proc. 84-2. The taxpayer's request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 17.05 of this revenue procedure as they relate to the taxpayer's particular situation.

.05 When technical advice is requested with respect to the application of section 7805(b) of the Code under the circumstances set forth in .04 above, the taxpayer has a right to a conference in the National Office to the same extent as does any taxpayer who is the subject of a technical advice request. See section 8 of Rev. Proc. 84-2.

SEC. 21. EFFECT OF OTHER DOCUMENTS

Rev. Proc. 83-1 is superseded.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Rev. Proc. 84-2

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 83-2, 1983-1 C.B. 558, which provides revised procedures for furnishing technical advice to District Directors and Chiefs, Appeals Offices, by the Associate Chief Counsel (Technical). It also tells taxpayers about their rights when a District Director or a Chief, Appeals Office, requests such advice. Changes to this revenue procedure will be incorporated annually in a new revenue procedure published as the second revenue procedure of the year.

SEC. 2. SCOPE

.01 The Chief Counsel through the Associate Chief Counsel (Technical) provides principles and rules for uniformly interpreting and applying the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical). The procedures for obtaining technical advice specifically applicable to federal firearms taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms. The procedures for obtaining technical advice specifically on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). See Rev. Proc. 80-26, 1980-1 C.B. 671. The procedures that apply to technical advice for employee plans and exempt organizations are followed in obtaining technical advice

on exemption of farmers' cooperatives from tax under section 521 of the Code, even though the Associate Chief Counsel (Technical) has jurisdiction for issuing technical advice under this section. The Associate Chief Counsel (Technical) also has jurisdiction for issuing technical advice under section 526, on shipowners' protection and indemnity associations; section 527(a), (b), (c), (d), (e), and (g), on political organizations; and section 528, on certain homeowners' associations, under this revenue procedure.

.02 In the Office of the Associate Chief Counsel (Technical), the authority to issue technical advice has been largely redelegated to the Branch Chiefs in the Individual Tax Division and the Corporation Tax Division.

SEC. 3. CHANGES

.01 Section 1 has been amended to state that changes to this revenue procedure will be incorporated annually in a new revenue procedure published as the second revenue procedure of the year. This will enable taxpayers, practitioners, and Service personnel to find future updates of this revenue procedure easily.

.02 Section 5.01 has been amended to require that each request for technical advice submitted by the Chief, Appeals Office, should be submitted to the Associate Chief Counsel (Technical) through the Director, Appeals Division. Sec. 7.02 and 9.07 have also been amended to require that responses to the Chief, Appeals Office, should be routed through the Director, Appeals Division. These changes have been made only for control purposes so that the Appeals Division of the National Office knows what requests are being submitted to the Associate Chief Counsel (Technical) and what technical advice memorandums are being issued to the Chief, Appeals Offices.

.03 Section 5.01 has also been amended to specifically state that section 1.9100 requests can be the subject of a technical advice request. This provides a more complete cross reference from section 5.01 of Rev. Proc. 84-1 and to section 5.11 of Rev. Proc. 84-2.

.04 Section 5.11, which concerns section 1.9100 of the Income Tax Regulations, has been amplified to indicate that all requests for section 1.9100 relief received by a District Director or Chief, Appeals Office, must be referred to the National Office for consideration. This conforms to Delegation Order No. 183 (Rev. 1), 1982-2 C.B. 747.

SEC. 4. DEFINITION AND NATURE OF TECHNICAL ADVICE

.01 For purposes of this revenue procedure, the word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and their representatives and issuers of section 103 obligations.

.02 Any reference to the National Office means only the Office of the Associate Chief Counsel (Technical).

.03 Any reference to District Director or District Office includes the office of the Director of the Foreign Operations District, where appropriate. Any reference to Chief, Appeals Office, includes Associate Chief, Appeals Office.

.04 "Technical advice" means advice or guidance furnished by the National Office upon requests of a District or an Appeals Office in response to any technical or procedural question that develops during any stage of any proceeding on the interpretation and proper application of tax law, tax treaties, regulations, revenue rulings, or other precedents published by the National Office to a specific set of facts. Such proceedings include (1) the examination of a taxpayer's return, (2) consideration of a taxpayer's claim for refund or credit, or (3) any other matter involving a specific taxpayer under the jurisdiction of the Chief, Examination Division, such as the consideration of a taxpayer's application to enter into an agreement about the useful life method, and rate of depreciation of business property provided by section 167(d) of the Code. These proceedings include an examination to determine whether obligations issued are described in section 103(a). They also include processing and considering nondocketed cases in an Appeals Office. Technical advice is furnished as a way of helping Service personnel close cases and establish and maintain consistent holdings throughout the Internal Revenue Service. A District Director or an Appeals Office may raise an issue in any tax period, even though technical advice may have been asked for and furnished for the same or a similar issue for another tax period. Technical advice does not include memoranda on matters of general technical application furnished to District or Appeals Offices when the issues are not raised in connection with a proceeding involving a specific taxpayer.

.05 If a District Director, Chief, Appeals Office, or a taxpayer requests technical advice on a determination letter under section 521 of the Code, the procedures under section 601.201(n) of the Statement of Procedural Rules must be followed.

.06 Only the National Office can revoke a ruling letter. Therefore, if a District Director or a Chief, Appeals Office, thinks that a ruling letter previously issued to a taxpayer should be modified or revoked, the procedures in section 5 of this revenue procedure must be followed.

.07 The provisions of this revenue procedure apply only to a case under a jurisdiction of a District Director or Chief, Appeals Office. Technical advice may be requested on issues considered in a prior Appeals disposition, not based on mutual concessions for the same tax period of the same taxpayer, if the Appeals Office that had the case concurs in the request. A District Director may not request technical advice on an issue if an Appeals Office is currently considering an identical issue of the same taxpayer (or of a related taxpayer within the meaning of section 267 of the Code or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504). A case remains under the jurisdiction of the District Director even though an Appeals Office has the identical issue under consideration in the case of another taxpayer (not related within the meaning of sections 267 and 1504, respectively) in a entirely different transaction. With

respect to the same taxpayer or the same transaction, when the issue is under the jurisdiction of an Appeals Office, and the applicability of more than one kind of tax is dependent upon the resolution of that issue, a District Director may not request technical advice on the applicability of any of the taxes involved.

SEC. 5. REQUESTING TECHNICAL ADVICE

.01 The District or Appeals Office is responsible for determining whether to request technical advice on any issue being considered. Each request must be submitted through channels and signed by a person who is authorized to sign for the District Director or Chief, Appeals Office, and should include, in writing, the arguments submitted by the District or Appeals Office in support of its position on the issue or issues. All requests for technical advice from Appeals Offices should be submitted to Associate Chief Counsel (Technical) through the Director, Appeals Division, CC:AP:PT. However, while the case is under the jurisdiction of the District Director or the Chief, Appeals Office, a taxpayer may request that an issue be referred to the National Office for technical advice. All request for technical advice should be made at the earliest possible stage of the proceedings. The grounds for a request are that a lack of uniformity exists on the disposition of the issue or that the issue is unusual or complex enough to warrant consideration by the National Office. Taxpayers may also request technical advice when seeking an extension of time fixed by regulations for making an election or application for relief pursuant to section 1.9100-1 of the Income Tax Regulations. See section 5.11 of this revenue procedure for additional information. Although taxpayers are encouraged to make written requests setting forth the facts, law, and argument on the issue, and reasons for requesting National Office technical advice, they may make the request orally. If, after considering the taxpayer's request, the examining officer or Appeals Officer thinks that the circumstances do not warrant referral of the case to the National Office, the examining officer or Appeals Officer will tell the taxpayer. (See section 6 for taxpayer's appeal rights when an examining officer or an Appeals Officer declines to request technical advice).

.02 When technical advice is going to be requested, whether or not on the request of the taxpayer, the taxpayer will be told about it and given a copy of the arguments submitted by the District Director or Chief, Appeals Office, in support of its position on the issue or issues, except as noted in section 5.10. If the examining officer or the Appeals Officer initiates the action, the Service will give the taxpayer a copy of the statement of the pertinent facts and the questions proposed for submission to the National Office. The request for advice should be worded to avoid possible misunderstanding in the National Office of the facts or the specific points at issue.

.03 If the Service initiates the request for technical advice, the taxpayer has 10 calendar days after receiving the statement of facts and specific questions to indicate in writing any disagreement about them. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office. Every effort should be made to reach agreement on the facts and the specific points at issue. If agreement cannot be reached, the taxpayer may send, within 10 calendar days after receipt of notice, a statement of the taxpayer's understanding of the specific points at issue. This statement will be forwarded to the National Office with the request for technical advice. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

.04 If the taxpayer initiates the action to request technical advice and the taxpayer's statement of the facts and points at issue is not wholly acceptable to the District or Appeals Office, the Service will tell the taxpayer in writing what the areas of disagreement are. The taxpayer has 10 calendar days after receiving the written notice to reply to it. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division or the Chief, Appeals Office. If agreement cannot be reached, both the statements of the taxpayer and the District or Appeals Office will be forwarded to the National Office with the request for technical advice.

.05 If it has not already been done, the taxpayer may submit a statement explaining the taxpayer's position on the issues and citing precedents that the taxpayer believes will bear on the case. This statement will be forwarded to the National Office with the request for technical advice. If the taxpayer's statement is received after the request for technical advice has been forwarded to the National Office, it will be forwarded there to be associated with the request for technical advice. The taxpayer is encouraged to comment on any legislation, tax treaties, regulations, revenue rulings, revenue procedures, or court decisions contrary to the taxpayer's position.

.06 At the time the taxpayer is told that the matter is being referred to the National Office, the taxpayer will also be told about the right to a conference in the National Office if an adverse decision is indicated and will be asked to say whether such a conference is desired.

.07 In connection with requests for technical advice, the taxpayer also has the same 10 days as in sections 5.03 and 5.04 to submit the statement described in section 5.09 of proposed deletions under section 6110(c) of the Code. If the taxpayer does not submit it, the District Director or the Chief, Appeals Office, will tell the taxpayer that such a statement is required. If the District Director or the Chief, Appeals Office, does not receive that statement within 10 days after such notification, the District Director or the Chief, Appeals Office, may decline to submit the request for technical advice. If the District Director or the Chief, Appeals Office, decides to request technical advice in a case in

which the taxpayer has not submitted the statement of proposed deletions, the National Office will make those deletions that the Commissioner determines are required by section 6110(c).

.08 The requirements for submitting statements and other material for proposed deletions in technical advice memoranda before public inspection is allowed do not apply to requests for any documents to which section 6104 of the Code applies.

.09 To help the National Office make the deletions required by section 6110(c) of the Code in technical advice memoranda to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, or if more information is proposed to be deleted, the statement must indicate the deletions proposed by the taxpayer. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of all statements of facts and supporting documents that are submitted to the National Office under sections 5.03 and 5.04. The material that the taxpayer wants deleted must be shown in brackets. The statement of proposed deletions must show the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for technical advice. If the taxpayer decides to request additional deletions under section 6110(c) before the National Office replies to the request for technical advice, the taxpayer may submit additional statements. The procedures in this paragraph also apply to additional information submitted during consideration of the technical advice request.

.10 The provisions of this section (about referring issues upon the taxpayer's request, telling the taxpayer about the referral of issues, giving the taxpayer a copy of the arguments submitted by the District Director or Chief, Appeals Office, in support of its position on the issue or issues, submitting proposed deletions, and granting conferences in the National Office) do not apply to technical advice memoranda, described in section 6110(g)(5)(A) of the Code, on cases involving criminal or civil fraud investigations and jeopardy or termination assessments. However, in these cases the taxpayer may provide the statement of proposed deletions to the National Office after all proceedings in the investigations or assessments are complete but before the Commissioner mails the notice, under section 6110(f)(1), of intention to disclose the technical advice memorandum.

.11 See Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the Income Tax Regulations. If a taxpayer requests an extension of time under section 1.9100-1 during an examination or when being considered by an Appeals Office, the procedures of Rev. Proc. 84-2 are applicable, except for Sec. 6. The examining officer or Appeals Officer is not authorized to deny consideration of a request for technical advice that involves section 1.9100-1 relief. All such requests must be referred to the National Office. See section 4.03 of Rev. Proc. 79-63.

.12 Form 4463, Request for Technical Advice, should be used for transmitting requests for technical advice to the National Office.

SEC. 6. APPEAL BY TAXPAYERS OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE

.01 If the examining officer, or Appeals Officer thinks that a taxpayer's request for referral of an issue to the National Office for technical advice does not warrant referral, the examining officer or Appeals Officer will tell the taxpayer.

.02 The taxpayer may appeal the decision of the examining officer or the Appeals Officer not to request technical advice by submitting to that official, within 10 calendar days after being told of the decision, a statement of the facts, law, and arguments on the issue, and the reasons why the taxpayer believes the matter should be referred to the National Office for technical advice. The taxpayer must justify in writing a request for an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

.03 The examining officer or the Appeals Officer submits the taxpayer's statement through channels to the Chief, Examination Division, or the Chief, Appeals Office along with the examining officer's or the Appeals Officer's statement of why the issue should not be referred to the National Office. The Chief determines, on the basis of the statement, whether technical advice will be requested. If the Chief determines that technical advice is not warranted and proposes to deny the request, the taxpayer is told in writing about the determination. In the letter to the taxpayer, the Chief states the reasons for the proposed denial (except in unusual situations when doing so would be prejudicial to the best interest of the Government). The taxpayer has 10 calendar days after receiving the letter to notify the Chief of agreement or disagreement with the proposed denial. The taxpayer may not appeal the decision of the Chief, Examination Division, or the Chief, Appeals Office, not to request technical advice from the National Office. However, if the taxpayer does not agree with the proposed denial, all data on the issue for which technical advice has been sought, including the taxpayer's written request and statements, will be submitted to the Assistant Commissioner (Examination) or the Director, Appeals Division, for review. If the Assistant Commissioner (Examination) or the Director, Appeals Division, thinks the circumstances warrant it, he or she may consult the Associate Chief Counsel (Technical) or his or her representatives. After this review, the district office or the Appeals Office is notified whether the proposed denial is approved or disapproved.

.04 While the matter is being reviewed, the district office or the Ap-

peals Office suspends action on the issue (except when the delay would prejudice the Government's interests) until it is notified that the proposed denial is approved or disapproved. This notification is made within 30 calendar days after receipt of the data. The review is solely on the basis of the written record and no conference is held on the matter.

SEC. 7. WITHDRAWAL OF REQUESTS

.01 The District Director or Chief, Appeals Office, may withdraw a request for technical advice at any time before the responding transmittal memorandum is signed. The District Director or Chief, Appeals Office, must notify the taxpayer in writing of intent to withdraw the request for technical advice except (1) when the period of limitation on assessment is about to expire and the taxpayer has declined to sign a consent to extend the period, or (2) when such notification would be prejudicial to the best interests of the government. If the taxpayer does not agree that the request for technical advice should be withdrawn, the procedure in section 6 of this revenue procedure must be followed.

.02 When a request for technical advice is withdrawn, the National Office may send its views to the District Director or the Chief, Appeals Office, when acknowledging the withdrawal request. In an Appeals case, acknowledgement of the withdrawal request should be sent to the appropriate Appeals Office, through the Director, Appeals Division, CC:AP:PT. In appropriate cases, the subject matter may be published as a revenue ruling or as a revenue procedure.

SEC. 8. CONFERENCES IN THE NATIONAL OFFICE

.01 If after an analysis of the technical advice request it appears that advice adverse to the taxpayer will be given, and if a conference has been requested, the taxpayer will be told, by telephone if possible, the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. If conferences are being arranged for more than one request for technical advice for the same taxpayer,they will be scheduled to cause the least inconvenience to the taxpayer. An extension of the 21-day period will be granted only if the taxpayer justifies it in writing and the Chief or Assistant Chief of the technical branch to which the case is assigned approves it. Because the purpose of these procedures is to facilitate the technical advice process by encouraging prompt submission of the required relevant material, requests for extensions should be justified by compelling facts and circumstances. The request for extension should be submitted before the end of the 21-day period. If unusual circumstances near the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told orally about the problem and of the forthcoming written request for extension. These requests must be promptly submitted. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right to the denial of an extension request. If it is not advised of problems with meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems with meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

.02 A taxpayer is entitled by right to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference is normally held at the branch level in the appropriate division (Individual Tax Division or Corporation Tax Division) of the office of the Associate Chief Counsel (Technical). It is attended by a person who has authority to sign the transmittal memorandum discussed in section 9.07 on behalf of the Branch Chief. When more than one branch has taken an adverse position on an issue within its jurisdiction presented in a request for technical advice, or when the position ultimately adopted by one branch will affect another branch's determination, a representative from each branch with authority to sign for the Branch Chief will attend the conference. In appropriate cases, the examining officer or the Appeals Officer may also attend the conference to clarify the facts in the case. If more than one subject is discussed at the conference, the discussion constitutes a conference for each subject. To promote a free and open discussion of the issues, the conference usually is held after the branch has an opportunity to study the case. However, the taxpayer may request that the conference of right be held at a stage earlier in the consideration of the case than the Service would ordinarily designate. The taxpayer has no right to appeal the action of a branch to a Division Director or to any other official of the Service.

.03 Because conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference is made.

.04 The senior Service representative at the conference ensures that the taxpayer has full opportunity to present views on all the issues in question. The Service representatives explain the Service's tentative decision on the substantive issues and the reasons for it. If prospective application under section 7805(b) of the Code is advanced by the taxpayer, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.05 An invitation to an individual conference is made if, after the conference of right, an adverse holding is proposed either (1) on a new issue or (2) on the same issue but on grounds different from those discussed at the first conference. When a proposed holding is reversed at a higher level with a result less favorable to the taxpayer, the taxpayer has no right to another conference if the grounds or arguments on which the reversal is based were discussed at the conference of right. The limitation on the number of conferences to which a

taxpayer is entitled does not prevent inviting a taxpayer to attend further conferences when National Office personnel think they are necessary. These additional conferences are held only at the invitation of the National Office.

.06 The taxpayer is responsible for furnishing in writing to the National Office within 21 calendar days after the conference any additional data, line of reasoning, precedents, etc., that the taxpayer proposed and that were discussed at the conference but not previously or adequately presented in writing. An extension of the 21-day period may be granted only if the taxpayer justifies it in writing and the Chief or the Assistant Chief of the Technical branch to which the case is assigned approves it. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those in section 8.01. Any additional material should be submitted in duplicate to the National Office. If the additional information would have a significant impact on the facts in the request for technical advice, the National Office sends a copy to the District Director or the Chief, Appeals Office, for comment on the facts contained in the additional information submitted. The District Director or the Chief, Appeals Office, gives the matter prompt attention.

.07 A taxpayer must get information on the status of the request for technical advice by contacting the District or Appeals Office that requested the technical advice.

.08 A District Director or a Chief, Appeals Office, may get current information on the status of the request for technical advice by calling the person whose name and telephone number are shown on the acknowledgement of receipt of the request for technical advice.

SEC. 9. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE

.01 As soon as the request for technical advice is assigned, the technical employee analyzes the file to see whether it meets all requirements of section 5. If it does not comply with the requirements of section 5.09 relating to the statement of proposed deletions, the National Office makes the deletions from the technical advice memorandum that the Commissioner determines are required by section 6110(c) of the Code.

.02 Usually, within 21 calendar days after the Branch Office receives the request for technical advice, a representative of the Branch telephones the District or Appeals Office to discuss the procedural and substantive issues in the request that come wihtin the Branch's jurisdiction. The Branch representative informs the District or Appeals Office:

(a) that the case is being returned because substantial additional information is required to resolve an issue, because significant unresolved factual variances exist between the statements of facts submitted by the District or Appeals Office and the taxpayer, or because major procedural problems cannot be resolved by phone; or

(b) that the case is not being returned but more information is needed or minor procedural deficiencies exist; or

(c) what the Branch representative's tentative conclusion is and the estimated date that the technical advice memorandum will be mailed; or

(d) that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

.03 Within 21 calendar days after the Branch receives the additional information requested in section 9.02(b), the Branch representatives telephones the District or Appeals Office to discuss the procedural and substantive issues in the request that come within the jurisdiction of the Branch. The representative indicates either (1) the tentative conclusion and the estimated date the technical advice memorandum will be mailed, or (2) the fact that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

.04 Because the Branch representative's tentative conclusion may change during the preparation and review of the technical advice memorandum, it is not, under any circumstances, considered final. The District or Appeals Office may not tell the taxpayer what the tentative conclusion is.

.05 When the technical advice request concerns matters within the jurisdiction of more than one Branch or more than one office in the same Branch, a representative of the Branch that received the original technical advice request informs the District or Appeals Office within the initial 21 calendar day period: (1) that the matters within the jurisdiction of another Branch or another office in the same Branch have been referred to the other Branch or office for consideration, and (2) that a representative of the other Branch or office will contact the District or Appeals Office about the referral of the technical advice request within 21 calendar days after receiving it in accordance with section 9.02.

.06 Generally, before replying to the request for technical advice, the National Office informs the taxpayer orally or in writing of the material likely to appear in the technical advice memorandum which the taxpayer proposed be deleted but which the Service determined should not be deleted. If so informed, the taxpayer may submit within 10 calendar days any further information, arguments, or other material that should be deleted. The Service attempts, if possible, to resolve all disagreements about proposed deletions before the National Office replies to the request for technical advice. However, the taxpayer does not have the right to a conference to resolve any disagreements about material to be deleted from the text of the technical advice memorandum. These matters, however, may be considered at any conference otherwise scheduled for the request.

.07 Replies to requests for technical advice are addressed to the District Director or the Chief, Appeals Office. When a request for technical advice is from Appeals, the response to the appropriate Appeals Office

will be routed through the Director, Appeals Division, CC:AP:PT. The replies to technical advice requests are in two parts. Each part identifies the taxpayer by name, address, identification number, and year or years involved. The first part of the reply is a transmittal memorandum. In unusual cases it is a way of giving the District or Appeals Office administrative information or other information that under the nondisclosure statutes or for other reasons, may not be discussed with the taxpayer. The second part (the "technical advice memorandum") contains: (1) a statement of the issues; (2) a statement of the pertinent facts in the issues; (3) a statement of the pertinent law, tax treaties, regulations, revenue rulings and other precedents published in the Bulletin, and court decisions; (4) a discussion of the rationale developed by the National Office; and (5) the conclusions of the National Office. The conclusions give direct answers, whenever possible, to the specific questions of the District or Appeals Office. The discussion of the issues is in enough detail so the District or Appeals officials know the reasoning underlying the conclusion. Accompanying the technical advice memorandum is a notice, under section 6110(f)(1) of the Code, of intention to disclose a technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). The District Director or the Chief, Appeals Office, forwards this notice to the taxpayer when the District Director or the Chief, Appeals Office gives a copy of the technical advice memorandum to the taxpayer according to section 9.08.

.08 The general practice of the Service is to give a copy of the technical advice memorandum to the taxpayer after it has been adopted by the District Director or the Chief, Appeals Office. However, in the case of technical advice memoranda described in section 6110(g)(5)(A) of the Code, relating to cases involving criminal or civil fraud investigations and jeopardy or termination assessments, a copy of the technical advice memorandum is not given to the taxpayer until all proceedings in the investigations or assessments are completed.

.09 If after receiving the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum the taxpayer wants to protest the disclosure of certain information in it, the taxpayer must submit a written statement within 20 calendar days identifying those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the technical advice memorandum proposed to be open to public inspection with brackets around deletions that are proposed by the taxpayer but that have not been made by the National Office. Generally, the National Office does not consider the deletion of any material that the taxpayer has not proposed be deleted before the National Office sent its reply to the request for technical advice to the District Director or the Chief, Appeals Office. Within 20 days after it receives the taxpayer's response to the notice under section 6110(f)(1), the National Office must mail the taxpayer its final administrative conclusion about the deletions to be made.

SEC. 10. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICES

.01 The District Director or the Chief, Appeals Office, processes the taxpayer's case on the basis of the conclusions in the technical advice memorandum unless (1) the District Director or the Chief, Appeals Office, thinks that the conclusions reached by the National Office in a technical advice memorandum should be reconsidered, or (2) the Chief, Appeals Office, in the case of technical advice unfavorable to the taxpayer, decides to settle the issue in the usual manner under existing authority.

.02 The District Director or the Chief, Appeals Office, gives the taxpayer (1) a copy of the technical advice memorandum described in section 9.07, and (2) the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). This requirement does not apply to technical advice memoranda involving civil fraud or criminal investigations; jeopardy or termination assessments, as described in section 5.10; or documents to which section 6104 applies.

.03 In those cases in which the National Office tells the District Director or the Chief, Appeals Office, that a copy of the technical advice memorandum should not be given to the taxpayer, the District Director or the Chief, Appeals Office, tells this to the taxpayer if the taxpayer requests a copy.

SEC. 11. EFFECT OF TECHNICAL ADVICE

.01 Except in rare or unusual circumstances, a holding in a technical advice memorandum that is favorable to the taxpayer is applied retroactively. Moreover, since technical advice, as described in section 4.04 of this revenue procedure, is issued only on closed transactions, a holding that is adverse to the taxpayer is also applied retroactively unless the Associate Chief Counsel (Technical) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the holding.

.02 A holding that modifies or revokes a holding in a prior technical advice memorandum is applied retroactively, with one exception. If the new holding is less favorable to the taxpayer than the earlier one, it generally is not applied to the period in which the taxpayer relied on the prior holding in situations involving continuing transactions.

.03 If a technical advise memorandum relates to a continuing action or a series of actions, it is ordinarily applied until specifically withdrawn or until the conclusion is modified or revoked by enactment of legislation, ratification of a tax treaty, or issuance of a United States Supreme Court decision, regulations (tempo-

rary or final), a revenue ruling, or other statement published in the Internal Revenue Bulletin. Publication of a notice of the proposed rulemaking does not affect the application of a technical advice memorandum.

.04 Generally, a technical advice memorandum that revokes or modifies a letter ruling or another technical advice memorandum is not applied retroactively for either the taxpayer to whom or for whom the ruling or memorandum was originally issued or for a taxpayer whose tax liability was directly involved in such ruling or memorandum if: (1) there has been no misstatement or omission of material facts; (2) the facts later developed are not materially different from the facts on which the ruling or memorandum was based; (3) there has been no change in the applicable law; (4) the ruling was originally issued for a prospective or proposed transaction; and (5) the taxpayer directly involved in the ruling or memorandum acted in good faith in relying on the ruling or memorandum and the retroactive revocation would be to the taxpayer's detriment. The tax liabilities of members of an industry are not directly affected by a ruling or a memorandum issued to or for one of the members. The holding in a revocation or modification of a ruling or a memorandum to or for one member of an industry may be retroactively applied to other members of that industry. A tax practitioner may not obtain the nonretroactive application for one client of a modification or revocation of a ruling or a memorandum that was previously issued to or for another client. When a ruling to a taxpayer or a memorandum involving a taxpayer is revoked with retroactive effect, the notice to the taxpayer, except in fraud cases, sets forth the grounds on which the revocation is being made and the reasons why the revocation is being applied retroactively.

SEC. 12. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including technical advice) will be applied without retroactive effect.

A taxpayer to whom a technical advice memorandum has been addressed or with respect to whom a technical advice request is pending may request that the Associate Chief Counsel (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any holding stated in the technical advice memorandum or to limit the retroactive effect of any subsequent modification or revocation of the technical advice memorandum.

.02 When a technical advice memorandum that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling or final regulations, a request to limit the retroactive effect of the modification or revocation of the technical advice memorandum must be made in the form of a request for a ruling when the request is submitted before a return is examined that contains the transaction that is the subject of the request for ruling. See section 20.02 of Rev. Proc. 84-1, page 342 of this Bulletin.

.03 When a taxpayer is informed of the modification or revocation of a technical advice memorandum, ruling letter, or determination letter during the course of an examination of the taxpayer's return by the District Director or during consideration by the Chief, Appeals Office, a request to limit the retroactive application of the modification or revocation of the technical advice memorandum, ruling letter, or determination letter must itself be made in the form of a request for technical advice. See section 5 of this revenue procedure. However, the taxpayer must also submit a statement, which will be forwarded to the National Office with the request for technical advice, that the request for technical advice is being made pursuant to section 7805(b) of the Code. This statement must also set forth the relief sought and an explanation of the reasons and arguments in support of the relief requested, and it must be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 11.04 of this revenue procedure as they relate to the taxpayer's particular situation.

.04 A request to limit the retroactive effect of a holding in a technical advice memorandum that does not modify or revoke a technical advice memorandum may be made as part of that technical advice request, either initially, or at any time before the technical advice memorandum is issued by the National Office. In such a case, the taxpayer must also submit a statement in support of the application of section 7805(b) of the Code, as described in .03 above.

.05 When a request for technical advice concerns only the application of section 7805(b) of the Code, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 8 of this revenue procedure. If the request for application of section 7805(b) is included in the request for technical advice on the substantive issues or is made before the conference of right on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. If the request for the application of section 7805(b) is made as part of a pending technical advice request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

SEC. 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 83-2 is superseded.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 994; 1.994-1.)

Rev. Proc. 84-3

SECTION 1. SCOPE

This revenue procedure, in accordance with section 1.994-1(e)(5)(v) of the Income Tax Regulations, prescribes the conditions and the procedures to be followed in cases in which intercompany prices paid by a DISC to its related supplier or commissions paid by a related supplier to a DISC, as originally determined by the parties under section 994 of the Internal Revenue Code, are redetermined by the Internal Revenue Service in a manner that results in an increase of the intercompany prices or reduction of the commissions. Procedures are prescribed below by which the DISC's related supplier and/or shareholder may request an adjustment of accounts and a reclassification of actual distributions previously made with respect to all or a part of the amount of the pricing or commission redetermination.

SEC. 2. BACKGROUND AND PURPOSE

Section 995(b) of the Code treats a portion of a DISC's taxable income for each taxable year as a deemed distribution to its shareholder, which is taxable to the shareholder as a dividend. Under section 996(a)(3) of the Code, actual distributions by a DISC out of previously taxed income (PTI), which consists of amounts taxed to a DISC's shareholder under section 995(b) are excluded from the shareholder's gross income. Actual distributions by a DISC out of its accumulated DISC income (ADI) or other earnings and profits (not constituting either PTI or ADI) are taxable to the DISC's shareholder as ordinary dividends.

Redeterminations by the Service of intercompany prices or commissions determined under the section 994(a) pricing rules generally have the effect of reducing a DISC's PTI and ADI for the taxable year of the redetermination. As a result of such a reduction in PTI, a portion of any nontaxable distribution previously made by a DISC out of PTI as originally computed by the parties is reclassified as a taxable distribution out of ADI or other earnings and profits.

SEC. 3. CASES IN WHICH ADJUSTMENT OF ACCOUNTS WILL BE PERMITTED

.01 The treatment provided in this revenue procedure will be available with respect to all transactions for any taxable year of a DISC to which intercompany prices paid by the DISC to its related supplier, or commissions paid by the related supplier to the DISC, as originally determined by the parties under section 994 of the Code, are subsequently redetermined by the Service in a manner that results in an increase of the intercompany prices or reduction of the commissions provided it is determined by the Service that the arrangements or transactions, or the terms thereof, giving rise to the redetermined intercompany prices or commissions did not have as one of their principal purposes the avoidance of Federal income tax. The determination as to whether one of the principal purposes was avoidance of Federal income tax will be based upon all the facts and circumstances of the case.

.02 The treatment provided in this revenue procedure will not be available if any part of any underpayment of tax by the related supplier and/or shareholder for any taxable year affected by the Service's redetermination is due to fraud.

SEC. 4. ADJUSTMENTS TO BE MADE OR ALLOWED

.01 In a case qualifying under section 3 above in which the DISC's shareholder complies with the requirements of section 5 below, the shareholder shall be permitted to exclude from its gross income all or part of any actual distribution received from the DISC that was originally a nontaxable distribution out of the DISC's PTI, but would (but for the application of this section 4.01) be converted into a taxable distribution out of the DISC's ADI or other earnings and profits by reason of a redetermination of DISC taxable income made by the Service for the taxable year of the DISC in which such distribution occurred. To the extent that a distribution is excluded from gross income pursuant to this paragraph, it shall not qualify as a distribution out of any of the DISC's earnings and profits accounts, or as a dividend under section 316 of the Code or for any other Federal income tax purpose; for example, no foreign tax shall be deemed to have been paid with respect thereto for purposes of the foreign tax credit under section 901(d) of the Code.

.02 In a case to which section 4.01 above applies, the account receivable established under section 1.994-1(e)(5) of the regulations by the DISC's related supplier in respect of the transactions which gave rise to the redetermination of the intercompany prices or commissions shall be deemed to have been paid by the DISC to the related supplier within 90 days after the date on which such account receivable was established to the extent of any amount excluded from the gross income of the DISC's shareholder pursuant to section 4.01 above. Thus, any distribution excluded from gross income under section 4.01 shall be reclassified and treated as a timely payment of an equivalent portion of the amount owed by the DISC to the related supplier by reason of the redetermination. The time, manner, and payment of any excess of an account receivable over an amount reclassified under the preceding sentence and also the interest attributable to an account receivable shall be governed by the rules set forth in section 1.994-1(e)(5) of the regulations.

.03 If the shareholder referred to in section 4.01 above and the related supplier referred to in section 4.02 above are different parties, the related supplier shall establish an account receivable from the shareholder for any amount which is excluded from the gross income of the shareholder under section 4.01 and deemed paid to the related supplier under section 4.02. The time and manner of payment of such account receivable and interest attributable thereto shall be governed by the rules applicable to accounts receivable established under section 1.994-1(e)(5) of the regulations.

.04 The election of a DISC's shareholder to invoke this revenue proce-

dure in no way affects the redetermination by the Service of the intercompany prices payable by the DISC or the commissions payable to the DISC. Such election shall, however, affect the taxable income of the shareholder, the DISC, and the DISC's related supplier to the extent indicated by sections 4.01, 4.02, and 4.03 above.

SEC. 5. PROCEDURES TO BE FOLLOWED

.01 *Cases pending with the Internal Revenue Service*

1 If a DISC's shareholder desires to invoke this revenue procedure, it must file a request in writing with the District Director of Internal Revenue or the Appeals Office having jurisdiction of the case before closing action is taken on the redetermination of DISC taxable income. The request shall be signed by a person having the authority to sign the shareholder's Federal income tax returns, and shall contain the following:

(a) a request that the shareholder be granted the treatment provided by section 4 of this revenue procedure for the years indicated; and

(b) an offer to enter into a closing agreement under section 7121 of the Code as provided in section 5.013 below.

2 The Service will determine whether the affected parties qualify under section 3 above for the requested treatment and inform the shareholder of its decision. If the request is rejected, the shareholder may pursue the matter through established channels of administrative appeal.

3 If the Service concludes that section 4 above properly applies and if the amount of the redetermination of DISC taxable income has been agreed upon, the shareholder will be requested to enter into a closing agreement, binding itself, the DISC, and any affected related supplier, establishing for each year involved:

(a) the amount of the redetermination of DISC taxable income;

(b) the amount of any actual distributions received by the shareholder which it elects to exclude from income under section 4.01 above;

(c) the amount of the account receivable from the DISC established by the DISC's related supplier under section 1.994-1(e)(5) of the regulations, net of the deemed payment under section 4.02 above;

(d) the amount of the account receivable from the DISC's shareholder established by the related supplier under section 4.03 above; and

(e) the parties' rights to receive payment of the accounts receivable referred to in (c) and (d) above free of further Federal income tax consequences, provided such payments are made within the time and in the manner prescribed by §1.994-1(e)(5) of the regulations.

.02 *Cases pending before the United States Tax Court.*—If a case has reached trial status in the Tax Court and it is determined that the taxpayer is entitled to the benefits of the provisions of section 4 above, the parties may stipulate or otherwise arrange with the Court so that any adjustment in tax for the years before the Court will reflect the application of section 4 above, procided the DISC's shareholder executes the required closing agreement.

.03 *Closed cases.*—In any closed case involving a redetermination of DISC income, the DISC's shareholder may file a request for the treatment provided by section 4 above, if such treatment will not change any taxpayer's liability for a year which is barred by the statute of limitations, or a year for which the tax liability has been finally determined by offer in compromise, closing agreement, or court action. Such request must be filed within 180 days after January 9, 1984, with the District Director for the District in which the shareholder filed its tax return for the year to which such redetermination relates, and shall contain the information required by section 5.011 above. The request will then be processed in the same manner as in a pending case described in sections 5.012 and 5.013 above.

.04 *Cases with the jurisdiction of the Department of Justice.*—If a taxpayer files a request for treatment under section 4 above with the appropriate District Director, with respect to a case within the jurisdiction of the Department of Justice, the Service, through its Chief Counsel, will recommend to the Department of Justice the action to be taken with respect to the taxpayer's request.

SEC. 6. EFFECTIVE DATE

This revenue procedure will not be effective until section 1.994-1(e)(5)(v) of the proposed Income Tax Regulations published in the Federal Register on January 9, 1984, is adopted in final form.

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26 CFR 601.601: Rules and regulations. (Also Part I, Sections 4996, 4997, 6232, 6402; 51.4996-1, 51.4997-1, 51.4997-2, 51.6402-1.)

Rev. Proc. 84-4 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set out the rules that will be contained in temporary regulations under section 6232 of the Internal Revenue Code, relating to the applicability of the provisions for consolidated partnership proceedings under sections 6221-6231 to the windfall profit tax. These temporary regulations, which are expected to be issued early in 1984, will be applicable to removal year 1983 only. Until the temporary regulations are published, taxpayers may rely on this revenue procedure.

SEC. 2 BACKGROUND

.01 Beginning with the 1983 removal year, section 6232 of the Code provides for consolidated administrative and judicial proceedings to determine the proper treatment of "partnership items" for windfall profit tax (WPT) purposes. Except to the extent otherwise provided in the regulations under section 6232, the rules governing these consolidated administrative and judicial proceedings will be similar to those set forth in sections 6221-6231 and the regulations thereunder.

.02 The term "partnership item" will be defined in the regulations under section 6232 of the Code. Generally, "partnership items" for WPT purposes will be those items that are

[1] Also released as News Release IR-84-2, dated January 6, 1984.

more appropriately determined at the partnership level rather than at the partner level. Examples of these items are the quantity of the oil removed from the premises, the removal and base prices, and the tier of the oil. Items that depend on the status of the partner, such as the independent producer amount and certain exemptions, are not partnership items.

.03 Section 4996(a)(1)(C) of the Code provides that the partner, rather than the partnership, shall be treated as the producer of the crude oil for windfall profit tax purposes. Section 51.4997-2(a)(2) of the Excise Tax Regulations requires the partnership to furnish each partner of that partnership a Form 6248, Annual Information Return of Windfall Profit Tax, by the later of 15 days following the receipt of such form by the partnership or the first April 30 following the end of the year to which the form relates.

.04 Although the partners, rather than the partnership, are treated as the producers of the partnership oil for WPT purposes, section 6232(c)(1) of the Code provides that the partnership may act on behalf of the partners with respect to the determination, assessment, and collection of the WPT to the extent provided by the regulations. Section 6232(c)(2) provides, however, that any group of partners owning in the aggregate at least 5 percent of the income interest of the partnership may elect to negate the partnership's authority to act on behalf of all partners.

.05 Section 6232(c)(3) of the Code provides that none of the rights granted to the partners under sections 6221-6231 are lost by virtue of the partnership's authority to act on behalf of the partners.

.06 Whether the partnership acts on behalf of the partners or not, administrative and judicial proceedings with respect to "partnership items" for WPT purposes will be consolidated as provided in sections 6221-6231 of the Code and the regulations under those sections.

SEC. 3 PROCEDURE

.01 If the partnership does not elect to be treated as authorized to act on behalf of the partners or does not comply with the requirements of section 3.03 for making this election, the partnership shall furnish a Form 6248 to each partner within the period prescribed in section 51.4997-2(a)(2) of the regulations. The partnership shall furnish Forms 6248 with respect to the partners to the Internal Revenue Service Center designated on that form within the time prescribed in section 51.4997-2(c)(4) of the regulations.

.02 The partnership shall be treated as authorized to act on behalf of the partners of that partnership if the partnership complies with the requirements of section 3.03. The authority to act on behalf of the partners may be negated by a 5-percent election, the procedures for which are set forth in section 3.07. The authority of the partnership to act on behalf of any particular partner may be negated by an individual election, the procedures for which are set forth in section 3.08.

.03 The partnership may elect to be treated as authorized to act for each partner of the partnership if the partnership complies with the procedures set forth in this paragraph.

1 The partnership shall furnish to the Internal Revenue Service a notice that states that the partnership intends to: 1) act on behalf of all partners in any judicial or administrative proceeding with respect to partnership items for WPT purposes; 2) pay on behalf of the partners any additional WPT determined to be due to reflect the proper treatment of partnership items; and 3) receive on behalf of the partners any credit for, or refund of, any overpayment of WPT attributable to partnership items (and to indemnify the Service for any duplicate refund made).

2 The notice shall be furnished to Austin Service Center (see section 3.09 for complete address) on or before March 31, 1984. The notice shall identify the partnership by name, address, and identification number and shall be signed by the person authorized to sign the Form 1065.

3 The partnership shall, by March 31, 1984, furnish to each partner of the partnership a notice that contains the same information (except partnership identification information and signature) contained in the notice required to be furnished to the Service by the partnership. In addition the notice shall: 1) inform each partner of the partner's allocable share of the WPT paid or withheld during 1983 with respect to partnership production (so that the partner may claim an income tax deduction for that amount); 2) explain the right of any group of partners holding a 5 percent or greater interest in the income of the partnership to negate the authority of the partnership to act on behalf of all partners by filing a notice in accordance with section 3.07; and 3) explain the right of each partner individually to elect not to have the partnership act on behalf of that partner by filing a notice in accordance with section 3.08.

.04 If the partnership elects to be treated as authorized to act on behalf of the partners with respect to the determination, assessment, and collection of the WPT attributable to partnership items and no 5-percent election is made to negate this authority, the following rules shall apply with respect to any partner who has not made an individual election:

1 The Tax Matters Partners (TMP) shall represent that partner in all administratve and judicial proceedings with respect to partnership items. Therefore, the partner is not entitled to receive notice of these proceedings from the TMP or the Service or to participate in these proceedings. A settlement agreement entered into between the Service and the TMP is binding on that partner.

2 The partnership shall compute and pay any additional WPT due on behalf of the partner or file an administrative adjustment request on behalf of the partner with respect to partnership items. That partner will not be allowed to file an administrative adjustment request or a claim for refund with respect to partnership items.

3 The partnership is not required to furnish that partner a Form 6248.

4 The partnership shall furnish a Form 6248 with respect to that partner to the Austin Service Center by

August 31, 1984. This Form 6248 shall show the amount of WPT allocable to that partner that was actually withheld or paid during 1983 and the adjustment made by the partnership with respect to that partner to eliminate any overpayment or underpayment. On or before the date on which the partnership furnishes to the Service the Form 6248, the partnership shall file a Form 720, Quarterly Federal Excise Tax Return, with Form 6047, Windfall Profit Tax, attached and pay any additional tax due with respect to that partner or file a Form 843, Claim, and claim any credit or refund due with respect to that partner.

.05 If the partnership elects to be treated as authorized to act for each partner and no 5-percent election is made, the following rules shall apply with respect to any partner who makes the individual election:

1 That partner retains any right with respect to the determination of the tax treatment of partnership items for WPT purposes that that partner would possess under sections 6221-6231 of the Code and the regulations under those sections. For example, the partner would be entitled to receive notice of the proceedings from the TMP or the Service if that partner would be entitled to receive notice under section 6223 and the regulations under that section.

2 A settlement agreement entered into between the Service and the TMP is binding on that partner if a settlement entered into under section 6224(c) of the Code would be binding on the partner.

3 The partnership shall furnish a Form 6248 for the partner to the Austin Service Center and to that partner by August 31, 1984. The Form 6248 furnished to the Service will not show any adjustment for an overpayment or underpayment with respect to that partner. The partnership shall also furnish to the Service a statement that identifies each partner that made the individual election by name, address, identification number, and percentage ownership interest in the partnership.

4 The partner shall file a separate Form 720 and pay an additional tax due with respect to the partner or file a Form 843 to claim any credit or refund due. These forms shall be filed with the Austin Service Center; the Form 720 shall be filed by October 31, 1984.

.06 If the partnership elects to act on behalf of the partners in accordance with the procedures set forth in section 3.03 but a 5-percent election is made to negate that authority, the partnership shall furnish a Form 6248 for each partner in the partnership to the Service and to the partner by August 31, 1984. The Forms 6248 furnished to Service shall be filed with the service center designated on that form. The partnership will not be permitted to make any adjustments with respect to the partners under these circumstances. A partner filing Form 720 or Form 843 shall file that form with the service center designated on the form; the Form 720 shall be filed by October 31, 1984.

.07 Any group of partners owning in the aggregate at least 5 percent of the income interest of the partnership may elect to negate the authority of the partnership to act on behalf of the partners by filing a written notice to that effect. The notice shall be filed with the Austin Service Center on or before June 30, 1984. The notice shall identify the partnership by name, address, and identification number and shall identify the partners forming the 5-percent group by name, address, identification number, and percentage interest in the partnership. The notice shall be signed by all members of the group making the election. A copy of the notice shall be furnished to the partnership.

.08 Any partner desiring that the partnership not be authorized to act on its behalf shall file a signed notice to that effect with the Austin Service Center on or before June 30, 1984. The notice shall contain the name, address, and taxpayer identification number of both the partner and the partnership. A copy of the notice shall be furnished to the partnership.

.09 The address of the Austin Service Center to be used for purposes of this revenue procedure is: Internal Revenue Service Center, WPT Staff, P.O. Box 1231, Austin, TX 28767, Stop 89.

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26 CFR 601.602: Forms and instructions. (Also Part I, Section 3302; 31.3302(c)-1.)

Rev. Proc. 84-5[1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to bring up to date the procedure to be followed in computing reductions in the credit against the tax reportable on Form 940, Employer's Annual Federal Unemployment Tax Return, for 1983.

SEC. 2. BACKGROUND

.01 Section 3301 of the Internal Revenue Code imposes an excise tax on employers based on wages paid to employees. Section 3306(a) defines the term "employer" for purposes of the tax imposed by section 3301.

.02 Section 3302 of the Code provides for credits against the tax imposed by section 3301. Reductions in the amount of credit otherwise allowable are provided for in section 3302(c). Section 3302(c)(2) provides that reductions shall occur if an employer pays wages for services performed in a state that has not restored amounts that were advanced under Title XII of the Social Security Act, 42 U.S.C. sections 1321-1324(1976).

.03 Section 3302(c)(2)(A) of the Code, in conjunction with section 3302(d), provides that, for each consecutive calendar year beginning with the second consecutive calendar year in which the advances have not been repaid, the reduction is equal to 0.3 percent of the wages (as defined in section 3306(b)) paid.

.04 Section 3302(c)(2)(B) of the Code provides for an additional reduction for the third or fourth consecutive year in which the advances have not been repaid and section 3302(c)(2)(C) provides for an additional reduction for the fifth or any succeeding consecutive year. Section 3302(d)(7) provides that the percentage of the additional reduction is determined by the Secretary of Labor.

[1] Also released as News Release IR-84-4, dated January 11, 1984.

.05 Section 3302(f) of the Code provides a cap on the credit reduction in the case of any state that meets certain solvency requirements, as determined by the Secretary of Labor on or before November 10. The credit reduction applicable to employers subject to the unemployment compensation law of that state is limited to either 0.6 percent of wages paid or the percentage credit reduction that was in effect in the case of the state for the preceding taxable year, if greater than 0.6 percent. A state that partially meets the solvency requirements may partially limit the credit reduction. Section 512 of the Social Security Amendments of 1983, 1983-29 I.R.B. 20, 35. A state must apply to the Secretary of Labor in order for a cap to be put into effect.

.06 Section 3302(d)(3) of the Code provides that credit reductions for any year may be forestalled if a state restores to the United States Treasury, before November 10 of that year, the full amount of the advances.

.07 For purposes of the tax imposed by section 3301 of the Code, section 3306(j)(1) provides that the term "state" includes the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

SEC. 3. CREDIT REDUCTIONS FOR 1983

In a letter of November 14, 1983, 48 Fed. Reg. 55931(1983), the Secretary of Labor advised the Secretary of the Treasury that none of the following states had repaid the advances by November 10, 1983. In addition, the Secretary of Labor set forth the appropriate credit reduction for each state's employers. As a result, credit reductions will take effect in the amount of the following percentages of the wages (as defined in section 3306(b) of the Code) paid by employers that are attributable to the following states:

(a) 0.3 percent—Kentucky;
(b) 0.6 percent—Arkansas, Delaware, Michigan, Minnesota, New Jersey, Ohio, Puerto Rico, Rhode Island, Vermont, the Virgin Islands, and West Virginia;
(c) 0.7 percent—Connecticut, Illinois, and Pennsylvania; and
(d) 1.1 percent—the District of Columbia.

SEC. 4. PROCEDURE

If a credit reduction applies, it is computed on Part I, lines 6 and 7 of the Form 940 for 1983, and carried to line 2, Part II or line 4, Part III.

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26 CFR 601.602: Forms and instructions. (Also Part I, Section 6053; 31.6053-3.

Rev. Proc. 84-6

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PART A.—GENERAL

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to provide the requirements and conditions for submitting Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, on magnetic tape instead of filing paper returns. Form 8027 information may be filed on magnetic tape and sent annually to the Service beginning in 1984. The due date for the first submission of Form 8027 on magnetic tape to the Internal Revenue Service is February 29, 1984.

SEC. 2. APPLICATION FOR MAGNETIC MEDIA REPORTING

.01 For the purposes of this Revenue Procedure, the employer is the organization supplying the information and the transmitter is the organization preparing the magnetic media file. The employer and transmitter may be the same organization. Employers or their transmitters are required to complete Form 4419, Application for Magnetic Media Reporting of Information Returns. Requests for copies of this form or for additional information on magnetic media reporting should be addressed to the attention of the Magnetic Media Coordinator of the Service Center listed in PART A, SEC. 7. of this Revenue Procedure.

.02 The Service will act on an application and notify the applicant of authorization to file, in writing, within 30 days of receipt of the application. Magnetic media returns may not be filed with the Service until the application has been approved.

.03 The Service will assist new filers with their initial magnetic media submission by encouraging the submission of test files for review in advance of the filing season. Approved employers or transmitters who wish to submit a test file should contact the Magnetic Media Coordinator of the Service Center listed in PART A, SEC. 7. of this Revenue Procedure.

.04 If there are hardware or software changes that would affect the characteristics of the magnetic media submission, the employer (or its transmitter) is required to submit a new Form 4419.

.05 Only employers or transmitters using equipment compatible with the Service's equipment will have their applications approved. Compatible tape characteristics are shown in PART B, SEC. 1.

SEC. 3. FILING OF MAGNETIC MEDIA REPORTS

.01 Packaging, shipping,and mailing instructions will be provided by the Service within 45 days of the granting of approval. A magnetic tape reporting package, which includes all necessary transmittals and labels, will be mailed to all approved filers.

.02 With the Service's concur-

rence, employers can submit a portion of their returns on magnetic media and the remainder on paper Forms 8027, provided there is NO DUPLICATE FILING. The magnetic media records and paper forms must be filed at the INTERNAL REVENUE SERVICE CENTER listed in Part A, SEC. 7. of this Revenue Procedure. A Form 8027-T, Transmittal of Employer's Annual Report of Allocated Tips, must accompany paper submissions and a Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must accompany magnetic media submissions.

.03 The affidavit which appears on Forms 8027-T and 4804 should be signed by the employer. A transmitter, service bureau, or disbursing agent may, however, sign the affidavit on behalf of the employer if all of these conditions are met:

(a) It has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under the State law.

(b) It signs the affidavit and adds the caption "For: (name of employer)".

.04 Although a duly authorized agent signs the affidavit, the employer is held responsible for the accuracy of the Form 8027 and will be liable for penalties for failure to comply with filing requirements.

.05 If a portion of the returns are submitted on paper documents, include a statement on the Form 8027-T that the remaining returns are being filed on magnetic media. Please note that Form 8027-T normally applies to the filing of information returns on paper; however, filers of magnetic media must review the Form 8027-T and file Form 8027-T if appropriate.

.06 If an allocation of tips is based on a good faith agreement, a copy of the agreement must accompany the submission.

.07 If an allocation rate of less than 8% has been granted by the District Director, a copy of the determination letter must accompany the submission. Employers with more than one establishment can receive approval from one district in each IRS region where establishments are located (see section 31.6053-3(h)(4) of the Employment Tax Regulations).

SEC. 4. FILING DATES

.01 Magnetic tape reporting to the Service for Form 8027 must be on a calendar year basis. The first due date of either paper or tape Forms 8027 is February 29, 1984.

SEC. 5. PROCESSING OF MAGNETIC MEDIA RETURNS

.01 The Service will copy the information from the original tapes and return the original tapes to the employer. Normally tapes will be returned within three months after the annual due date for submission to the Service, or within three months after actual receipt of acceptable tapes, whichever is later.

.02 All files submitted must conform totally to this revenue procedure. *IF FILES ARE UNPROCESSIBLE, THEY WILL BE RETURNED TO THE FILER FOR CORRECTION.* Corrected files must be filed with the Service Center as soon as possible. If the delay will be more than two weeks, contact the Service Center Magnetic Media Coordinator for instructions. Corrected files will be returned by the Service within six months of receipt.

SEC. 6. EFFECT ON PAPER RETURNS

.01 If a portion of the returns is reported on magnetic media and the remainder is reported on paper forms, those returns not submitted on magnetic media must be filed on Form 8027.

SEC. 7. MAGNETIC MEDIA COORDINATOR CONTACT

Requests for additional copies of this revenue procedure or for additional information on magnetic media reporting of Forms 8027 should be addressed to the attention of the Magnetic Media Coordinator of:

Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

SEC. 8. DEFINITIONS

Element	*Description*
EIN	Employer Identification Number which has been assigned by Internal Revenue Service to the reporting entity.
Employer	The organization supplying the information.
Establishment	A food or beverage operation where tipping of food or beverage employees is customary.
File	For the purpose of this procedure, a file consists of all magnetic media records submitted by an Employer or Transmitter.
Transmitter	Person or organization preparing magnetic media file(s). May be Employer or agent of Employer.

PART B. MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 The magnetic tape specifications contained in this part of the procedure define the required format and contents of the records to be included in the file. These specifications must be adhered to unless deviations have been specifically granted by the Service in writing.

.02 In most intances, the Service will be able to process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 7 channel BCD (binary coded decimal) with
  (1) Either Even or Odd Parity and
  (2) A density of 800 BPI.

(b) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with
  (1) Odd Parity and
  (2) A density of 800, 1600, or 6250 BPI.

(c) 9 channel ASCII (American Standard Coded Information Interchange) with

(1) Odd Parity and
(2) A density of 800, 1600, or 6250 BPI.

.03 All compatible tape files must have the following characteristics:

(a) Type of tape—0.5 inch (12.7 mm) wide, computer grade magnetic tape on reels of up to 2400 feet (731.52 m) within the following specifications:
(1) Tape thickness: 1.0 or 1.5 mils
(2) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm)

(b) Interrecord Gap—¾ inch.

SEC. 2. RECORD LENGTH

.01 The tape record defined in this procedure may be blocked or unblocked, subject to the following:

(a) *A FIXED RECORD OF 464 POSITIONS IS REQUIRED.*

(b) All records except the Header and Trailer Labels may be blocked.

(c) A block must not exceed 2320 tape positions.

(d) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9's. Do not pad a block with blanks.

SEC. 3. OPTIONS FOR FILING

For the purposes of this procedure the following conventions must be used.

Header Label:
1. Employers may use standard headers provided they begin with 1HDR, HDR1, VOL1, or VOL2.
2. Consist of a maximum of 80 positions.
3. Header and Trailer Labels are optional unless more than one reel is being submitted. If more than one reel is being submitted Header and Trailer Labels are REQUIRED.

Trailer Label:
1. Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.
2. Consist of a maximum of 80 positions.
3. Header and Trailer Labels are optional unless more than one reel is being submitted. If more than one reel is being submitted Header and Trailer Labels are REQUIRED.

Record Mark:
1. Special character used to separate blocked records on tape.
2. Can be written only at the end of a record or block.
3. For odd parity tapes, use BCD bit configuration 011010 ("A82").

Tape Mark:
1. Used to signify the physical end of the recording on tape.
2. For even parity, use BCD configuration 001111 ("8421").
3. May follow the header label and precede and/or follow the trailer label.

RECORD NAME: 8027 MAGNETIC TAPE RECORD

Tape Position	*Field Title*	*Length*	*Description and Remarks*
1-15	Establishment Identification Number	15	REQUIRED. Enter the unique 15 digit number for each establishment. The number is determined as follows: A. The first nine digits must be the EIN as shown on the employer's Form 941 or 941E, and in tape positions 132-140 of this record. B. The tenth digit identifies the kind of establishment. Enter the number which describes the type of establishment, as shown below: 1 for an establishment that serves evening meals only (with or without alcoholic beverages). 2 for an establishment that serves evening meals and other meals (with or without alcoholic beverages). 3 for an establishment that serves only meals other than evening meals (with or without alcoholic beverages). 4 for an establishment that serves food, if at all, only as an incidental part of the business of serving alcoholic beverages. C. The last five digits are for identifying individual establishments of an employer reporting under the same EIN. The employer numbers the various establishments uniquely until each establishment the employer is required to file a return for has a number. NUMERICS ONLY.
16-55	Establishment Name	40	REQUIRED. Enter the name of the establishment. Left justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, NUMERICS, BLANKS, HYPHENS, AMPERSANDS, AND SLASHES.

Tape Position	*Field Title*	*Length*	*Description and Remarks*
56-95	Establishment Street Address	40	REQUIRED. Enter the street address of the establishment. Left justify and blank fill. ALLOWABLE CHARACTERS ARE ALPHAS, NUMERICS, SLASHES, HYPHENS, AMPERSANDS, AND BLANKS.
96-120	Establishment City	25	REQUIRED. Enter the city of the establishment. Left justify and blank fill. ALLOWABLE CHARACTERS ARE ALPHAS, HYPHENS AND BLANKS.
121-122	Establishment State	2	REQUIRED. Enter state code of the establishment; must be one of the following:

state	code
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Kentucky	KY
Louisiana	LA
Maine	ME
Maryland	MD
Massachusetts	MA
Michigan	MI
Minnesota	MN
Mississippi	MS
Missouri	MO
Montana	MN
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH
Oklahoma	OK
Oregon	OR
Pennsylvania	PA
Rhode Island	RI
South Carolina	SC
South Dakota	SD
Tennessee	TN
Texas	TX
Utah	UT
Vermont	VT

Tape Position	*Field Title*	*Length*	*Description and Remarks*
			Virginia VA Washington WA West Virginia WV Wisconsin WI Wyoming WY
123-131	Establishment ZIP Code	9	REQUIRED. Enter the ZIP code of the establishment. Left justify and blank fill. ALLOWABLE CHARACTERS ARE NINE NUMERICS or FIVE NUMERICS AND FOUR BLANKS.
132-140	Employer Identification Number	9	REQUIRED. Enter the 9-digit number assigned to the employer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9's, or ALL ZEROES.
141-180	Employer Name	40	REQUIRED. Enter the name of the employer as it appears on your tax forms (e.g. Form 941). Any extraneous information must be deleted. Left justify and blank fill. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSANDS, HYPHENS, AND SLASHES.
181-220	Employer Street Address	40	REQUIRED. Enter street address of employer. Left justify and blank fill. ALLOWABLE CHARACTERS ARE ALPHAS, NUMERICS, HYPHENS, AMPERSANDS, SLASHES AND BLANKS.
221-245	Employer City	25	REQUIRED. Enter the city of the employer. Left justify and blank fill. ALLOWABLE CHARACTERS ARE ALPHAS, HYPHENS, AND BLANKS.
246-247	Employer State	2	REQUIRED. Enter state code of employer. Must be one of the abbreviations shown above in the state abbreviation table for Establishment State (Tape Positions 121-122).
248-256	Employer ZIP Code	9	REQUIRED. Enter ZIP code of employer. Left justify and blank fill. ALLOWABLE CHARACTERS ARE NINE NUMERICS or FIVE NUMERICS AND FOUR BLANKS.
257-268	Charged Tips (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total amount of tips that are shown on charge receipts for this period in 1983. Field is in dollars and cents. Right justify and zero fill. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DECIMAL POINTS, DOLLAR SIGNS, OR COMMAS.
269-280	Charged Tips (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total amount of tips that are shown on charge receipts for this period in 1983. Field is in dollars and cents. Right justify and zero fill. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DECIMAL POINTS, DOLLAR SIGNS, OR COMMAS.
281-292	Charged Receipts (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total sales, other than carryout sales or sales with an added service charge of 10 percent or more, that are on charge receipts on which there were charged tips for this period in 1983. This includes credit card charges, other credit arrangements, and charges to a hotel room unless the employer's normal accounting practice consistently excludes charges to a hotel room. Do not include any state or local taxes in the amount reported. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT INCLUDE DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.

Tape Position	*Field Title*	*Length*	*Description and Remarks*
293-304	Charged Receipts (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total sales, other than carryout sales or sales with an added service charge of 10 percent or more, that are on charge receipts on which there were charged tips for this period in 1983. This includes credit card charges, other credit arrangements, and charges to a hotel room unless the employer's normal accounting practice consistently excludes charges to a hotel room. Do not include any state or local taxes in the amount reported. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT INCLUDE DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
305-316	Service Charges Less Than 10 Percent (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total amount of service charges less than 10 percent that have been added to customer's bills and have been distributed to your employees for this period of 1983. In general, service charges added to the bill are not tips since the customer does not have a choice. These service charges are treated as wages and are included on Form W-2. For a more detailed explanation, see Revenue Ruling 69-28, which is contained in the Internal Revenue Cumulative Bulletin 1969-1 starting on page 270. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
317-328	Service Charges Less Than 10 Percent (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total amount of service charges less than 10 percent that have been added to customer's bills and have been distributed to your employees for this period of 1983. In general, service charges added to the bill are not tips since the customer does not have a choice. These service charges are treated as wages and are included on Form W-2. For a more detailed explanation, see Revenue Ruling 69-28, which is contained in the Internal Revenue Cumulative Bulletin 1969-1 starting on page 270. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
329-340	Indirect Tips Reported (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total amount of tips reported by indirectly tipped employees (e.g. busboys, service bartenders, cooks) for this period of 1983. Do not include tips received by employees in December, 1982 but not reported until January, 1983. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
341-352	Indirect Tips Reported (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total amount of tips reported by indirectly tipped employees (e.g. busboys, service bartenders, cooks) for this period of 1983. Include tips received by employees in December, 1983 but not reported until January, 1984. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
353-364	Direct Tips Reported (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total amount of tips reported by directly tipped employees (e.g. waiters, waitresses, bartenders) for this period of 1983. Do not include tips received by employees in December, 1982 but not reported until January, 1983. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.

Tape Position	*Field Title*	*Length*	*Description and Remarks*
365-376	Direct Tips Reported (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total amount of tips reported by directly tipped employees (e.g. waiters, waitresses, bartenders) for this period of 1983. Include tips received by employees in December, 1983 but not reported until January, 1984. Right justify and zero fill. Field is in dollars and cents. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
377-388	Total Tips Reported (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total amount of tips reported by all employees (e.g. busboys, cooks, waiters, waitresses, bartenders) for this period of 1983. Do not include tips received by employees in December 1982 but not reported until January 1983. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
389-400	Total Tips Reported (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total amount of tips reported by all employees (e.g. busboys, cooks, waiters, waitresses, bartenders) for this period of 1983. Include tips received by employees in December 1983 but not reported until January 1984. Right justify and zero fill. Field is in dollars and cents. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
401-412	Gross Receipts (Jan. 1-Mar. 31)	12	REQUIRED. Enter the total gross receipts from the provision of food and/or beverages for this establishment for this period of 1983. Do not include in gross receipts charged tips shown on charged sales (tape positions 257-268) unless you have reduced the cash sales amount by paying cash to tipped employees for charged tips due to them. Do not include state or local taxes in gross receipts. If you do not charge separately for food or beverages when other services are included (such as a package deal for food and lodging), make a good faith estimate of the gross receipts attributable to the food or beverages. This estimate reflects the cost of providing the food or beverages plus a reasonable profit factor. Right justify and zero fill. Field is in dollars and cents. If no entry zero fill. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
413-424	Gross Receipts (Apr. 1-Dec. 31)	12	REQUIRED. Enter the total gross receipts from the provision of food and/or beverages for this establishment for this period of 1983. Do not include in gross receipts charged tips shown on charged sales (tape positions 269-280) unless you have reduced the cash sales amount by paying cash to tipped employees for charged tips due to them. Do not include state or local taxes in gross receipts. If you do not charge separately for food or beverages when other services are included (such as a package deal for food and lodging), make a good faith estimate of the gross receipts attributable to the food or beverages. This estimate reflects the cost of providing the food or beverages plus a reasonable profit factor. Right justify and zero fill. Field is in dollars and cents. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
425-436	Tip Percentage Rate Times Gross Receipts (Apr. 1-Dec. 31)	12	REQUIRED. Enter the amount determined by multiplying Gross Receipts for this period of 1983 (tape positions 413-424) by the Tip Percentage Rate (tape positions 437-440). Right justify and zero fill. For example, if the value of Gross Receipts is

Tape Position	Field Title	Length	Description and Remarks
			"000045678900" and Tip Percentage rate is "0800", multiply $456,789.00 by .0800 to get $36,543.12 and enter "000003654312". If tips are allocated using other than the 9 month period from April 1 to Dec. 31, enter zeros. Field is in dollars and cents. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
437-440	Tip Percentage Rate	4	REQUIRED. Enter 8 percent (0800) unless a lower rate has been granted by the District Director. The determination letter must accompany the magnetic media submission. NUMERICS ONLY. DO NOT ENTER DECIMAL POINT.
441-452	Allocated Tips (Apr. 1-Dec. 31)	12	REQUIRED. If Tip Percentage Rate Times Gross Receipts (tape positions 425-436) is greater than Total Tips Reported (tape positions 389-400) for this period of 1983, then the difference becomes Allocated Tips. Otherwise, enter all zeros. Right justify and zero fill. If tips are allocated using other than the 9 month period from April 1 to Dec. 31, enter the amount of allocated tips from your records. Field is in dollars and cents. NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.
453	Allocation Method	1	REQUIRED. Enter the allocation method used if Allocated Tips (tape positions 441-452) is greater than zero as follows: 1 for allocation based on hours worked. 2 for allocation based on gross receipts. 3 for allocation based on a good faith agreement. The good faith agreement must accompany the magnetic media submission. If Allocated tips is equal to zero, enter 0 (zero).
454-457	Number of Directly Tipped Employees	4	REQUIRED. Enter the total number of directly tipped employees employed by the establishment for tax year 1983. Right justify and zero fill. NUMERICS ONLY.
458-462	Transmitter Control Code (TCC)	5	REQUIRED. Enter the 5-digit Transmitter Control Code assigned by the IRS.
463	"BLANK"	1	REQUIRED. Enter character used to represent a blank.
464	"HYPHEN"	1	REQUIRED. Enter character used to represent a hyphen.
463	"SLASH"	1	REQUIRED. Enter character used to represent a slash.
463	"AMPERSAND"	1	REQUIRED. Enter character used to represent an ampersand.
464	IRS USE	1	Blank.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 501; 1.401-1, 1.501(a)-1.)

Rev. Proc. 84-7[1]

SECTION 1. PURPOSE

This Revenue Procedure obsoletes Rev. Proc. 77-15, 1977-1 C.B. 572, relating to the procedures of the Internal Revenue Service for the adoption of Form 5612, Model Profit-Sharing Plan, Form 5613, Restated Model Profit-Sharing Plan, Form 5614, Model Money Purchase Plan, and Form 5615, Restated Model Money Purchase Plan (hereinafter referred to as Model Plans). It also provides that such Model Plans will no longer be considered to automatically meet the requirements of section 401 of the Internal Revenue Code.

SEC. 2. BACKGROUND AND GENERAL INFORMATION

01. Rev. Proc. 77-15, 1977-1 C.B. 572, set forth the procedures for employers who adopt the Service-issued

[1] Also released as News Release IR-84-8, dated January 17, 1984.

Model Plans described in Section 1 above. That Revenue Procedure provided that determination letters generally would not be issued with respect to the qualification of an employer's adoption of one of those Model Plans. However, it also provided that such a plan would be considered to satisfy the requirements of section 401 of the Code, even though no determination letter was issued, if the adoption met the requirements of that Revenue Procedure.

02. Rev. Proc. 80-30, 1980-1 C.B. 685, contains procedures relating to the issuance of determination letters concerning the qualification of certain individually designed pension, annuity, profit-sharing, stock bonus, and bond purchase plans described in sections 401, 403(a), and 405 of the Code, and the exemption from federal income tax of any related trust.

03. Rev. Proc. 81-19, 1981-1 C.B. 689, modified Rev. Proc. 80-30 to provide for the optional use of Form 6406, Short Form Application for Determination for Amendment of Employee Benefit Plan (Other than Master or Prototype Plans of Self-Employed Individuals), in requesting determination letters on plan amendments to a plan that has previously received a determination letter as to qualification and to provide for the issuance of determination letters on the qualification of the entire plan, as amended, when requested on the appropriate application form.

SEC. 3. OBSOLESCENCE OF MODEL PLANS

Form 5612, Model Profit-Sharing Plan, Form 5613, Restated Model Profit-Sharing Plan, Form 5614, Model Money Purchase Plan, and Form 5615, Restated Model Money Purchase Plan, are hereby obsolete as of the date of publication of this Revenue Procedure.

SEC. 4. INSTRUCTIONS TO TAXPAYERS

01. Employers may not rely on the qualification of any Model Plan adopted after the publication of this Revenue Procedure.

02. An employer who properly adopted a Model Plan before the publication of this Revenue Procedure may continue to rely upon the qualified status of the form of the plan until the earliest of: a) the date the employer modifies the plan or trust, b) the date the employer files an application for a determination letter in accordance with section 4.03 of this Revenue Procedure, or c) the first plan year beginning after December 31, 1983.

03. An employer who adopted a Model Plan before the publication of this Revenue Procedure may file an application with the appropriate Key District Director for a determination as to the qualified status of such plan and any amendments thereto in accordance with the procedures set forth in Rev. Proc. 80-30 as modified by Rev. Proc. 81-19 and this Revenue Procedure. In addition, such employer may use Form 5307 (Short Form Application for Determination for Employee Benefit Plan; see section 4.05 of Rev. Proc. 80-30) if the plan, trust, and amendments are submitted with such application form. Notwithstanding the above, the employer can use Form 6406 in requesting determination letters on Model Plans only after a determination letter has once been issued with respect to all provisions of that plan.

SEC. 5. DETERMINATION LETTERS

Key District Directors will issue determination letters on the qualification under section 401 of the Code of the Model Plans described above and amendments thereto, and on the exemption from federal income tax of trusts forming part of such plans. Applications for such determination letters will be processed in accordance with procedures set forth in Rev. Proc. 80-30, as modified by Rev. Proc. 81-19 and this Revenue Procedure.

SEC. 6. EFFECT ON OTHER DOCUMENTS

01. Rev. Proc. 77-15, 1977-1 C.B. 572, is obsolete and may not be relied upon after the date of publication of this Revenue Procedure in the Internal Revenue Bulletin.

02. Rev. Proc. 80-30, 1980-1 C.B. 685, is modified to remove therefrom sections 2.08 and 15.011 and to permit use of Form 5307 in accordance with this Revenue Procedure.

SEC. 7. EFFECTIVE DATE

This Revenue Procedure is effective February 6, 1984, the date of its publication in the Internal Revenue Bulletin. However, employers who adopted Model plans pursuant to Rev. Proc. 77-15 may continue to rely on those adoptions during the period described in section 4.02.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-8

SECTION 1. BACKGROUND

Rev. Proc. 83-22, 1983-1 C.B. 680, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 4 of Rev. Proc. 83-22 is entitled, Areas in Which Rulings or Determination Letters Will Not Ordinarily Be Issued.

SEC. 2. PROCEDURES

Rev. Proc. 83-22 is hereby amended by adding to section 4.01 the following:

Sections 38, 46, and 48-Investment Tax Credit—Application of these sections where the formal ownership of property is in a party other than the taxpayer, except when title is held merely as security.

Sections 167 and 168—Depreciation; Accelerated Cost Recovery System-Application of these sections where the formal ownership of property is in a party other than the taxpayer, except when title is held merely as security.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all the ruling requests currently on hand in the National Office on February 6, 1984, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to the requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22 is amplified.

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26 CFR 601.602: Tax forms and instructions. (Also Part I, Section 6011; 1.601-1.)

Rev. Proc. 84-9

SECTION 1. PURPOSE

This revenue procedure states the Internal Revenue Service (the Service) requirements relating to acceptable privately designed and printed (reproduced) or computer-prepared substitute federal tax return forms, (i.e., Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.) and computer-generated substitute schedules or forms to be attached thereto. It also authorizes the use of reproductions of official forms and gives direction for the proper completion of returns.

SEC. 2. SCOPE

This revenue procedure is the guide for preparing substitutes for most printed, computer-prepared and computer-generated tax forms. This procedure does not include guidance for Form 1040-ES, Form 1042S, Form 5498, the Form 1099 series, and the Form W-2 series. (See Sec. 18 to obtain guidance for the excluded forms.)

SEC. 3. DEFINITIONS USED HERE

.01 *Substitute Form.* A tax form (or related schedule) that differs in any way from the official version and is intended to replace the entire form that is printed and distributed by the Service. This term also covers those approved substitute forms exhibited in this revenue procedure.

.02 *Printed Form.* A form produced using conventional printing processes. Also, a printed form which has been reproduced by photocopying or similar processes.

.03 *Preprinted Pin-Fed Form.* A printed form that has marginal perforations for use with automated and high-speed printing equipment.

.04 *Computer-Prepared Substitute Form.* A pre-printed form in which the taxpayer's name, address and tax entry information has been inserted by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

.05 *Computer-Generated Substitute Form.* A form that is entirely prepared by the use of a computer printer so that all the line numbers, line captions, and the tax amount data entries are in the same typeface. No graphics usually appear on the form. (Most tax returns requiring signature and establishing tax liability may not be computer generated. Among them are Forms 1040, 1040A, 1040EZ, and 1120.)

.06 *Manually Prepared Form.* A pre-printed form in which the taxpayer's name, address, and tax entry information is entered by an individual using a pen, pencil, typewriter, or other non-automated equipment.

.07 *Graphics.* Those parts of a printed tax form that are not tax amount entries or called-for information. Generally, these are line numbers, captions, instructions, special indicators, borders, rules, and strokes created by typesetting, photo-graphics, photo-composition, etc.

.08 *Acceptable Reproduced Form.* A photocopy of an original form or of an unchanged reproduction proof supplied by the Service. (A reproduction is not a substitute form.)

.09 *Supporting Statement (Supplemental Schedule).* A document providing detailed information to support an entry for a line(s) on an official or approved substitute form and filed with (attached to) a tax return. (A supporting statement is not a tax form and does not take the place of an official form, unless specifically permitted elsewhere in this procedure).

SEC. 4. MESSAGE TO TAX RETURN PREPARERS

IF YOU PLAN TO CHANGE OR MODIFY *ANY* TAX FORMS, YOU MUST FOLLOW INTERNAL REVENUE PROCEDURES, AND, IN MANY CASES, YOU MUST GET OFFICIAL APPROVAL BEFORE USING SUBSTITUTE FORMS. THE SERVICE IS CONTINUING A PROGRAM TO IDENTIFY AND CONTACT TAX RETURN PREPARERS USING UNAPPROVED FORMS WHICH DO NOT CONFORM TO THIS REVENUE PROCEDURE AND IMPEDE PROCESSING OF THE RETURN.

SEC. 5. HIGHLIGHTS OF PERMITTED CHANGES AND REQUIREMENTS

.01 THINGS YOU *CAN DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR USE AS SUBSTITUTE TAX FORMS. PRIOR APPROVAL IS NOT REQUIRED.

1 You can PHOTOCOPY any tax form and use it instead of the official one.

2 You can REPRODUCE ANY CURRENT tax form as cut sheets, snap-sets, and marginally-punched, pin-fed forms, so long as you use an official Service version of the master copy. Official versions are supplied by the Service, such as those in the taxpayer's tax package, those in Package X, those printed in revenue procedures, and reproduction proofs sold by the Service.

3 You can ADJUST the graphics on specified areas of printed Forms 1040 and 1040A (and other forms) to allow for computer-printed or word processor fill-in. Only the areas listed in this revenue procedure may be adjusted without specific prior approval.

4 You can PRINT AND DUPLICATE the substitute "worksheet-type" versions of Schedules A and B of Form 1040 (see exhibits). The Service will accept these substitute schedules instead of the official versions. These Schedules serve different purposes. One allows the form to contain state tax information which is blocked out before filing with the sevice. The other allows the form to be used singly or as part of a snap-set.

.02 THINGS YOU *CANNOT DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR USE AS SUBSTITUTE TAX FORMS.

1 You cannot, without prior Service approval, change any Internal Revenue Service tax forms or use

your own (non-approved) version, unless specifically permitted by revenue procedure.

2 You cannot adjust any of the graphics on Forms 1040, 1040A and 1040EZ (except in those areas specified in revenue procedures) without prior approval from the Service.

3 Generally, you cannot use your own version of Schedule A (Form 1040) UNLESS YOU FIRST GET IT APPROVED. The Service wants only one Schedule A—either yours or ours; yours needs prior approval from the Service.

4 With some exceptions, you cannot omit filling out pertinent referenced (numbered or lettered) lines of the official Schedule A (and other tax forms) when attaching a supporting statement. Exceptions to line completion requirements are listed in this revenue procedure.

5 You cannot use your own preprinted label on tax returns filed with the Service. The ONLY label permitted is the one provided the taxpayers in their tax packages. Otherwise, the taxpayer's name, address, and other identifying information must be entered on the return in the spaces provided.

.03 THINGS YOU CAN DO TO FILE COMPUTER-PREPARED/GENERATED FORMS. PRIOR APPROVAL IS NOT REQUIRED.

1 You can DUPLICATE the approved, computer-generated formats of SCHEDULES A, B, C, D, E, F, G, R, RP, SE, W (of this revenue procedure) and use them without prior approval.

2 You can FILL IN official Internal Revenue Service supplied forms using computer or word-processing equipment. Internal Revenue Service forms are designed for a vertical spacing of six lines to the inch, with money amount columns wide enough to allow for the computer printing of ten characters.

3 You can CHANGE CERTAIN SPECIFIED AREAS on the Forms 1040 and 1040A (spelled out in the revenue procedures) to assist computer-printing requirements and to allow for a little more room on certain lines.

4 If you meet the requirements, standards, and qualifications of this revenue procedure, *you can*, without prior approval, computer-generate your own substitutes of the tax forms (except for actual tax returns) not exhibited here. (See Agreement in Sec. 21)

.04 THINGS YOU CANNOT DO TO INTERNAL REVENUE SERVICE FORMS.

1 You cannot use computer graphics on any Internal Revenue Service form without prior approval. (See Exception in Sec. 22).

2 You cannot computer-generate the TAX RETURNS THEMSELVES (i.e. forms requiring signatures and that establish tax liability; for example, Forms 1040, 1040A, 1400EZ, 1120, 940 and 941). These forms must be preprinted using conventional printing processes, photocopying or similar reproduction processes. The forms may be filled in by a computer, by a word processor, or the like, but the forms themselves must be printed like the Service versions are. First-time users of forms designed using computer graphics submitted must receive prior written approval. (See Exception in Sec. 22)

SEC. 6. APPROVAL

.01 *Basic Requirements.* Preparers who desire to file substitute privately designed and printed tax forms and/or computer-generated and computer-prepared tax forms must develop such substitutes using these guidelines. These substitutes, unless excepted by revenue procedure, must be approved by the Service before being filed.

.02 *Requests for Approval.*

1 IRS cannot approve your substitute form until the official form has been published. Please propose your substitute after you have examined the official form.

2 You should know the IRS revenue procedure relating to the official form before you attempt to alter the form to meet your needs. Any alteration of forms must be within the limits acceptable to the Internal Revenue Service. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.

3 When specific approval of any substitute form is desired, a sample of the proposed substitute should be forwarded for consideration by letter to the Internal Revenue Service, Attention: Substitute Forms Program Coordinator, D:R:R:I, 1111 Constitution Avenue, N.W., Washington, DC 20224. To expedite multiple forms approval, we prefer that your proposed forms be submitted in separate sets by return. For example, Forms 1040 and their normally related schedules or attachments should be separated from Forms 1120, etc., if at all possible. Schedules and forms (i.e., Forms 3468, 4136, etc.) that can be used with more than one type of substitute return (1040, 1041, 1120, etc.) should be submitted only once for approval, regardless of the number of different tax returns they may ultimately be associated with.

4 As no IRS office outside Washington, D.C. is authorized to approve substitute forms, unnecessary delay may result if forms are sent elsewhere for approval. All such forms must be forwarded to the above address for formal control, review, and official approval.

.03 *When to Send Proposed Substitutes.* Proposed substitutes should be sent to the address listed in .02 above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices that your substitute is acceptable. Quarterly filed forms, such as the Form 941, must be submitted by the first day of the last month of the quarter.

.04 *Accompanying Statement.* When the sample substitute is submitted, there should be an accompanying statement that lists the form number of each substitute requested and details those items that deviate from the official form in position, arrangement, appearance, line numbers, additions, deletions, etc. Included with each of the items should be a detailed reason or justification for the change and an approximation of the number of forms expected to be filed.

.05 *Approval/Non-Approval Letter.* The Service sends a formal letter of approval/non-approval. Approval letters may contain qualifications for use of the substitutes. Non-approval letters may specify the changes required for approval, but also may require resubmission for approval.

.06 *Duration of Approval.*

1 Approvals are good for only one calendar year (January through December) or, in the case of corporation tax forms (with the exception noted below), for the remainder of the quarters of the calendar year.

2 PLEASE NOTE: In most cases each new filing season requires a new approval, even if the official form does not change. But see the exceptions in 3 and 4 below.

3 Exception: Quarterly tax forms in the 94X series (941, 942, etc.) are approved only for one quarter. Each new quarter requires a new approval.

4 Exception: Limited continued use of a minor change approved for a tax year 1982 form is allowed for the same form in tax year 1983. See 07. below for the limitations and for other requirements. Examples of such changes are the use of abbreviated words, revised form spacing, compressed text lines, shortened captions, etc., which do not change the consistency of lines or text on the official forms.

.07 *Limited Continued Use of an Approved Change.*

1 If you received written approval of a tax year *1982* substitute form governed by this revenue procedure and wish to continue to use the approved change in your tax year *1983* substitute form, you may revise the official form current in *1983* to include this change, and without additional written approval, use it as a tax year *1983* substitute form, PROVIDED you comply with the requirements in this revenue procedure. See exception in 2 below.

2 This means that if you received written approval for a specific change on a specific form last year, you may again make the same change on the same form this year, if the item changed is present on this year's official form. Thus, the change allowed in last year's approved substitute Schedule A, for example, can be continued in your new substitute for this year. This does not, however, include continuation of the limited approval previously granted authorizing extended use of the 1981 (double-column format) Schedule A, during the 1982 tax year only. The new substitute does not have to be sent to the IRS, and written approval is not required. However, the new substitute must conform to the official *1983* form in other respects: date, Office of Management and Budget (OMB) approval number, Paperwork Reduction Act Notice Statement, sequence number, arrangement, item caption, line number, line reference, sequence, etc. It must also comply with this revenue procedure—which may have eliminated, added to, or otherwise changed the guideline which affected the change approved last year. Additionally, you will be bound by the "Agreement" in Section 21.
EXCEPTION: Those written approvals which stated that the approved change or form would not be allowed in any other tax year.

3 This authorization for continued use of an approved change is limited to the continuation of design logic from a tax year *1982* substitute form to a tax year *1983* substitute form.

.08 *Requested Copies.* In our letter of approval, *you may* be requested to send to the Service eleven (11) copies of each approved form. When received, the copies will be used to notify Internal Revenue Service Centers that your substitute forms are approved. The requested forms should be assembled in sets. A set constitutes a return with the related schedules and forms in the same order as they will be filed, i.e., Form 1040, Schedules A, B, C, etc., Forms 2440, 2441, etc.

.09 *Responsibility.* Following the receipt of initial approval for a substitute forms package, or of a software output program to print substitute forms, it is the responsibility of the originator (designer or distributor) to provide each subsequent client firm or individual with the pertinent Service forms requirements which must be met for continuing acceptability. Examples of this responsibility include the use of prescribed print paper, font size, legibility, state tax data deletion, the legal requirement of the Paperwork Reduction Act Notice for informing all users of substitute forms of the official use and collection requirements stated in the instructions for the official IRS forms, completion of documents, etc.

SEC. 7. OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR ALL SUBSTITUTE FORMS

.01 *New Legal Requirements of the Paperwork Reduction Act of 1980.* Public Law 96-511 requires that: (1) OMB approve IRS tax forms, (2) each IRS form contains (in the upper right corner) the OMB approval number and any expiration date, and (3) each IRS form (or its instructions) state why IRS is collecting the information, how it will be used, and whether or not the information is required to be furnished. This information *must* be provided to every user of any official or substitute tax form.

.02 *Application to Substitute Forms.*

1 *Approval Number and Date Is Required.* All substitute forms must contain in the upper right corner (see Marginal Printing, Sec. 11.02.1(c)) the OMB number and any expiration date that is on the IRS form.

2 *Format Required (3 Options).*

(a) OMB No. XXXX-XXXX (preferred)
or
OMB # XXXX-XXXX

(b) OMB No. XXXX-XXXX (preferred)
Expires XXXXXX (mmddyy)
or
OMB # XXXX-XXXX
Expires XXXXXX (mmddyy)

(c) OMB No. XXXX-XXXX Expires XXXXXX (mmddyy) (preferred)
or
OMB # XXXX-XXXX Expires XXXXXX (mmddyy)

3 *Required Explanation to Users of Substitute Forms.* You must also inform the users of your substitute

forms of the IRS use and collection requirements stated in the instructions for the official IRS form.

.03 *Obtaining OMB Number, Date, and Statement.* The OMB approval number, expiration date, and use and collection requirements may be obtained from the IRS printed form (or its instructions), the reproduction proof (or instructions), or from IRS.

SEC. 8. GENERAL GUIDELINES

.01 *Official Form Is the Standard.* Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. For the most frequently used tax forms, the quickest way to obtain an official form is to request reproduction proofs of these forms. (See Sec. 20.)

.02 *Design.* Each form must follow the design of the official form as to format, arrangement, item caption, line numbers, line references, and sequence.

.03 *State Tax Information Prohibited.* State tax information must not appear (be visible) on the federal tax return which is filed with the Internal Revenue Service Center, except where amounts are claimed on or required by the federal return, e.g., line 8, Schedule A (Form 1040). (See Sec. 12.05 Block Out Methods.)

.04 *Federal and State Columns.* When a form is designed with both federal and state columns, THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.

.05 *Vertical Alignment of Amount Fields.*

1 When a form is to be computer-prepared, you may remove the vertical line in the amount field that separates dollars from cents. When a form is to be computer-generated, vertically align the amount entry fields where possible. You must also use one of the ten-character amount formats shown in Sec. 23.04.

2 When a form is to be manually prepared, the federal column must have a vertical line or some type of indicator in the amount field to separate dollars from cents if the official form has a vertical line. The cents columns must be at least ⅛-inch wide.

.06 *Sequence Number.* Please note that most forms have a recently added "sequence number" located just below the year designation in the upper right corner of the form. Form 1040 also has one opposite line 56 on the left side. The Service uses this number to indicate the order in which forms are processed when filed with a return. On computer-prepared forms it must be printed no less than 12-point, bold-face type and centered below the form's year designation. On computer-generated forms, place this sequence number following the year designation for the tax form and separate with an asterisk. (Example: 1983 * 07).

.07 *Forms with Sequence Numbers Required.* THE SEQUENCE NUMBER IS REQUIRED ON THE FORMS LISTED BELOW. Please note that some of the numbers have been changed since last year.

Form 1040 Schedule/Form	Sequence Number
1040	06 (Left of Line 56)
A	07
B	08
C	09
D	11
E	12
F (Page 1)	13
(Page 2)	14
G	17
R and RP	18
SE	19
W	21
982	51
1116	52
1310	53
2106	54
2119	22
2120	55
2210	56
2210F	57
2350	58
2440	23
2441	24
2555	34
2688	59
2952	60
3468	25
3646	61
3903	62
3903F	63
4136	26
4137	64
4255	65
4469	66
4562	67
4563	68
4684	27
4797	28
4798	69
4835	70
4868	71
4952	72
4970	73
4972	74
5329	29
5544	75
5695	31
5713	76
5884	77
6198	32
6249	78
6251	33
6252	79
6478	80
6765	81
6781	82
6793	83
8082	84

.08 *Paid Preparer's Information and Signature Area.*

1 On Forms 1040A, 1040, and 1120 etc., the "Paid Preparer's Use Only" area may not be rearranged or relocated. You may, however, add three extra lines to the paid preparer's address area without prior approval. This applies to other tax forms as well.

2 On Form 1040EZ this information must be provided at the bottom of the form below the taxpayer's signature area. As an alternative, the printed Paid Preparer's Information and Signature Area from either a Form 1040 or 1040A may be attached to the bottom of Form 1040EZ.

.09 *Assemblage of Forms.* When filing a return (i.e., Form 1040), the return must be arranged in this order: (1) the tax return, (2) Form

1040 schedules and forms in sequence number order, (3) all others (Form 1120, 1120S, 1065, 1041, etc.), lettered schedules (Schedule D, etc.) in alphabetical order and numbered forms in numerical order (Forms 2220, 4626, etc.), (4) supporting statements in the same sequence as the forms they support, and (5) additional information required or voluntarily submitted. In this way, they are received in the order in which they must be processed. If you do not send them to us in this order, the Service has to disassemble them and place them in this order before processing is continued.

SEC. 9. PHYSICAL ASPECTS AND REQUIREMENTS: PAPER

.01 *Paper Content.* The paper must be:

1 Chemical wood writing paper that is equal to or better than the quality used for the official form;

2 at least 18 pound (17″ x 22″, 500 sheets) or

3 at least 45 pound (25″ x 38″, 500 sheets).

.02 *Paper Prohibited.* Carbon-bonded paper is prohibited from use for all substitute forms filed with the Service.

.03 *Paper with Chemical Transfer Properties—LIMITED USE.* Chemical transfer paper for all substitute forms may be used ONLY when the following specifications are met.

1 Each ply within the chemical transfer set of forms must be labeled.

2 Only the top ply (ply one and white in color), the one which contains chemical on the back only (coated back), may be filed with the Service. For example, a set containing three plies would be constructed as follows: ply one (coated back), "Federal Return, File with IRS"; ply two (coated front and back), "Taxpayer's copy"; and ply three (coated front), "Preparer's copy."

3 The file designation, "Federal Return, File with IRS," for ply one must be printed in the bottom right margin (just below the last line of the form) in 12-point, bold-face type. It is not mandatory, but recommended, that the file designation, "Federal Return, File with IRS," be printed in a contrasting ink for visual emphasis.

4 Carbon Paper. We prefer that you do not attach any carbon paper to any return you file with the Service.

.04 *Paper and Ink color.* We prefer that the color of paper substantially duplicate that of the original form. You may use white paper. This means that your substitute must be printed in black ink and may be on white or on the color paper the Service form is printed on. An exception to this rule is that Forms 1040A, 1040EZ and 1040 substitute reproductions may be in black ink without the colored screening. Any additional exception to this rule requires written approval from the Service.

.05 *Page Size.* Substitute or reproduced forms and computer-prepared/generated substitutes may be the same size as the official form (8″ x 11″, in most cases or they may be the standard commercial size (8½″ x 11″) exclusive of pin-feed holes. The thickness of the stock cannot be less than .003 inch.

.06 *Lined Paper.* Computer-generated substitute forms must be submitted on quality lined, machine paper. Lined, color-barred paper is also acceptable. Lined paper assists Service employees during processing of the returns by allowing speedy and accurate location of tax entries corresponding to line captions. The lines provide the basic means for eye-travel from one side of the form to the other.

.07 *Exception to Lined Paper Requirement.* If your printer has underlining capability, you do not have to use lined or color-barred paper so long as you underline every other text line on the form. The underlining must be a continuous line and extend from the left text margin to the right text margin and be the same length for all lines on the page.

SEC. 10. PHYSICAL ASPECTS AND REQUIREMENTS: PRINTING

.01 *Printing Medium.* The private printing of all substitute tax forms must be by conventional printing processes, photocopying, computer-graphics, or similar reproduction processes.

.02 *Legibility.* All forms must have a high standard of legibility, both as to printing and reproduction and as to fill-in matter. The Service reserves the right to reject those with poor legibility.

.03 *Type Font.* Almost all federal tax forms are printed using "News Gothic" as the basic type font. We request that you use this type font when composing any substitute forms.

.04 *Image Size.* The image size of printed substitute forms should be as close as possible to that of the official form. You may omit any text on both computer-prepared and computer-generated forms that is solely instructional.

.05 *Title Area Changes.* To allow a larger top margin for marginal printing and more lines per page (see Sec. 11 below), the title line(s) for all substitute forms (not including the form's year designation and sequence code, when present), may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of the Treasury Internal Revenue Service" and reference to instructions in the form's title area.

.06 *Remove Government Printing Office Symbol.* When privately printing substitute tax forms, the Government Printing Office symbol and/or jacket number must be removed. In the same place, using the same type size, print the Employer Identifying Number (EIN) or the Social Security Number (SSN) of the printer or designer.

.07 *Printing On One Side of Paper.* While it is preferred that both sides of the paper be used for substitute and reproduced forms, resulting in the same page arrangement as that of the official form or schedule, the Service will not object if only one side of the paper is used.

.08 *Photocopy Equipment.* The Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires

only that the reproduced forms satisfy the conditions stated in revenue procedures.

.09 *Reproductions.* Reproductions of official forms and substitute forms which do not meet the requirements of this revenue procedure may not be filed instead of the official forms.

.10 *Removal of Instructions.* You may remove all references to instructions. No prior approval is needed.

SEC. 11. PHYSICAL ASPECTS AND REQUIREMENTS: MARGINS

.01 *Margin Size.*

1 The format of the reproduced tax return when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for Service employees to make the necessary entries on the form during processing.

2 A one-half to one quarter inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-feed holes) of all computer-generated substitutes. The margin area is also used by Service employees to make necessary entries on the form during processing.

.02 *Marginal Printing.*

1 *Non-Tax Material Allowed in Limited Areas.*

(a) One any 8- or 8½-inch-wide Service or substitute form, you may print your logo, company or firm name, identifying and collation symbols, etc., in the *left half of the top margin.*

(b) With the exception of the actual tax return forms (i.e., Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.), you may also print in the *left vertical margin* and in the *left half of the bottom margin.*

(c) Printing is never allowed in the *right half of the top margin* of the tax return form (i.e. Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc). The Service uses this area to imprint a File Location Number for each return.

2 *Prior Approval Not Required.* Prior approval is not required for the marginal printing allowed in 1 above when used with the unchanged exhibits in this revenue procedure or when printed on an official form, on a photocopy of an official form or on an (unchanged) IRS reproduction proof.

3 *Prior Approval Required.* The marginal printing allowance in 1 above is also the guide for the preparation of acceptable substitute forms. There is no exception to the requirement that no printing is allowed in the *right half of the top margin* of the tax return form.

SEC. 12. APPROVED SUBSTITUTE FORMATS FOR FORM 1040 SCHEDULES

.01 *Exhibits of Approved Formats.* Two sets of exhibits (Exhibits A-1 and B-1 and A-2 & B-1) are at the end of this revenue procedure. They are acceptable substitutes for the official forms. They are intended to be used in place of the official forms and may be used without prior approval. Both sets are usable for manual entry or computer preparation. Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in some specific cases. Please note that the Service does NOT supply reproduction proofs for these exhibits.

.02 *Printing or Duplication of Exhibits A-1 and A-2 and B-1 and B-2.* You may (1) print these exhibits or (2) duplicate them photographically or by using photo-reproduction techniques, PROVIDING YOUR PRINTED OR REPRODUCED IMAGES ARE EXACTLY LIKE THE ONES IN THE EXHIBITS. WITH THE EXCEPTION NOTED BELOW, NOTHING CAN BE CHANGED.

.03 *EXCEPTION.* In Exhibit A-1 and A-2 you may change the areas containing "other" items (lines 4c, 11, 15, 18 and 24), as follows: (1) the areas inside the perimeter of the boxes containing the dash-leaders (---) and designated by the circled numbers may be used to print any particular deduction item associated with the corresponding deduction category, and (2) the dash-leaders may be removed (BUT YOU MAY NOT CHANGE THE AMOUNT COLUMN BOX SIZE OR POSITION).

.04 *Exhibits A-1 and A-2.*

1 *Exhibit A-1.* This substitute Schedule A format may be used as a single sheet or as one of the copies of a snap-set. It is designed to be used in place of the official Schedule A (Form 1040).

2 *Exhibit A-2.* This substitute Schedule A format may be used as a single sheet when both federal and state tax information is placed on the same form.

3 *No State Tax Information.* NO STATE TAX INFORMATION CAN APPEAR ON THESE FORMS WHEN FILED WITH THE FORM 1040. THE STATE COLUMN MAY BE PRESENT BUT THE *STATE TAX INFORMATION MUST NOT BE VISIBLE* WHEN FILED WITH THE SERVICE. We prefer that the entire state column be *COMPLETELY BLOCKED OUT.*

.05 *BLOCK OUT METHODS.* A suggested method to block out the state tax information is: (1) place the substitute form in a clear plastic folder, (2) on the folder, place a strip of opaque material the exact width and length of the column you wish to block out, then (3) photocopy the substitute form while still in the folder. The result will be a form with only the federal tax information visible. Another method is to take a black marking pen and, using either vertical or horizontal strokes, cross out the state figures. Carbon-interleaved sets may be used where the amounts entered in the state column are filled in with black carbon overprint. This copy may be filed with the return.

.06 *Exhibits B-1 and B-2.* These exhibits correspond to Exhibits A-1 and A-2, the provisions in .04.1 and 2 above apply. Both of these exhibits are acceptable for use in place of the official Schedule B (Form 1040).

.07 *Exhibits A-1 and B-1 and A-2 and B-2.* These exhibits may be used as sets when the return calls for both Schedule A and B.

Acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the Exhibits section of this revenue procedure. The exhibits are for Schedule A, B, C, D, E, F, G, R, RP,

SE and W. All are acceptable substitutes for the official forms. They are intended to be used (without change) in place of the official forms and may be used without prior approval. All lines (including those not used for tax information) must be printed. (Any change to text or format of an exhibit requires prior written approval.) Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in specific cases.

SEC. 13. SPECIFICATIONS FOR FILING SUBSTITUTE SCHEDULES K-1

Prior approval is NOT required for a substitute Schedule K-1 that accompanies Form 1065 (for partnership), a Form 1120-S (for small business corporation), or a Form 1041 (for fiduciary) when the substitute Schedule K-1 meets all of the following requirements.

.01 The Schedule K-1 need contain only the line items required for use by the taxpayer.

.02 The line items must be in the same order and arrangement as those in the official form.

.03 The line items must be numbered, titled, and/or captioned exactly as shown on the official form.

.04 Each taxpayer's information must be on a separate piece of paper.

SEC. 14. REQUIRED PREPARATION OF FORMS

.01 *Completely Fill In Lines.* You must completely fill in all the applicable numbered or reference lines on computer-prepared or generated forms (not just the totals) BUT ALL THE ITEMS THAT MAKE UP THE TOTALS AS WELL before attaching any supporting statement (see Sec. 15 below for exceptions).

.02 *IRS Processing of Forms.* The Service processes the return based on information entered on the official forms or approved substitutes. References are made to attachments ONLY as required by law and as processing requirements direct. When you fail to complete all the pertinent lines on the official forms, Internal Revenue Service Tax Examiners have to locate the information on your attachment and write it on the proper line of the official form. This unfortunate process causes delays in processing the return and increases the potential for errors both in transcription and in interpretation.

.03 *Notification of Preparers.* THE SERVICE IS CONTINUING A PROGRAM TO NOTIFY PREPARERS WHO FAIL TO MEET THE REQUIREMENT TO COMPLETELY FILL IN LINES.

SEC. 15. EXCEPTIONS TO LINE COMPLETION REQUIREMENTS

.01 *Zero Entries.* Detailed information for any deduction or income category may be omitted from the printout if the category total to be reported is zero. However, the substitute form must show the total (zero when applicable) for each category. This means when no tax information is applicable, leave the line blank.

.02 *Lines Captioned "Other" (All Forms).* It is not necessary to fill in every numbered or referenced line of tax forms when the line caption calls for "Other," i.e., "Other (itemize)," "Other (specify)," "Other (attach schedule), etc. Examples of this exception are lines 4c, 11, 15, 18 and 24 for Schedule A, Form 1040. When this occurs, you may use a supporting statement and enter only the total amount of these "Other" items on the line of the official form. However, we prefer that you use the space on the official form when it is adequate.

.03 *Schedule A (Form 1040).* All numbered and lettered lines must be filled in, if applicable. Supporting statements may be used to give the details of the totals entered on such lines but may not be used as a substitute for a collection of lines. For example, the detailed information for "Taxes" may not be shown on a supporting statement (supplemental schedule) and only line 12 filled in. Also, for example, the details of "State and local income taxes" may be shown on a supporting statement and the total of such taxes entered on line 8. Also, the total of itemized deductions must be entered on line 26.

.04 *Schedule B (Form 1040).* Lines 2, 4 and 9 need not be filled in on the form. A supporting statement may be used for the details of interest and dividend income and the appropriate totals of such income entered on lines 3, 5 and 10 unless nominee distribution or accrued interest criteria apply. (See the tax package instructions concerning interest).

.05 *Schedule C (Form 1040).* All lines must be filled in when applicable except the lines where "Other expenses-specify" are listed. (See instruction in .02 above).

.06 *Schedule E (Form 1040).*

1 When there are entries on page 1 for any of the Part I, the following requirements must be met: (1) in Part I, lines 1 and 2, the questions must be answered and tax information must be entered on the lines provided.

2 Supporting statements may be used for the details of rental and royalty income and expenses. The appropriate totals must be carried and entered in the total column for lines 3, 17, 18 and 21 through 25.

3 Part II (page 2)—The income and loss from various partnerships, estates or trusts, and small business corporations also may be detailed on a supporting statement, but the appropriate total income and total loss must be entered on lines 26 through 40.

.07 *Form 4562.* This form need not always be used to report depreciation. Instead, you may use a supporting statement so long as it contains the same information as called for on the Form 4562. It is important that your form provides the required computations equivalent to the official form so that related return entries can be confirmed and/or recomputed if required.

.08 *Schedule F (Form 1040).* If the cash method is used, only page one is needed. Otherwise both pages one and two must be entirely printed.

SEC. 16. SUPPORTING STATEMENTS

.01 *Use of Supporting Statements.* SUPPORTING STATEMENTS ARE TO BE USED TO SUPPORT LINE ENTRIES ON THE OFFICIAL FORM. Unless specifically

authorized by this revenue procedure (see Sec. 15), THEY MUST NOT BE USED TO AVOID COMPLETING REQUIRED LINES ON THE OFFICIAL FORM.

.02 *Requirements for Supporting Statements.* Supporting statements must: (1) provide details and explain entries made on the official form, (2) furnish all required information in the same sequence as called for on the official form, and (3) furnish any additional information in the order of appearance on the form to which it refers.

.03 *Cross-Reference.* Each supporting statement must be referenced to the form it supports, and the entry on the form must be cross-referenced to the supporting statement. For example, put "Statement X" on the top of the supporting statement that contains the identified line number and the supporting information, and put "See Statement X" on the line of the form that references the statement.

.04 *Extent of Use.* You may attach supporting statements to explain or support any line item on an official or approved substitute form.

.05 *Assemblage.* For filing purposes, supporting statements are not attached directly to their related forms. Rather, all supporting statements are assembled in the same sequence as the forms they support; they are then placed after the lettered and numbered forms (See Sec. 8.09).

.06 *Multiple Supporting Statements.* Supporting statements for each numbered or lettered tax form may be on one page or may be on multiple pages. But each numbered or lettered form must have a separate page for its supporting statement(s). Each page should be the size of the form it supports, or it may be 8″ x 11″ or 8½″ x 11″.

.07 *Not Reviewed for Approval.* The Service does not give its approval for specific supporting statements. The taxpayer or the tax practitioner for the taxpayer, must meet the needs as they arise, using the guidelines in this revenue procedure.

SEC. 17. SPECIFICATIONS FOR FILING SUBSTITUTE FORMS

.01 *Filing Substitute Forms.* Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

.02 *Computer-Prepared Tax Forms.* For filing purposes the Service will accept computer-prepared tax forms (i.e., Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.) filled in by a computer or by word-processing equipment, but these forms MUST be pre-printed.

.03 *Computer-Generated Forms.* For filing purposes, the Service will accept computer-generated versions of forms that are attached to individual and business income tax returns, provided the substitutes and their manner of completion meet the guidelines prescribed herein.

.04 *Combination of Manually Prepared and Computer-Prepared/Generated Forms.* For filing purposes, the Service will accept substitute tax forms that contain a combination of computer-prepared/generated and manually filled in information.

.05 *Taxpayer and Preparer Signatures.* All taxpayer signatures on forms to be filed with the Service must be original signatures, affixed subsequent to the reproduction process. However, the income tax preparer can satisfy the manual signature requirement by signing a completed income tax return form, making a photocopy of the return form, and having the taxpayer sign and file the photocopy. (See Rev. Rul. 78-370, 1978-2 C.B. 336.)

.06 *Use Preaddressed Label.* When filing substitute or reproduced forms, use the preaddressed label included in the tax package the Service sent to the taxpayer. Use of the label avoids larger processing costs because it reduces the potential for error—the kind of error which can delay the receipt of refund and information needed by the taxpayer. No other label may be used.

.07 *Use Internal Revenue Service Envelope.* When filing substitute or reproduced forms, use the envelope enclosed with the taxpayer's tax package. This envelope is coded for sorting into several categories. Use of the coded envelope can help speed up the processing and reduce processing costs. Do not use the Service-provided, tax-package envelope for other correspondence with the Service, as its misuse can delay the correspondence.

.08 *Voluntarily Submitted Information.* Additional information required or voluntarily submitted should be on the same size paper as the official form and attached to the return following the supporting statements. (See Sec. 8.09.)

SEC. 18. GUIDANCE FROM OTHER REVENUE PROCEDURES

Guidance for the substitute tax forms not covered in this revenue procedure and the revenue procedures which govern their use, are as follows:

Form 1040-ES Revenue Procedure—82-7, 1982-1 C.B. 410, not reprinted for distribution.

Form 1042S Revenue Procedure—81-28, 1981-2 C.B. 549, Order as IRS Publication 1161.

Form W-2 series Revenue Procedure—81-15, 1981-1 C.B. 670, order as IRS Publication 1141.

Form 1099 series and Form 5498 Revenue Procedure 83-26, 1979-1 C.B. 516. Order as IRS Publication 1091.

SEC. 19. ORDERING REVENUE PROCEDURES

.01 If you receive Package X, Informational Copies of Federal Tax Forms, you may use the Form 2333P, Order Blank for Revenue Procedures, contained therein to order the following revenue procedures:

Pub. 1091, the revenue procedure on magnetic tape reporting for information returns (Forms 5498 and 1099).

Pub. 1141, the revenue procedure on specification for private printing of Forms W-2, W-2P, and W-3.

Pub. 1149, the revenue procedure on magnetic tape reporting for Windfall Profit Tax (Form 6248).

Pub. 1161, the revenue procedure on reprinted paper substitutes for Form 1042S.

Pub. 1162, the revenue procedure on group exemption procedures.

Pub. 1167, the combined revenue

procedure on reproduction requirements and substitute (printed) computer-prepared and computer-generated tax forms and schedules.

.02 The above listed revenue procedures may be obtained also by writing to: Internal Revenue Service, Revenue Procedure, P. O. Box 25866, Richmond, VA 23260. Be sure to order using IRS Publication number.

SEC. 20. ORDERING REPRODUCTION PROOFS

.01 The Service provides for the public camera-ready, reproduction proofs of many of its printed tax forms. These reproduction proofs can only be ordered by using Form 6747. Order for Reproduction Proofs. Form 6747 can be obtained by written request to Internal Revenue Service, PM:S:FM:P, Attention: Reproduction Proof Coordinator, Room 1528, 1111 Constitution Ave., N.W., Washington, DC 20224.

.02 Basic specifications, such as margin, pagination, etc., will be printed in the margins of the reproduction proofs and must be removed before printing. The official reproduction proof margins across the top, bottom, and sides must be maintained on all reproductions and substitute forms.

.03 A charge of $1.00 per page will be made for each reproduction proof regardless of page size. After an order has been filled, invoices will be maled to the requestor.

SEC. 21. AGREEMENT

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: The Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the person or company agrees to accept the determination of the Service as to whether or not the form may continue to be used during the filing season, and also agrees to work with the Service in correcting noted deficiencies. Notification of deficiencies may be made by letter, phone call, or both.

SEC. 22 CONDITIONS— TAX FORMS (1040A, 1040EZ, 1040, 1120, 940, 941, Etc.)

.01 *PROHIBITED FORMS.*

1 COMPUTER-GENERATED VERSIONS.

Computer-generated versions of a tax return form (e.g. Form 1040, 1040EZ, 1040A, 1120, 940, 941 etc.) which requires a signature are not permitted. Only preprinted substitutes of these forms are allowed. Approval is extended to consider certain types of computer-generated graphic formats as acceptable "preprinted" substitutes. All such forms must have formal approval prior to their use.

2 *COMPUTER-GENERATED GRAPHICS—First Time Users.*

First-time users who design substitute forms using computer-graphics (e.g. laser printing), dot matrix (addressable printing, etc.) must receive prior approval before using them. Exception: Experienced users who have previously received written approval from the Service for tax forms do not need written approval before using their forms. This assumes that all new requirements for the tax year have been fully complied with, based on actual comparison with the final versions of the official IRS forms. However, users are bound by agreement in Sec. 21.

.02 *FILL-IN INFORMATION.*

The tax return form itself (i.e., 1040, 1040A, 1040EZ, 1120, 940, 941, etc.) may be filled in by a computer printer or other similar automated equipment, but the form itself must be created beforehand (i.e. preprinted) using conventional printing methods, photocopying, computer-graphics (laser printing) or other similar reproduction processes.

.03 *CHANGES PERMITTED TO THE FORMS 1040, 1040A & 1040EZ.*

1 Certain changes (listed below) are permitted to the graphics of the form without prior approval, but these changes apply only to preprinted forms as described in .02 above.

2 Changes not requiring prior approval are good only for the annual filing period, January through December.

3 Other Changes Not Listed. All changes not listed here require prior approval from the Service BEFORE the form may be filed with the Service.

SEC. 23. CHANGES PERMITTED TO GRAPHICS (FORMS 1040A, 1040 AND 1040EZ)

Changes Permitted to the Graphics on Forms 1040, 1040A and 1040EZ and, Where Applicable, on Other Forms as Well for Use With Computer-Prepared (i.e. printed forms *Only*).

.01 *Adjustments.*

You may make minor vertical and horizontal spacing adjustments to allow for computer or word-processing printing. This includes widening the amount columns or tax entry areas so long as the adjustments do not exceed other provisions stated in revenue procedures. No prior approval is needed for these changes. However, the user of forms with such changes are bound by the "Agreement" in Section 21.

.02 *Name and Address Area.*

1 The horizontal rules and instructions within the name and address area may be removed and the entire area left blank; no line or instruction can remain in the area.

2 The heavy ruled border (when present) that outlines the name and address area must not be removed, relocated, expanded or contracted.

3 Required Format

(a) When the name and address area is left blank, as provided in 1 above, the following format MUST be used when printing the taxpayer's name and address. Otherwise, unless the taxpayer's preprinted label is affixed over the information entered in this area, the lines must be filled-in as shown.

1st name line (35 characters maximum)

In-care-of name line (35 characters maximum)

Street address (35 characters maximum)

City, State (24 char. max.), one blank char., & zip (five char.)

(b) When there is no in-care-of name line, the name and address will consist of only three lines. Examples of the formats follow:

Example of name and address with NO in-care-of name line:

JOHN AND MARY JONES
1234 ANYWHERE ST. APT 111
ANYTOWN, DC. 12345

Example of name and address WITH in-care-of name line:

JOHN AND MARY JONES
C/O THOMAS A. JONES
4311 SOMEWHERE AVE.
SAMETOWN, DC 54321

(c) YOU MAY NOT USE YOUR OWN PREADDRESSED LABEL ON ANY INTERNAL REVENUE SERVICE FORM.

(d) The ONLY label that may be used is the OFFICIAL INTERNAL REVENUE SERVICE LABEL SUPPLIED to the taxpayer in his/her tax package. Please use the official Internal Revenue Service supplied label to help reduce errors.

(e) For identification purposes, you may computer print the taxpayer's name and address on the form and afterward affix the OFFICIAL INTERNAL REVENUE SERVICE SUPPLIED LABEL over the computer printed address. This applies whether or not the horizontal rules and the instructions have been removed from the address area.

.03 *Social Security Number (SSN) AND Employer Identification Number (EIN) Area.*

1 The vertical lines separating the format arrangement of the SSN/EIN may be removed.

2 When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 or 00-0000000, respectively.

.04 *Cents Columns.*

1 You may remove the vertical rule that separates the dollars from the cents.

2 All entries in the amount column should have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.

3 You may omit printing the cents, but all amounts entered on the form must follow a consistent format. YOU ARE STRONGLY URGED TO ROUND OFF THE FIGURES TO WHOLE DOLLAR AMOUNTS.

4 When printing money amounts, you must use one of the following ten-character formats: (a) 0,000,000. (b) 000,000.00

5 When there is no entry for a line, leave the line blank.

.05 *"Paid Preparer's Use Only" Area.*

1 On all forms, where present, the paid preparer's information area may NOT be rearranged or relocated.

2 You may add three lines and remove the horizontal rules in the preparer's address area.

3 Form 1040EZ preparers must sign the return and provide all other required information. This information should be provided at the bottom of the form below the taxpayer's signature area. (See Section 8.)

SEC. 24. CHANGES PERMITTED TO FORM 1040A GRAPHICS

No prior approval is needed for the following changes (for use with computer-prepared forms only).

.01 *Line 4.*

The line caption may be compressed vertically to one line (to allow for same line entry for the name of the qualifying unmarried child) by using the following caption:

"Head of household; unmarried childs's name. . . . . ." name field

.02 *Line 5c.*

To allow for a two-line field for printing dependent children's names, you may shorten the caption to:

"Dep. children" (names field)
(names field)

.03 *Line 5d.*

1 The number of lines for listing "other dependents" may be expanded to a maximum of 5.

2 Column captions may be shortened to one line descriptions.

.04 *LINE 9a (and 9b).*

These lines may be changed to allow larger amount entry fields by removing references to instructions.

.05 *Other Lines.*

Any line whose caption takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

.06 *Page 2 (Form 1040A).*

All lines must be present and numbered in the order shown on the official form. (Note that Page 2 has been substantially revised for 1983.)

SEC. 25. OTHER CHANGES PROHIBITED

NO OTHER CHANGES TO THE FORM 1040A GRAPHICS ARE ALLOWED WITHOUT PRIOR APPROVAL.

SEC. 26. CHANGES PERMITTED TO THE FORM 1040 GRAPHICS (FOR USE WITH COMPUTER-PREPARED FORMS ONLY)

No prior approval is needed for the following changes:

.01 *Line 4.* This line may be compressed horizontally (to allow for a larger entry area for the name of the qualifying unmarried child) by using the following caption:

"Head of household; unmarried child's name" (name field)

.02 *Line 6c.*

To allow for a two-line field for printing dependent children's names you may shorten the caption to:

"Dep. children" (names field)
(names field)

.03 *Line 6d.*

1 The vertical lines separating columns (1) through (5) may be removed. The captions may be shortened to allow a one-line caption for each column.

2 The number of lines for listing "other dependents" may be expanded to a maximum of 5 by compressing other noted areas and lines.

.04 *Other Lines.*

Any other line whose caption takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

.05 *Line 21.*

1 This line may be expanded vertically to a maximum of 3 lines.

2 The amount entry box must remain a single entry and the cross

hatched shading must extend down the numbered line box to the same number of lines you add.

.06 *Line 38.* You may change the line caption to read "Tax" and computer-print either the words "FROM TAX TABLES:" OR "FROM SCHEDULE/FORM" and computer-print the appropriate text.

.07 *Line 39.* You may change the caption to read: "Additional taxes from Form/Section" and computer-print only the form(s) or/and section number that apply.

SEC. 27. OTHER CHANGES PROHIBITED

NO OTHER CHANGES TO THE FORM 1040 GRAPHICS ARE PERMITTED WITHOUT PRIOR APPROVAL.

SEC. 28. ACCEPTABLE FORMATS OF COMPUTER-GENERATED FORMS AND SCHEDULES

1 Exhibits of acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the Exhibits section of this revenue procedure.

2 Use of Acceptable Formats. If your computer-generated forms appear exactly like the exhibits, no prior authorization is needed.

3 CHANGES TO EXHIBITS NOT PERMITTED WITHOUT PRIOR APPROVAL. Any change to the text or format of any of the exhibits requires PRIOR WRITTEN APPROVAL.

SEC. 29. COMPUTER-GENERATED FORMS NOT SHOWN AS EXHIBITS IN THIS REVENUE PROCEDURE

.01 Those desiring to computer-generate forms not shown here may do so, but they must design such forms themselves by following the manner and style of those in the Exhibits section of this publication and by taking care to observe other requirements and conditions stated here.

.02 Computer-generated forms so designed DO NOT require prior approval from the Service. However, the user of such forms is bound by the "Agreement" in Sec. 21 above.

.03 If you wish, you may submit any substitute form to the Service for approval consideration.

SEC. 30. INSTRUCTIONS FOR PREPARING COMPUTER-GENERATED SUBSTITUTES

.01 *Format Arrangement.*

The format of each substitute schedule or form must follow the format of the official schedule or form as to item caption, line reference, line numbers, sequence, form arrangement and format, etc. Basically try to make the form look like the official one, with readability being a primary factor. Use periods and/or other special characters to separate the various parts and sections of the form. With the exceptions in .02 below, all line numbers and items must be printed even though an amount is not entered on the line.

02 *Line Numbers.*

1 When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a substitute form.

2 The reference code must be printed to the left of the corresponding captioned line and also immediately preceding the data field even if there is no reference code immediately preceding the data field on the official form.

3 In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parentheses and the first character of the data field. (See example below.)

4 A decimal point (i.e., a period) should be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars, or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

Example:

9 REAL ESTATE	9.	495.00
10A GENERAL SALES	10A.	
10B GEN SALES MOTOR VEH	10B.	198.00
or		
9 REAL ESTATE	(9)	496.00
10A GENERAL SALES	(10A)	
10B GEN SALES MOTOR VEH	(10B)	198.00

.03 *Multiple Page Forms.* With the exceptions noted below, when printing multiple page forms the entire form with all its parts and pages must be printed. When printed on continuous forms, they must be burst and pin-feed holes removed before filing with the return.

.04 *Exception to Forms that must be entirely printed in whole or in part. Schedule F.* Depending on which accounting method is used, cash or accrual, the following will apply. If the cash accounting method is used only page one needs to be printed. Otherwise both page one and two must be entirely printed.

SEC. 31. ADDITIONAL INSTRUCTIONS FOR ALL FORMS

.01 Internal control numbers and identifying symbols of the computer preparer may be shown on the substitute, if the use of such numbers or symbols is acceptable to the taxpayer and the taxpayer's representative. If shown, such information must not be printed in the top one-half inch clear area, from the center to the right edge, of any form or schedule requiring a signature. With the exception of the actual tax return form (i.e. Forms 1040, 1120, 940, 941, etc.), you may also print in the left vertical and bottom left margins. The bottom left margin you may use extends 3½ inches from the left edge of the form. (See Sec. 11 for more information on this subject.)

.02 Descriptions for captions, lines, etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contrac-

tions and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line or item.

1 Explanatory detail and/or intermediate calculations for derivation of fine line totals, may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the line on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column. This column is reserved for official numbered and lettered lines that correspond to the ones on the official form. If a supporting statement is submitted, intermediate calculations or subtotals may be formatted at the preparer's option.

2 Text prescribed for the official form, which is solely instructional in nature, e.g., "Attach this schedule to Form 1040," "See instructions," etc., may be omitted from the substitute form.

3 Information for more than one schedule may not be shown on the same printout page without prior approval from the Service. Except for computer-generated Schedules A and B (Form 1040), almost any form may be continued on two or more pages if necessary. When a form is continued on two or more pages, clearly identify at the bottom of each page, including page 1, that is continued, e.g., "page 1, Schedule C continued." It is strongly recommended that a substitute form not exceed the same number of pages used for the official form.

4 Identify all computer-prepared substitutes clearly; print the form designation one-half inch from the top margin and one and one-half inches from the left margin; print the title centered on the first line of print; and print the taxable year and, where applicable, the sequence number on the same line one-half to one inch from right margin. Include the taxpayer's name and SSN on all forms and attachments. Also print the OMB number and (when applicable) the forms expiration date.

5 The state tax column may be present, but the state tax information must NOT be visible on the copy filed with the Service. When a form is designed with both federal and state columns, THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.

6 Attach all payments (check or money order, no cash) to the front of the tax return.

SEC. 32. FILING SUBSTITUTE FORMS WITH IRS

Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

SEC. 33. SPECIAL FORM 1040EZ OPTICAL CHARACTER RECOGNITION (OCR) REQUIREMENTS

.01 *The 1983 Form 1040EZ is designed in OCR format.* IRS has the capability to machine read this form by optical character recognition (OCR) equipment (Scan-Optics-System 540).

.02 It is optional to produce the 1040EZ substitute as a normal (black and white) reproduction, or as an actual OCR version. The following criteria applies if the form is to be OCR scannable. Otherwise, you may print this form under the previous general guidelines of this Revenue Procedure.

.03 An acceptable substitute OCR Form 1040EZ must generally be an exact replica of the official OCR reproduction proof with respect to layout, content and required OCR characteristics.

.04 The specific paper requirements which must be met for the development of substitute (privately printed) forms include the following.

1 Color and quality of paper—Paper must be white, OCR grade bond, with no flourescent additives or water marks, and with zero rag content.

2 Reflectivity of paper—Must be 80% or greater.

3 Opacity—The paper opacity ratio must be 80% or more.

4 Paper Weight—Specified paper weight is 20 lb. OCR bond (.0035").

5 Dirt—Must not exceed 10 parts per million.

6 Finish (smoothness)—Must be between 90 and 160 units (Sheffield).

7 Porosity—Paper should have a Gurley reading between 15 and 95.

8 Gloss—Paper with shiny or lustrous appearance (glossy) should be avoided.

9 Size—Form trim size must be 8" x 11".

.05 The specific ink requirements which must be met for this form include the following.

1 Print Color—The face of the form print in black and green, the back prints in black only.

2 Ink—Green ink used must be highly reflective OCR type such as Sinclair and Valentine J-27975 or an exact match. Black ink used must be non-reflective.

3 Face Registration—Black to green must be .02" (plus or minus) both horizontally and vertically.

4 Face Screen—Forms contain a green screened background equal to a 15% tone of a 110-line screen. Follow registration marks on repro-proof for screen positioning. Handprint boxes are included on Page 1 of the reproduction proof and should be printed as a 50% value of the recommended OCR green ink. Inks used for handprint boxes must reflect at least 90% of the background on which it is printed as measured in the visible range.

5 Face Margins—Approximately ⅜" head from top trimmed edge to screen (½" to black image). ⅛" outside from trimmed edges to screen. Exact margins are provided with repros.

6 Back Margins—½" head, 5/16" foot, and 5/16" sides.

06. *Typography*—Type must be substantially identical in both size and shape with corresponding type on the official from reproduction proof.

.07 To assure proper alignment and position of hand-printed characters representing return lines 1 through 11 tax data, they must be hand printed (entered) into the preprinted amount field boxes on the form.

A #2 lead wooden pencil is recommended as the writing tool which will consistently provide the required stroke width and print contrast on entered characters.

.08 Reading of handprinted characters requires adherance to the following techniques.

2 Enter numeric amount digits carefully and clearly. Fill at least ⅔ of the individual character box height, keeping the character within the box with no overlapping or touching characters. Specific required digit constraints are shown below.

2 When entering "fours", keep the top open.

3 When entering "one", do not use serifs.

4 When entering "twos", do not add extra loops.

5 All character lines must be connected, with no gaps.

.09 *Use Taxpayer's Preaddressed Label.* Reproduced OCR Forms 1040EZ must have ONLY the taxpayer's preaddressed label affixed to be processable as an OCR document. Substitute labels and handwritten name/address information is not acceptable.

.10 All the general and detailed provisions of this Revenue Procedure apply (in addition to this specific OCR Section) for the development of substitute OCR Forms 1040EZ.

SEC. 34 EFFECT ON OTHER DOCUMENTS

This revenue procedure supersedes Revenue Procedure 83-9, 1983-1 C.B. 639 and Revenue Procedure 83-10, 1983-1 C.B. 651.

Exhibit A-1 (Preferred Format)

(Form 1040)

Department of the Treasury
Internal Revenue Service

Substitute Schedule A
Itemized Deductions

OMB No. 1545-0074

1983
07

Name(s) as shown on Form 1040

Your social security number

Medical and Dental Expenses	1	Medicines and drugs	1			
	2	Write 1% of Form 1040, line 33	2			
	3	Subtract line 2 from line 1. If line 2 is more than line 1, write zero			3	
	4	Other medical and dental expenses:				
		a Doctors, dentists, nurses, hospitals, insurance premiums you paid for medical and dental care, etc.			4a	
		b Transportation			4b	
		c Other (list—include hearing aids, dentures, eyeglasses, etc.) ▶			4c	
	5	Add lines 3 through 4c			5	
	6	Multiply amount on Form 1040, line 33, by 5% (.05)			6	
	7	Subtract line 6 from line 5. If line 6 is more than line 5, write zero			▶	7
Taxes	8	State and local income			8	
	9	Real estate			9	
	10	a General sales (see sales tax tables)			10a	
		b General sales on motor vehicles			10b	
	11	Other (list—include personal property) ▶			11	
	12	Add lines 8 through 11. Write your answer here			▶	12
Interest Expense	13	a Home mortgage interest paid to financial institutions			13a	
		b Home mortgage interest paid to individuals (show that person's name and address) ▶			13b	
	14	Credit cards and charge accounts			14	
	15	Other (list) ▶			15	
	16	Add lines 13a through 15. Write your answer here			▶	16
Contributions	17	a Cash contributions. (If you gave $3,000 or more to any one organization, report those contributions on line 17b.)			17a	
		b Cash contributions totaling $3,000 or more to any one organization. (Show to whom you gave and how much you gave.) ▶			17b	
	18	Other than cash (attach required statement)			18	
	19	Carryover from prior year			19	
	20	Add lines 17a through 19. Write your answer here			▶	20
Casualty and Theft Losses	21	Total casualty or theft loss(es) (attach Form 4684) (see page 20 of Instructions)			▶	21
Miscellaneous Deductions	22	Union and professional dues			22	
	23	Tax return preparation fee			23	
	24	Other (list) ▶			24	
	25	Add lines 22 through 24. Write your answer here			▶	25
Summary of Itemized Deductions	26	Add lines 7, 12, 16, 20, 21, and 25				26
	27	If you checked Form 1040 { Filing Status box 2 or 5, write $3,400 / Filing Status box 1 or 4, write $2,300 / Filing Status box 3, write $1,700 }				27
	28	Subtract line 27 from line 26. Write your answer here and on Form 1040, line 34a. (If line 27 is more than line 26, see the Instructions for line 28 on page 21.)			▶	28

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule A (Form 1040) 1983

Exhibit A-2 (Acceptable Format)
(Form 1040)

Department of the Treasury
Internal Revenue Service

Substitute Schedule A
Itemized Deductions

OMB No. 1545-0074

1983
07

Name(s) as shown on Form 1040 | Your social security number

Medical and Dental Expenses	1	Medicines and drugs	1		
	2	Write 1% of Form 1040, line 33	2		
	3	Subtract line 2 from line 1. If line 2 is more than line 1, write zero		3	
	4	Other medical and dental expenses:			
		a Doctors, dentists, nurses, hospitals, insurance premiums you paid for medical and dental care, etc.		4a	
		b Transportation		4b	
		c Other (list—include hearing aids, dentures, eyeglasses, etc.) ▶		4c	
	5	Add lines 3 through 4c		5	
	6	Multiply amount on Form 1040, line 33, by 5% (.05)		6	
	7	Subtract line 6 from line 5. If line 6 is more than line 5, write zero		7	
Taxes	8	State and local income		8	
	9	Real estate		9	
	10	a General sales (see sales tax tables)		10a	
		b General sales on motor vehicles		10b	
	11	Other (list—include personal property) ▶		11	
	12	Add lines 8 through 11. Write your answer here		12	
Interest Expense	13	a Home mortgage interest paid to financial institutions		13a	
		b Home mortgage interest paid to individuals (show that person's name and address) ▶		13b	
	14	Credit cards and charge accounts		14	
	15	Other (list) ▶		15	
	16	Add lines 13a through 15. Write your answer here		16	
Contributions	17	a Cash contributions. (If you gave $3,000 or more to any one organization, report those contributions on line 17b.)		17a	
		b Cash contributions totaling $3,000 or more to any one organization. (Show to whom you gave and how much you gave.) ▶		17b	
	18	Other than cash (attach required statement)		18	
	19	Carryover from prior year		19	
	20	Add lines 17a through 19. Write your answer here		20	
Casualty and Theft Losses	21	Total casualty or theft loss(es) (attach Form 4684)		21	
Miscellaneous Deductions	22	Union and professional dues		22	
	23	Tax return preparation fee		23	
	24	Other (list) ▶		24	
	25	Add lines 22 through 24. Write your answer here		25	
Summary of Itemized Deductions	26	Add lines 7, 12, 16, 20, 21, and 25		26	
	27	If you checked Form 1040 { Filing Status box 2 or 5, write $3,400 / Filing Status box 1 or 4, write $2,300 / Filing Status box 3, write $1,700 }		27	
	28	Subtract line 27 from line 26. Write your answer here and on Form 1040, line 34a. (If line 27 is more than line 26, see the Instructions for line 28 on page 21.)		28	

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule A (Form 1040) 1983

Exhibit B-1 (Preferred Format)

Substitute Schedule B
Interest and Dividend Income

Schedules A&B (Form 1040) 1983 — 08 — OMB No. 1545-0074 — Page 2

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side) — Your social security number

Part I Interest Income

If you received more than $400 in interest or you received any interest from an All-Savers Certificate, you must complete Part I and list ALL interest received. If you received interest as a nominee for another, or you received or paid accrued interest on securities transferred between interest payment dates, see page 22.

Interest income other than interest from All-Savers Certificates		Amount
1 Interest income from seller-financed mortgages. (See Instructions and show name of payer.) ▶	1	
2 Other interest income (list name of payer) ▶	2	
3 Add lines 1 and 2	3	

Interest from All-Savers Certificates (ASCs). (See page 22.)		Amount
4	4	
5 Add amounts on line 4	5	
6 Write the amount of your ASC exclusion from the worksheet on page 22 of Instructions	6	
7 Subtract line 6 from line 5	7	
8 Add lines 3 and 7. Write your answer here and on Form 1040, line 8 ▶	8	

Part II Dividend Income

If you received more than $400 in gross dividends (including capital gain distributions) and other distributions on stock, or you are electing to exclude qualified reinvested dividends from a public utility, complete Part II. If you received dividends as a nominee for another, see page 22.

Name of payer		Amount
9	9	
10 Add amounts on line 9	10	
11 Capital gain distributions. Enter here and on line 15, Schedule D.*	11	
12 Nontaxable distributions. (See Instructions for adjustment to basis.)	12	
13 Exclusion of qualified reinvested dividends from a public utility. (See page 22 of Instructions.)	13	
14 Add lines 11, 12, and 13	14	
15 Subtract line 14 from line 10. Write your answer here and on Form 1040, line 9a ▶	15	

**If you received capital gain distributions for the year and you do not need Schedule D to report any other gains or losses, do not file that schedule. Instead, enter 40% of your capital gain distributions on Form 1040, line 14.*

Part III Foreign Accounts and Foreign Trusts

If you received more than $400 of interest or dividends, OR if you had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must answer both questions in Part III.	Yes	No
16 At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country? (See page 23 of the instructions for exceptions and filing requirements for Form 90-22.1.)		
If "Yes," write the name of the foreign country ▶		
17 Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926		

For Paperwork Reduction Act Notice, see Form 1040 Instructions. — Schedule B (Form 1040) 1983

Exhibit B-2 (Acceptable Format)

(Form 1040)
Department of the Treasury
Internal Revenue Service

Substitute Schedule B
Interest and Dividend Income

08

OMB No. 1545-0074

1983

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side)

Your social security number

Part I.—Interest Income		Federal	
1 Interest income from seller-financed mortgages. (Show name of payer)	1		
2 Other interest income (list name of payer)			
3 Add lines 1 and 2	3		
4 Interest from All-Savers Certificates (List)			
5 Add amounts on line 4	5		
6 All-Savers Certificates exclusion	6		
7 Subtract line 6 from line 5	7		
8 Add lines 3 and 7. Write your answer here and on Form 1040, line 8	8		
Part II.—Dividend Income			
9 Gross dividends (list)			
10 Add amounts on line 9	10		
11 Capital gain distributions. Enter here and on line 15, Schedule D.	11		
12 Nontaxable distributions. (See Instructions for adjustment to basis.)	12		
13 Exclusion of qualified reinvested dividends from a public utility. (See page 22 of Instructions.)	13		
14 Add lines 11, 12, and 13	14		
15 Subtract line 14 from line 10. Write your answer here and on Form 1040, line 9a	15		

Part III.—Foreign Accounts and Foreign Trusts	Yes	No
16 At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country?		
17 Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926		

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule B (Form 1040) 1983

EXHIBIT CG - A (SCHEDULE A)

SCHEDULE A (FORM 1040) ITEMIZED DEDUCTIONS 1983 * 07
OMB NO. 1545-0074

JOHN Q. & MARY J. TAXPAYER SSN 000-00-0000

MEDICAL AND DENTAL EXPENSES********		00,000.00
1 MEDICINE AND DRUGS	1.	
2 1% OF LINE 33, FORM 1040	2.	
3 SUBTRACT LINE 2 FROM LINE 1 (ZERO IF MINUS)	3.	
4 OTHER MEDICAL AND DENTAL EXPENSES:		
A DOCTORS, DENTISTS, NURSES, HOSPITALS, ETC	4A.	
B TRANSPORTATION	4B.	
C OTHER (LIST)		
1st		
2nd - OR SEE STATEMENT XX	4C.	
5 ADD LINES 3 THRU 4C	5.	
6 5% OF LINE 33, FORM 1040	6.	
7 SUBTRACT LN. 6 FROM LN. 5 (OR ZERO)	7.	
TAXES********		
8 STATE AND LOCAL INCOME	8.	
9 REAL ESTATE	9.	
10A GENERAL SALES	10A.	
B GENERAL SALES ON MOTOR VEHICLES	10B.	
11 OTHER (LIST) - 1ST		
2ND - OR SEE STATEMENT XX	11.	
12 ADD LINES 8 THRU 11	12.	
INTEREST EXPENSE********		
13A HOME MORTGAGE INTEREST TO FINANCIAL INSTITUTIONS	13A.	
B HOME MORTGAGE INTEREST TO INDIVIDUALS (LIST)- 1st		
2nd OR SEE STATEMENT XX	13B.	
14 CREDIT CARDS AND CHARGE ACCOUNT	14.	
15 OTHER (LIST) - 1st		
2nd		
3rd - OR SEE STATEMENT XX	15.	
16 ADD LINES 13A THRU 15	16.	
CONTRIBUTIONS********		
17A CASH CONTRIBUTIONS UNDER $3,000	17A.	
B CASH CONTRIBUTIONS OF $3,000 AND OVER (LIST)		
1st		
2nd OR SEE STATEMENT XX	17B.	
18 OTHER THAN CASH	18.	
19 CARRYOVER FROM PRIOR YEARS	19.	
20 ADD LINES 17A THRU 19	20.	
CASUALTY AND THEFT LOSSES AND MISCELLANEOUS DEDUCTIONS********		
21 TOTAL CASUALTY/THEFT LOSSES FROM FORM 4684	21.	
MISCELLANEOUS DEDUCTIONS********		
22 UNION AND PROFESSIONAL DUES	22.	
23 TAX RETURN PREPARATION FEE	23.	
24 OTHER (LIST) 1st		
2nd		
3rd - OR SEE STATEMENT XX	24.	
25 ADD LINES 22 THRU 24	25.	
SUMMARY OF ITEMIZED DEDUCTIONS********		
26 ADD LINES 7, 12, 16, 20, 21 AND 25	26.	
27 FILING STATUS ZERO BRACKET AMOUNT	27.	
28 SUBTRACT LINE 27 FROM LINE 26	28.	00,000.00

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG - B (SCHEDULE B)

SCHEDULE B (FORM 1040) DIVIDEND AND INTEREST INCOME 1983 *08

OMB NO. 1545-0074

JOHN Q. & MARY J. TAXPAYER SSN 000-00-0000

PART I INTEREST INCOME
INTEREST INCOME OTHER THAN ASCS

			AMOUNT
1.	INTEREST INCOME FROM SELLER FINANCED MORTGAGE NAME OF PAYER	1.	
2.	OTHER INTEREST INCOME (LIST) (1st PAYER) (2nd PAYER) (3rd PAYER) (4th PAYER)	2.	00,000.00
3.	ADD LINES 1 AND 2	3.	00,000.00
	INTEREST FROM ALL-SAVERS CERTIFICATES (ASCS)		
4.	1st 2nd 3rd	4.	00,000.00
5.	TOTAL OF LINE 4	5.	
6.	ASC EXCLUSION	6.	
7.	LINE 5 MINUS LINE 6	7.	
8.	TOTAL LINES 3 AND 7	8.	00,000.00

****

PART II DIVIDEND INCOME

			AMOUNT
9.	NAME OF PAYER (1st PAYER) (2nd PAYER) (3rd PAYER) (4th PAYER)	9.	
10.	TOTAL OF LINE 9	10.	00,000.00
11.	CAPITAL GAIN DISTRIBUTIONS	11.	
12.	NON TAXABLE DISTRIBUTIONS	12.	
13.	EXCLUSION DIVIDEND FROM PUB. UTILITY	13.	
14.	ADD LINES 11, 12 AND 13	14.	
15.	LINE 10 MINUS LINE 14	15.	00,000.00

****

PART III - FOREIGN ACCOUNTS AND FOREIGN TRUSTS

16.	DID YOU HAVE AN INTEREST IN OR A SIGNATURE OR OTHER AUTHORITY OVER A BANK ACCOUNT, SECURITIES ACCOUNT, OR OTHER FINANCIAL ACCOUNT IN A FOREIGN COUNTRY	(ANS)
17.	WERE YOU THE GRANTOR OF OR TRANSFEROR TO A FOREIGN TRUST WHICH EXISTED DURING THE CURRENT TAX YEAR WHETHER OR NOT YOU HAVE ANY BENEFICIAL INTEREST IN IT?	(ANS)

****

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG - C (SCHEDULE C)

SCHEDULE C (FORM 1040) PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION (SOLE PROPRIETORSHIP) 1983 # 09
OMB NO. 1545 - 0074

JOHN Q. AND MARY J. TAXPAYER SSN 000-00-0000

****

A. MAIN BUSINESS ACTIVITY: PRODUCT:
B. BUSINESS NAME AND ADDRESS:
C. EMPLOYER ID NO.: 00-0000000
D. METHOD(S) USED TO VALUE CLOSING INVENTORY:
(1) X COST
E. ACCOUNTING METH.: (1) XX CASH
F. WAS THERE ANY MAJOR CHANGE IN THE METHOD OF VALUATION? (ANS)
G. DID YOU DEDUCT EXPENSES FOR OFFICE IN HOME? (ANS)

****

PART I - INCOME:

1	A GROSS RECEIPTS OR SALES	1A.	0,000.00.
	B RETURNS AND ALLOWANCES	1B.	
	C BALANCE (LINE 1A LESS LINE 1B)	1C.	0,000.00
2	COST OF GOODS SOLD AND/OR OPERATIONS	2	
3	GROSS PROFIT (LINE 1C LESS LINE 2)	3.	0,000.00
4A	WINDFALL PROFIT TAX CREDIT/REFUND FOR 83	4A.	
4B	OTHER INCOME - SEE STATEMENT XX	4B.	
5	TOTAL INCOME (ADD LINES 3, 4A & 4B)	5.	0,000.00.

****

PART II-DEDUCTIONS:

6	ADVERTISING	0,000,000.	23	REPAIRS	
7	BAD DEBTS		24	SUPPLIES (NOT PT III)	
8	BANK CHARGES		25	TAXES (NOT WINDFALL)	0,000.00
9	CAR/TRUCK EXPENSES		26	TRAVEL & ENTERTAINMENT	
10	COMMISSIONS		27	UTILITIES & PHONE	
11	DEPLETION		28A	WAGES	
12	DEPRECIATION (NOT PT III)		B	JOBS CREDITS	
13	DUES AND PUBLICATIONS		C	28A LESS 28B	
14	EMPLOYEE BENE PROGMS		29	WINDFALL PROF TAX	
15	FREIGHT (NOT PT III)		30	OTHER EXPENSES (LIST)	
16	INSURANCE		A		
17	INTEREST ON BUS. DEBT		B		
18	LAUNDRY AND CLEANING		C		
19	LEGAL/PROF'L SERVICES		D		
20	OFFICE EXP		E		
21	PENSION/PROFIT SHARING		F		
22	RENT ON BUSINESS PROP		G		
			H		
			I	OR SEE STATEMENT XX	

****

31	TOTAL DEDUCTIONS (ADD COLS. 6 THROUGH 30I)	31.	0,000.00
32	NET PROFIT (OR LOSS) (LINE 5 LESS LINE 31)	32.	0,000.00
33	IF LOSS, DO YOU HAVE AMTS IN THIS BUSINESS NOT AT RISK?	(ANS)	

****

PART III - COST OF GOODS SOLD AND/OR OPERATIONS

1.	INVENTORY AT BEGINNING OF YEAR (EXPLAIN IF DIFFERENT)	1	0,000,000
2.	PURCHASES (LESS COST OF PERSONAL ITEMS)	2	
3.	COST OF LABOR (DO NOT INCLUDE OWN SALARY)	3	
4.	MATERIALS AND SUPPLIES	4	
5.	OTHER COSTS	5	
6.	ADD LINES 1 THROUGH 5	6	
7.	INVENTORY AT END OF YEAR	7	
8.	COST OF GOODS AND/OR OPERATIONS (LN 6 MINUS LN 7)	8	0,000,000.

****

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG - D (SCHEDULE D - PAGE 1)

SCHEDULE D — CAPTIAL GAINS AND LOSSES — 1983*11
(Form 1040 — OMB NO. 1545-0074
JOHN Q. AND MARY J. TAXPAYER — SSN 000-00-0000

**********PART I - SHORT-TERM CAPTIAL GAINS AND LOSSES**********

	(A) KIND OF PROPERTY	(B) DATE ACQ.	(C) DATE SOLD	(D) GROSS SALE PRICE	(E) COST OR BASIS	(F) LOSS: (E) LESS (D)	(G) GAIN: (D) LESS (E)
1.	(1ST)	MM/YY	MM/YY	0,000,000.	0,000,000.	0,000,000	0,000,000.
	(2ND)						
	(3RD)	OR SEE STATEMENT XX					

2	GAIN FROM SALE/EXC RES.	2.XXXXXXXXXXXXXXXX		0,000,000.
3	SHORT-TERM CAP GAIN (FROM F 6252)	3.XXXXXXXXXXXXXXXX		
4	YOUR SHARE OF NET S-TERM GAIN PARTN/FIDUC....	4.	0,000,000.	0,000,000.
5	ADD LN 1 - 4 COLS F & G.....	5.		
6	COMBINE LN 5, COLS F & G.....	6.		
7	SHORT TERM (LOSS) CARRYOVER (AFTER 1969).....	7.		
8	NET ST GAIN OR LOSS ADD LNS 6 & 7.....	8.		0,000,000.

********** PART II - LONG-TERM CAPITAL GAINS AND LOSSES**********

9	(1st)	MM/YY	MM/YY	0,000,000.	0,000,000.	0,000,000	0,000,000.
	(2nd)						
	(3rd)	OR SEE STATEMENT XX					

10	GAINS FROM SALE/EXC RES.	10.XXXXXXXXXXXXXXXXXX		0,000,000.
11	LONG-TERM CAP GAIN - INSTALL. SALES (F6252)	11.XXXXXXXXXXXXXXXXXX		
12	YOUR SHARE NET L-TERM GAIN/LOSS PARTN/FIDUC	12.0,000,000		0,000,000.
13	ADD LNS 9 thru 12, COLS F & G.....	13.		
14	ADD LN 13 COL F & G, ENTER GAIN OR LOSS.....	14.		
15	CAPITAL GAIN DISTRIBUTIONS.....	15.		
16	GAIN FROM FORM 4797.....	16.		
17	ADD LNS 14 THRU 16.....	17.		
18	L-TERM CAPITAL LOSS CARRYOVER AFTER 1969.....	18.		
19	NET L-TERM GAIN OR (LOSS), ADD LNS 17 AND 18.....	19.		0,000,000.

SCHEDULE D CONTINUED ON PAGE 2

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

SCHEDULE D (CON'T) PG 2 1983
(FORM 1040)

JOHN Q. & MARY J. TAXPAYER SSN 000-00-0000

********** PART III SUMMARY OF PARTS I & II **********

20 ADD LINE 8 & 19.....20.
21 IF LINE 20 IS GAIN ENTER SMALLER OF LINE 19 OR 20.....21.
22 ENTER 60% of LINE 21.....22.
23 SUBTRACT LINE 22 FROM LINE 20.....23.
24 IF LN 20 LOSS, ENTER ONE OF THE FOLLOWING AMOUNTS:.....24.
(I) IF LINE 8 IS ZERO OR A NET GAIN, ENTER 50% OF LINE 20,
(II) IF LINE 19 IS ZERO OR A NET GAIN, ENTER LINE 20; OR
(III) IF LN 8 & 19 ARE LOSS, ENTER LN 8 AMT + 50% LN 19
25 ENTER SMALLEST OF LINE 24, $3,000 OR ADJ TAXABLE INCOME.....25.

****

PART IV COMPLETE IF YOU ELECT OUT OF THE INSTALLMENT METHOD AND ARE REPORTING A NOTE, ETC., AT LESS THAN FACE VALUE

(ANS) CHECK IF ELECTED
ENTER FACE AMOUNT OF NOTE.....0,000,000.
ENTER THE PERCENTAGE OF VALUATION OF NOTE.....XX%.

****

PART V COMPUTATION OF POST-1969 CAPITAL LOSS CARRYOVERS (83 to 84)
SECTION A. - SHORT-TERM CAPTIAL LOSS CARRYOVER

26 ENTER LOSS SHOWN ON LINE 8; IF NONE, ENTER ZERO.....26.
27 ENTER GAIN SHOWN ON LINE 19.....27.
28 REDUCE ANY LOSS ON LINE 26 TO EXTENT OF ANY GAIN ON 27.....28
29 ENTER SMALLER OF LINE 25 OR 28.....29.
30 SUBTRACT LINE 29 FROM LINE 28.....30
********** SECTION B - LONG TERM CAP. LOSS CARRY OVER **********
31 SUBTRACT LINE 29 FROM LINE 25.....31.
32 ENTER LOSS FROM LINE 19;.....32.
33 ENTER GAIN SHOWN ON LINE 8:.....33.
34 REDUCE ANY LOSS ON LINE 32 TO EXTENT OF GAIN ON LINE 33.....34
35 MULTIPLY AMOUNT ON LINE 31 BY 2.....35.
36 SUBTRACT LINE 35 FROM LINE 34.....36.

EXHIBIT CG - E (SCHEDULE E - PAGE 1)

SCHEDULE E SUPPLEMENTAL INCOME SCHEDULE 1983 * 12
(FORM 1040) OMB NO. 1545 - 0074
JOHN Q. AND MARY J. TAXPAYER SSN 000-00-0000

********** PART I - RENT & ROYALTY INCOME/LOSS **********

1 EXPENSES FOR VACATION HOME/UNIT? (ANS)

2 IF "YES" DID YOU OR FAMILY USE FOR MORE THAN 14 DAYS DURING THE YEAR? (ANS)

DESCRIPTION OF PROPERTIES

PROPERTY A (SHOW KIND AND LOCATION)
PROPERTY B
PROPERTY C

RENTAL AND ROYALTY INCOME		PROPERTIES A	B	C	TOTALS
3 A RENTS RECEIVED		00,000.	00,000.	00,000.	00,000,000.
B ROYALTIES RECEIVED					
RENTAL AND ROYALTY EXPEN.					
4 ADVERTISING	4.				
5 AUTO AND TRAVEL	5.				
6 CLEANING AND MAINTENANCE	6.				
7 COMMISSIONS	7.				
8 INSURANCE	8.				
9 INTEREST	9.				
10 LEGAL PROF FEES	10.				
11 REPAIRS	11.				
12 SUPPLIES	12.				
13 TAXES NOT WINDFALL	13.				
14 UTILITIES	14.				
15 WAGES AND SALARIES	15.				
16. OTHER (LIST)	16.				
(1ST)					
(2ND)					
(3RD)					
(4TH) OR SEE STATEMENT					
17 TOTAL EXPENSES	17.				17.
18 DEPRECIATION EXPENSE	18.				18.
19 TOTAL (ADD LINES 17 & 18)	19.				XXXXXXXXXXXXXXXXX
20 INCOME OR (LOSS)	20.				XXXXXXXXXXXXXXXXX
21 ADD PROFIT PROPERTIES					21.
22 ADD LOSS PROPERTIES					22.
23 COMBINE LNS 21/22					23.
24 NET FARM PROFIT/LOSS					24.
25 TOTAL RENT/ROYALTY INC.					25.

SCHEDULE E CONTINUED ON PAGE 2

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG - E (SCHEDULE E - PAGE 2)

SCHEDULE E (CONT'D) PAGE 2 1983
(FORM 1040) SSN 000-00-0000
JOHN Q. & MARY J. TAXPAYER

****

PART II INCOME OR LOSS FROM PARTNERSHIPS, ESTATES OR TRUSTS, S-BUSINESS CORP.

(A) NAME	(B) FOREIGN	(C) EIN	(D) NET LOSS	(E) NET INCOME
		00-0000000	00,000,000.	

(INSERT INFO HERE & BETWEEN LINES 29 & 30, 31 & 32 AS NEEDED OR SEE STATEMENT X)

26	ADD AMOUNTS IN COLUMNS (D) AND (E)	26.	
27	COMBINE AMOUNTS IN (D) AND (E) ENTER NET INCOME	27	
28	SEC. 179 DEDUCTION	28	0,000.
29	TOTAL PARTNERSHIP INCOME LINES 27 and 28	29	
30	ADD AMOUNTS IN COLUMNS (D) AND (E)	30.	
31	TOTAL ESTATE OR TRUST INCOME	31	
32	ADD AMOUNTS IN COLUMNS (D) AND (E)	32.	
33	NET INCOME (LOSS)	33	
34	SEC. 179 DEDUCTION	34	
35	TOTAL SMALL BUSINESS CORP. INCOME	35	

PART III WINDFALL PROFIT TAX SUMMARY

36	WINDFALL PROFIT TAX CREDIT OR REFUND	36
37	WINDFALL PROFIT TAX WITHELD IN 1983	37
38	COMBINE AMOUNTS ON LINES 36 and 37	38

PART IV SUMMARY

39	TOTAL INCOME OR (LOSS).	39
40	FARMERS AND FISHERMEN GROSS INCOME	40

********** PART V - DEPRECIATION CLAIMED IN PART I **********

(A) PROP DESCRIPTION	(B) DATE ACQUIRED	(C) COST	(D) PRIOR YR DEPR	(E) DEPR METHOD	(F) L/R	(G) DEPR 1983
PROPERTY A.....						
1ST	2/80	0,000,000.	0,000,000.	SL	L	0,000,000.
(ADD LINES AS NEEDED)						
TOTAL PROP A		OR SEE STATEMENT XX				

****

PROPERTY B
1ST
(ADD LINES AS NEEDED) OR SEE STATEMENT XX
TOTAL PROP B

****

(C PROPERTY-ADD AS NEEDED)
OR SEE STATEMENT XX

EXHIBIT CG - F (SCHEDULE F - PAGE 1)

SCHEDULE F (FORM 1040) — FARM INCOME AND EXPENSES — 1983 * 13

OMB NO. 1545-0074

JOHN Q. & MARY J. TAXPAYER — SSN 000-00-0000

COMM DISPOSAL (PIK) FEED(X) SALES (X) — EIN 00-0000000

PART I - FARM INCOME CASH METHOD

SALE OF PURCHASED LIVESTOCK & OTHER ITEMS

	(A) DESCRIBE	(B) AMT REC'D	(C) COST
1	LIVESTOCK	0,000,000.	0,000,000.
	SEE STATEMENT XX		
2	OTHER ITEMS		
	SEE STATEMENT XX		
3	TOTALS	0,000,000.	0,000,000.
4	PROFIT (LOSS) L3B LESS L3C		0,000,000.

** LVSTK & PROD SALES + OTHER FARM INCOME **

	KIND	AMOUNT
5	CATTLE/CALVES	0,000,000.
6	SHEEP	
7	SWINE	
8	POULTRY	
9	DAIRY PRODUCTS	
10	EGGS	
11	WOOL	
12	COTTON	
13	TOBACCO	
14	VEGETABLES	
15	SOYBEANS	
16	CORN	
17	OTHER GRAINS	
18	HAY/STRAW	
19	FRUITS AND NUTS	
20	MACHINE WORK	
21	A PATRONAGE DIVIDENDS	
	B LESS NON-INCOME ITEMS	
	C NET PATRONAGE DIVID	
22	PER UNIT RETAINS	
23	NONPATRONAGE DISTRIBUTION	
24A	AGRIC. PMTS CASH PMTS	
B	MATERIALS/SERVICES	
25	COMMODITY CREDIT LOANS	
26	FEDERAL GAS TAX CREDIT	
27	STATE GAS TAX REFUND	
28	CROP INS PROCEEDS	
29	OTHER-SPECIFY-SEE STMT XX	
30	ADD LNS 5 THRU 29	000,000.00
31	GROSS PROFITS ADD LNS 4&30	000,000.00

PART II - FARM DEDUCTIONS CASH AND ACCRUAL METHOD

32A	LABOR HIRED	0,000,000
32B	JOBS CREDIT	
32C	BALANCE	
33	REPAIRS	
34	INTEREST	
35	RENT OF FARM	
36	FEED PURCHASED	
37	SEEDS & PLANTS	
38	FERTILIZERS, LIME	
39	MACHINE HIRE	
40	SUPPLIES PURCH	
41	BREEDING FEES	
42	VET & MEDICINE	
43	GAS, FUEL, OIL	
44	STORAGE	
45	TAXES	
46	INSURANCE	
47	UTILITIES	
48	FREIGHT, TRUCKING	
49	CONSERVATION EXP	
50	LAND CLEARING	
51	PENSION & PROFIT SHARING	
52	EMPL BENEFIT	
53	DEPR (FORM 4562)	
54	OTHER (SPECIFY) (1ST) OR SEE STATEMENT XX (2ND)	
55	TOTAL DEDUCT	

56 NET FARM PROFIT/LOSS LN 31 LESS LN 55

57 IF, LOSS, DO YOU HAVE AMTS FOR FARM THAT ARE NOT "AT RISK" (ANS)

SCHEDULE F CONTINUED ON PAGE 2

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EXHIBIT CG - F (SCHEDULE F - PAGE 2)

SCHEDULE F (CON'T) PAGE 2 1983 #14

JOHN Q. & MARY J. TAXPAYER SSN 000-00-0000

**********PART III - FARM INCOME - ACCURAL METHOD**********

	A. KIND	B. INV.BEGIN YR.	C. COST	D. SALES	E. INVENTORY-YR END
58	CATTLE/CALVES	:	:	:	:
59	SHEEP	:	:	:	:
60	SWINE	:	:	:	:
61	POULTRY	:	:	:	:
62	DAIRY PRODUCTS	:	:	:	:
63	EGGS	:	:	:	:
64	WOOL	:	:	:	:
65	COTTON	:	:	:	:
66	TOBACCO	:	:	:	:
67	VEGETABLES	:	:	:	:
68	SOYBEANS	:	:	:	:
69	CORN	:	:	:	:
70	OTHER GRAINS	:	:	:	:
71	HAY AND STRAW	:	:	:	:
72	FRUITS/NUTS	:	:	:	:
73	MACHINE WORK	:	:	:	:
74	OTHER (SPECIFY)	:	:	:	:
	(1ST)	:	:	:	:
	(2ND)	:	:	:	:
	(3RD) OR SEE	:	:	:	:
	STATEMENT	:	:	:	:
		:	:	:	:
		:	:	:	:
75	TOTALS	:	:	:	:

**********PART IV SUMMARY OF INCOME AND DEDUCTIONS-ACCRUAL METHOD**********

76	INVENTORY OF LIVESTOCK, CROPS; PRODUCTS/END OF YEAR	76.
77	SALES OF LIVESTOCK, CROPS, AND PRODUCTS AT END OF YEAR	77
78	AGRICULTURE PROGRAM PAYMENTS: A CASH	78A.
	B MATERIALS AND SERVICES	78B.
79	COMMODITY CREDIT LOANS UNDER ELECTION (OR FORFEITED)	79.
80	FEDERAL GASOLINE TAX CREDIT	80.
81	STATE GASOLINE TAX REFUND	81.
82	OTHER FARM INCOME (LIST)	82.
83	ADD LINES 76 THROUGH 82	83.
84	INVENTORY AT BEGINNING OF YEAR	84.
85	COST - LIVESTOCK & PRODUCTS PURCHASED DURING THE YEAR	85.
86	TOTAL (ADD LINES 84 and 85)	86.
87	GROSS PROFITS (SUBTRACT LINE 86 FROM LINE 83)	87.
88	TOTAL DEDUCTIONS FROM PART II, LINE 55	88.
89	NET PROFIT/LOSS (SUBTRACT LINE 88 FROM LINE 87)	89.
90	IF LOSS - DO YOU HAVE AMOUNTS NOT AT RISK	90. (ANS)

EXHIBIT CG - G (SCHEDULE G)

SCHEDULE G INCOME AVERAGING 1983 * 17

(FORM 1040) OMB NO. 1545-0074

JOHN Q AND MARY J TAXPAYER SSN 000-00-0000

STEP 1		FIGURE YOUR INCOME FOR 1979-1982	
1979	1	AMOUNT FROM 1979 FORM 1040, LINE 34	1.
	2	TOTAL EXEMPTIONS TIMES $1,000	2.
	3	SUBTRACT LINE 2 FROM LINE 1	3.
1980	4	AMOUNT FROM 1980 FORM 1040, LINE 34	4.
	5	TOTAL EXEMPTIONS TIMES $1,000	5.
	6	SUBTRACT LINE 5 FROM LINE 4	6.
1981	7	AMOUNT FROM 1981 FORM 1040, LINE 34	7.
1982	8	AMOUNT FROM 1982 FORM 1040, LINE 37	8.
	9	ALL INCOME EARNED FROM OUTSIDE THE U.S. OR WITHIN U.S. POSSESSIONS, EXCLUDED FOR 1979 THRU 1982	9.
TOTAL	10	ADD LINES 3, 6, 7, 8, AND 9	10.
STEP 2		FIGURE YOUR AVERAGEABLE INCOME	
	11	LINE 10 TIMES 30%	11.
	12	TAXABLE INCOME FOR 1983 FROM FORM 1040, LN. 37	12.
	13	PREMATURE EXCESS DISTRIBUTION	13.
	14	SUBTRACT LINE 13 FROM LINE 12	14.
	15	EXCESS COMMUNITY INCOME	15.
	16	SUBTRACT LINE 15 FROM LINE 14	16.
	17	AMOUNT FROM LINE 11 ABOVE	17.
	18	SUBTRACT LINE 17 FROM 16 - AVERAGEABLE INCOME	18.
STEP 3		FIGURE YOUR TAX	
	19	LINE 18 TIMES 20%	19.
	20	AMOUNT FROM LINE 11 ABOVE	20.
	21	ADD LINES 19 AND 20	21.
	22	AMOUNT FROM LINE 15 ABOVE	22.
	23	ADD LINES 21 AND 22	23.
	24	TAX ON AMOUNT ON LINE 23	24.
	25	TAX ON AMOUNT ON LINE 21	25.
	26	TAX ON AMOUNT ON LINE 20	26.
	27	SUBTRACT LINE 26 FROM LINE 25	27.
	28	LINE 27 TIMES 4	28.
	29	TAX ON AMOUNT ON LINE 12	29.
	30	TAX ON AMOUNT ON LINE 14	30.
	31	SUBTRACT LINE 30 FROM LINE 29	31.
	32	ADD LINES 24, 28 & 31	32.

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EXHIBIT CG - R (SCHEDULE R)

SCHEDULE R (FORM 1040) — CREDIT FOR THE ELDERLY — 1983 * 18
OMB NO. 1545-0074

JOHN Q. TAXPAYER — SSN 000-00-0000

****

SCHEDULE R - INDIVIDUAL(S) 65 OR OVER HAVING ANY KIND OF INCOME

FILING STATUS (B XX MARRIED FILING JOINT RETURN, ONLY ONE OVER 65)

1	ENTER $3750, $2500 OR $1875..... 1.	000,000.00
2A	ENTER AMOUNTS RECEIVED AS NON-TAX PENSIONS OR ANNUITIES.2A.	
2B	ENTER AMOUNT FROM FORM 1040 LN 33.....2B.	
2C	ENTER $10,000, $7500 or $5000.....2C.	
2D	LINE 2B LESS LINE 2C.....2D.	
2E	ENTER 50% OF LINE 2D.....2E.	
3	ADD LINES 2A AND 2E.....3.	
4	SUBTRACT LINE 3 FROM LINE 1.....4.	
5	MULTIPLY LINE 4 BY 15%.....5.	
6	ENTER AMOUNT OF TAX FROM FORM 1040, LINE 40.....6.	
7	ENTER SMALLER AMOUNT FROM LINE 5 OR LINE 6.....7. (ENTER THIS AMOUNT ON FORM 1040, LINE 41)	

****

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG - RP (SCHEDULE RP)

SCHEDULE RP CREDIT FOR ELDERLY UNDER 65 YEARS 1983 * 18
(FORM 1040) OMB NO. 1545-0074
JOHN Q. & MARY J. TAXPAYER SSN 000-00-0000
****

RET SYS NAME:

FILING STATUS ( ) MARRIED FILING JOINT RETURN, ONE UNDER 65

		(A)	(B)
1	ENTER $3750, $2500 OR $1875..... 1.	00,000.00	00,000.00
2A	ENTER AMTS REC'D NON-TAX (PENS, ANNUT).2A.		
2BI	(UNDER 62) ENTER ALL OVER $900.....2BI.		
2BII	(62) + ENTER AMTS PER INSTRUCTIONS.. 2BII.		
3	ADD LINES 2A AND 2B.....3.		
4	SUBTRACT LINE 3 FROM LINE 1.....4.		
5A	(UNDER 65) ENTER OTHER $ NOT ON LN 2A..5A.		
5B	(65+) ENTER OTHER $ RECEIVED.....5B.		
6	ENTER SMALLER OF LN 4 OR 5.....6.		
7	ADD COLS (A) & (B) LINE 6.....7.	XXXXXXX	
8	MULTIPLY LINE 7 BY 15%.....8.	XXXXXXX	
9	ENTER TAX FROM FORM 1040, LINE 40.....9.	XXXXXXX	
10	ENTER SMALLER OF LN 8 OR 9.....10.	XXXXXXX	

(ENTER THIS AMOUNT ON FORM 1040, LINE 41)

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG - SE (SCHEDULE SE)

SCHEDULE SE 1983 * 19

COMPUTATION OF SOCIAL SECURITY SELF-EMPLOYMENT TAX

(FORM 1040) OMB NO. 1545-0074

MARY J. TAXPAYER SSN 000-00-0000

****

PART I - REGULAR COMPUTATION OF NET EARNINGS FROM SELF EMPLOYMENT

1 NET PROFIT OR (LOSS) FROM SCHEDULE F, LN. 56, OR 89 AND FARM PARTNERSHIPS, SCHEDULE K-1 (1065), LN.18B.....1.

2 NET PROFIT OR (LOSS) FROM SCHEDULE C, LN. 32, AND SCHEDULE K-1, (FORM 1065), LN. 18B (OTHER THAN FARMING)...2.

FORM 4361 FILED (ANS)

PART II - OPTIONAL COMPUTATION OF NET EARNINGS FROM SELF EMPLOYMENT

3 MAXIMUM INCOME FOR OPTIONAL METHOD.....3. 1,600.00

4 FARM OPTIONAL METHOD -2/3 RDS OF GROSS PROFITS FROM SCH. F, LN. 31 OR 87 AND FARM PARTNERSHIPS, SCH. K-1, (1065), LN. 18A, OR $1,600, WHICHEVER IS SMALLER.....4.

5 SUBTRACT LINE 4 FROM LINE 3.....5.

6 NONFARM OPTIONAL METHOD - SMALLER, 2/3 RDS GROSS PROFITS FROM SCH. C, LN. 5, AND SCH. K-1 (1065), LINE 18C (OTHER THAN FARMING), $1,600, OR, IF YOU ELECTED FARM OPTIONAL METHOD, AMOUNT ON LINE 5.....6.

PART III - COMPUTATION OF SOCIAL SECURITY SELF EMPLOYMENT TAX

7	AMOUNT FROM PART I, LINE 1, OR, PART II, LINE 4.....7.	
8	AMOUNT FROM PART I, LINE 2, OR, PART II, LINE 6.....8.	
9	ADD LINES 7 AND 8.....9.	
10	LARGEST AMOUNT SUBJECT TO SOCIAL SECURITY OR RRTA TAX.....10.	35,700.00
11A	TOTAL FICA WAGES FROM W-2 AND RRTA COMPENSATION.....11A.	
11B	UNREPORTED TIPS SUBJECT TO SST (FORM 4137).....11B.	
11C	ADD LINES 11A AND 11B.....11C.	
12	SUBTRACT LINE 11C FROM LINE 10.....12.	
13	SMALLER OF LINE 9 OR 12 (OR LN 13 X .0935).....13.	
14	SELF EMPLOYMENT TAX - ENTER ON FORM 1040, LINE 50.....14.	

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EXHIBIT CG-W (SCHEDULE W)

SCHEDULE W DEDUCTION FOR MARRIED WORKING COUPLE 1983*21
(FORM 1040) OMB No. 1545-0074
JOHN Q AND MARY J TAXPAYER SSN 000-00-0000

		(A)SELF	(B)SPOUSE
1	WAGES, SALARIES, TIPS, ETC.	000,000	000,000
2	NET PROFIT/LOSS FM SELF-EMP.		
3	TOTAL EARNED INCOME (LN 1 PLUS LN 2)		
4	ADJUSTMENTS FM 1040 (LN 24, 25a, 26 & 30)		
5	QUAL. EARNED INCOME (LN 3 MINUS LN 4)	000,000	000,000
6	ENTER SMALLER OF LN 5A OR 5B	XXXXXX	000,000
7	MULTIPLY LN 6 BY .10	XXXXXX	X.10
8	DEDUCTION (ENTER ON FORM 1040 LN 29)	XXXXXX	000,000

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

26 CFR 601.103: Summary of general procedure.
(Also Part I, Sections 3406, 6676.)

Rev. Proc. 84-10 [1]

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SECTION 2. TRANSMITTER "T" RECORD
SECTION 3. PAYER "A" RECORD
SECTION 4. PAYEE "B" RECORD
SECTION 5. END OF PAYER "C" RECORD
SECTION 6. END OF TRANSMISSION "F" RECORD

PART A.—GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to present the requirements of the computer matching program announced in Internal Revenue Service News Release IR-83-150 (dated 12-2-83) on how payers of reportable interest or dividends can verify the names and taxpayer identification numbers (social security numbers) of their account holders.

.02 Under this revenue procedure, only accounts required to use social security numbers (SSNs) as the taxpayer identification number should be submitted for Service validation. For this project, the IRS will access a file which contains only names and SSNs. Any account submitted with an employer identification number (EIN) will fail the validation and cause an incorrect setting of the Valid/Incorrect Indicator in the Payee "B" Record. Therefore, the payer should delete from the tape file sent to the IRS for validation, all accounts that are properly using EIN's such as corporations, financial institutions, exempt organizations and all others exempt from backup withholding.

SEC. 2. BACKGROUND

.01 This document is a revenue procedure under the Interest and Dividend Tax Compliance Act of 1983 related to backup withholding requirements and the exercise of due diligence under sections 3406 and 6676 of the Internal Revenue Code of 1954. Section 3406 was added to the Code by section 104 of the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 371) and section 6676 of the Code was amended by section 105 of the Act (Pub. L. 98-67, 97 Stat. 380). Regulations issued under the Act added a new Part 35a, Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983, to Title 26 of the Code of Federal Regulations.

.02 Under the Interest and Dividend Tax Compliance Act of 1983, payers of reportable interest, dividends, or patronage dividends are subject to a $50 penalty for each Form 1099 with an incorrect or missing taxpayer identification number unless the payer has exercised "due diligence" in soliciting the number from the payee. In general, to show that due diligence has been exercised in connection with accounts established or instruments acquired on or before December 31, 1983, a payer must have sent a mailing or mailings as described in A-5 and A-6 of section 35a.9999-1 to each payee who has not certified under penalties of perjury that the payee's taxpayer identification number is correct.

.03 Also under the Interest and Dividend Tax Compliance Act of 1983 payers are required to commence backup withholding on any payment made to a payee if the Service notifies the payer that the payee has provided an incorrect taxpayer identification number unless the payee provides corrected information to the payer within 30 days.

.04 This document explains what payers are required to do in order to participate in this computer matching program. Incorrect payee taxpayer identification numbers (social security numbers) on the payer's files will result in penalties to the payer if the payer makes information returns using such numbers and has not exercised due diligence. Payers must send magnetic tape files in the format specified in PART B of this document to the Magnetic Media Coordinator at the Service Center shown in PART A, SEC. 7 of this document. Upon receipt of these records, the Service will compare the payee's name and SSN against a Social Security Administration (SSA) file of SSN/name combinations and will provide the payer/transmitter with tapes on which the payee records have been marked as either valid or incorrect. Because the Service is using the number provided by SSA for such name, an invalid number notification may occur if the payee has not recorded a name change with SSA. Thus, payees will be instructed to contact SSA if the number is correct, but the name is not. Payers are required (1) to notify the payees of the name and social security number listed on the payer's record for that account, (2) to provide a form for use in correcting and certifying the information or for certifying the correctness of listed information; and (3) to notify the payees that backup withholding will com-

[1] Also released as News Release IR-84-16, dated February 1, 1984.

mence in 30 days unless the payer receives certified corrected information or certification that the listed information is correct. The Service will provide a form letter for explaining this to payees.

.05 With respect to payees who are identified as having provided incorrect number/name combinations to the payers by the computer matching program, payers will be required to impose backup withholding on payments made to such payee unless the payer receives certified corrected information or certification that the listed information is correct from the payee within 30 days after the Service notifies the payer of such incorrect name and/or taxpayer identification number.

.06 If the payer obtains new information from the payee, the payer is required to use the corrected information on 1984 and future 1099s.

.07 *WARNING*: As previously indicated in Information Release 83-150, dated December 2, 1983, using this computer matching program is not a substitute for the mailing or mailings required by the Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983. Thus, payers who have not sent the mailing or mailings as described in A-5 and A-6 of section 35a.9999-1 of the Temporary Employment Tax Regulations will be liable for a $50 penalty for each information return filed in respect of payments made during 1984 without the payee's correct name or social security number. However, those payers who obtain corrected information from payees before the information returns are filed for 1984 will be able to avoid penalties with respect to those Forms 1099 containing corrected information.

SEC. 3. APPLICATION FOR MAGNETIC TAPE REPORTING

.01 For the purpose of this revenue procedure, the payer is the organization requesting SSN validation and the transmitter is the organization preparing the magnetic tape file. The payer and transmitter may be the same organization.

.02 Any payer electing to use this procedure must send a Letter of Intent addressed to the attention of the Magnetic Media Coordinator at one of the Service Centers listed in PART A, SEC 7. The letter must contain all of the following:

(a) Payer name;

(b) Payer address;

(c) Payer city, state and zip code;

(d) Payer's Employer Identification Number (EIN);

(e) Name of person to contact in payer's office;

(f) Phone number of contact in payer's office;

(g) Transmitter name, if applicable;

(h) Transmitter address, if applicable;

(i) Service Center where file will be sent for processing;

(j) An approximate number of records in the file;

(k) An approximate number of tape reels in the file;

(l) Tape characteristics of input files;

(m) Tape characteristics of output files (see PART C, SEC. 1); and

(n) Payer's indication of one of the following options:

(1) use of the Service provided form letter; or

(2) use of a payer developed substitute form letter.

.03 The Letter of Intent must be received by the Service by March 9, 1984.

.04 The Magnetic Media Coordinator will respond in writing to the Letter of Intent by March 30, 1984.

SEC. 4. FILING OF TAPES

.01 The Magnetic Media Coordinator will provide the following items to the payer/transmitter once the Letter of Intent has been approved:

(a) Form 4804, Transmittal of Information Returns Reported on Magnetic Media, stamped in boxes 12 and 14 (Kind of Document) as "SSN Validation". This stamped Form 4804 must accompany the shipment of tape files under this revenue procedure.

(b) Form 5064, Magnetic Tape Labels, stamped as "SSN Validation".

.02 The affidavit appearing on Form 4804 does not have to be signed.

.03 The payer/transmitter *must* provide the Service with a number of blank tapes equal to the number input for Service validation. The Service will return the marked file to the payer/transmitter on these tapes.

.04 All tape files submitted must conform exactly with this revenue procedure. *IF FILES ARE UNPROCESSABLE, THEY WILL BE RETURNED TO THE FILER.*

SEC. 5. PROCESSING TIMETABLE

.01 Tapes will be accepted by the Magnetic Media Coordinator whenever the payer/transmitter is able to create them in conformance with the procedures outlined herein.

.02 These tape files may be submitted any time after March 31, 1984 and will be processed and returned to the payor/transmitter within 60 days after receipt at the Service Center.

.03 No tape files will be accepted at the Service Centers after October 31, 1984.

For this account type—	In the Social Security Number of the Payee "B" Record, enter the SSN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. An individual's account.	The individual.	The individual.
2. A joint account (husband and wife, adult and minor, or any two or more individuals).	One of the owners of the account.	The individual whose SSN is entered.
3. Account in the name of a guardian or committee for a designated ward, minor, or incompetent person.	The ward, minor, or incompetent person.	The individual whose SSN is entered.
4. Custodian account of a minor (Uniform Gifts to Minors Act).	The minor.	The minor.
5. The usual revocable savings trust account (grantor is also trustee).	The grantor-trustee	The grantor-trustee
6. A so-called trust account that is not a legal or valid trust under State law.	The actual owner.	The actual owner.
7. A sole proprietorship.	The owner.	The owner.

SEC. 6. SOCIAL SECURITY NUMBERS

.01 Under section 6019 of the Internal Revenue Code, recipients of dividends, interest, or other payments are required to furnish Social Security Numbers (SSNs) to the payer. The number must be furnished to be payer whether or not the payee is required to file a tax return or is covered by Social Security.

.02 The SSN to be furnished to the Service depends primarily upon the manner in which the account is maintained or set up on the payer's record. The SSN to be provided must be that of the owner of the account. If the account is recorded in more than one name, furnish the SSN and name of one of the owners of the account. The SSN provided must be the correct SSN for the name of the payee provided in the first name line of the Payee "B" Record.

.03 Sole proprietors who are payers should show their Employer Identification Number in the Payer "A" Record. However, sole proprietors who are not required to have an Employer Identification Number should use their Social Security Numbers.

.04 Sole proprietors' Social Security Numbers must be used in the Payee "B" Record.

.05 The chart below will help you determine the number to be furnished to the Service.

SEC. 7. MAGNETIC MEDIA COORDINATOR CONTACTS

Requests for additional copies of this revenue procedure or for additional information on magnetic media reporting should be addressed to the attention of the Magnetic Media Coordinator of one of the following:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
Post Office Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(d) Internal Revenue Service
Atlanta Service Center
Post Office Box 47-421
Doraville, GA 30362

(e) Internal Revenue Service
Memphis Service Center
Post Office Box 1900
Memphis, TN 38101

(f) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
Covington, KY 41019

(g) Internal Revenue Service
Kansas City Service Center
Post Office Box 24551
2306 East Bannister Rd.
Stop 43
Kansas City, MO 64131

(h) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

(i) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
Ogden, UT 84409

(j) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

SEC. 8. DEFINITIONS

Element	*Description*
b	Denotes a blank position.
Coding Range	Indicates the allowable values for a particular type of statement.
EIN	Employer Identification Number which has been assigned by Internal Revenue Service to the reporting entity.
File	For the purpose of this procedure, a file consists of all magnetic tape records submitted by a Payer or Transmitter.
Payee	Person(s) or organization(s) receiving payments from the Payer.
Payer	Person or organization, including paying agent, making payments. The Payer will be held responsible for the completeness, accuracy and timely submission of magnetic tape files.
Special Character	Any character that is not a numeral, a letter or a blank.
SSA	Social Security Administration.
SSN	Socal Security Number assigned by SSA.
Taxpayer Identification Number (TIN)	May be either an EIN or SSN (under this revenue procedure, SSN only)
Transmitter	Person or organization preparing magnetic tape file(s). May be Payer or agent of Payer.
Incorrect SSN	SSN/Name combination does not match current files at IRS. Either the name or the number could be incorrect.

PART B.—INPUT MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 The magnetic tape specifications contained in this part of the procedure define the required format and content of the records to be included in the input file.

.02 In most instances, the Service will be able to process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 7 channel BCD (binary coded decimal) with
  (1) Either Even or Odd Parity and
  (2) A density of 556 or 800 BPI.

(b) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with
  (1) Odd Parity and
  (2) A density of 800, 1600,or 6250 BPI.

(c) 9 channel ASCII (American Standard Coded Information Interchange) with
  (1) Odd Parity and
  (2) A density of 800, 1600, or 6250 BPI.

.03 All compatible tape files must have the following characteristics:

(a) Type of tape - 0.5 inch (12.7 mm) wide, computer grade magnetic tape on reels of up to 2400 feet (731.52 m) within the following specifications:
  (1) Tape thickness: 1.0 or 1.5 mils
  (2) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm)

(b) Interrecord Gap - ¾ inch

SEC. 2. RECORD LENGTH

.01 The tape records defined in this procedure must be BLOCKED as follows:

(a) A block must be 4,000 tape positions.

(b) A record must be 200 tape positions.

(c) All remaining positions of a block containing less than 20 records must be filled with 9's. DO NOT PAD A BLOCK WITH BLANKS.

(d) All records except the Header and Trailer Labels, must be blocked.

SEC. 3. FILING CONVENTIONS

For the purposes of this procedure the following conventions must be used:

Header Label:
1. Payers may use standard headers provided they begin with 1HDR, HDR1, VOL1, VOl2, or "bLABEL".
2. Consist of a maximum of 80 positions.
3. Position 9 MUST NOT contain the letters A, B, C, F, or T.

Trailer Label:
1. Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.
2. Consist of a maximum of 80 positions.

Record Mark:
1. Special character used to separate blocked records on tape.
2. Can be written only at the end of a record or block.
3. For odd parity tapes, use BCD bit configuration 011010 ("A82").

Tape Mark:
1. Used to signify the physical end of the recording on tape.
2. For even parity, use BCD configuration 001111 ("8421").
3. May follow the header label and precede and/or follow the trailer label.

SEC. 4. TRANSMITTER "T" RECORD

.01 Identifies the transmitter of the tape file.

.02 Only one Transmitter Record is required for the entire tape file. This record must be the first record on the first reel of the file.

.03 THIS RECORD IS REQUIRED EVEN IF THE PAYER AND TRANSMITTER ARE THE SAME PERSON OR ORGANIZATION.

RECORD NAME: TRANSMITTER "T" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "T".
2-3	Service Center Code	2	REQUIRED. Enter the 2 digit Service Center Code where the files are sent for processing. See table below for Service Center Code: *Service Center* — *Code* Andover — 08 Atlanta — 07 Austin — 18 Brookhaven — 19 Cincinnati — 17 Fresno — 89 Kansas City — 09 Memphis — 49 Ogden — 29 Philadelphia — 28
4-83	Transmitter Name	80	REQUIRED. Enter the name of the transmitter in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left justify and fill with blanks.
84-123	Transmitter Mailing Address	40	REQUIRED. Enter the mailing address of the transmitter. Left justify and fill with blanks.
124-163	Transmitter City, State And Zip Code	40	REQUIRED. Enter the city, state and zip code of the transmitter. Left justify and fill with blanks.
164-200	Blanks	37	REQUIRED. Enter Blanks.

SEC. 5. PAYER "A" RECORD

.01 Identifies the payer of the tape file.

.02 A transmitter may include Payee "B" Records for more than one payer on a tape reel, however, each payer's Payee "B" Record(s) must be preceded by an "A" Record. An "A" Record may be blocked with "B" Records, however, the "A" Record *must appear as the first record in the block.*

RECORD NAME: PAYER "A" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "A".
2-10	Payer's Federal EIN	9	REQUIRED. Must be the *valid* 9-digit number assigned to the payer by the Internal Revenue Service. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9's OR ALL ZEROES.
11-90	Payer Name	80	REQUIRED. Enter the name of the payer in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left justify and fill with blanks.

RECORD NAME: PAYER "A" RECORD —Continued

Tape Position	Field Title	Length	Description and Remarks
91-130	Payer Mailing Address	40	REQUIRED. Enter the mailing address of the payer. Left justify and fill with blanks.
131-170	Payer City, State and Zip Code	40	REQUIRED. Enter the city, state and zip code of the payer. Left justify and fill with blanks.
171-200	Blanks	30	REQUIRED. Enter blanks.

SEC. 6. PAYEE "B" RECORD

.01 Contains the payee's Social Security Number (SSN) and entity information from individual accounts.

.02 All payee records *must contain correct payee name and address information* entered in the fields prescribed in this section.

.03 The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payee's surname may be entered by the payers. A blank MUST precede the identifying surname in the First Payee Name Line of all Payee "B" Records unless the surname begins in the first position of the field.

RECORD NAME: PAYEE "B" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "B".
2-5	Name Control	4	OPTIONAL. Enter the first 4 letters of the surname of the payee. Surnames of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. IF NOT PROVIDED FILL WITH BLANKS.
6-14	Social Security Number	9	REQUIRED. Enter the 9-digit Social Security Number of the payee. See PART A, SECTION 1.02.
15-34	Payer's Account Number for Payee	20	OPTIONAL. Payer may use this field to enter the payee's account number. Although this item is optional, its use will facilitate easy reference to specific records in the payer's file should any questions arise.
35-74	First Payee Name Line	40	REQUIRED. Enter the name of the payee whose Taxpayer Identification Number appears in tape positions 6-14 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required, utilize the Second Payee Name Line field below. If there are multiple payees, only the name of the payee whose Social Security Number has been provided should be entered in this field. The names of the other payees should be entered in the Second Payee Name Line field. No descriptive or other data is to be entered in this field.
75-114	Second Payee Name Line	40	REQUIRED. If the payee name requires more space than is available in the First Payee Name Line, enter the remaining portion of the name in this field. If there are multiple payees, this field may be used for those payees' names who are not associated with the Social Security Number provided in tape positions 6-14 above. Left justify and fill unused portions with blanks. FILL WITH BLANKS IF NO ENTRIES ARE REQUIRED IN THIS FIELD.
115-154	Payee Mailing Address	40	REQUIRED. Enter mailing address of payee. Left justify and fill unused positions with blanks. This field MUST NOT contain any data other than the payee's mailing address. THIS FIELD MUST BE PRESENT.

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
155-194	Payee City, State and Zip Code	40	REQUIRED. Enter the city, state and Zip Code of the payee, in that sequence. Use U.S. Postal Service abbreviations for states. Left justify and fill unused positions with blanks. THIS FIELD MUST BE PRESENT.
195-199	Blank	5	REQUIRED. Enter Blanks.
200	Valid/Incorrect Indicator	1	REQUIRED. See PART A, SECTION 1.02. This field will be marked by the Service as follows: *Indicator* — *Reason* 0 — SSN and Payee Name match Service files 1 — SSN not present on Service files 2 — Payee name does not match Service files for this SSN

SEC. 7. END OF PAYER "C" RECORD

.01 The End of Payer "C" Record is a summary record for a given payer.

.02 The "C" Record will contain the totals of the payees filed by a given payer. The "C" Record must be written after the last Payee "B" Record for a given payer. For each "A" Record on the file, there must be a corresponding "C" Record.

.03 Payers/Transmitters must verify the accuracy of the totals in the "C" Records and must enter the totals on the transmittal, Form 4804, which will accompany the shipment.

RECORD NAME: END OF PAYER "C" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "C".
2-11	Number of Payees	10	REQUIRED. Enter the number of payees covered by the payer on this file. Right justify and zero fill.
12-200	Blank	189	REQUIRED. Enter Blanks.

SEC. 8. END OF TRANSMISSION "F" RECORD.

.01 The "F" Record is a summary of the number of payers and tapes in the entire file.

.02 This record should be written after the last "C" Record.

.03 Only a Tape Mark or a Tape Mark and Trailer Label may follow the "F" Record.

RECORD NAME: END OF TRANSMISSION "F" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "F"
2-5	Number of Payers	4	REQUIRED. Enter the total number of payers in the transmission. Right justify and zero fill.
6-8	Number of Reels	3	REQUIRED. Enter the total number of reels in transmission. Right justify and zero fill.
9-30	Zero	22	REQUIRED. Enter Zeroes.
31-200	Blank	170	REQUIRED. Enter Blanks.

SEC. 9. RECORD LAYOUTS

TRANSMITTER "T" RECORD—RECORD LAYOUT

RECORD TYPE	SERVICE CENTER CODE	TRANSMITTER NAME	TRANSMITTER MAILING ADDRESS	TRANSMITTER CITY, STATE AND ZIP CODE	BLANKS
1	2-3	4-83	83-123	124-163	164-200

PAYER "A" RECORD—RECORD LAYOUT

RECORD TYPE	PAYER'S FEDERAL EIN	PAYER NAME	PAYER MAILING ADDRESS	PAYER CITY, STATE AND ZIP CODE	BLANKS
1	2-10	11-90	91-130	131-170	171-200

PAYEE "B" RECORD—RECORD LAYOUT

RECORD TYPE	NAME CONTROL	SOCIAL SECURITY NUMBER	PAYER'S ACCOUNT NUMBER FOR PAYEE	FIRST PAYEE NAME LINE	SECOND PAYEE NAME LINE
1	2-5	6-14	15-34	35-74	75-114

PAYEE MAILING ADDRESS	PAYEE CITY, STATE AND ZIP CODE	BLANKS	VALID/ INCORRECT INDICATOR
115-154	155-194	195-199	200

END OF PAYER "C" RECORD—RECORD LAYOUT

RECORD TYPE	NUMBER OF PAYEES	BLANKS
1	2-11	12-200

END OF TRANSMISSION "F" RECORD—RECORD LAYOUT

RECORD TYPE	NUMBER OF PAYERS	NUMBER OF REELS	ZERO	BLANK
1	2-5	6-8	9-30	31-200

PART C.—OUTPUT MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 The Service will return to the payer/transmitter a magnetic tape SUPPLIED BY the payer/transmitter. The output records will be in the same format as input. All of the Payee "B" Records will be marked as either valid or incorrect as specified in PART B, SEC. 6.03, position 200.

.02 The characteristics of the output tapes will be:

(a) 9 channel ANSI Label/ASCII Data/1600 BPI

or

(b) 9 channel ANSI Label/ASCII Data/6250 BPI

(c) Type of tape—0.5 inch (12.7 mm) wide, computer grade magnetic tape on reels of up to 2400 feet (731.52 m) within the following specifications:

(1) Tape thickness: 1.0 or 1.5 mils

(2) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm)

(d) Interrecord Gap—¾ inch.

.03 The sequence of the output files will be SSN within EIN.

BLANK TAPES MUST BE PROVIDED BY THE FILER FOR EVERY SUBMITTED INPUT FILE

SEC. 2. TRANSMITTER "T" RECORD

.01 The format of the output file will be the same as the input file.

.02 See PART B, SEC. 4 for field definitions.

SEC. 3. PAYER "A" RECORD

.01 The format of the output file will be the same as the input file.

.02 See PART B, SEC. 5 for field definitions.

SEC. 4. PAYEE "B" RECORD

.01 The format of the output file will be the same as the input file.

.02 The Payee "B" Records will be marked by Service programs in tape position 200 (Valid/Incorrect Indicator) as to whether the record was valid or incorrect.

.03 See PART B, SEC. 6 for field definitions.

SEC. 5. END OF PAYER "C" RECORD

.01 The format of the output file will be the same as the input file.

.02 See PART B, SEC. 7 for field definitions.

SEC. 6. END OF TRANSMISSION "F" RECORD

.01 The format of the output file will be the same as the input file.

.02 See PART B, SEC. 8 for field definitions.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 3504, 6011; 31.3504-1, 31.6011(a)-1.)

Rev. Proc. 84-11

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide a means whereby Reporting Agents preparing Form 941, Employer's Quarterly Federal Tax Returns, for groups of taxpayers can furnish the required information in the form of magnetic tape instead of paper documents.

.02 This revenue procedure reflects the current changes to the tape specifications.

SEC. 2. APPLICATION FOR TAPE REPORTING

.01 Agents who desire to file authorized federal tax returns on magnetic tape must first file a letter of application or submit Form 4995, Application for Magnetic Tape Filing of Form 941, Employer's Quarterly Federal Tax Return (see Exhibit 1). The letter should be addressed to the Director, Internal Revenue Service Center, Attention: Magnetic Tape Coordinator, where the Reporting Agent normally files the returns. Addresses of the Internal Revenue Service Centers are shown in Section 10 of this revenue procedure. The letter of application must contain the following:

1. Name, address and EIN (Employer Identification Number) of the person, organization, or firm making the application.

2. Name, title, and telephone number of the person to contact regarding the application.

3. Type and nature of equipment to be used to prepare the tape file, i.e., manufacturer and model of main frame and tape drives, tape width (½", ¾", etc), density (characters per inch), and recording code (BCD, Excess 3, Octal, etc.).

4. List of the taxpayers to be included on the initial establishment of the Magnetic Tape Filing system. The list must be in triplicate with the data shown in the exact order as Exhibit 2. Show each taxpayer's name, complete address (including Zip Code), and EIN: sort into EIN sequence. See Section 6.03 for additional details.

5. Internal Revenue Service Center where paper tax returns were last filed.

6. Signature of the Agent or Agent's employee authorized to prepare federal tax returns for taxpayers.

7. An agreement by the Reporting Agent to keep copies of the Powers of Attorney on file at the Agent's principal place of business for examination by the Internal Revenue Service upon request. Such copies must be retained until the statute of limitations for the last return filed under its authority expires.

8. An agreement to fully pay the tax by Federal Tax Deposits.

SEC. 3. POWER OF ATTORNEY

.01 A Power of Attorney must be submitted for each filer on the list attached to Form 4995 or the letter of application. The Power of Attorney may be submitted on an Internal Revenue Service Form 2848. Power of Attorney and Declaration of Representative (see Exhibit 3), which is available on request; or any other instrument which clearly states that the Reporting Agent is granted the authority to file and sign the return. The Power of Attorney filed under this revenue procedure is not subject to the rules contained in the Conference and Practice Requirements (Treasury Regulation 601.502).

.02 Both the taxpayer, or his authorized representative, and the Reporting Agent must sign the Power of Attorney. The signed document will remain in effect until such time as it is revoked by the taxpayer, terminated by written notification from the Reporting Agent, or expires under its own terms.

1. The following persons may execute a Power of Attorney on behalf of a corporation or other business taxpayer:

(a) The individual if the person required to make the return is an individual;

(b) The president, vice president, or other principal officer, if the person required to make the return is a corporation;

(c) A responsible and duly authorized member or officer having knowledge of its affairs, if the person required to make the return is a partnership or other unincorporated organization.

(d) The fiduciary, if the person required to make the return is a trust or estate; or

(e) An agent who is duly authorized in accordance with Regulations 31.6011(a)-7.

.03 The scope of the Power of Attorney for Magnetic Tape Filing will be governed according to the following:

1. Power of Attorney will delegate to the Reporting Agent the power to sign and file appropriate federal tax returns.

2. The Power of Attorney becomes effective for the tax period the Agent notifies the Service that the employer or filer is being added to the Magnetic Tape Filing System and remains in effect for subsequent periods until revoked, terminated or expired.

3. The Power of Attorney is automatically revoked when the Reporting Agent notifies the Service that a taxpayer is no longer included in the Magnetic Tape Filing System.

4. The receipt of a Power of Attorney for Magnetic Tape Filing has no

effect on prior Powers of Attorney on file for other purposes for a given taxpayer.

5. The Power of Attorney for Magnetic Tape Filing will be a limited power of attorney, i.e., notices, refunds and other output resulting from filing on magnetic tape will be mailed to the taxpayer.

6. Requests from a Reporting Agent for information or adjustments on an account for which the taxpayer has authorized Magnetic Tape Filing will be honored by the service center.

7. Requests for address changes may not be made by the Reporting Agent. Requests for address changes for taxpayers that are reported under Magnetic Tape Filing will be processed only if they originate with one of the following:

(a) The taxpayer,

(b) An employee of the Internal Revenue Service, or

(c) An attorney-in-fact if the attorney has a full Power of Attorney for all tax matters concerning a taxpayer, and has filed a copy of the Power of Attorney with the Internal Revenue Service.

SEC. 4. ATTORNEY OF AGENTS APPLICATION

.01 The Service will act on applications and notify applicants of authorization or disapproval within 30 days of receipt of Form 4995.

.02 Generally, Reporting Agents using equipment compatible with the Service's can presume that tape filing will be approved. Compatible tape characteristics are shown in Section 12. If the Reporting Agent has the capability to prepare several types of tapes, the Service prefers that compatible tapes be prepared.

.03 If the Reporting Agents propose to submit convertible tapes, i.e., tapes requiring translation, the Service will either translate these tapes or provide translation through other government agencies. Magnetic Tape Filing will be disapproved when the Service is unable to obtain facilities to translate a Reporting Agent's file to a compatible form. (See Section 12 for specifications.)

.04 Once authorization to file tax data on magnetic tape has been granted to a Reporting Agent, such approval will continue to effect in succeeding tax periods as long as the requirements of this revenue procedure are met, and there are no equipment changes by the Reporting Agent. However, new applications are required if users change from compatible tapes to equipment producing tapes that require translation, or if they discontinue Magnetic Tape Filing for one or more periods, then decide to resume this method of reporting.

SEC. 5. EFFECT ON PAPER DOCUMENTS

.01 Authorization to file on magnetic tape does not immediately stop the filing on paper tax returns, but merely initiates filing of such returns on the Magnetic Tape Filing System.

.02 The initial filing of tax returns on magnetic tape will be on trial tapes. Each taxpayer included on the magnetic tape must also be on the paper form until authorized by the Service to discontinue filing returns on paper. The paper returns must be arranged in the same order as the returns reported on the magnetic tape and filed at the same location and in the same shipment. In general, the Service will be able to notify the Reporting Agent to discontinue filing paper returns within one quarter after the initial filing of magnetic tape. The notification will depend upon the performance standard of the magnetic tape.

.03 Duplicate returns or duplicate tape and paper returns should never be submitted after the Reporting Agent is authorized to discontinue filing paper returns.

.04 "Paper" 941 filers are required to transmit with their return, copies of any W-4's claiming 14 or more exemptions. If the Reporting Agent files magnetic tape 941's for a taxpayer, but does not report W-4 information on magnetic tape, the paper W-4's should be submitted to the service center with a cover letter.

SEC. 6. FILING TAPE RETURNS

.01 Packaging, shipping, and mailing instructions will be provided in the letter granting initial approval issued by the Service in response to the letter of application for Magnetic Tape Filing.

.02 The Service will expect a tape return to be submitted for those individually approved magnetic tape filers until the Reporting Agent formally notifies IRS that specific employers are being deleted from their current Magnetic Tape Filing inventory.

.03 The Reporting Agent will be provided with a validated copy of the Agent's Listing for taxpayers authorized to file on magnetic tape. This authorization will contain each taxpayer's EIN, four position alpha Name Control, the DO (District Office) Code and the Tax Class. This will be the source of the EIN and Name Control to be used on magnetic tape by the Reporting Agent as an identification of each taxpayer.

.05 Enclose in the first box of the tape shipment to the Service the following:

1. Form 4996, Magnetic Tape Filing Transmittal for Form 941, Employer's Quarterly Federal Tax Return, in duplicate. (See Exhibit 4.)

2. A control listing identifying actual taxpayers previously approved by the Service for Magnetic Tape Filing that are contained on the current tape file being submitted. List the taxpayers in EIN sequence with each taxpayer's name and address.

.06 Agents must submit a paper Schedule A for those taxpayers who elect to treat backup withholding as a separate tax and make separate Federal Tax Deposits. The paper Schedule A should be sent with the magnetic tape shipment.

SEC. 7. ADDING AND DELETING FILERS FROM MAGNETIC TAPE FILING SYSTEM

.01 When adding or deleting filers, the Service must receive (in triplicate and in the same format as shown in Exhibit 2) a listing which contains the complete names, addresses and EIN's of the taxpayers the Reporting Agent wants added or deleted from the Magnetic Tape Filing System. The words "ADDITIONS" or "DELETIONS" should be entered after the

title, "Agent's Listing," and the effective date.

.02 The Service will provide a validated copy of the updated Agent's Listing to the Reporting Agent. Under no circumstances is a new filer to be included on the Magnetic Tape Filing System until the validated copy is received from the Service.

.03 A Power of Attorney authorization must be included for each taxpayer to be added to the Magnetic Tape Filing System.

.04 The Reporting Agent should indicate on the last magnetic tape return submitted for a filer that it is either the "Final Return" or a "Discontinued Filer" in the Tax Data "B" Record.

.05 The Reporting Agent may not always know that the final magnetic tape return for a particular taxpayer is being submitted at the time the tape is being sent in. When the Reporting Agent determines that the previous tape contained the last return to be prepared for the individual filer, action should be taken to notify the service center which authorized the Magnetic Tape Filing of one of the following conditions:

1. The taxpayer is out of business (state the effective date) and will no longer be liable for filing returns (Final Return), or

2. The Reporting Agent will no longer be submitting returns on magnetic tape for the taxpayer who is still in business and is still liable for such returns (Discontinued Filer).

.06 Lists of proposed quarterly (Form 941) filer additions, deletions, etc., must be received in the service center at least 2 working days prior to the end of the second month of a quarter. This will permit the Service to properly validate applications and to respond to the Agent within 30 days of receipt of the lists.

SEC. 8. DUE DATES AND CORRECTED RETURNS

.01 The due dates prescribed for filing paper returns with the Service will also apply to Magnetic Tape Filing of Federal tax returns.

.02 In no case should returns with more than one due date be included on one tape file.

.03 Adjustments may be made on returns submitted on magnetic tape. If an offsetting entry is required to FICA taxes because there is a difference between the total amount of employee tax included in Line 8 (Total FICA Taxes) of Forms 941 and the total amounts actually deducted from the remuneration of employees, due to fractions of cents added or dropped in collecting employee tax from employees, this difference should be reported as a "Fractions Only" adjustment to FICA taxes on the magnetic tape (Tax Data "B" Record, tape positions 257-266).

.04 If employee FICA tax is not applicable to amounts included in Line 6 of Form 941 (Taxable FICA Wages Paid), report this amount as "FICA TIP" adjustment on the magnetic tape (Tax Data "B" Record, tape positions 257-266).

.05 All other adjustments, including adjustments to Income Tax Withheld, combinations of "Fractions Only" and FICA-TIP" adjustments, and Sick Pay Adjustment to Income Tax Withheld must be reported as Adjustment for Preceding Quarters on the magnetic tape (Tax Data "B" Record, tape, positions 189-198).

.06 All adjustments reported in Tax Data "B" Record in tape positions 257-266 must be explained on Form 941c or in a detailed statement. All other adjustments reported (Tax Data "B" Record, tape positions 189-198 and 346-355) must also be explained in an appropriate statement except as provided in section 08. Include all statements and Forms 941c with the magnetic tape shipment for approval and subsequent adjustment action.

SEC. 9. FILING FORMS W-2 (COPY A) WITH THE SOCIAL SECURITY ADMINISTRATION

The Reporting Agents who file Forms 941 on magnetic tape for employers must file the wage information directly with the Social Security Administration on tape or paper documents. For directions for tape filing, you may call or write the appropriate Service Center Magnetic Tape Coordinator, or any Social Security Administration office and ask for Technical Information Bulletin 4a (TIB-4a), or you can write to the following address:

Social Security Administration
Bureau of Data Processing
P.O. Box 2317
Baltimore, MD 21203

SEC. 10. ADDITIONAL INFORMATION

Requests for additional copies of this revenue procedure, applications for Magnetic Tape Filing, requests for copies of appropriate input record element specifications, and requests for tape filing information should be addressed to the Director, Internal Revenue Service Center, Attention: Magnetic Tape Coordinator, at one of the following addresses:

1. North-Atlantic Region
   (a) Andover Service Center
   P.O. Box 311
   Andover, MA 01810
   (b) Brookhaven Service Center
   P.O. Box 486
   Holtsville, NY 11742
2. Mid-Atlantic Region
   (a) Philadelphia Service Center
   P.O. Box 245
   Bensalem, PA 19020
3. Central Region
   (a) Cincinnatti Service Center
   P.O. Box 267
   Covington, KY 41012
4. Southeast Region
   (a) Atlanta Service Center
   P.O. Box 47-421
   Doraville, GA 30340
   (b) Memphis Service Center
   P.O. Box 30309
   Airport Mail Facility
   Memphis, TN 38130
5. Midwest Region
   (a) Kansas City Service Center
   P.O. Box 5321
   Kansas City, MO 64131
6. Southwest Region
   (a) Austin Service Center
   P.O. Box 934
   Austin, TX 78767
7. Western Region
   (a) Ogden Service Center
   P.O. Box 9948
   Ogden, UT 84409
   (b) Fresno Service Center
   P.O. Box 12866
   Fresno, CA 93779

SEC. 11. CONVENTIONS AND DEFINITIONS

.01 Conventions

1. Certain conventions may be required by the programming system or equipment used by the Reporting Agent, with respect to header and trailer labels, record and tape marks. Their use is optional, but if present they must adhere to the following:

(a) Header Label
  (1) Can only be the first record on a reel.
  (2) Must consist of a maximum of 80 characters.
  (3) First 4 characters must be 1HDR/VOL 1/HDR1/or HDR2

(b) Trailer Label
  (1) Can only be the last record of a reel.
  (2) Must consist of a maximum of 80 characters.
  (3) First 4 characters must be 1EOR (End of Reel) or 1EOF (End of File).

(c) Record Mark
  (1) Can only be at the end of a block or the end of a record.

(d) Tape Mark
  (1) If trailer labels are not used, the tape mark can only follow an End of Reel "F" Record or an End of File "E" Record.
  (2) If header and trailer labels are used, the tape mark must precede the header label and must follow the trailer label.

.02 Definitions

Element	*Description*
Reporting Agent	Person or organization preparing and filing magnetic tape equivalents of Federal tax returns. NOTE: This revenue procedure does not restrict a non-financial organization who performs a payroll or tax service from being a Reporting Agent. However, see Revenue Procedure 80-31, Employment Taxes, concerning the requirements under which Federal Tax Deposits can be made by the Reporting Agent.
Taxpayer	Persons or organization liable for the payment of tax. The taxpayer will be held responsible for the completeness, accuracy and timely submission of the magnetic tape files.
b	Denotes a bland position.
EIN	Employer Identification Number.
Record	A group of related fields of information, treated as a unit.
Blocked Records	Two or more records grouped together between interrecord gaps.
Blocking Factors	The number of records grouped together to form a block.
Unblocked Records	Single records written between interrecord gaps.
File	A file consists of all tape records submitted by a Reporting Agent.
Record Mark	Special character used either to limit the number of characters in data transfer or to separate blocked records on tape. For compatibility with the Service's equipment, use BCD bit configuration A82.
Tape Mark	Special character that is written on tape. For compatibility with the Service's equipment, use BCD bit configuration 8421.
Lozenge	Special character to indicate name line combination. For compatibility with the Service's equipment, use BCD bit configuration BA84.
Special Character	Any character that is not a numeral, letter, or blank.
Reel	A spool of magnetic tape.

SEC. 12. MAGNETIC TAPE SPECIFICATIONS

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. A compatible tape file must conform to all of the following:

Type of tape	½ inch Mylar base, oxide coated
Recording density	556, 800, 1600, or 6250 CPI (characters per inch)
Parity	Even or odd
Interrecord Gap	¾ inch
Recording Code	7 channel binary coded decimal (BCD), 9 channel, EBCDIC, ASCII

.02 An acceptable file will contain, for each Reporting Agent, the following:

1. An Agent "A" Record,
2. A series of Tax Data "B" Records,
3. A series of Checkpoint "C" Records,
4. An End of Location "D" Record, and
5. An End of File "E" Record. In addition, multiple reel files will have an End of Reel "F" Record.

.03 All records including headers and trailers, if used, must be written at the same density.

.04 Affix an external lable to each tape with the following information:

1. Name of Reporting Agent,
2. Number of tax returns transmitted on this reel of tape,
3. Payment period in YYMM (Year, Year, month, month) format, for example 8109,
4. Density (200, 556, 800, 1600, 6250),
5. Channel (7 or 9),
6. Parity (odd or even),
7. Name of computer manufacturer,
8. Tape Drive,
9. Main Frame, and
10. Sequence number of reel and total number of reels in file (for example, 1 of 3).

.05 Since the Service is not restricting Magnetic Tape Filing or Reporting Agents with specific types of equipment, or prescribing the methods used to prepare the tape files, the Agent "A" Record, End of Reel "F" Record and End of File "E" Record perform the functions normally assigned to header and trailer labels and related conventions. The Agent "A" Record serves the purpose of a header label, the End of Location "D" Record signals that no more Tax Data "B" Records are written on the file for a given location of the Reporting Agent, the End of Reel "F" Record signals that no more Tax Data "B" Records are written on the reel, and the End of File "E" Record indicates that there is no further data to be processed. In addition to the functions stated above, the End of Reel "F" Record and the End of Location "D" Record are used to balance each reel or each series of Tax Data "B" Records for a given location of the Reporting Agent on a reel.

.06 Record Length

1. The tape records prescribed in the specifications may be blocked or unblocked subject to the following:

(a) A block may not exceed 4,000 tape positions.

(b) If the use of blocked records would result in a short block at the end of a Tax Data "B" Record and the next record is too large to include in the block, the remaining positions of the block should be filled with 9's. No other digits or characters other than 9's are specified or acceptable for filling (or padding) any tape input data blocks.

(c) Two forms of blocking are acceptable:

(1) Only Tax Data "B" Records are blocked; all other records are unblocked.

(2) All records, except header and trailer labels, if used, are blocked. In this case, if employers from more than one location are reported on the same tape, the Agent "A" Record cannot be in the middle of a block, but must be the first record in a block.

.07 Agent "A" Record

1. Identifies the Reporting Agent who prepares and transmits the tape file. When multiple reels are required for a single file, the Agent "A" Record must be repeated at the first record (second record if header labels are used) on every succeeding reel in the file, and the reel number must be incremented by 1 for each tape reel after the first reel. A Reporting Agent may include Tax Data "B" Records prepared at more than one location, on the same tape, but they must have the same DO Code; however, Tax Data "B" Records prepared at different locations with different DO Codes must be on separate tapes and preceded by an Agent "A" Record. Contact the Magnetic Tape Coordinator for additional details if necessary.

AGENT "A" RECORD

Tape Position	*Element Name*	*Agent Data Record Entry or Definition*
1	Record Type	Enter "A" Must be first character of each Agent "A" Record.
2-3	DO Code	Enter two numeric digits District Office Code furnished by IRS.
4-5	Tax Period	Enter YQ (Year, Qtr.). For example: tax period "14" represents the year 1981 and the fourth quarter of the year.
6-7	Reel Number	Serial number assigned by the Reporting Agent to each reel, starting with 01. If header labels are used, this should be the same as Reel Sequence Number.
8-16	EIN-Reporting Agent	Enter the 9 numeric characters of the Reporting Agent's Employer Identification Number. DO NOT include the hyphen.
17-20	Blank	Reserved for use by the Service.
21-23	Record Length-Agent "A" Record	Enter number of positions (178) for Agent "A" Record. If a Record mark is used at the end of each record, include it in the count. DO NOT include in count if used only at the end of the block.
24-27	Record Length "B" Record	Enter number of positions (648) for "B" Record. If a record mark is used at the end of each record, include it in the count. DO NOT include in court if used only at the end of the block.
28-67	lst Name Line Reporting Agent	Enter first name line of Reporting Agent. Left justify and fill with blanks.
68-107	2nd Name Line Reporting Agent	Enter second name line of Reporting Agent. If the second name line is a combination of the first name line, enter a lozenge in tape position 67 and continue name, beginning with tape position 68. Left justify and fill with blanks. Fill with blanks if not required.
108-147	Street Address-Reporting Agent	Enter street address of Reporting Agent. Left justify and fill with blanks. Fill with blanks if street not required.
148-167	City-Reporting Agent	Enter city of Reporting AGent. Left justify and fill with blanks.
168-169	State-Reporting Agent	Enter the official Post Office two position State Code. See Section 13 for a list of the State Code abbreviations.
170-173	Blank	Reserved for use by the Service.
174-178	Zip Code Reporting Agent	Enter Zip Code of Reporting Agent.

.08 Tax Data "B" Record

1. Contains tax information for each filer reported by the Reporting Agent. The number of Tax Data "B" Records appearing on one tape reel will depend on the number of taxpayers represented (only one tax return for each EIN). A Checkpoint Totals "C" Record and then an End of Location "D" Record must follow the last Tax Data "B" Record for a location or DO Code change. In addition, the Tax Data "B" Records must be arranged in ascending order EIN sequence within DO Code.

2. Tax Data "B" Records may be blocked together with Record Types A, C, D, E, and F or the Tax Data "B" Records may be blocked alone with Record Types A, C, D, E, and F unblocked. Records should have a blocking factor for which blocks will not exceed 4,000 tape positions. All records must be fixed length and for the current tax period. All money amount fields must contain dollars and cents and all liability amounts must be fullpaid.

FORM 941 TAX DATA "B" RECORD

Tape Position	*Element Name*	*Entry or Definition*
1	Record Type	Enter "B". Must be the first character of each Form 941 Tax Data "B" Record.
2-36	Employer's Name First	Enter 1st name line of taxpayer. Left justify and fill with blanks. First five positions must be filled.
37-71	Employer's Name Second Line	Enter 2nd name line of taxpayer. Left justify and fill with blanks.
72-75	Name Control	Enter the 4 position alpha/numeric name control from the validated Agent's Listing. Blanks may be present in the low order position(s).
76-84	EIN-Employer	Enter the 9 numeric characters of the Employer Identification Number as given on the "Employer Entity Control Card." DO NOT enter a hyphen. Blanks are not acceptable.
85-119	Street Address-Employer	Enter the street address of the taxpayer. Left justify and fill with blanks.
120-139	City-Employer	Enter the city in which the taxpayer is located. Left justify and fill with blanks. First three positions must be filled.
140-145	State-Employer	Enter the official Post Office two position State Code. See Section 13. Last four positions are blanks.
146-150	Zip Code-Employer	Enter the 5 numeric characters of the Post Office Zip Code. If unknown, fill with blanks.
151	Address Change-Indicator	Enter ZERO if taxpayer's address has not changed since previous filing of Form 941 return; otherwise enter "1".
152	New Account Indicator	Enter ZERO if Reporting Agent has reported the taxpayer on magnetic tape in the prior quarter. Enter "1" if this is the first consecutive quarter the Reporting Agent is reporting the taxpayer on magnetic tape. (If the taxpayer has been reported on magnetic tape, is discontinued from tape filing for one or more quarters, and this is the first quarter the taxpayer is again being reported under the Magnetic Tape Filing System, enter "1" for a new account.)
153	Final Return Indicator	Enter ZERO if this is not taxpayer's final return. Enter "1" if this is the taxpayer's final return.
154	Discontinued Employer (Filer) Indicator	Enter ZERO if Reporting Agent will be reporting for the taxpayer in the subsequent quarter. Enter "1" if the taxpayer is being removed from the Magnetic Tape Filing System but is still liable for Form 941 returns.
155	Adjustment Indicator	Enter ZERO if no adjustments. Enter "1" if "Fractions Only." Enter "3" if "FICA Tip" only (Employee previously reached maximum limitation thru a combination of wages and tips). Enter "4" for "Side Pay" only. Enter "2" for all other adjustments including combinations of "1", "3" and "4". ALL ADJUSTMENTS OF "2" CATEGORY MUST BE SUPPORTED BY PAPER DOCUMENTATION.
156-162	Total Number of Employees in Pay Period including March 12. (Exclude household employees	Enter the total of all individuals in the payroll period of service for which wages are ordinarily paid. This field is applicable for the first quarter only. Zero fill the field for all other quarters. NOTE: The elements which follow are a tape facsimile of the printed Form 941, and are to be reported in accordance with the instructions thereon. Right justify all amounts entered and fill with zeros. All money amounts must be dollars and cents.
163-174	Total Wages and Tips, etc.	Line 2 of Form 941 (on 1984 format for example).
175-188	Amount of Income Tax Withheld	Line 3a of Form 941 (on 1984 format for example).

FORM 941 TAX DATA "B" RECORD—Continued

Tape Position	*Element Name*	*Entry or Definition*
189-198 ±	Adjustments for Preceding Quarters	If amount is negative, minus sign low order tape positions 198. Positive amounts may be unsigned or plus signed.
199-212 ±	Adjusted Total Income Tax Withheld	If amount is negative, minus sign low order tape positions 212. Positive amounts may be unsigned or plus signed.
213-226	Taxable FICA Wages Paid	Wages paid to employees—not taxes.
227-236	Taxable tips Reported	Tips reported by employees—not taxes.
237-246	Tips Deemed to be Wages	Amount reported by employer as difference between minimum wage and the actual amount paid. NOTE: This field applies to those employees who are subject to the Minimum Wage provisions of the Fair Labor Standard Act.
247-256	Total FICA Taxes	Line 8 of Form 941 (on 1984 format for example).
257-266 ±	Adjustment to FICA Tax	If amount is negative, minus sign low order tape position 266. Positive amounts may be unsigned or plus signed.
267-276 ±	Adjusted Total of FICA Taxes	If amount is negative, minus sign low order tape position 276. Positive amounts may be unsigned or plus signed.
277-291	Total Taxes	If amount is negative, minus sign low order tape position 289. Positive amounts may be unsigned or plus signed.
292-301	Earned Income Credit	Advance payment of EIC during the quarter. Must contain ZEROS if no amount paid.
302-316	Total Taxes Deposited	FTD's plus overpayment from prior quarter.
317-331	Balance Due	Must contain only ZEROS if even or overpaid.
332-345	Backup Withholding Amount	Amount withheld for Backup Withholding. (See Sec. 6.06 on Schedule A)
346-355	Adjustment to Backup Withholding	If amount is negative, minus sign low order tape position 355. Positive amounts may be unsigned or plus signed (See Sec. 6.06 on Schedule A)
356-366	Amount Remitted	Must contain ZEROS.
367-377	Excess	Taxes deposited and/or overpayments from prior quarters may result in a credit to the taxpayer. If so, enter the amount of the credit.
378	Credit Elect	Enter ZERO if credit is to be applied to next return; enter "1" if amount is to be refunded or if Excess (tape positions 337-347) is zero.
379-382	Number of FTD's Made	Enter the number of Federal Tax Deposits made during the tax period. Right justify and fill with ZEROS.
383-397	Amount of FTD's	Enter the total (dollars and cents) amount of the FTD's purchased.
398-407	Overpayment from Previous Quarter	Enter the amount overpaid for the previous quarter.
408-417	Tax Liability, 3rd Day (1st month)	Enter the tax liability for the period ending with the 3rd day of the 1st month.
418-427	Tax Liability, 7th Day (1st month)	Enter the tax liability for the period ending with the 7th day of the 1st month.
428-437	Tax Liability, 11th Day (1st month)	Enter the tax liability for the period ending with the 11th day of the 1st month.
438-447	Tax Liability, 15th Day (1st month)	Enter the tax liability for the period ending with the 15th day of the 1st month.
448-457	Tax Liability, 19th Day (1st month)	Enter the tax liability for the period ending with the 19th day of the 1st month.
458-467	Tax Liability, 22nd Day (1st month)	Enter the tax liability for the period ending with the 22nd day of the 1st month.

FORM 941 TAX DATA "B" RECORD—Continued

Tape Position	*Element Name*	*Entry or Definition*
468-477	Tax Liability, 25th Day (1st month)	Enter the tax liability for the period ending with the 25th day of the 1st month.
478-487	Tax Liability, Last Day (1st month)	Enter the tax liability for the period ending with the last day of the 1st month.
488-497	Tax Liability, 3rd Day (2nd month)	Enter the tax liability for the period ending with the 3rd day of the 2nd month.
498-507	Tax Liability, 7th Day (2nd month)	Enter the tax liability for the period ending with the 7th day of the 2nd month.
508-517	Tax Liability, 11th Day (2nd month)	Enter the tax liability for the period ending with the 11th day of the 2nd month.
518-527	Tax Liability, 15th Day (2nd month)	Enter the tax liability for the period ending with the 15th day of the 2nd month.
528-537	Tax Liability, 19th Day (2nd month)	Enter the tax liability for the period ending with the 19th day of the 2nd month.
538-547	Tax Liability, 22nd Day (2nd month)	Enter the tax liability for the period ending with the 22nd day of the 2nd month.
548-557	Tax Liability, 25th Day (2nd month)	Enter the tax liability for the period ending with the 25th day of the 2nd month.
558-567	Tax Liability, Last Day (2nd month)	Enter the tax liability for the period ending with the last day of the 2nd month.
568-577	Tax Liability, 3rd Day (3rd month)	Enter the tax liability for the period ending with the 3rd day of the 3rd month.
578-587	Tax Liability, 7th Day (3rd month)	Enter the tax liability for the period ending with the 7th day of the 3rd month.
588-597	Tax Liability, 11th Day (3rd month)	Enter the tax liability for the period ending with the 11th day of the 3rd month.
598-607	Tax Liability, 15th Day (3rd month)	Enter the tax liability for the period ending with the 15th day of the 3rd month.
608-617	Tax Liability, 19th Day (3rd month)	Enter the tax liability for the period ending with the 19th day of the 3rd month.
618-627	Tax Liability, 22nd Day (3rd month)	Enter the tax liability for the period ending with the 22nd day of the 3rd month.
628-637	Tax Liability, 25th Day (3rd month)	Enter the tax liability for the period ending with the 25th day of the 3rd month.
638-647	Tax Liability, Last Day (3rd month)	Enter the tax liability for the period ending with the last day of the 3rd month.
648	First Time 3-Banking Day Depositor *or* 95% Safe Haven Rule	Enter ZERO if taxpayer's first time 3-banking day depositor or is making deposits using the 95% Safe Haven. Otherwise, enter "1".

.09 Checkpoint Totals "C" Record

1. Write this record after each 100 or fewer Tax Data "B" Records. Additionally, write this record after the last Tax Data "B" for a DO Code or location of an Agent's "A" Record has been written. Each Checkpoint Totals "C" Record must contain a count of Tax Data "B" Records, the sum of Total Taxes, the Total Number of FTD's made and the sum of the Total Amounts of FTD's for all Tax Data "B" Records which have not been summarized in preceding Checkpoint Totals "C" Records.

2. The Checkpoint Totals "C" Record must be followed by a Tax Data "B" Record or an End of Location "D" Record. If the Checkpoint Totals "C" Record is at the end of the reel, it will be followed by an End of Reel "F" Record.

3. All Checkpoint Totals "C" Records must be fixed length. All money amount fields will contain dollars and cents. The Checkpoint Totals "C" Records cannot be followed by a Tape Mark.

CHECKPOINT TOTALS "C" RECORD

Tape Position	*Element Name*	*Entry or Definition*
1	Record Type	Enter "C". Must be first character of the Checkpoint Totals "C" Record.
2-6	Number of Tax Data "B" Records	Enter number of Tax Data "B" Records processed since last Checkpoint Totals "C" Record or Agent "A" Record has been written. Right justify and ZERO fill if less than five positions are required.
7-22	Total Taxes	Enter the sum of Total Taxes in dollars and cents from Tax Data "B" Records in the preceding 100 or fewer records (tape positions 277-291). Right justify and ZERO fill.
23-29	Number of FTD's Made	Enter total number of Federal Tax Deposits made during the tax period for Tax Data "B" Records in the preceding 100 or fewer records (tape positions 379-382). Right justify and ZERO fill.
30-45	Total Amount of FTD's	Enter the sum of the Total Amount of FTD's in dollars and cents for Tax Data "B" Records in the preceding 100 or fewer records (tape positions 383-397). Right justify and ZERO fill.

.10 End of Location "D" Record

1. Write this record after the last Checkpoint Totals "C" Record has been written for a DO Code or a Reporting Agent's location contained in the Agent's "A" Record. Each End of Location "D" Record must contain a count of Tax Data "B" Records, the sum of Total Taxes, the Total Number of FTD's made and the sum of the Total Amount of FTD's for all Tax Data "B" Records for the preceding Agent "A" Record.

2. The End of Location "D" Record must be followed by an Agent "A" Record or an End of Reel "F" Record. If the End of Location "D" Record is at the end of the reel, it will be followed by an End of Reel "F" Record.

3. All End of Location "D" Records must be fixed length. All money amounts will contain dollars and cents. The End of Location "D" Record cannot be followed by a Tape Mark.

END OF LOCATION "D" RECORD

Tape Position	*Element Name*	*Entry or Definition*
1	Record Type	Enter "D". Must be the first character of the End of Location "D" Record.
2-6	Number of Tax Data "B" Records	Enter number of Tax Data "B" Records processed since the last Agent "A" Record has been written. Right justify and ZERO fill if less than five positions are required.
7-22	Total Taxes	Enter the sum of Total Taxes in dollars and cents from all preceding Tax Data "B" Records from the last Agent "A" Record (tape positions 277-291). Right justify and ZERO fill.
23-29	Number of FTD's Made	Enter total number of Federal Tax Deposits made during the tax period from all preceding Tax Data "B" Records from the last Agent "A" Record (tape positions 379-382). Right justify and ZERO fill.
30-45	Total Amount of FTD's	Enter the sum of the Total Amount of FTD's in dollars and cents from preceding Tax Data "B" Records from the last Agent "A" Record (tape positions 383-397 Right justify and ZERO fill.

.11 End of "E" Record

1. Write this record after the last End of Location "D" Record in the file. All money amounts will contain dollars and cents. All End of File "E" Records must be fixed length. This record can be followed only by a Tape Mark or Tape Mark and Trailer Label.

END OF FILE "E" RECORD

Tape Position	*Element Name*	*Entry or Definition*
1	Record Type	Enter "E". Must be the first character of the End of File "E" Record.
2-6	Number of Tax Data "B" Records	Enter number of Tax Data "B" Records (including the Reporting Agent) which are reported on the tape file. Only one Tax Data "B" Record is permissible for each taxpayer. Right justify and ZERO fill if less than five positions are required.
7-22	Total Taxes	Enter the sum of Total Taxes in dollars and cents for all Tax Data "B" Records reported on the tape file (tape positions 277-291). This should balance to Total Taxes accumulated in Checkpoint Totals "C" Records (tape positions 7-22). Right justify and ZERO fill.
23-29	Number of FTD's Made	Enter total number of Federal Tax Deposits made during the tax period for all Tax Data "B" Records reported on the tape file (tape positions 379-382). This should balance to number of FTD's accumulated in Checkpoint Totals "C" Records (tape positions 23-29). Right justify and ZERO fill.
30-45	Total Amount of FTD's	Enter the sum of the Total Amount of FTD's in dollars and cents from all Tax Data "B" Record on the tape file (tape positions 383-397). This should balance to Total Amount of FTD's accumulated in Checkpoint Totals "C" Records (tape positions 30-45). Right justify and ZERO fill.

.12 End of Reel "F" Record

1. Write this record when the end of the normal writing area of each reel has been reached, but all records in the file have not been written. This record indicates that there are additional reels in the file. Each End of Reel "F" Record must contain a count of Tax Data "B" Records, the sum of Total Taxes, the Total Number of FTD's made and the sum of the Total Amount of FTD's for all Checkpoint Totals "C" Records not summarized in previous End of Location "D" Records.
2. The End of Reel "F" Record cannot be followed by an Agent "A" Record, Tax Data "B" Record, Checkpoint Totals "C" Record. End of Location "D" Record or End of File "E" Record. A Tape Mark or Tape Mark and Trailer Label only can follow this record.
3. DO NOT use this record on the Final Reel of the file being transmitted.

END OF REEL "F" RECORD

Tape Position	*Element Name*	*Entry or Definition*
1	Record Type	Enter "F". Must be the first character of the End of Reel "F" Record.
2-6	Number of Tax Data "B" Records	Enter total number of Tax Data "B" Records contained on this tape reel that have not been summarized in previous End of Location "D" Records. This total will include "B" Records that are summarized in previous Checkpoint Totals "C" Records subsequent to the previous End of Location "D" Record. Right justify and ZERO fill.
7-22	Total Taxes	Enter the sum of Total Taxes in dollars and cents from all preceding Tax Data "B" Records from the last Agent "A" Record (tape positions 277-291). Right justify and ZERO fill.
23-29	Number of FTD's Made	Enter the total number of Federal Tax Deposits made during the tax period from all preceding Tax Data "B" Records from the last Agent "A" Record (tape positions 379-382). Right justify and ZERO fill.
30-45	Total Amount of FTD's	Enter the sum of Total Amount of FTD's in dollars and cents from preceding Tax Data "B" Records from the last Agent "A" Record (tape positions 383-397). Right justify and ZERO fill.

SEC. 13. POST OFFICE STATES CODES

Enter the official two position Post Office State Code abbreviations for States and Territories in the Agent "A" Records and Tax Data "B" Records according to the following:

STATE	CODE
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Kentucky	KY
Louisiana	LA
Maine	ME
Maryland	MD
Massachusetts	MA
Michigan	MI
Minnesota	MN
Mississippi	MS
Missouri	MO
Montana	MT
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH
Oklahoma	OK
Oregon	OR
Pennsylvania	PA
Rhode Island	RI
South Carolina	SC
South Dakota	SD
Tennessee	TN
Texas	TX
Utah	UT
Vermont	VT
Virginia	VA
Washington	WA
West Virginia	WV
Wisconsin	WI
Wyoming	WY
Puerto Rico	PR
Virgin Islands	VI
Guam	GU

SEC. 14. TAPE LAYOUT

The following chart shows by tape of file the sequence of the Record according to the complexity of the tape file(s).

Type of File	1st Record Type	2nd Record Type	3rd from last Record Type	2nd from last Record Type	Next to last Record Type	Last Record Type
One DO Code, one Checkpoint Total "C" Record, single reel	A	B	B	C	D	E
One DO Code, two or more Checkpoint Totals "C" Records, single reel:						
First "C" Record	A	B	B	B	B	C
Second "C" Record	B	B	B	B	B	C
Last "C" Record	B	B	B	C	D [1]	E
One DO Code, multiple reels:						
First reel	A	B	B	B	C [2]	F [3]
Last reel	A [4]	B	B	C	D	E

D1 The End of Location "D" Record must include the totals of all Checkpoint Totals "C" Records that precede it up to the previous Agent "A" Record.
C2 A Checkpoint Totals "C" Record must be written at the end of a reel before the End of Reel "F" Record is written.
F3 The End of Reel "F" Record can only be a Tape Mark or a Tape Mark and Trailer Label.
A4 An Agent "A" Record must be written as the first record of each subsequent reel to the first reel.

SEC. 15. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes Rev. Proc. 81-53 and Rev. Proc. 82-68.

SEC. 16. EFFECTIVE DATE

This Revenue Procedure is effective April 1, 1984.

Exhibit 1

Form **4995**
(Rev. January 1979)
Department of the Treasury
Internal Revenue Service

Application for Magnetic Tape Filing of Form 941, Employer's Quarterly Federal Tax Return

Please complete this form, attach requested items, and mail to:

Internal Revenue Service Center

Name and Address (*Street, City, State, and ZIP Code*) of your organization

Your employer identification number

First quarter for which you plan to file Forms 941 on magnetic tape *(Check appropriate box and enter year)*

☐ 1 ☐ 2 ☐ 3 ☐ 4 19 _____

Name of person IRS may contact regarding this request

Title

Area code and telephone number

Estimated volume of documents you plan to file

	On tape	On paper
Form 941		

Type of equipment on which you will prepare tapes

Main Frame		Tape Drive	
Manufacturer	Model	Manufacturer	Model
Tape			**Number of Tracks**
Width	Density	Recording Code	☐ 7 ☐ 9

Internal Revenue Office where you filed Forms 941 last quarter

I ☐ do ☐ do not request blank Federal tax deposit forms, with keypunch instructions. Please send me a total of _____ forms. (*I understand the Internal Revenue Service will not mail the FTD forms to me until my tape file has been satisfactorily processed.*)

I have included with this application the following:

1. A list of my employer clients (*arranged in employer identification number sequence*) showing a. Name,
   b. Complete address,
   c. ZIP Code,
   d. Employer identification number.
2. A copy of the power of attorney for each of the Form 941 employers, arranged in employer identification number sequence.

As the tax return filing agent for these employers, I agree to keep copies of their required powers of attorney on file for examination by the Internal Revenue Service on request. I will retain these copies until the statute of limitations for their tax returns expires.

Signature and title of filing agent responsible for preparation of tax returns	Date

Form **4995** (Rev. 1-79)

Exhibit 2

AGENT'S LISTING

_____(1)

_____

_____

Employer Identification Number	Name Control (2)	T/P Name & Address	District Office Code (2)	Tax Class (2)	Bank ID #

(1) Enter Reporting Agent's complete name and address.
(2) Information will be supplied by Internal Revenue Service.

Form **2848**
(Rev. October 1983)
Department of the Treasury
Internal Revenue Service

Exhibit 3
Power of Attorney and Declaration of Representative

▶ See separate Instructions

OMB No. 1545-0150

PART I.— Power of Attorney

Taxpayer(s) name, identifying number, and address including ZIP code (Please type or print)

Enter the Client's name and address

hereby appoints (name(s), CAF number(s), address(es), including ZIP code(s), and telephone number(s) of individual(s)) *

Enter the Reporting Agent's name and address

For IRS Use Only		
File So.		
Level		
Receipt		
Powers		
Blind T.		
Action		
Ret.Ind.		

as attorney(s)-in-fact to represent the taxpayer(s) before any office of the Internal Revenue Service for the following tax matter(s) (specify the type(s) of tax and year(s) or period(s) (date of death if estate tax)):

Type of tax (Individual, corporate, etc.)	Federal tax form number (1040, 1120, etc.)	Year(s) or period(s) (Date of death if estate tax)
Employer's Quarterly Federal Tax Return filed on Magnetic Tape	941	

The attorney(s)-in-fact (or either of them) are authorized, subject to revocation, to receive confidential information and to perform any and all acts that the principal(s) can perform with respect to the above specified tax matters (excluding the power to receive refund checks, and the power to sign the return (see regulations section 1.6012-1(a)(5), Returns made by agents), unless specifically granted below).

Send copies of notices and other written communications addressed to the taxpayer(s) in proceedings involving the above tax matters to:

1 ☐ the appointee first named above, or

2 ☐ (names of not more than two of the above named appointees) .....

.....

Initial here ▶ ..... if you are granting the power to receive, but not to endorse or cash, refund checks for the above tax matters to :

3 ☐ the appointee first named above, or

4 ☐ (name of one of the above designated appointees) ▶ ....

This power of attorney revokes all earlier powers of attorney and tax information authorizations on file with the Internal Revenue Service for the same tax matters and years or periods covered by this power of attorney, except the following:

.....

..... (Specify to whom granted, date, and address including ZIP code, or refer to attached copies of earlier powers and authorizations.)

Signature of or for taxpayer(s)

(If signed by a corporate officer, partner, or fiduciary on behalf of the taxpayer, I certify that I have the authority to execute this power of attorney on behalf of the taxpayer.)

..... (Signature) ..... (Title, if applicable) ..... (Date)

(Also type or print your name below if signing for a taxpayer who is not an individual.)

..... (Signature) ..... (Title, if applicable) ..... (Date)

* You may authorize an organization, firm, or partnership to receive confidential information, but your representative must be an individual who must complete Part II.

For Privacy Act and Paperwork Reduction Act Notice, see page 1 of the Instructions. Form **2848** (Rev. 10-83)

If the power of attorney is granted to a person other than an attorney, certified public accountant, enrolled agent, or enrolled actuary, the taxpayer(s) signature must be witnessed or notarized below. (The representative must complete Part II. Only representatives listed there are recognized to practice before the Internal Revenue Service.)

The person(s) signing as or for the taxpayer(s): (Check and complete one.)

☐ is/are known to and signed in the presence of the two disinterested witnesses whose signatures appear here:

_____ _____
(Signature of Witness) (Date)

_____ _____
(Signature of Witness) (Date)

☐ appeared this day before a notary public and acknowledged this power of attorney as a voluntary act and deed.

Witness: _____ _____ NOTARIAL SEAL
(Signature of Notary) (Date) (if required by State law)

PART II.—Declaration of Representative

I declare that I am not currently under suspension or disbarment from practice before the Internal Revenue Service, that I am aware of Treasury Department Circular No. 230 as amended (31 C.F.R. Part 10), Regulations governing the practice of attorneys, certified public accountants, enrolled agents, enrolled actuaries, and others, and that I am one of the following:

1 a member in good standing of the bar of the highest court of the jurisdiction indicated below;
2 duly qualified to practice as a certified public accountant in the jurisdiction indicated below;
3 enrolled as an agent prusuant to the requirements of Treasury Department Circular No. 230;
4 a bona fide officer of the taxpayer organization;
5 a full-time employee of the taxpayer;
6 a member of the taxpayer's immediate family (spouse, parent, child, brother or sister);
7 a fiduciary for the taxpayer;
8 an enrolled actuary (the authority of an enrolled actuary to practice before the Service is limited by section 10.3(d)(1) of Treasury Department Circular No. 230);
9 Commissioner's special authorization (see instructions for Part II, item 9) an agent pursuant to the requirements Rev. Proc. 84-11;

and that I am authorized to represent the taxpayer identified in Part I for the tax matters there specified.

Designation (insert appropriate number from above list)	Jurisdiction (State, etc.) or Enrollment Card Number	Signature	Date

Exhibit 4

Form **4996**
(Rev. January 1979)
Department of the Treasury
Internal Revenue Service

Magnetic Tape Filing Transmittal for Form 941, Employer's Quarterly Federal Tax Return

Please complete 2 copies of this form for each tape file and enclose with the first box of files in the shipment.

Reporting Agent's Name and Address *(Street, City, State, and ZIP Code)*	Date Quarter Ended on Form 941 Returns
	Employer Identification Number

1. Number of Form 941 returns filed on the accompanying tape . . . . . _____

2. Total wages and tips subject to withholding, plus other compensation (*add the amount for this item on all 941's and enter total here*) . . . . . _____

3. Taxable FICA wages paid (*add the amount for this item on all 941's and enter total here*) . . . . . _____

4. Taxable tips reported (*add the amount for this on all 941's and enter total here*) . . . . . _____

5. Total taxes (*add the amount for this item on all 941's and enter total here*) . . . . . _____

6. Total taxes deposited (*add the amount for this item on all 941's and enter total here*) . . . . . _____

Power of attorney to file the Employer's Quarterly Federal Tax Returns, Form 941, on the accompanying magnetic tape have been filed with _____ Internal Revenue Service Center.

Total Forms 941 filed on paper this quarter in separate shipment ▶ _____

Total Forms 941c included in this shipment ▶ _____

Note: The IRS tape program involves only the tax data part of Form 941. You should contact the Social Security Administration about the reporting of Form W-2 (Copy A) and Form W-3 wage data direct to them on tape.

Under penalties of perjury, I declare that the tax returns and accompanying schedules and statements on the enclosed magnetic tape are, to the best of my knowledge and belief, true, correct, and complete.

Signature of agent or authorized employee responsible for preparation of tax returns

Title	Date

Form **4996** (Rev. 1-79)

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-12

SECTION 1. BACKGROUND

Rev. Proc. 83-22, 1983-1 C.B. 680, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 4 of Rev. Proc. 83-22 is entitled "Areas In Which Rulings Or Determination Letters Will Not Ordinarily Be Issued."

SEC. 2. PURPOSE

Rev. Proc. 83-22 is hereby amended by adding to section 4 the following new sections:

Section 864.—Definitions—Whether a taxpayer is engaged in trade or business within the United States.

Section 894.—Income Affected by Treaty.—Whether a taxpayer has a permanent establishment in the United States for the purpose of any United States Income Tax Treaty.

Section 901.—Taxes of Foreign Countries and of Possessions of United States.—Whether a person claiming credit has established, based on all of the relevant facts and circumstances, the amount, if any, paid by the dual capacity taxpayer pursuant to the qualifying levy, that is not paid in exchange for a specific economic benefit. Section 1.901-2A(c)(2) of the regulations.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on February 27, 1984, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22 is amplified.

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26 CFR 601.201 Rulings and determination letters.
(Also Part I, Section 103; 1.103-1.)

Rev. Proc. 84-13

SECTION 1. BACKGROUND

Rev. Proc. 83-22, 1983-1 C.B. 680 sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 4 of Rev. Proc. 83-22 is entitled Areas in Which Rulings or Determination Letters Will Not Ordinarily Be Issued.

SEC. 2. PROCEDURE

Rev. Proc. 83-22 is amplified to include the following under section 4:

Section 103.—Interest on Certain Governmental Obligations: Whether an issue of industrial development bonds is exempt under section 103(b) of the Code when 10 percent or more of the proceeds of the issue (minus "neutral costs" as described in Rev. Rul. 80-171, 1980-2 C.B. 44) are used to finance a facility in which an owner (or a related person) or a lessee (or a related person), who was a user of the facility at any time before the bonds were issued, will be a user of the facility after the bonds are issued.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on February 27, 1984, the date of publication of this Revenue Procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22 is amplified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-14

SECTION 1. BACKGROUND

Section 6 of Rev. Proc. 83-22, 1983-1 C.B. 680, provides a list of those areas of the Internal Revenue Code, under the jurisdiction of the Associate Chief Counsel (Technical), in which the Service is prohibited by statute from issuing rulings or determination letters. Section 3.01 of Rev. Proc. 83-22 provides a list of specific areas in which rulings or determination letters will not be issued.

SEC. 2. PROCEDURE

.01 Rev. Proc. 83-22 is amended by deleting from section 6 the following subsection:

".01 Section 61.—Gross Income Defined.—Employee fringe benefits. Pub. L. 97-34, 1981-2 C.B. 256."

.02 Rev. Proc. 83-22 is further amended by adding to section 3.01 the following new paragraph:

"Section 61.—Gross Income Defined.—Before January 1, 1985, a matter involving the federal income tax treatment of nonstatutory employee fringe benefits."

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective January 1, 1984.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22 is modified and amplified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-15

SECTION 1. BACKGROUND

Rev. Proc. 83-22, 1983-1 C.B. 680, contains a list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which rulings or determination letters will not be issued.

SEC. 2. PROCEDURE

Section 3 of Rev. Proc. 83-22 is amplified by adding a subsection as follows:

Section 801.—Definition of a Life Insurance Company.—Whether a life insurance policy issued during 1984 will meet the definition of life insurance until Congress acts upon legislation concerning the taxation of life insurance companies.

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective January 1, 1984.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22 is amplified.

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26 CFR 145.4-2: Application of the floor stocks tax on tires.

Rev. Proc. 84-16

SECTION 1. PURPOSE

The purpose of this revenue procedure is to establish an alternative method of computing the amount of the floor stocks tax on tires.

SEC. 2. BACKGROUND

Section 521(b) of the Surface Transportation Assistance Act of 1982, Pub. L. 97-424, 1983-1 C.B. 405, 413, imposes a floor stocks tax on certain tires held in a dealer's inventory for sale on January 1, 1984. Section 145.4-2(b) of the regulations thereunder provides that the floor stocks tax is computed by applying the total weight of the tire to rates specified in the regulation.

Many retail tire dealers have encountered difficulty in determining the weight of the tires in their inventory to which the tax applies.

SEC. 3. PROCEDURE

In lieu of weighing the tires, dealers may compute the floor stocks tax as the excess of the amount of tax that would have been imposed if a tire had been sold by the manufacturer after December 31, 1983, over the amount of tax that was imposed on the tire. For this purpose the tax imposed on any type and size tire may be determined using the dealer's purchase invoice for that tire, if the tax is separately stated, or the amount of tax listed for that type and size tire in the manufacturer's or distributor's price list effective for December 1983. The tax that would be imposed on the sale by the manufacturer after December 31, 1983, may be determined using the tax listed for that type and size tire in the manufacturer's or distributor's price list in effect for January 1, 1984. For tube type tires, the amount of tax listed on the invoice or price list for December 31, 1983, must be reduced by any tax attributable to the inner tube which is included in the tax listed for the tire.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective January 1, 1984.

26 CFR 601.105: Examination of returns & claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Sections 584, 2031, 2032, 2512; I.584-1, 20.2031-2, 20.2032-1, 25.2512-1.)

Rev. Proc. 84-17

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to provide guidelines for the determination of the fair market values of participating interests in common trust funds for purposes of section 2031, 2032, and 2512 of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND

.01 Section 584(a) of the Code defines a common trust fund as a fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed to the fund by the bank in its capacity as a trustee, executor, administrator, or guardian, or custodian of accounts and which is maintained in conformity with rules and regulations of the Board of Trustees of the Federal Reserve System or the Comptroller of the Currency. Section 584(b) provides that a common trust fund is exempt from normal taxes and surtaxes and is not considered a corporation. Section 584(c) provides that income, gains and losses of a common trust fund are passed through to each participant in the fund.

.02 Section 2031 of the Code provides that the value of the gross estate is the value of the included property as of the date of decedent's death. Section 2032 provides for an alternate valuation date six months from the date of death with the added provision that property disposed of during the six month interval be valued as of the date of disposition. Section 2512 provides that the value of property transferred by gift is the value of such property on the date of the gift.

SEC. 3. SCOPE AND OBJECTIVE

For estate and gift tax purposes, the property to be valued is the participating interest in the common trust fund. To value the participating interest it is first necessary to value the common trust fund in which the participating interest own a proportionate share. Comptroller of the Currency Regulations section 9.18, 12 C.F.R. Section 9.18 (1982), requires that national banks administering common trust funds must value the assets of the fund at least quarterly and that additions and withdrawals be accomplished only on valuation dates.

SEC. 4. APPLICATION

The valuation date for estate and gift tax purposes often does not coincide with the scheduled bank valuation date. In such instances it is necessary to find a method of valuing participating interests in common trust funds for dates falling between two scheduled bank valuation dates, and the following computations should be employed.

.01 Fair market value is determined using the same weighted average method as is used for valuing stocks and bonds provided in section 20.2031-2 of the Estate Tax Regulations.

.02 The interpolation is accomplished by weighting the values on the scheduled bank valuation dates in inverse proportion to the number of days between those valuation dates and the valuation date for estate and gift tax purposes. Thus, if the scheduled bank valuation dates fell A days before and B days after the valuation date for estate and gift tax purposes and the values were $X and $Y respectively, fair market value would be:

$$\frac{AY + BX}{A + B}$$

.03 This application may be illustrated by the following example:

Assume the scheduled bank valuation date occurred 25 days before the valuation date for estate and gift tax purposes and resulted in a value determination of at $100 per unit. The next scheduled bank valuation date occurred 66 days after the valuation date for estate and gift tax purposes at $105 per unit. The fair market value on the valuation date for estate and gift tax purposes is:

$$\frac{25(105) + 66(100)}{91} = \$101.37$$

SEC. 5. EFFECTIVE DATE

This Revenue Procedure is effective March 5, 1984, the date of publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Ruling and determination letters.

Rev. Proc. 84-18

SECTION 1. BACKGROUND

Rev. Proc. 83-22, 1983-1 C.B. 680, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 83-22 is entitled, Areas Under Extensive Study in which Rulings or Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulation or Otherwise. Rev. Proc. 83-68, 1983-2 C.B. 586, amended Rev. Proc. 83-22 by adding to section 5 the following area:

Section 38, 46, and 48- Investment Tax Credit- Application of these sections where any use of vessels is transferred to an agency or department of the United States government under agreement designated as a time charter or service agreement.

SEC. 2. PROCEDURE

Rev. Proc. 83-22 is hereby modified by deleting the paragraph added to section 5 by Rev. Proc. 83-68.

SEC. 3. EFFECTIVE DATE

The revision set forth in this revenue procedure is effective as of March 5, 1984, the date of publication in the Internal Revenue Bulletin.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22 is modified and Rev. Proc. 83-68 is superseded.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, Section 6661.)

Rev. Proc. 84-19

SECTION 1. PURPOSE

The purpose of this revenue procedure is to identify, for returns filed in 1984, circumstances under which the disclosure on a taxpayer's return of an item or a position taken, with no specific reference to section 6661 of the Internal Revenue Code, is adequate disclosure for the purpose of reducing the understatement under section 6661.

SEC. 2. BACKGROUND

.01 Section 6661 of the Code imposes an addition to the tax for a substantial understatement. A substantial understatement is defined as an understatement of liability for income tax which exceeds the greater of 10 percent of the amount required to be shown on the return or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). An understatement is defined as the excess of the amount required to be shown on the return over the amount reported thereon.

.02 In the case of an item not attributable to a tax shelter, the amount of the understatement is reduced if the taxpayer discloses in the return or an attachment thereto the identity and amount of the item as well as the specific facts or the position taken relevant to the tax treatment of the item. Disclosure on a return of items attributable to a tax shelter will not reduce an understatement.

.03 In general, rules providing guidance on the adequacy of disclosure for purposes of reducing an understatement under section 6661 of the Code will be set forth in regulations. The Commissioner has determined that in certain circumstances described in section 3 of this revenue procedure, disclosure of an item on the return with no further statement is adequate disclosure for purposes of section 6661, provided the taxpayer furnishes all required information in accordance with the applicable forms and instructions. This revenue procedure provides guidelines as to when such disclosure is adequate.

SEC. 3. PROCEDURE

Additional disclosure of facts relevant to, or positions with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of tax under section 6661 of the Code provided, however, the forms and attachments are completed in a clear manner and in accordance with the instructions thereto, and the information on the return is disclosed in the manner described below.

(1) Schedule A, Form 1040, Itemized Deductions:

(a) Medical Expenses: Complete lines 1-7 supplying all required information. Line 4c must be itemized listing each item and its cost.

(b) Taxes: Complete lines 8-12 supplying all required information. Line 11 must list each type of tax and amount paid.

(c) Interest Expense: Complete lines 13-16 supplying all required information. Line 15 must list each payee and amount paid to same.

(d) Contributions: Complete lines 17-20 supplying all required information. If a contribution of property other than cash is made, the statement required by section 1.170A-1(a)(2)(ii) of the Income Tax Regulations must be attached to return.

(e) Casualty and Theft Losses: Form 4684, Casualties and Thefts, must be completed and attached to return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Trade or Business Expenses:

(a) Casualty and Theft Losses: The procedure outlined in Sec. 3(1)(e) above, must be followed.

(b) Legal Fees: The name of each payee and the amount paid to same must be listed.

(c) Specific Bad Debt Charge-off: The name of each debtor and the amount written off must be listed.

(d) Reserve for Bad Debts: Schedule F, Form 1120 or Form 1120S, must be completed, supplying all required information.

(e) Reasonableness of Officers' Compensation: Schedule E, Form

1120 or Form 1120S, must be completed. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed".

(f) Repair as Opposed to Capital Expenditure: The amount of repairs stated.

(g) Taxes (other than foreign taxes): The amount of taxes stated.

(3) Other:

(a) Sale or Exchange of Principal Residence: Complete Form 2119, Sale or Exchange of Principal Residence, and attach to the return.

(b) Employee Business Expenses: Form 2106, Employee Business Expenses, must be attached to return supplying all required information.

(c) Moving Expenses: Form 3903, Moving Expenses Adjustment, must be attached to return supplying all required information.

SEC 4. EFFECTIVE DATE

This revenue procedure is effective for returns filed in 1984, the due date (regardless of extensions) for filing of which is after December 31, 1983.

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26 CFR 601.702: Publication and public inspection. (Also Part I, Section 6103.)

Rev. Proc. 84-20

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to provide instructions to Federal and State agencies requesting the following data from the Internal Revenue Service:

a) Taxpayer Addresses

b) Tax Delinquent Account Status Indicator (Federal agencies only)

.02 The instructions in this Revenue Procedure relate to large volume requests. Information on procedures regarding non-volume requests can be obtained by contacting the local Internal Revenue District Office.

.03 The Internal Revenue Service is authorized to provide taxpayer addresses under certain provisions of the Internal Revenue Code. Among these provisions are:

a) Section 6103(m)(2) which reads as follows:

"(2) FEDERAL CLAIMS—

(A) IN GENERAL—Except as provided for in subparagraph (B), the Secretary may, upon written request, disclose the mailing address of a taxpayer for use by officers, employees, or agents of a Federal agency for purposes of locating such taxpayer to collect or compromise a Federal claim against the taxpayer in accordance with sections 3711, 3717, and 3718 of Title 31.

(B) SPECIAL RULE FOR CONSUMER REPORTING AGENCY—In the case of an agent of a Federal agency which is a consumer reporting agency (within the meaning of section 603(f) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f))), the mailing address of a taxpayer may be disclosed to such agent under subparagraph (A) only for the purpose of allowing such agent to prepare a commercial credit report on the taxpayer for use by such Federal agency in accordance with sections 3711, 3717, and 3718 of Title 31."

b) Section 6103(d) relating to the disclosure to any State agency, body, or commission, or its legal representative, which is charged under the laws of such State with responsibility for the administration of State tax laws.

.04 The Internal Revenue Service is authorized to provide a Tax Delinquent Account Status Indicator to Federal agencies under Section 6103(l)(3) of the Internal Revenue Code. This Section authorizes the Secretary of Treasury to disclose to a Federal agency administering any included Federal loan program, whether an applicant for a loan under such program has a tax delinquent account (TDA).

a) For purposes of the above paragraph, the term "included Federal loan program" means any program under which the United States or a Federal agency makes, guarantees, or insures loans, and with respect to which there is in effect a determination by the Director of the Office of Management and Budget (which has been published in the Federal Register) that the application of the above paragraph to such program will substantially prevent or reduce future delinquencies under such program. A listing of included Federal loan programs was published in the Federal Register dated December 27, 1982, 47 F.R. 57595.

.05 Recipients of information under section 6103(l)(3) and (d) of the Code are subject to the safeguard requirements of section 6103(p)(4). Agencies which receive information under section 6103(m)(2) of the Code are subject to the safeguard requirements of section 6103(p)(4) if they redisclose the information to an agent. The agent also will be subject to the safeguard requirements.

SEC. 2. BACKGROUND

.01 The information provided will be extracted monthly from the Internal Revenue Service Individual Master File (IMF) and Business Master File (BMF) located at the Internal Revenue Service National Computer Center (NCC) in Martinsburg, West Virginia. The IMF contains tax accounts of individuals. The BMF contains tax accounts of business entities (i.e. corporations, subchapter S corporations, partnerships, exempt organizations and estates).

.02 IMF Address Requests may be made on magnetic tape or computer punch cards.

.03 Tax Delinquent Account Status Indicator Requests and BMF Address Requests must be made on magnetic tape.

.04 The Taxpayer Identification Number (TIN) provides an indication whether the taxpayer's account would be found on the IMF or BMF. Accounts are established on the IMF under Social Security Numbers (SSN, format xxx-xx-xxxx). Accounts are established on the BMF under Employer Identification Numbers (EIN, format xx-xxxxxxx), except for estates, which appear on the BMF with an SSN.

.05 Data will be extracted from the IMF and BMF based on the existence of a match between the master file

and the data record submitted by the requester. *Both* the Taxpayer Identification Number (TIN) and name control on the data record request must match with a record on the Master File before any data is extracted. Without a match, the Service will not be able to provide the requested data. See Section 13 for instructions for determining Name Control.

.06 If unsure as to whether an account would appear on the IMF or BMF it may be expedient to request information from both the IMF and the BMF.

.07 Accounts for married individuals are sometimes established on the IMF using the SSN of one of the individuals as the control or primary SSN. Submissions for IMF extracts will first be run against the IRS Spouse-Primary SSN Record File to determine the primary SSN. Although the primary SSN identified will be used in the IMF extract process, the SSN shown on the output tape will be that provided by the requesting agency.

SEC. 3. APPLICATION FOR INCLUSION IN PROGRAM

.01 Federal agencies wishing to receive data under Sections 6103(m)(2) or (1)(3) for debt collection purposes should submit their application to:

Internal Revenue Service
1111 Constitution Ave., N.W.
Room 7012, D:R:R:IM
Washington, D.C. 20224
Attn: Debt Collection Requests

The application should indicate whether the agency wishes to enter into an agreement to receive address data, TDA data or both. The application should also indicate whether data will be requested from the IMF, BMF (or both) and whether the request submissions will be made via magnetic tape or punch cards.

.02 Federal or State agencies wishing to receive data under sections other than 6103(m)(2) or (1)(3) should submit their application to:

Internal Revenue Service
1111 Constitution Ave. N.W.
Washington, D.C. 20224
Attn: Director, Disclosure and Security
Division PM:S:DS

.03 Upon receipt and approval of an application from an agency, the Service will prepare Form 5181, Agreement Covering Reimbursable Services (see Exhibit A). The requesting agency will be provided an original and copy of the prepared agreement.

.04 The requesting agency will complete boxes 5a, b, and c and 9a, b, and c of the Form 5181. The person indicated in box 5a will be the person coordinating requests and receipt of data from the Service. The signature in box 9a must be that of the agency head or other delegated official authorized to request data under the Act.

.05 The original of the signed agreement should be returned to the Service at the address indicated in .01 above.

.06 The Service will receive the signed agreement from agencies. After signature of the Service's approving official is obtained, a copy of the agreement will be returned to the requesting agency. Upon receipt of the signed agreement, the agency may begin making submissions for the type of data specified in the agreement.

.07 Each approved agreement returned to a requesting agency will provide an "Agency Code(s)" to be used in all data requests. Distinct agency codes will be provided for each type of request.

SEC. 4. PUNCH CARD SUBMISSIONS

.01 Ship punch card input (prepaid) to the Service Center assigned at the time of initial contracting. The following is a list of Service Centers and their addresses:

Andover Service Center
Director
Andover Service Center
310 Lowell Street
Andover, MA 01812

Atlanta Service Center
Director
Atlanta Service Center
4800 Buford Highway
Chamblee, GA 30006

Austin Service Center
Director
Austin Service Center
3651 South Interregional Highway
Austin, TX 78740

Brookhaven Service Center
Director
Brookhaven Service Center
1040 Waverly Avenue
Holtsville, NY 11799

Cincinnati Service Center
Director
Cincinnati Service Center
201 West Second Street
Covington, KY 41019

Fresno Service Center
Director
Fresno Service Center
5045 East Butler Avenue
Fresno, CA 93888

Kansas City Service Center
Director
Kansas City Service Center
2306 East Bannister Road
Kansas City, MO 64170

Memphis Service Center
Director
Memphis Service Center
3131 Democrat Road
Memphis, TN 38110

Ogden Service Center
Director
Ogden Service Center
1160 West 1200 South Street
Odgen, UT 84201

Philadelphia Service Center
Director
Philadelphia Service Center
11601 Roosevelt Boulevard
Philadelphia, PA 19155

.02 Punch card input will be converted to tape at the Service Centers and shipped to NCC for matching.

.03 Prior to tape conversion, validity checks will be performed on punch cards at the Service Center. Cards containing errors (e.g., an alphabetic character in the Social Security Number, a Social Security Number outside the range of numbers assigned for use by the Social Security Administration, etc.) will be screened out and returned to the customer. These cards will not be converted to tape for matching.

.04 Include a transmittal letter with each shipment. The transmittal should identify the punch cards as input to IRS Project 719, indicate the number of cards submitted and the return address. The transmittal should also include the name and telephone number of an individual within the agency who can aid in reconciling shipping problems.

.05 After the NCC matching extract, output will be returned to the Service Centers for creation of Forms 4453, Taxpayer Address. Service Centers will ship Forms 4453 back to the requesting agency prepaid. Unless otherwise requested by the customer, punch card input will be destroyed upon shipment of Forms 4453.

SEC. 5. PUNCH CARD INPUT SPECIFICATIONS (IMF ADDRESS REQUESTS ONLY)

.01 Punch Card Input Format

Card Columns	*Contents*
1-3	*Agency Code.* Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for IMF punch card address requests.
4-12	*Social Security Number.* Enter the nine digit Social Security Number which will be used for matching with the IMF.
13-15	*Project Code.* Enter the constant "719" which identifies this as an IMF Address Request.
16-41	*Agency Case Control Number.* This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 16-24 blank if you desire your output in sequence by SSN.
42-45	*Name Control.* Enter the four character Name Control which will be used for matching with the IMF.
46-51	*Blanks.* Leave these positions blank.
52-80	*Optional Use.* The customer may use this field for a particular need. The data will not be printed on the output.

SEC. 6. PUNCH CARD OUTPUT SPECIFICATIONS, FORM 4453.

.01 If there is a match on both Social Security Number and Name Control, Form 4453 will be printed, formatted as in Exhibit B. The data elements are:

Element	*Contents*
1	*Name and Address.* The name provided is that which was entered by the taxpayer on the most recent tax return. A second name line may be present showing a continuation of the first name line (i.e., "in care of Joe Doe", "John Doe, Executor," etc.) The address will show the latest street address, Post Office Box number, or other address, city, state and Zip Code furnished by the taxpayer on a tax return or a notice of change of address provided to the Service by the taxpayer. Zeros in all five positions of the Zip Code indicate that the taxpayer did not provide a valid Zip Code and the city or town could not be located in the Zip Code Master File maintained by the Service. Zeros in the last two positions indicate that only the area code (the first three digits) could be determined.
2	*Social Security Number.* As input.
3	*Agency Code.* As input.
4	*Agency Case Control Number.* As input.
5	*Name Control.* As input.
6	*Last Filing Date.* The year of latest activity on the taxpayer's account. This information is provided to State agencies only. It is not provided to Federal agencies.
7	*0 or 1.* IRS use only.

.02 If there is no match between the input Social Security Number and/or Name control and the Individual Master File, Form 4453 will be printed, formatted as in Exhibit C. The data elements are:

Element	*Contents*
1	*Name and Address.* If the input Social Security Number (or SSN extracted from Spouse-Primary SSN Record File) does not match an SSN on the Individual Master File, ***NO RECORD SSN*** will be printed in this area. If the input Name Control does not match the Name Control for that record on the Master File, ***NO RECORD NC*** will be printed in this area.
2	*Social Security Number.* As input.
3	*Agency Code.* As input.
4	*Agency Case Control Number.* As input.

SEC. 7. TAPE SUBMISSIONS

.01 Tape submissions must be in the format specified for that type of request.

.02 Separate tapes must be submitted for address requests and TDA requests. Separate tapes must also be submitted for IMF and BMF requests. A separate tape, therefore, is required for each of the following type requests:

a) IMF Address Requests
b) IMF TDA Requests
c) BMF Address Requests
d) BMF TDA Requests

.03 An agency may submit any combination of types of requests in a given month, or even make no tape submission in a given month. They should not, however, combine more than one type of request on a single reel of tape. There is no limitation on the number of reels of tape that may be submitted in a month for a particular type of request.

.04 A file is defined as one or more reels of a specific type of request, submitted at one time.

.05 It is the responsibility of the requesting agency to assure that input record data meet all specifications. Data Records containing invalid characters in the Taxpayer Identification Number field or in the Agency Code field will be dropped from processing. Duplicate requests by the same agency will also be dropped.

SEC. 8. SHIPMENT OF TAPES

.01 Ship input tapes (prepaid) to:

Internal Revenue Service
National Computer Center
Martinsburg, WV 25401
Attn: Chief Librarian

.02 Each input tape reel should contain the following information on its label:

a) Agency Name
b) Tape Reel Identification Number
c) An indication of "Request for Taxpayer Address Data or TDA Data."
d) Assigned Agency Code Number for type of request.
e) IMF or BMF extract

.03 For each shipment, a transmittal letter should be sent under separate cover to the National Computer Center. The transmittal should indicate the number of reels in the shipment, the reel identification number of each reel, the number of records on each reel, the assigned agency code for each reel, and the type of request (BMF TDA, IMF Address, etc.). The transmittal should also include the name and telephone number of an individual within the agency who can aid in reconciling shipping problems.

.04 Address the transmittal to:

Internal Revenue Service
National Computer Center
P.O. Box 1208
Martinsburg, WV 25401

.05 Please provide magnetic tapes (at least three tapes) for your output, when making initial input shipment. The input tape is scheduled for a 100 day retention. After that time, the input tape will be scratched and the tape used for your next output.

.06 If IRS tapes must be used to provide output, new tapes will be used. The cost of these tapes will be reflected in the agency billing.

SEC. 9. INPUT TAPE SPECIFICATIONS

.01 All input tape should be submitted with the following characteristics:

a) 9 track
b) 1600 BPI
c) Extended binary coded decimal (EBCDIC)
d) Odd Parity

.02 Each tape reel must contain the following types of records.

Header Record
Tape Mark (after the Header Record)
Data Records—Maximum of 100 data records per block. Separate blocks from each other by an interrecord gap. Each tape reel can consist of several sets of data blocks.
Tape Mark after the last Data Record on a Tape.
Trailer Record
Tape Mark

.03 BMF TDA Requests
(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Enter the constant "1HDR" to identify this record as a Header Record.
5-15	*Blanks.* Leave these positions blank.
16	*Dash.* Enter a dash (-).
17-19	*Reel Sequence Number.* Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank.* Leave this position blank.
21-30	*To Job Number.* Enter the constant "1550102000".
31-35	*Creation Date (YYDDD).* Enter the date the file was created. YY indicates the low order digit of the year and DDD the Julian day of the year, from 001-366.
36	*Dash.* Enter a dash (-).
37-39	*Retention Period.* Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank.* Leave this position blank.

Position(s)	Contents
41-50	*From Job Number.* Enter the constant "AGENCY-nnn" where "nnn" is the agency code assigned for TDA requests.
51-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Record(s)*

Position(s)	Contents
1	*Blank.* Leave this position blank.
2-4	*Project Code.* Enter the constant "155".
5-7	*Agency Code.* Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for TDA requests.
8	*TIN Indicator.* Enter "2" if EIN or "0" if SSN.
9-17	*TIN.* Enter the nine digit EIN or SSN which will be used for matching with the BMF.
18-43	*Agency Case Control Number.* This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 18-26 blank if you desire your output in sequence by TIN.
44-45	*Blanks.* Leave these positions blank.
46-49	*Name Control.* Enter the four character Name Control which will be used for matching with the BMF.
50-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the last data record on a reel.

(c) *Trailer Record*

Position(s)	Contents
1-4	*Trailer Record I.D.* Enter the constant "1EOR" or "1EOF" to identify this tape record as the trailer record. Use "1EOR" to signify the end of a reel and "1EOF" to signify the end of a file.
5	*Blank.* Leave this position blank.
6-10	*Block Count.* Enter the number of data blocks on this reel of tape.
11-20	*Reel Record Count.* For customer's use (no entry required).
21-30	*Reel Hash Count.* For customer's use (no entry required).
31-40	*File Record Count.* For customer's use (no entry required).
41-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the trailer record.

.04 BMF Address Requests

(a) *Header Record*

Position(s)	Contents
1-4	*Header Label I.D.* Enter the constant "1HDR" to identify this record as a Header Record.
5-15	*Blanks.* Leave these positions blank.
16	*Dash.* Enter a dash. (-)
17-19	*Reel Sequence Number.* Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank.* Leave this position blank.
21-30	*To Job Number.* Enter the constant "1550101000".
31-35	*Creation Date (YYDDD).* Enter the date the file was created. YY indicates the low order digits of the year and DDD the Julian day of the year, from 001-366.
36	*Dash.* Enter a dash (-).
37-39	*Retention Period.* Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank.* Leave this position blank.
41-50	*From Job Number.* Enter the constant "AGENCY-nnn" where "nnn" is the agency code number assigned for BMF address requests.
51-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Records*

Position(s)	Contents
1	*Blank.* Leave this position blank.
2-4	*Project Code.* Enter the constant "155".
5-7	*Agency Code.* Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for BMF address requests.
8	*TIN Indicator.* Enter "2" if EIN or "0" if SSN.
9-17	*TIN.* Enter the nine digit EIN or SSN which will be used for matching with the BMF.

Position(s)	*Contents*
18-43	*Agency Case Control Number.* This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 18-26 blank if you desire your output in sequence by TIN.
44-45	*Blanks.* Leave these positions blank.
46-49	*Name Control.* Enter the four character Name Control which will be used for matching with the BMF.
50-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the last data record on a reel.

(c) *Trailer Record*

Positions	*Contents*
1-4	*Trailer Record I.D.* Enter the constant "1EOR" or "1EOF" to identify this tape record as the trailer record. Use "1EOR" to signify the end of a reel and "1EOF" to signify the end of a file.
5	*Blank.* Leave this position blank.
6-10	*Block Count.* Enter the number of data tape blocks in the reel of tape.
11-20	*Reel Record Count.* For customer's use (no entry required).
21-30	*Reel Hash Count.* For customer's use (no entry required).
31-40	*File Record Count.* For customer's use (no entry required).
41-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the trailer record.

.05 IMF TDA Requests

(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Enter the constant "1HDR" to identify this record as a Header Record.
5-15	*Blanks.* Leave these positions blank.
16	*Dash.* Enter a dash (-).
17-19	*Reel Sequence Number.* Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank.* Leave this position blank.
21-30	*To Job Number.* Enter the constant "4550101000".
31-35	*Creation Date (YYDDD).* Enter the date the file was created. YY indicates the low order digits of the year and DDD the Julian day of the year, from 001-366.
36	*Dash.* Enter a dash (-).
37-39	*Retention Period.* Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank.* Leave this position blank.
41-50	*From Job Number.* Enter the constant "4550111000".
51-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Record(s)*

Position(s)	*Contents*
1	*Blank.* Leave this position blank.
2-4	*Project Code.* Enter the constant "455" to identify this as a IMF TDA request.
5-7	*Agency Code.* Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for TDA requests.
8	*Blank.* Leave this position blank.
9-17	*Social Security Number.* Enter the nine digit Social Security Number which will be used for matching with the IMF.
18-43	*Agency Case Control Number.* This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 18-26 blank if you desire your output in sequence by SSN.
44-45	*Blanks.* Leave these positions blank.
46-49	*Name Control.* Enter the four character Name Control which will be used for matching with the IMF.
50-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the last data record on a reel.

(c) *Trailer Record*

Positions	*Contents*
1-4	*Trailer Record I.D.* Enter the constant "1EOR" or "1EOF" to identify this tape record as the trailer record. Use "1EOR" to signify the end of a reel and "1EOF" to signify the end of a file.

Position(s)	*Contents*
5	*Blank.* Leave this position blank.
6-10	*Block Count.* Enter the number of data tape blocks in the reel of tape.
11-20	*Reel Record Count.* For customer's use (no entry required).
21-30	*Reel Hash Count.* For customer's use (no entry required)
31-40	*File Record Count.* For customer's use (no entry required).
41-80	*Blank.* Leave these positions blank.

Enter a tape mark following the trailer record.

.06 IMF Address Requests

(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Enter the constant "1HDR" to identify this tape record as a Header Record.
5-15	*Blanks.* Leave these positions blank.
16	*Dash.* Enter a dash (-).
17-19	*Reel Sequence Number.* Enter a three digit number indicating the sequence of this reel within the file. Number sequentially beginning with 001.
20	*Blank.* Leave this position blank.
21-30	*To Job Number.* Enter the constant "7190701000".
31-35	*Creation Date (YYDDD).* Enter the date the file was created. YY indicates the low order digits of the year and DDD the Julian day of the year, from 001-366.
36	*Dash.* Enter a dash (-).
37-39	*Retention Period.* Enter the constant "100". This indicates the maximum period that this tape will be held for entry into the program.
40	*Blank.* Leave this position blank.
41-50	*From Job Number.* Enter the constant "7190101000".
51-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the Header Record.

(b) *Data Records(s)*

Position(s)	*Contents*
1	*Blank.* Leave this position blank.
2-4	*Project Code.* Enter the constant "719" which identifies this as an IMF Address Request.
5-7	*Agency Code.* Enter the three digit number assigned at the time of initial negotiation. Use only the agency code assigned for IMF Address requests.
8-16	*Social Security Number.* Enter the nine digit Social Security Number which will be used for matching with the IMF.
17-42	*Agency Case Control Number.* This field is provided for the use of the customer and may contain any alphabetic or numeric data needed for control purposes, or may be used as a reference field, at the discretion of the customer. Output data will be sorted in alpha-numeric sequence by the first nine positions of this field. Leave positions 17-25 blank if you desire your output in sequence by SSN.
43-44	*Magnetic Tape Code.* Enter the two digit code assigned by the Service.
45-48	*Name Control.* Enter the four character Name Control which will be used for matching with the IMF.
49-50	*Blanks.* Leave these positions blank.

Enter a tape mark following the last data record on a reel. If it is necessary to pad the last block, pad with 9's.

(c) *Trailer Record*

Position(s)	*Contents*
1-4	*Trailer Label I. D.* Enter the constant "1EOR" or "1EOF" to identify this tape record as the trailer record. Use "1EOR" to signify the end of a reel and "1EOF" to signify the end of a file.
5	*Blank.* Leave this position blank.
6-10	*Block Count.* Enter the number of data tape blocks in the reel of tape.
11-80	*Blanks.* Leave these positions blank.

Enter a tape mark following the trailer record.

SEC. 10. RETURN OF OUTPUT TAPES

.01 Output tapes will be returned to the requesting agency at the address provided on the Form 5181. Output tapes will be returned approximately three weeks after the original due date at NCC.

.02 Tapes will be formatted according to the type of request. See Section 11 for specific formats.

.03 Separate tapes will be returned for each type of request submitted.

.04 Each output tape will be labeled with the following information:

a) Agency Name
b) Tape Reel Identification Number
c) Assigned Agency Code Number for type of request
d) IMF or BMF extract
e) Address or TDA request.

SEC. 11. OUTPUT TAPE SPECIFICATIONS

.01 Output tape will have the following characteristics:

a) 9 track

b) 1600 BPI
c) Extended binary coded decimal (EBCDIC)
d) Odd Parity

.02 Each tape reel will contain the following types of records:

Header Record
Tape Mark (after the Header Record)
Data Records. Tape Blocks separated from each other by an interrecord gap.
Tape Mark after the last Data Record on a tape.
Trailer Record
Tape Mark

Each tape reel may consist of one or more sets of data blocks.

.03 BMF TDA Requests

(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Constant "1HDR".
5-15	*Blanks.*
16	*Dash* (-).
17-19	*Reel Sequence Number.* As input.
20	*Blank.*
21-30	*To Job Number.* Will appear as constant "TDA CHECK".
31-35	*Creation Date (YYDDD).* This is the date of the BMF extract. The YY represents the low order digits of the year and DDD is the Julian day of the year, from 001-366.
36	*Dash* (-).
37-39	*Retention Period.* Constant "100".
40	*Blank.*
41-50	*From Job Number.* Will appear as constant "1550512000".
51-80	*Blanks.*

(b) *Data Record(s)*

Position(s)	*Contents*
1-4	*Record Length.* Service use only.
5	*Separation Code.* Service use only.
6-8	*Project Code.* Constant "155".
9-11	*Agency Code.* As input.
12	*TIN Indicator.* As input.
13-21	*TIN.* As input.
22-47	*Agency Case Control Number.* As input.
48-49	*Blanks.*
50-53	*Name Control.* As input.
54	*Blank.*
55	*Delinquency Indicator.* This field indicates the TDA status of the account on the BMF. The codes in this field have the following meanings:
	"Y"—indicates delinquency status.
	"N"—no indication of delinquency status.
	"blank"—no match obtained at the Master File with the TIN/Name Control combination provided.
56-80	*Blanks.*

A tape mark will appear following the last data record on a reel.

(c) *Trailer record*

Position(s)	*Contents*
1-4	*Trailer Record I.D.* Constant "1EOR" or "1EOF".
5	*Blank.*
6-10	*Block Count.* As input.
11-20	*Reel Record Count.* As input (entry not required).
21-30	*Reel Hash Count.* As input (entry not required).
31-40	*File Record Count.* As input (entry not required).
41-80	*Blanks.*

A tape mark will appear following the trailer record.

.04 BMF Address Requests

(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Constant "1HDR".
5-15	*Blanks.*
16	*Dash* (-).
17-19	*Reel Sequence Number.* As input.
20	*Blank.*
21-30	*To Job Number.* Will appear as constant "NAME ADDR".
31-35	*Creation Date (YYDDD).* This is the date of the BMF extract. The YY represents the low order digits of the year and DDD is the Julian day of the year, from 001-366.
36	*Dash* (-).
37-39	*Retention Period.* Constant "100".
40	*Blank.*
41-50	*From Job Number.* Will appear as the constant "1550511000".
51-80	*Blanks.*

A tape mark will appear following the Header Record.

(b) *Data Records*

Position(s)	*Contents*
1-4	*Record Length.* Service use only.
5	*Separation Code.* Service use only.
6-8	*Project Code.* Constant "155".

Position(s)	*Contents*
9-11	*Agency Code.* As input.
12	*TIN Indicator.* As input.
13-21	*TIN.* As input.
22-47	*Agency Case Control Number.* As input.
48-49	*Blanks.*
50-53	*Name Control.* As input.
54-55	*Blanks.*
56-90	*First Name Line.* The name provided is that which was entered by the taxpayer on the most recent tax return. Subsequent name lines may be blank or may show a continuation of the first name line. They may also show information such as "in care of John Doe" or "John Doe, Executor". If the input EIN or Name Control do not match with the corresponding fields on the Master File—"***NO RECORD EIN***" or "***NO RECORD NC***" will appear in the first name line field.
91-125	*Second Name Line.*
126-160	*Third Name Line.*
161-195	*Fourth Name Line.*
196-230	*Street Address.*
231-250	*City.*
251-252	*State Code.*
253-257	*Zip Code.*

These fields will show the latest street address, Post Office Box number, or other address, city, state and Zip Code furnished by the taxpayer on a tax return or a notice of change of address provided to IRS by the taxpayer.

Zeros in all five positions of the Zip Code indicate that the taxpayer did not provide a valid Zip Code and the city or town could not be located in the Zip Code Master File maintained by the Service. Zeros in the last two positions indicate that only the area code (the first three digits) could be determined.

A tape mark will follow the last data record on the reel.

(c) *Trailer Record*

Position(s)	*Contents*
1-4	*Trailer Record I.D.* Constant "1EOR" or "1EOF".
5	*Blank.*
6-10	*Block Count.* As input.
11-20	*Reel Record Count.* As input (entry not required).
21-30	*Reel Hash Count.* As input (entry not required).
31-40	*File Record Count.* As input (entry not required).
41-80	*Blanks.*

A tape mark will appear following the trailer record.

.05 IMF TDA Requests

(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Constant "1HDR".
5-15	*Blanks.*
16	*Dash (-).*
17-19	*Reel Sequence Number.* As input.
20	*Blank.*
21-30	*To Job Number.* Will appear as constant "4550901000".
31-35	*Creation Date.* (YYDDD) This is the date of the IMF extract. The YY represents the low order digits of the year and DDD represents the Julian day of the year, from 001-366.
36	*Dash (-).*
37-39	*Retention Period.* Constant "100".
40	*Blank.*
41-50	*From Job Number.* Will appear as constant "4550711000".
51-80	*Blanks.*

A tape mark will appear following the Header Record.

(b) *Data Record(s)*

Position(s)	*Contents*
1	*Blank*
2-4	*Project Code.* Constant "455".
5-7	*Agency Code.* As input.
8	*Blank.*
9-17	*SSN.* As input.
18-43	*Agency Case Control Number.* As input.
44-45	*Blanks.*
46-49	*Name Control.* As input.
50	*Blanks.*
51	*Delinquency Indicator.* This field indicates the TDA status of the account on the IMF. The codes in this field have the following meanings: "Y"—indicates delinquency status. "N"—no indication of delinquency status. "blank"—no match obtained at the Master File with the SSN/Name Control combination provided.
52-80	*Blanks.*

A tape mark will appear following the last data record on a reel.

(c) *Trailer Record*

Position(s)	*Contents*
1-4	*Trailer Record I.D.* Constant "1EOR" or "1EOF".
5	*Blank.*
6-10	*Block Count.* As input.
11-20	*Reel Record Count.* As input (entry not required).
21-30	*Reel Hash Count.* As input (entry not required).
31-40	*File Record Count.* As input (entry not required).
41-80	*Blanks.*

A tape mark will appear following the trailer record.

.06 IMF Address Requests

(a) *Header Record*

Position(s)	*Contents*
1-4	*Header Label I.D.* Constant "1HDR".
5-15	*Blanks.*
16	*Dash (-).*
17-19	*Reel Sequence Number.* As input.
20	*Blank.*
21-30	*To Job Number.* Will appear as constant "7192501000".
31-35	*Creation Date.* (YYDDD) This is the date of the IMF extract. The YY represents the low order digits of the year and DDD represents the Julian day of the year, 001-366.
36	*Dash (-).*
37-39	*Retention Period.* Constant "100".
40	*Blank.*
41-50	*From Job Number.* Will appear as the number of the Service file that created the extract.
51-80	*Blanks.*

A tape mark will appear following the Header Record.

(b) *Data Record(s)*

Position(s)	*Contents*
1-4	*Record Length.* Service use only.
5	*IRS Code.* Service use only.
6-7	*Magnetic Tape Code.* As input.
8-10	*Agency Code.* As input.
11	*IRS Code.* Service use only.
12-14	*Blanks.*
15-23	*Social Security Number.* As input.
24-49	*Agency Case Control Number.* As input.
50-84	*First Name Line.* The name provided is that which was entered by the taxpayer on the most recent tax return. Subsequent name lines may be blank or may show a continuation of the first name line. They may also show information such as "in care of John Doe" or "John Doe, Executor". If the input SSN (or SSN extracted from the Spouse-Primary SSN Record File) or Name Control do not match with the corresponding fields on the Master File "***NO RECORD SSN***" or "***NO RECORD NC***" will appear in the first name line field.
85-119	*Second Name Line.*
120-154	*Street Address.*
155-179	*City and State.*
180-184	*Zip Code.*

These fields will show the latest street address, Post Office Box number, or other address, city, state and Zip Code furnished by the taxpayer on a tax return or a notice of change of address provided to IRS by the taxpayer.

Zeros in all five positions of the Zip Code indicate that the taxpayer did not provide a valid Zip Code and the city or town could not be located in the Zip Code Master File maintained by the Service. Zeros in the last two positions indicate that only the area code (the first three digits) could be determined.

185-188	*Name Control.* As input.
189-190	*Blanks.*
191	*Service Use Only.*
192-212	*Blanks.*

A tape mark will appear following the last data record on a reel.

(c) *Trailer Record*

Position(s)	*Contents*
1-4	*Trailer Label I.D.* Constant "1EOR" or "1EOF".
5	*Blank.*
6-10	*Block Count.* As input.
11-30	*Zeros.*
31-80	*Blanks.*

A tape mark will appear following the trailer record.

SEC. 12. USE OF REQUEST OUTPUT

.01 Users should be aware of the limitations of the delinquency indication. It reflects only the Master File status of the account at the time of the extract. For instance, the account could show delinquency status but a payment agreement could have been recently established between the Service and the taxpayer. Or the extract could show an account as delinquent but by the time the agency receives the output or is ready to use the informa-

tion, the delinquent amount may have been paid.

.02 There is also the possibility that a taxpayer may be delinquent but in an amount less than that which creates a delinquency indication on the Master File. In such a case, the extract will indicate that the taxpayer's account is not in delinquent status.

.03 Requestors should take care to provide correct information to the Service. They should be aware that if they fail to do so, there is the slight possibility that through coincidental circumstances, the data provided may not be that of the individual for whom the request was made. For instance, if information is requested for John Smith, but an erroneous SSN is provided which happens to be that of a Joe Smith, the Master File will match the account of Joe Smith and the data provided will reflect that account.

SEC. 13. DETERMINING A NAME CONTROL

.01 Each input data record will require a name control. Determine according to the following instructions.

.02 Individuals

a) The name control of an individual is the first four significant characters of the last name (including hyphens). In surnames of less than four characters, the remaining positions are blank. Disregard blanks or apostrophes between letters.

Individual Name	*Name Control*
John A. Fir	FIR
James P. Ai	AI
John A. El-Oak	EL-O
Mary Van Elm	VANE
Joe McCedar	MCCE
Ann O'Spruce	OSPR
Dorothy Willow	WILL
Mr. John Holly	HOLL
Harry Maple, Owner	MAPL
Pfc. M. Ralph Evergreen	EVER
John Di Pine	DIPI
Mark D'Oak	DOAK
John De la Rose	DELA

.03 Corporations

a) The name control of a corporation is derived from the first four significant characters of the name.

b) An exception to this rule is to exclude the word "the" when used as a prefix to the name and the word "the" is followed by more than one word.

c) In instances where a numeric is followed by a decimal (.) as part of the name, replace the decimal point (.) with a hyphen (-) when determining the name control.

Business Name	*Name Control*
John Field Plows Inc.	JOHN
The Meadowlawk Co.	MEAD
The Opah	THEO
The 813 Club Inc.	813C
11th Street Inc.	11TH
P & P Company	P&PC
Y-Z Drive Co.	Y-ZD
RS Corporation	RSCO
ZZZ Club	ZZZC
J.R. Olive Inc.	JROL
Pier Pickle Ltd.	PIER
18.8 Acres, Inc.	18-8

.04 Partnerships

a) Derive the name control for partnership entities from the legal name of the partnership. If the legal name contains the name of a partner, derive the name control from the surname of the first listed partner. If the legal name does not contain the name of a partner, derive the name control from the first four characters in the legal name. Do not use a trade name (doing business as) to determine name control.

.05 Other Organizations

a) Unions, municipal groups, churches, lodges, associations, tax exempt organizations, foundations, funds and other like entities are assigned name controls as if corporate names. Chapter, department and local designations should be ignored.

Name of Organization	*Name Control*
Scottish Rite of Free Heather	SCOT
Ice Wagon Drivers Helpers Union	ICEW
(The) Shrine of the Little River Church	SHRI
NCO Open Mess Bldg.-000	NCOO
Piranha Pension Plan Board of Trustees	PIRA
Ibex Foundation	IBEX
Seattle Local 55 Veterans of Space Wars	VETE
Local 210 International Orchid Assn.	INTE
Diocese of Roseville, St. Violet's Hospital	STVI

b) Political activity entities should be name controlled as a corporation unless the entity is an individual's name.

Name of Organization	*Name Control*
Sinking Fund Commission of the City of Lilliput	SINK
Phineous Kudzu Campaign Fund	KUDZ

.06 Estates

Derive the Name Control from the surname of the decedent.

SEC. 14. SCHEDULES

.01 Master File extracts will be made monthly. The schedule for 1984 processing is as follows:

Punch Cards Received At Service Centers by:	*Or Tapes Received at NCC by:*	*Will be included scheduled to begin:*
January 13*	January 20*	January 23*
February 10	February 17	February 20
March 16	March 23	March 26
April 13	April 20	April 23
May 11	May 18	May 21
June 15	June 22	June 25
July 13	July 20	July 23
August 10	August 17	August 20
September 14	September 21	September 24
October 12	October 19	October 22
November 9	November 16	November 19
December 7	December 14	December 17

*BMF processing only.

.02 The Master File extract process requires approximately two and one half weeks. Output tapes will be mailed from NCC approximately three weeks from the tape received due dates specified above. Forms 4453 will be mailed from Service Centers approximately six weeks from the punch card received due dates specified above.

.03 Processing schedules are not flexible. Agencies are responsible for assuring that input is received in ample time to be included in the month's processing. Input received late will be processed in the next month.

SEC. 15. REIMBURSEMENT

All work done by the Service for agencies will be performed on a reimbursable basis. Billing will be based on the number of data records processed and the number of IRS tapes required for output. The cost per data record is tentatively projected to be eight cents ($.08) for IMF requests and four cents ($.04) for BMF requests. The cost per IRS tape will be $12.

SEC. 16. QUESTIONS

Any questions regarding the material in this Revenue Procedure can be addressed to the Internal Revenue Project Coordinator whose name appears on the Form 5181.

SEC. 17. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 83-29, 1983-1 C.B. 712, is superseded.

Exhibit A

Form **5181** (Rev. April 1983) Department of the Treasury Internal Revenue Service	**Agreement Covering Reimbursable Services** *See "Terms and Conditions" on reverse*	Project Number

1. Name of organization requesting services on reimbursable basis	2. Address

3. Project title or type of service requested

4. Internal Revenue Project Coordinator	5. Project Coordinator of Requesting Organization
a. Name and title	a. Name and title
b. Address	b. Shipping Address *(No., Street, City, State, ZIP Code)*
c. Telephone	c. Telephone

6. Cost and Financing	a. Total estimated cost of services $
	b. Method of Billing ☐ In advance ☐ Actual cost to be billed as work is completed ☐ Other *(Explain)*

Federal Government Agencies normally will make payment by Standard Form 1080. Non-governmental organizations, etc. will send payment by check drawn to order of **Accounting Section, Internal Revenue Service, Washington, DC, 20224.**

7. Period of Agreement	This agreement shall become effective on the date approved by the Government and shall not extend beyond the end of the Government fiscal year or_____. For a renewal, apply to the Internal Revenue Project Coordinator.

8. For Internal Revenue Use Only		9. For Use of Requesting Organization	
a. Approved by *(signature)*		a. Accepted by *(Signature of Authorized Official)*	
b. Title	c. Date	b. Title	c. Date

Form **5181** (Rev. 4-83)

Terms and Conditions

1.- The authority to perform services on a cost basis is contained in Section 6103(p)(2) and Section 6108(b) of the Internal Revenue Code (IRC). The performance of services is authorized only when consistent with the basic public obligations of the Internal Revenue Service (the Service). If necessary to fulfill its public obligations, the Service may reject or terminate any part of this agreement and return the unused balance of funds advanced.

2. Although every reasonable effort is made to avoid delays and errors in the performance of its work, the Service is not responsible for delays or errors in the services performed. The cost of data recompilations or corrections must be paid for by the requesting party.

3. Direct and indirect actual costs will be charged for reimbursable work. If funds advanced to the Service are more than the actual cost of performing the work, the difference will be returned. If an estimate is less than the actual costs incurred, the requesting organization agrees to pay for the actual costs incurred.

4a. Section 6103(p)(4) of the IRC provides specific requirements for Federal, state and local organizations to safeguard Federal returns and return information as a condition for receiving the information.

b. Section 7213 of the IRC makes illegal disclosure of returns or return information a felony punishable by a fine not to exceed $5000 or imprisonment of not more than 5 years, or both, together with the costs of prosecution. IRC Section 7431 makes persons liable for civil damages who knowingly or negligently disclose returns or return information illegally.

5. The Service reserves the right to use a copy of all data provided under this agreement.

6. The requester may cancel this agreement only by giving the Service written notice 30 days before cancellation. Payment to the Service shall include actual costs to the date of cancellation. The Service will exercise due diligence to prevent incurring costs after the cancellation date. However, payment shall also be made for unavoidable commitments up to the date the agreement would have expired.

Exhibit B

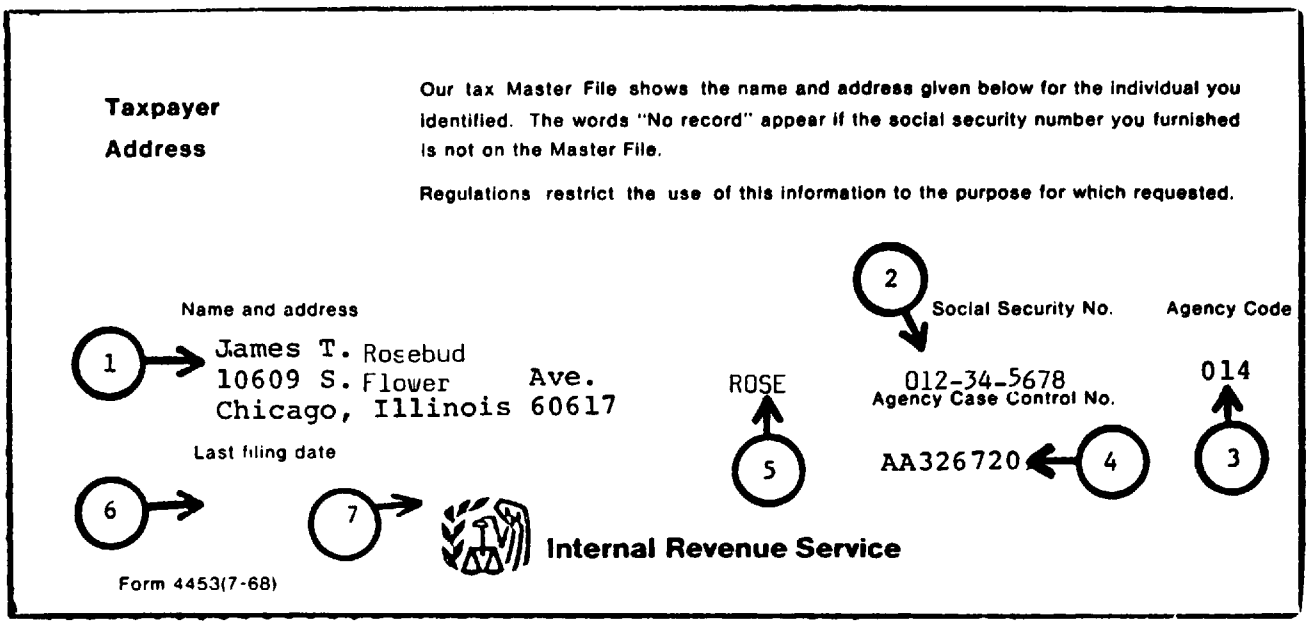
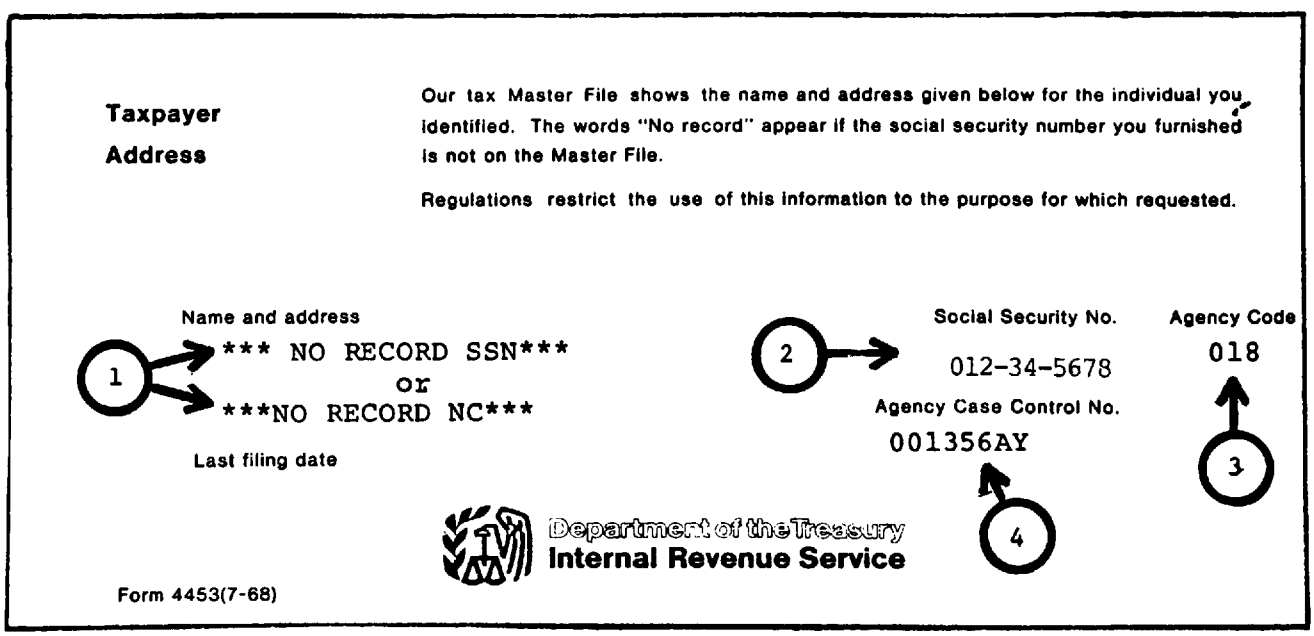


Exhibit C



26 CFR 601.201: Rulings and determination letters

Rev. Proc. 84-21

SECTION 1. BACKGROUND

Rev. Proc. 83-22, 1983-1 C.B. 680, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 83-22 is entitled, Areas Under Extensive Study in Which Rulings or Determination Letters Will Not Be Issued Until The Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations Or Otherwise.

SEC. 2. PROCEDURE

Rev. Proc. 83-22 is hereby modified by deleting from section 5 the following subsection:

".19 Section 1372.—Election by Small Business Corporation [now section 1362.—Election; Revocation; Termination].—Whether trailer or mobile home parks qualify as electing small business corporations."

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective March 19, 1984, the date of publication of this revenue procedure in the Internal Revenue Bulletin.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 83-22 is modified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-22

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 The purpose of this revenue procedure is to update Rev. Proc. 83-22, 1983-1 C.B. 680, as amplified and modified by subsequent revenue procedures, by providing a revised list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which the Internal Revenue Service will not issue advance rulings or determination letters.

.02 Changes

1 New section 3.011 refers to section 61. See Rev. Proc. 84-14, page 431, this Bulletin.

2 New section 3.019 refers to section 163. See Rev. Proc. 83-31, 1983-1 C.B. 722.

3 New section 3.0131 refers to section 641. See Rev. Proc. 83-61, 1983-2 C.B. 581.

4 New section 3.0135 refers to section 801. See Rev. Proc. 84-15, page 431, this Bulletin.

5 New section 3.0145 refers to section 7701. See Rev. Proc. 83-50, 1983-2 C.B. 555.

6 New section 4.011 refers to sections 38, 46, and 48. See Rev. Proc. 84-8, page 374, this Bulletin.

7 New section 4.012 refers to section 61. See Rev. Proc. 83-55, 1983-2 C.B. 572.

8 New section 4.015 refers to section 103. See Rev. Proc. 84-13, page 431, this Bulletin.

9 New section 4.018 refers to sections 167 and 168. See Rev. Proc. 84-8, page 374, this Bulletin.

10 New section 4.0115, which refers to section 341, supersedes old section 4.0111. See Rev. Proc. 83-85, 1983-2 C.B. 604.

11 New section 4.0118 refers to section 864. See Rev. Proc. 84-12, page 431, this Bulletin.

12 New section 4.0120 refers to section 894. See Rev. Proc. 84-12, page 431, this Bulletin.

13 New section 4.0121 refers to section 901. See Rev. Proc. 84-12, page 431, this Bulletin.

14 New section 4.024 refers to a transaction affected by pending litigation among the parties to the transaction. See Rev. Proc. 83-75, 1983-2 C.B. 593.

15 New section 5.02 refers to sections 61 and 162. See Rev. Proc. 83-62, 1983-2 C.B. 581.

16 New section 5.05 refers to section 101. See Rev. Proc. 83-45, 1983-1 C.B. 780.

17 New section 5.06 refers to section 103. See Rev. Proc. 83-64, 1983-2 C.B. 584.

18 Old section 5.08 has been deleted. See Rev. Proc. 83-42, 1983-1 C.B. 778.

19 New section 5.11 refers to section 306(b)(4). See Rev. Proc. 83-82, 1983-2 C.B. 598.

20 New section 5.12 refers to section 334(b)(2). See Rev. Proc. 83-57, 1983-2 C.B. 574.

21 New section 5.13 refers to section 336. See Rev. Proc. 83-57, 1983-2 C.B. 574.

22 New section 5.14 refers to section 338. See Rev. Proc. 83-57, 1983-2 C.B. 574.

23 New section 5.19 refers to section 368. See Rev. Proc. 83-53, 1983-2 C.B. 569.

24 New section 5.24 refers to sections 708 and 741. See Rev. Proc. 83-39, 1983-1 C.B. 774.

25 New section 5.26 refers to section 801(b). See Rev. Proc. 83-57, 1983-2 C.B. 574.

26 New section 5.27 refers to section 802(b)(3). See Rev. Proc. 83-57, 1983-2 C.B. 574.

27 New section 5.28 refers to section 809(d)(11). See Rev. Proc. 83-57, 1983-2 C.B. 574.

28 New section 5.29 refers to section 815(d)(2). See Rev. Proc. 83-57, 1983-2 C.B. 574.

29 New section 5.30 refers to section 817. See Rev. Proc. 83-57, 1983-2 C.B. 574.

30 New section 5.31 refers to section 818(b)(3). See Rev. Proc. 83-57, 1983-2 C.B. 574.

31 Old section 5.18 has been deleted. See Rev. Proc. 83-60, 1983-2 C.B. 580.

32 Old section 5.19 has been deleted. See Rev. Proc. 84-21, this page, this Bulletin.

33 New section 5.32 refers to section 1248. See Rev. Proc. 83-88, 1983-2 C.B. 613.

34 Old section 5.23 has been deleted. See Rev. Proc. 83-67, 1983-2 C.B. 586.

35 New section 5.39 refers to section 7701. See Rev. Proc. 83-52, 1983-2 C.B. 569.

36 Old section 6.01 has been deleted. See Rev. Proc. 84-14, page 431, this Bulletin.

37 The amplification made by Rev. Proc. 83-80, 1983-2 C.B. 597, does not appear in this document because the prohibition contained in Pub. L. 98-63, 1983-2 C.B. 351, as extended by Pub. L. 98-107, has expired.

38 Section 6 has been deleted because there are no areas now for

which the Service is prohibited by statute from issuing rulings or determination letters.

SEC. 2. BACKGROUND AND SCOPE OF APPLICATION

.01 Background.

Whenever appropriate in the interest of sound tax administration, it is the policy of the Service to answer inquiries of individuals and organizations regarding their status for tax purposes and the tax effects of their acts or transactions, prior to the filing of returns or reports that are required by the revenue laws.

There are, however, certain areas in which, because of the inherently factual nature of the problems involved, or for other reasons, the Service will not issue advance rulings or determination letters. These areas are set forth in three sections of this revenue procedure. Section 3 reflects those areas in which advance rulings and determinations will not be issued. Section 4 sets forth those areas in which they will not ordinarily be issued. "Not ordinarily" connotes that unique and compelling reasons must be demonstrated to justify a ruling or determination letter. Those sections reflect a number of specific questions and problems as well as general areas. Section 5 lists specific areas for which the Service is temporarily not issuing advance rulings and determinations because those matters are under extensive study.

With respect to the items listed, revenue rulings or revenue procedures may be published in the Internal Revenue Bulletin from time to time to provide general guidelines regarding the position of the Service.

Additions or deletions to this revenue procedure as well as restatement of items listed will be made by modification of this revenue procedure. Changes will be published as they occur throughout the year and will be incorporated annually in a new revenue procedure published in the first quarter of the next calendar year. These lists should not be considered all inclusive. Decisions not to rule on individual cases, as contrasted with those that present significant pattern issues, are not reported in this revenue procedure and will not be added to subsequent revisions.

The authority and general procedures of the Technical Function of the National Office of the Internal Revenue Service or the Offices of the District Directors of the Internal Revenue with respect to the issuance of advance rulings and determination letters with respect to Code sections under the jurisdiction of the Associate Chief Counsel (Technical) are outlined in Rev. Proc. 84-1, page 342, this Bulletin.

.02 Scope of Application.

This revenue procedure is not to be considered as precluding the submission of requests for technical advice to the National Office from the Office of a District Director of the Internal Revenue or a Chief, Appeals Office.

SEC. 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

.01 Specific questions and problems.

1 Section 61.—Gross Income Defined.—Before January 1, 1985, a matter involving the federal income tax treatment of nonstatutory employee fringe benefits.

2 Section 79.—Group-Term Life Insurance Purchased for Employees.—Whether a group insurance plan for 10 or more employees qualifies as group-term insurance if the amount of insurance is not computed under a formula that would meet the requirements of section 1.79-1(c)(2)(ii) if the group consisted of fewer than 10 employees.

3 Section 83—Property Transferred in Connection with Performance of Services.—Whether a restriction constitutes a substantial risk of forfeiture if the employee is a controlling shareholder. Also, whether a transfer has occurred if the amount paid for a purported transfer of property involves a nonrecourse obligation.

4 Section 105(h).—Amount Paid to Highly Compensated Individuals under a Discriminatory Self-Insured Medical Expense Reimbursement Plan.—Whether, following a determination that a self-insured medical expense reimbursement plan is discriminatory, that plan had previously made reasonable efforts to comply with tax discrimination rules.

5 Section 117.—Scholarships and Fellowship Grants.—Whether an employer-related scholarship or fellowship grant is excludable from the employee's gross income if there is no intermediary private foundation distributing the grants, as there was in Rev. Proc. 76-47, 1976-2 C.B. 670.

6 Section 119.—Meals or Lodging Furnished for the Convenience of the Employer.—Whether the value of meals or lodging is excludable from gross income by an employee who is a controlling shareholder of the employer.

7 Sections 121 and 1034.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55; Rollover of Gain on Sale of Principal Residence.—Whether property qualifies as the taxpayer's principal residence.

8 Section 162.—Trade or Business Expenses.—Whether compensation is reasonable in amount.

9 Section 163.—Interest.—The income tax consequences of transactions involving "shared appreciation mortgage" (SAM) loans in which a taxpayer, borrowing money to purchase real property, pays a fixed rate of interest on the mortgage loan below the prevailing market rate and will also pay the lender a percentage of the appreciation in value of the real property upon termination of the mortgage. This applies to all SAM arrangements where the loan proceeds are used for commercial or business activities, or where used to finance a personal residence if the facts are not similar to those described in Rev. Rul. 83-51, 1983-1 C.B. 48. (Also sections 61, 451, 461, 856, 1001, and 7701).

10 Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 170(f)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the

death of the life or lives used to measure the term of such interest.

11 Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

12 Section 213(a).—Medical, Dental, Etc., Expenses.—Whether a capital expenditure for an item that is ordinarily used for personal, living, or family purposes, such as a swimming pool, has as its primary purpose the medical care of the taxpayer or the taxpayer's spouse or dependent, or is related directly to such medical care.

13 Section 264(b).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether "substantially all" the premiums of a contract of insurance are paid within a period of 4 years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

14 Section 264(c)(1).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether section 264(c)(1) of the Code applies.

15 Section 269.—Acquisitions Made to Evade or Avoid Income Tax.—Whether an acquisition is within the meaning of section 269 of the Code.

16 Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation consists entirely or partly of its notes payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to the shareholder in the future, upon the happening of specified defaults by the corporation.

17 Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation in exchange for a shareholder's stock consists entirely or partly of the corporation's promise to pay an amount is based on, or contingent on, future earnings of the corporation, when the promise to pay is contingent on working capital being maintained to a certain level, or any other similar contingency.

18 Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies to a redemption of stock if after the redemption the distributing corporation used property that is owned by the shareholder from whom the stock is redeemed and the payments by the corporation for the use of the property are dependent upon the corporation's future earnings or are subordinate to the claims of the corporation's general creditors. Payments for the use of property will not be considered to dependent upon future earnings merely because they are based on a fixed percentage of receipts or sales.

19 Section 302.—Distributions in Redemption of Stock.—Whether the acquisition or disposition of stock described in section 302(c)(2)(B) of the Code has, or did not have, as one of its principal purposes the avoidance of federal income taxes within the meaning of that section, unless the facts and circumstances are materially identical to those set forth in Rev. Rul. 56-556, 1956-2 C.B. 177, Rev. Rul. 56-584, 1956-2 C.B. 179, Rev. Rul. 57-387, 1957-2 C.B. 225, Rev. Rul. 77-293, 1977-2 C.B. 91, or Rev. Rul. 79-67, 1979-1 C.B. 128.

20 Section 302(b)(4) and (e) (pre-TEFRA sections 346(a)(2) and (b)). —Partial Liquidation.—The amount of working capital attributable to a business or portion of a business terminated that may be distributed in partial liquidation.

21 Section 311 and 336.—Taxability of Corporation on Distribution; General Rule.—Upon distribution of property in kind by a corporation to its shareholders, in complete liquidation under section 331 of the Code (when under the facts a sale of the property by the corporation would not qualify under section 337) and section 346(a) (pre-TEFRA section 346(a)(1)), in partial liquidation under section 302(b)(4) and (e) (pre-TEFRA sections 346(a)(2) and (b)) or in redemption of stock under section 302(a), followed by a sale of the property, whether the sale can be deemed to have been made by the corporation under the doctrine of *Commissioner v. Court Holding Company*, 324 U.S. 331 (1945), 1945 C.B. 58.

22 Section 312.—Effect on Earnings and Profits.—The determination of the amount of earnings and profits of a corporation.

23 Sections 302(b)(4) and (e) (Pre-TEFRA sections 346(a)(2) and (b)), 331, 332, 333 and section 346(a) (pre-TEFRA section 346(a)(1)).—Effects on Recipients of Distributions in Corporate Liquidations.—The tax effect of the liquidation of a corporation preceded or followed by the reincorporation of all or a part of the business and assets when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the liquidating corporation and the transferee corporation is owned by the same shareholders; or when a liquidation is followed by the sales of the corporate assets by the shareholders to another corporation in which such shareholders own more than a nominal amount of the stock (that is, more than 20 percent in value).

24 Section 337.—Gain or Loss; Certain Liquidations.—The application of this section to a corporation upon the sale of property, in connection with its liquidation, to another corporation, when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the selling corporation and the purchasing corporation is owned by the same persons.

25 Section 351.—Transfers to Controlled Corporation.—

(a) That this section applies to a transfer by a shareholder of stock in one corporation (acquired) to another corporation (acquiring), in an exchange otherwise qualifying for treatment under this section, if the exchange is part of a larger transaction that fits a pattern common to acquisitive reorganizations, and after the transaction the acquiring corporation has control of the acquired corporation (within the meaning of section

368(c)), unless there is a continuing interest through stock ownership in the acquiring corporation on the part of the former shareholders of the acquired corporation that is equal in value to at least 50 percent of the value of all of the stock of the acquired corporation outstanding immediately before the overall transaction. For purposes of this determination, liabilities assumed or liabilities to which the property transferred is subject, will be considered to be part of the total consideration received. See Rev. Rul. 80-284, 1980-2 C.B. 117, and section 3.02 of Rev. Proc. 77-37, 1977-2 C.B. 568, 569.

(b) That this section applies to a transfer by a corporation (acquired) of a substantial portion of its assets to another corporation (acquiring), in an exchange otherwise qualifying for treatment under this section, if the exchange is part of a larger transaction that fits a pattern common to acquisitive reorganizations, unless there is a continuing interest through stock ownership in the acquiring corporation on the part of the acquired corporation or shareholders of the acquired corporation that is equal in value to at least 50 percent of the value of all of the stock of the acquired corporation outstanding immediately before the overall transaction. For purposes of this determination, liabilities assumed or liabilities to which the property transferred is subject, will be considered to be part of the total consideration received. In addition, for purposes of this revenue procedure, an acquired corporation shall be deemed to have transferred a substantial portion of its assets if the transferred assets constitute 15 percent or more of its gross assets. See Rev. Rul. 80-285, 1980-2 C.B. 119, and section 3.02 of Rev. Proc. 77-37.

26 Section 368(a)(1)(B).—Definitions Relating to Corporate Reorganizations.—The acceptability of an estimation procedure or the acceptability of a specific sampling procedure to determine the basis of stock acquired by an acquiring corporation in a reorganization described in section 368(a)(1)(B).

27 Section 368(a)(1)(E).—Definitions Relating to Corporate Reorganizations.—Whether a transaction constitutes a corporate recapitalization within the meaning of section 368(a)(1)(E) of the Code (or a transaction that also qualifies under section 1036) except when the recapitalization is an integral part of a larger transaction and it is impossible to determine the tax consequences of the larger transaction without making a determination with regard to the recapitalization.

28 Section 451.—General Rule for Taxable Year of Inclusion.—The tax consequences of a nonqualified unfunded deferred compensation arrangement with respect to a controlling shareholder employee eligible to participate in the arrangement.

29 Sections 451 and 457.—General Rule for Taxable Year of Inclusion; Deferred Compensation Plans with Respect to Service for State and Local Governments.—The tax consequences to unidentified independent contractors in nonqualified unfunded deferred compensation plans. This applies to plans established under section 451 of the Code by employers in the private sector and to eligible state plans under section 457. However, a ruling with respect to a specific independent contractor's participation in such a plan may be issued.

30 Section 453.—Revolving Credit Sales as Installment Sales.—Whether a proposed sampling procedure will be acceptable by the Service for the purpose of determining the portion of revolving credit balances to be treated as installment account balances. See Rev. Proc. 64-4, 1964-1 (Part 1) C.B. 644, and Rev. Proc. 65-5, 1965-1 C.B. 720.

31 Section 641.—Imposition of Tax.—Whether the period of administration or settlement of an estate is reasonable or unduly prolonged.

32 Section 642(c).—Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.—Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

33 Section 704(b)(2).—Partner's Distributive Share Determined.—Whether the allocation to a partner under the partnership agreement of income, gain, loss, deduction, or credit (or an item thereof) has substantial economic effect.

34 Section 704(e).—Family Partnerships.—Matters relating to the validity of a family partnership when capital is not a material income producing factor.

35 Section 801.—Definition of a Life Insurance Company.—Whether a life insurance policy issued during 1984 will meet the definition of life insurance until Congress acts upon legislation concerning the taxation of life insurance companies.

36 Section 856.—Definition of a Real Estate Investment Trust.—Whether a corporation whose stock is "paired" with or "stapled" to that of another corporation will qualify as a real estate investment trust under section 856 of the Code if the activities of the corporations are integrated.

37 Section 1221.—Capital Asset Defined.—Whether specialty stock allocated to an investment account by a registered specialist on a national securities exchange is a capital asset.

38 Section 1551.—Disallowance of Surtax Exemption and Accumulated Earnings Credit.—Whether a transfer is within section 1551 of the Code.

39 Section 2031.—Definition of Gross Estate.—Actuarial factors for valuing interests in the prospective gross estate of a living person.

40 Section 2055.—Transfers for Public, Charitable, and Religious Uses.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 2055(e)(2)(B) of the Code if that interest may be prepaid before the expiration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

41 Section 2512.—Valuation of Gifts.—Actuarial factors for valuing prospective or hypothetical gifts of a donor.

42 Section 2522.—Charitable and Similar Gifts.—Whether a charitable lead interest qualifies as a guaranteed annuity interest for purposes of section 2522(c)(2)(B) of the Code if that interest may be prepaid before the ex-

piration of the specified term of that interest or before the death of the life or lives used to measure the term of such interest.

43 Section 7701.—Definitions. —Whether a foreign arrangement that is a participant in a domestic arrangement classified as a partnership for U.S. tax purposes will itself be classified as a partnership.

44 Section 7701.—Definitions. —Whether a foreign limited liability company will be classified as a partnership if the taxpayer requests classification as a partnership and (1) the taxpayer is a corporation and less than 20 percent of the interests in the limited liability company are held by independent parties or (2) the taxpayer is not a corporation and independent parties hold only a nominal interest in the company.

45 Section 7701.—Definitions. —Whether an organization, formed in a state that has a statute corresponding to the Uniform Limited Partnership Act or the Revised Uniform Limited Partnership Act, lacks the corporate characteristic of continuity of life where, in the case of the removal of a general partner, the partnership agreement allows less than a majority in interest of limited partners to elect a new one to continue the partnership.

.02 General Areas

1 The results of transactions that lack bona fide business purpose or have as their principal purpose the reduction of federal taxes.

2 A matter upon which a court decision adverse to the government has been handed down and the question of following the decision or litigating further has not yet been resolved.

3 A matter involving the prospective application of the estate tax to the property or the estate of a living person.

4 A matter involving alternate plans of proposed transactions or involving hypothetical situations.

5 A matter involving the federal tax consequences of any proposed federal, state, local or municipal legislation. The Service may provide general information in response to an inquiry.

6 Whether reasonable cause exits under Subtitle F (Procedure and Administration) of the Code.

7 Whether a proposed transaction would subject the taxpayer to a criminal penalty.

8 A request that does not comply with the provisions of Rev. Proc. 84-1.

9 Whether, under the common law rules applicable in determining the employer-employee relationship, a professional staffing corporation (loan-out corporation) or the subscriber is the employer of individuals if:

(a) the loan-out corporation hires employees of the subscriber and assigns the employees back to the subscriber or;

(b) the loan-out corporation assigns individuals to subscribers for more than a temporary period (1 year or longer).

SEC. 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED

.01 Specific questions and problems.

1 Sections 38, 46, and 48.—Investment Tax Credit.—Application of these sections where the formal ownership of property is in a party other than the taxpayer, except when title is held merely as security.

2 Section 61.—Gross Income Defined.—Determination as to who is the true owner of property in cases involving the sale of securities, or participation interests therein, where the purchaser has the contractual right to cause the security, or participation interest therein, to be purchased by either the seller or a third party.

3 Sections 61 and 163.—Gross Income Define; Interest.—Determinations as to who is the true owner of property or the true borrower of money in cases in which the formal ownership of the property or liability for the indebtedness is in another party.

4 Section 103.—Interest on Certain Governmental Obligations. —Whether municipal bonds will meet the "security interest test" under section 103(b)(2)(B) of the Code and section 1.103-7(b)(4) of the regulations because an underlying arrangement is inferred, as illustrated in Rev. Rul. 80-251, 1980-2 C.B. 40, and Rev. Rul. 80-339, 1980-2 C.B. 42, when payments not pledged as security for the bonds are received in respect of the bond-financed property used in the trade or business of nonexempt persons in an amount equal to more than 25 percent of the principal or interest payments on the bonds.

5 Section 103.—Interest on Certain Governmental Obligations. —Whether an issue of industrial development bonds is exempt under section 103(b) of the Code when 10 percent or more of the proceeds of the issue (minus "neutral costs" as described in Rev. Rul. 80-171, 1980-2 C.B. 44) are used to finance a facility in which an owner (or a related person) or a lessee (or a related person), who was a user of the facility at any time before the bonds were issued, will be a user of the facility after the bonds are issued.

6 Section 162.—Trade or Business Expenses.—Whether the requisite risk shifting and risk distribution necessary to constitute insurance are present for purposes of determining the deductibility under section 162 of amounts paid (premiums) by a taxpayer for insurance, unless the facts of the transaction are within the scope of Rev. Rul. 77-316, 1977-2 C.B. 53, or Rev. Rul. 78-338, 1978-2 C.B. 107.

7 Section 167.—Depreciation.

(a) Useful lives of assets.

(b) Depreciation rates.

(c) Salvage value of assets.

8 Sections 167 and 168.—Depreciation; Accelerated Cost Recovery System.—Application of these sections where the formal ownership of property is in a party other than the taxpayer, except when title is held merely as security.

9 Section 170(c).—Charitable, etc., Contributions and Gifts. —Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property, may deduct the fair market value of the property transferred and leased back as a charitable contribution.

10 Section 302.—Distribution in Redemption of Stock.—The tax effect of the redemption of stock for notes, when the payments on the notes are to be made over a period in excess of 15 years from the date of issuance of such notes.

11 Section 302(b)(4) and (e) (pre-TEFRA section 346(a)(2)).—Partial Liquidation.—Whether a distribution will qualify as a distribution in partial liquidation under section 302(b)(4) and (e)(1)(A) (pre-TEFRA section 346(a)(2)) of the Code unless it results in a 20 percent or greater reduction in (1) gross revenue, (2) net fair market value of assets, and (3) employees.

12 Sections 304 and 357.—Redemption Through Use of Related Corporations; Assumption of Liability.—A transaction similar to that described in Rev. Rul. 80-240, 1980-2 C.B. 116, holding that sections 304(a)(1) and 357(a) of the Code are inapplicable because there was no assumption of liability, unless the taxpayer can satisfy the Internal Revenue Service that the liability was incurred by the taxpayer as a mere intermediary agent for the newly created corporate transferee. To establish this, the taxpayer must submit to the Internal Revenue Service documented evidence, composed at the time the liability was incurred, which indicates that the unrelated lender had agreed to release the transferor-borrower from any and all obligation on the liability in favor of the corporate transferee. Further, the taxpayer must show, or represent to the Internal Revenue Service that transfer and assumption actually occurred, or will actually occur within 12 months of the date the debt was incurred.

13 Section 306.—Disposition of Certain Stock.—Whether the distribution or disposition or redemption of "section 306 stock" in a closely held corporation is in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 306(b)(4) of the Code.

14 Sections 331 and 346(a).—Gain or Loss to Shareholders in Corporate Liquidations.—The tax effect of the liquidation of a corporation by a series of distributions, when the distributions in liquidation are to be made over a period in excess of 3 years from the adoption of the plan of liquidation.

15 Section 341.—Collapsible Corporations.—Whether a corporation will be considered to be a "collapsible corporation," that is, whether it was "formed or availed of" with the view of certain tax consequences. However, ruling requests will be considered on this matter when the enterprise (1) has been in existence for at least 20 years or has clearly demonstrated that it has realized a substantial part of the taxable income to be derived from the manufacturing constructing, producing, or purchasing of property as defined in section 341(b)(1)(A) of the Code and as described in Rev. Rul. 72-48, 1972-1 C.B. 102, (2) has had an aggregate change in the shareholders' interests of not more than 10 percent during that period (except for transfers among family members, as defined in section 267(c)(4)), and (3) had conducted substantially the same trade or business during that period. The period referred to in (2) or (3) above is the lesser of 20 years of corporate existence or the period in which the enterprise has realized a substantial part of the taxable income from activities defined in section 341(b)(1)(A).

16 Section 351.—Transfers to Controlled Corporation.—The tax effect of the transfer when part of the consideration received by the transferors consists of bonds, debentures, or any other evidence of indebtedness of the transferee and the term of the "indebtedness" is either less than 10 years or a determination as to whether the "indebtedness" is properly classified as debt or equity is required in order to establish that the requirements of section 351 are met.

17 Section 801.—Definition of Life Insurance Company.—Whether the requisite risk shifting and risk distribution necessary to constitute insurance are present for purposes of determining if a company is an "insurance company" under section 1.801-3(a) of the regulations, unless the facts of the transaction are within the scope of Rev. Rul. 77-316, 1977-2 C.B. 53, or Rev. Rul. 78-338, 1978-2 C.B. 107.

18 Section 864.—Definitions.—Whether a taxpayer is engaged in trade or business within the United States.

19 Section 871.—Tax on Nonresident Alien Individuals.—The determination as to whether an alien individual is either a resident or nonresident of the United States will not be made with respect to situations in which the determination is dependent on factual representations that cannot be confirmed until the close of the alien individual's affected taxable year(s), that is, representations concerning an alien individual's projected stay and activities in the United States.

20 Sections 894.—Income Affected by Treaty.—Whether a taxpayer has a permanent establishment in the United States for the purpose of any United States Income Tax Treaty.

21 Section 901.—Taxes of Foreign Countries and of Possessions of United States.—Whether a person claiming credit has established, based on all of the relevant facts and circumstances, the amount, if any, paid by the dual capacity taxpayer pursuant to the qualifying levy, that is not paid in exchange for a specific economic benefit. Section 1.901-2A(c)(2) of the regulations.

22 Section 992.—Requirements of a Domestic International Sales Corporation.—The tax effects of a Domestic International Sales Corporation's stock being held by individuals who are also shareholders in a related supplier corporation.

23 Section 7701.—Definitions.—Whether what is generally known as a foreign corporation will be classified as a partnership for U.S. tax purposes if the taxpayer requests classification as a partnership.

24 Section 7701.—Definitions.—Whether a foreign partnership will be classified as an association for U.S. tax purposes if the taxpayer requests classification as an association.

.02 General areas.

1 Any matter in which the determination requested is primarily one of fact, e.g., market value of prop-

erty, or whether an interest in a corporation is to be treated as stock or indebtedness.

2 The tax effect of any transaction to be consummated at some indefinite future time.

3 Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of trade or business.

4 The tax effect of a transaction if any part of the transaction is involved in litigation among the parties affected by the transaction, except for transactions involving bankruptcy reorganizations.

SEC. 5. AREAS UNDER EXTENSIVE STUDY IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED UNTIL THE SERVICE RESOLVES THE ISSUE THROUGH PUBLICATION OF A REVENUE RULING, REVENUE PROCEDURE, REGULATIONS OR OTHERWISE.

.01 Section 61.—Gross Income Defined.—Whether amounts voluntarily deferred by a taxpayer under a deferred compensation plan maintained by an organization described in section 501 of the Code are currently includible in the taxpayer's gross income.

.02 Sections 61 and 162.—Gross Income Defined; Trade or Business Expenses.—The tax consequences with respect to a salary reduction arrangement under which an employee receives and returns salary amounts to the employer. (Also sections 3121, 3306, and 3401).

.03 Section 79.—Group-Term Life Insurance Purchased for Employees.—Whether life insurance provided for employees under a "retired lives reserve" plan will be considered group-term insurance (also sections 61, 72, 83, 101, 162, 264, and 641).

.04 Section 101.—Certain Death Benefits.—Whether proceeds of "self-insured" life and survivor benefit plans established through a trust qualified under section 501(c)(9) of the Code are excludable from the beneficiary's gross income as amounts paid by reason of the death of the insured under section 101(a).

.05 Section 101.—Whether the death benefit payable under a single premium increasing death benefit life insurance policy will be excludable from the gross income of the beneficiary thereof pursuant to section 101(a).

.06 Section 103.—Interest on Certain Governmental Obligations. —With respect to requests made pursuant to Rev. Proc. 79-12, 1979-1 C.B. 492, whether municipal bonds will meet the "trade or business test" and the "security interest test" under sections 103(b)(2)(A) and (B) of the Code and section 1.103-7(b)(5) of the regulations when the proceeds are used to finance facilities such as electric energy, gas or water facilities and, pursuant to a contract to take, or to take or pay for, a nonexempt person purchases 75 percent or more of the actual output of the facility but less than 25 percent of the subparagraph (5) output of the facility as defined in section 1.103-7(b)(5)(ii)(*b*) of the regulations.

.07 Sections 162 and 262.—Commuting Expenses.—Whether expenses are nondeductible commuting expenses.

.08 Section 168(f)(8).—Special Rule for Leases.—The tax consequences in certain areas specifically reserved in the Temporary Income Tax Regulations under the Economic Recovery Act of 1981, relating to special rules for leases. The areas specifically reserved are: section 5c.168(f)(8)-8(b)(9) on retirements and casualties; section 5c.168(f)(8)-9 on the transfer of investment tax credit by section 168(f)(8) leases; section 5c.168(f)(8)-10 on leases between related parties; and section 5c.168(f)(8)-11 on consolidated returns.

.09 Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant-Stockholder.—If a cooperative housing corporation, as defined in section 216(b)(1) of the Code, transfers an interest in real property to a corporation (not a cooperative housing corporation), in exchange for stock or securities of the transferee corporation, which engages in commercial activity with respect to the real property interest transferred, whether (1) the income of the transferee corporation derived from the commercial activity, and (2) any cash and property attributable to the real property interest transfered that may be distributed by the transferee corporation to the cooperative housing corporation, will be considered as gross income of the cooperative housing corporation for the purpose of determining whether 80 percent or more of the gross income of the cooperative housing cooperation is derived from tenant-stockholders within the meaning of section 216(b)(1)(D).

.10 Section 302(b)(4) and (e) (also pre-TEFRA section 346(a)(2) and (b)).—Partial Liquidation.—Whether the absence of an actual redemption of stock is a meaningless gesture within the meaning of Rev. Rul. 79-257, 1979-2 C.B. 136, as amplified by Rev. Rul. 81-3, 1981-1 C.B. 125, when:

(i) the corporation has outstanding more than one class of stock and there are priorities in dividend or liquidating distributions or any other differences in stock rights, or

(ii) either under the terms of the stock or as established contractually, there are outstanding any rights affecting the corporation's stock, such as, but not limited to, warrants, options, convertible securities, shareholder agreements, or rights of first refusal.

.11 Section 306(b)(4).—Transactions Not in Avoidance.—Whether section 306(b)(4) of the Code applies to the distribution and disposition or redemption of "section 306 stock" that is subject to mandatory redemption.

.12 Section 334(b)(2) (pre-TEFRA).—Liquidation of Subsidiary.—Whether an acquiring corporation may treat the life insurance reserves received in the liquidation as unsecured liabilities assumed.

.13 Section 336 (pre-TEFRA). —Distribution of Property in Liquidation.—Whether the liquidation of a life insurance subsidiary is a termi-

nation pursuant to section 815(d)(2).

.14 Section 338 (pre-TEFRA section 334(b)(2)).—Certain Stock Purchases Treated as Asset Acquisitions.—The tax consequences, under subchapter L, from the stock purchase and the deemed purchase of the assets of a life insurance subsidiary.

.15 Section 351.—Transfer to Corporation Controlled by Transferor.—Whether section 351 applies to the transfer of widely held developed or undeveloped real property or interests therein; widely held oil and gas properties or interests therein; or any similarly held properties or interests to a corporation in exchange for shares of stock of such corporation when (i) the transfer is the result of solicitation by promoters, brokers, or investment houses, or (ii) the transferee corporation's stock is issued in a form designed to render it readily tradable.

.16 Section 351.—Transfer to Corporation Controlled by Transferor.—Whether section 351 of the Code applies to the transfer of an interest in real property by a cooperative housing corporation (as defined in section 216(b)(1)) to a corporation in exchange for stock or securities of the transferee corporation when the transferee corporation engages in commercial activity with respect to the real property interest transferred.

.17 Section 368.—Definitions Relating to Corporate Reorganizations.—Whether a transaction qualifies under either section 368(b)(1)(B) or section 351(a) of the Code by reason of Rev. Rul. 67-448, 1967-2 C.B. 144, when the same transaction is structured under sections 368(a)(1)(A) and 368(a)(2)(E) (as a reverse triangular merger) and fails to qualify for an advance ruling under those sections merely because (i) the "substantially all" requirement set forth in section 3.01 of Rev. Proc. 77-37, 1977-2 C.B. 568, is not met, or (ii) the "control" requirement of section 368(a)(2)(E)(ii) is not met where the step transaction doctrine may be applied to treat a prior redemption of stock as part of the plan of reorganization.

.18 Section 368.—Definitions Relating to Corporate Reorganizations.—The tax consequences of a transaction intended to qualify as a reorganization under section 368(a)(1)(E) of the Code when the plan or reorganization provides for the use of contingent or escrow stock arrangements, and where the share adjustment is triggered by an event the occurrence or non-occurrence of which is within the control of the shareholders or is triggered by a Service audit of the shareholders or the corporation.

.19 Section 368.—Definitions Relating to Corporate Reorganizations.—Whether the conversion of a financial institution from mutual to stock will qualify under section 368(a)(1)(G) and section 368(a)(3)(D) of the Code, unless the stock of the converted financial institution is acquired by a financial institution to which either section 585 or section 593 of the Code applies.

.20 Section 422A.—Incentive Stock Options.—Whether Holding (1) of Rev. Rul. 80-244, 1980-2 C.B. 234, relating to section 1036, applies to incentive stock options.

.21 Section 565.—Consent Dividends.—Whether the consent dividend procedure under section 565 applies to corporations other than those corporations to which sections 535, 545, 556, 852, and 857 are applicable.

.22 Section 671.—Trust Income Deductions, and Credits Attributable to Grantor and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (4) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under section 673 to 677.

.23 Section 704(e).—Family Partnerships.—Any matter relating to a family partnership in which, on formation of the partnership or other specified date, there is a special allocation of an item of income, gain, loss, deduction or credit for the purpose of fixing or freezing the value of a partner's partnership interest.

.24 Sections 708 and 741—Issues arising under subchapter K of the Code and issues of disposition or recapture with respect to assets held by a partnership if a corporation that holds a partnership interest liquidates and distributes the partnership interest to shareholders.

.25 Section 721.—Nonrecognition of Gain or Loss on Contribution.—Whether section 721 applies to the contribution of widely held developed or undeveloped real property or interests therein; widely held oil and gas properties or interests therein; or any similarly held properties or interests to a partnership in exchange for an interest in the partnership when (i) the contribution is the result of solicitation by promoters, brokers, or investment houses, or (ii) the interest in the transferee partnership is issued in a form designed to render it readily tradable.

.26 Section 801(b).—Life Insurance Reserves Defined.—Whether the life insurance reserves acquired in the liquidation of a life insurance subsidiary qualify as unsecured liabilities assumed by the acquiring corporation for purposes of section 334(b)(2) (pre-TEFRA) and section 338 (added by TEFRA).

.27 Section 802(b)(3)—Life Insurance Company Taxable Income Defined.—Whether the liquidation of a life insurance sudsidiary pursuant to either section 334(b)(2) (pre-TEFRA) or section 338 (added by TEFRA) is a termination under section 315(d)(2) causing a distribution from the subsidiary's policyholders surplus account.

.28 Section 809(d)(11)—Other Deductions.—Whether a portion of the purchase price of the stock of the life insurance subsidiary is properly allocable to insurance in force.

.29 Section 815(d)(2)—Termination as Life Insurance Company.—Whether the liquidation of a life in-

surance subsidiary pursuant to section 334(b)(2) (pre-TEFRA) or section 338 (added by TEFRA) is a termination requiring the application of section 802(b)(3).

.30 Section 817—Rules Relating to Certain Gains and Losses.—Whether the purchase of the stock of a life insurance subsidiary and its subsequent liquidation under section 334(b)(2) (pre-TEFRA) or section 338 (added by TEFRA) is, in fact, a purchase of the subsidiary's insurance contracts.

.31 Section 818(b)(3)—Amortization of Premium and Accrual of Discount-Exception.—Whether the difference between the face value of bonds held by a life insurance subsidiary liquidating under section 334 (b)(2) (pre-TEFRA) or section 338 (added by TEFRA) and the amount allocable to such bonds pursuant to the liquidation is market discount and need not be accrued.

.32 Section 1248—Gain From Certain Sales or Exchanges of Stock In Certain Foreign Corporations.—Whether the earnings and profits of a controlled foreign corporation attributable to stock exchanged in a transaction subject to section 1248 should be reduced by the amount of gain treated as a dividend in the hands of the seller under section 1248(a).

.33 Section 1502.—Regulations. —Whether a parent cooperative housing corporation (as defined in section 216(b)(1)) will be permitted to file a consolidated income tax return with its transferee subsidiary if the transferee engages in commercial activity with respect to the real property interest transferred to it by the cooperative housing corporation.

.34 Section 2503.—Taxable Gifts. —Whether the transfer of property to a trust will be a gift of a present interest in property when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (4) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (5) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under section 673 to 677.

.35 Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether section 2514(e) of the Code will be applicable to each beneficiary in regard to the power when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (4) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (5) there is right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under section 673 to 677.

.36 Sections 3121, 3306, and 3401. —Employment Taxes.—Who is the employer of an "employee-owner" as defined in section 269A of the Code.

.37 Section 7701.—Definitions. —The classification of arrangements formed as trusts under local law, in which the trust borrows money to purchase equipment or property and leases it to third parties, and in which the grantor or grantors have a beneficial interest in the trust and the power to manage the activities of the trust.

.38 Section 7701.—Definitions. —The classification of limited liability companies for federal income tax purposes.

.39 Section 7701—Definitions. —The classification of an arrangement as a fixed investment trust when the arrangement has multiple classes of equitable ownership.

SEC. 7. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 83-22, 83-31, 83-39, 83-42, 83-45, 83-50, 83-52, 83-53, 83-55, 83-57, 83-60, 83-61, 83-62, 83-64, 83-67, 83-75, 83-80, 83-82, 83-85, 83-88, 84-8, 84-8, 84-12, 84-13, 84-14, 84-15, 84-18, and 84-21 are superseded.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 403, 501; 1.401-1, 1.403(a)-1, 1.501(a)-1)

Rev. Proc. 84-23

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SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 80-29, 1980-1 C.B. 681, to

set forth the procedures of the Internal Revenue Service pertaining to the issuance of opinion letters relating to master or prototype pension, annuity, and profit-sharing plans involving sections 401 and 403(a) of the Internal Revenue Code, as amended by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. 97-248, 1982-2 C.B. 462, and the status for exemptions of related trusts or custodial accounts under section 501(a).

SEC. 2. GENERAL INFORMATION

.01 Rev. Proc. 83-36, 1983-1 C.B. 763, sets forth the general procedures of the Service relating to the issuance of rulings, determination letters, and opinion letters on Employee Plans and Exempt Organization matters.

.02 Rev. Proc. 80-29 sets forth the general procedures relating to the issuance of opinion letters by the National Office as to the acceptability of the form of master and prototype plans.

.03 Rev. Proc. 80-30, 1980-1 C.B. 685, sets forth the general procedures relating to the issuance of determination letters on the qualification of pension, profit-sharing, stock bonus, and bond purchase plans.

.04 TEFRA substantially altered the requirements that a plan must meet in order to be qualified under section 401(a) of the Code. The TEFRA qualification changes are effective for years beginning after December 31, 1983, except for provisions amending Code section 415, which have an earlier effective date. The Service has issued substantive guidelines, specifically cited later in this revenue procedure, for conforming plans to the TEFRA requirements.

SEC. 3. OVERVIEW OF REVENUE PROCEDURE

.01 *Reliance*—Under Rev. Proc. 80-29, most master and prototype plans designed to cover self-employed individuals (HR-10 M & P's) were automatically deemed to satisfy the requirements of section 401(a) of the Code with respect to a particular adopting employer where the sponsor of the master or prototype plan had been issued a favorable opinion letter. However, most opinion letters issued for master and prototype plans not designed to cover self-employed individuals (corporate M & P's) did not express an opinion with respect to whether the plan as adopted by an employer satisfied the requirements for qualification under section 401(a). An employer wishing to know the effect of the adoption of an approved corporate M & P could, however, request a determination letter from the Service as to whether the plan as adopted was qualified. Except in the case of rare or unusual circumstances, an employer adopting an HR-10 M & P received automatic assurance that any disqualification of the plan would be non-retroactive (i.e. reliance), but an employer adopting a corporate M & P needed to obtain a favorable determination letter (and satisfy section 13 of Rev. Proc. 80-30) to have the same reliance. The difference in treatment between HR-10 and corporate M & P's stemmed from the fact that under corporate M & P's many of the qualification requirements (such as coverage and discrimination) depended on the facts and circumstances of the particular employer, while under HR-10 M & P's, the plan would attain qualified status solely on the basis of the applicable statutory provisions.

TEFRA changed the law relating to both plans that cover self-employed individuals and plans that do not. Most of the distinctions between these two types of plans were eliminated. Consequently, plans covering self-employed individuals may utilize plan provisions for which plan qualification may vary with the facts and circumstances of adopting employers. Because the previous distinctions between HR-10 and corporate M & P's have disappeared, it is necessary for the Service to make changes with respect to the reliance on opinion letters. Notwithstanding the changes made by TEFRA, some plans may still attain qualified status without regard to the particular facts and circumstances of the adopting employers. An employer adopting such a plan, a standardized form plan, for which a favorable opinion letter has been issued does not need a determination letter in order to obtain reliance. For the definition of standardized form plan see section 4.07. For special instructions applicable to standardized form plans see section 6. An employer adopting any master or prototype plan other than a standardized form plan must obtain a determination letter for that plan in order to obtain reliance.

.02 *Defined Contribution M & P's Allocation Provision/Employer Reliance*—Rev. Rul. 76-250, 1976-2 C.B. 124, holds that a defined contribution plan may require that a participant be employed as of the last day of the plan year to share in the allocation of employer contributions for that year (employment requirement) but that such an employment requirement may result in prohibited discrimination. Whether or not a defined contribution plan that contains such an employment requirement is discriminatory can only be determined from the facts and circumstances in the actual operation of the plan. Under this revenue procedure defined contribution M & P's, including standardized form plans (see section 4.07), may contain this employment requirement. However, a defined contribution M & P which contains this employment requirement, including a standardized form plan and a plan for which a favorable determination letter has been issued, may subsequently become discriminatory in operation and lose its qualified status as of the date it becomes discriminatory.

.03 *Reductions in Permissible Number of Plans*—Pre-TEFRA, sponsors frequently maintained a large number of different master and prototype plans (HR-10, corporate, pension, profit-sharing, etc.). Because of the parity provisions of TEFRA, the same master or prototype plan can be used for corporate and non-corporate employers. Thus, a single TEFRA plan may be used to replace several plans. However, the sponsor should indicate in accordance with section 9.03 the master or prototype plans that the new plan replaces.

Under this revenue procedure,

combinations of certain categories of plans in one document are not permitted. See section 9.04. However, to ease the administrative burden, the use of one basic plan document for a combination of defined contribution plans and one basic plan document for several defined benefit plans is permitted. See section 4.04 for the definition of the term "basic plan document." The only differences will be in the adoption agreements. See section 4.03 for the definition of the term "adoption agreement."

.04 *Multiple Plans*—A sponsor may utilize one basic plan document with respect to several plans. A sponsor, for example, may submit four plans with respect to a given defined benefit basic plan document (an integrated standardized form plan, a nonintegrated standardized form plan, a non-integrated non-standardized form plan, and an integrated non-standardized form plan). A sponsor also may use one basic plan document for a money purchase plan other than a target benefit plan, a target benefit plan, and a profit-sharing plan. A separate adoption agreement and completed application form must be submitted with respect to each such defined benefit and defined contribution plan. In the case of a simultaneous submission, only one basic plan document need be provided. If the request is not simultaneous, separate basic plan documents must be submitted (but the number of the basic plan document remains the same).

Paired plans must be submitted simultaneously. See section 4.08 for the definition of the term "paired plans." Paired plans are paired by the basic plan documents. Two defined contribution plans that are paired (a profit-sharing and a money purchase plan) must share one basic plan document. A sponsor in pairing a defined benefit plan with a defined contribution plan may provide an integrated defined benefit, and a non-integrated defined benefit plan, as part of the paired plan arrangement only if both the integrated defined benefit plan and the non-integrated defined benefit plan share the identical basic plan document.

.05 *Special Provisions Required in Master and Prototype Plans*—Because of the nature of the master and prototype program, this revenue procedure requires that special provisions be included in every master or prototype plan. Section 5 includes some of these requirements. Thus, for example, plans must contain language permitting the sponsor to amend the master or prototype plans. Furthermore, provisions must be included that assure compliance with section 411(a)(10) and (d)(6) of the Code, such as in the event an adopting employer amends the plan by revising the options selected in the adoption agreement. The plan language is required in order that the employer's plan may remain in the master and prototype program and still satisfy the requirements of sections 411(a)(10) and (d)(6).

Master and prototype plans may be adopted by an employer that has other plans covering the same employees. Such plans must be aggregated for purposes of section 415 of the Code. Aggregation under section 416 of the Code may also be required. It is impossible for sponsors of master or prototype plans to include form language that properly aggregates with any other plan of an adopting employer. Therefore, provision is made to enable adopting employers to add additional language to the master or prototype plan.

.06 *Experimental Mass Submitter Program*—In order to further reduce the paperwork burden, the Service is establishing an experimental mass submitter program. See section 17. This program offers reduced paperwork coupled with faster service. After the TEFRA submissions are substantially completed, the Service will evaluate the effects of this program and decide whether it should be established on a permanent basis.

SEC. 4. DEFINITIONS

.01 *Master Plan*—A "master plan" is a plan (including a plan covering self-employed individuals) that is made available by a "sponsoring organization" (see section 4.06) for adoption by employers and for which a single funding medium (for example, a trust or custodial account) is established, as part of the plan, for the joint use of all adopting employers. A master plan consists of two separate documents, an adoption agreement and a basic plan document (see sections 4.03 and 4.04).

.02 *Prototype Plan*—A "prototype plan" is a plan (including a plan covering self-employed individuals) which is made available by a sponsoring organization for adoption by employers and under which a separate funding medium is established for each adopting employer. A prototype plan consists of two separate documents, an adoption agreement and a basic plan document.

.03 *Adoption Agreement*—An "adoption agreement" is the portion of the plan containing all the options that may be selected by the adopting employer.

.04 *Basic Plan Document*—A "basic plan document" is the portion of the plan containing all the nonelective provisions applicable to all adopting employers. No options (including blanks to be completed) may be provided in the basic plan document.

.05 *Opinion Letter*—An "opinion letter" is a written statement issued by the National Office to a sponsoring organization pursuant to this revenue procedure as to the acceptability of the form of a master or prototype plan and any related trust or custodial account under sections 401, 403(a), and 501(a) of the Code.

.06 *Sponsoring Organization*—A "sponsoring organization" is a trade or professional organization having characteristics similar to those described in section 1.501(c)(6)-1 of the Income Tax Regulations, a bank (as defined in section 581 of the Code), an insured credit union (within the meaning of section 101(6) of the Federal Credit Union Act), an insurance company, a regulated investment company (as defined in section 851), an investment advisor that has an advisory contract with one or more regulated investment companies, or a principal underwriter that has a principal underwriting contract with one or more regulated investment companies.

.07 *Standardized Form Plan*—A "standardized form plan" is a master or prototype plan which meets the following requirements:

1 The provisions governing eligibility and participation are such that the plan by its terms must cover all employees except those that may be excluded under section 410(a)(1) or (b)(3) of the Code. For example, a plan providing full and immediate vesting may exclude employees who do not have at least three years of service. However, the adoption agreement may provide options as to whether some or all of the employees described in sections 410(a)(1) and (b)(3) are to be excluded.

2 The eligibility requirements under the plan are not more favorable for officers, owners, or highly compensated employees than for other employees.

3 The vesting schedule in the plan provides vesting at a rate at least as favorable for every year as would be required by the schedules set forth in section 416(b)(1)(A) or (B) of the Code if the plan were top-heavy for every year after 1983.

4 The contributions (including forfeitures) provided under the plan (if a defined contribution plan other than a target benefit plan) or the benefits (if a defined benefit plan or a target benefit plan that complies with Rev. Rul. 76-464, 1976-2 C.B. 115) are a uniform percentage of total compensation. In making this determination, the plan may take into account benefits provided under the Social Security Act, provided the plan is properly integrated.

.08 *Paired Plans*—"Paired plans" are either a combination of two defined contribution standardized form plans or a combination of one or two defined contribution standardized form plans and one defined benefit standardized form plan (for example, a money purchase pension plan, a profit-sharing plan and a unit benefit or flat benefit pension plan), so designed that if any single plan, or combination of plans, is adopted by an employer, each plan by itself, or the plans together, will meet the anti-discrimination rules set forth in section 401(a)(4) of the Code, the contribution and benefit limitations set forth in section 415, and the top-heavy provisions set forth in section 416. Paired plans must have the same sponsoring organization.

SEC. 5. PROVISIONS REQUIRED IN EVERY MASTER OR PROTOTYPE PLAN

.01 *Sponsor Amendments*—Master or prototype plans must provide a procedure for sponsor amendment so that changes in the Code, regulations, revenue rulings or other statements published by the Internal Revenue Service, or corrections of prior approved plans may be applied on a group basis.

.02 *Employer Amendments*—Except for amendments permitted under sections 5.04 and 5.08, an employer that amends any provision of an approved master or prototype plan including its adoption agreement (other than to change the choice of options, if the plan permits or contemplates such a change) or an employer that chooses to discontinue participation in a plan as amended by its sponsoring organization and does not substitute another approved master or prototype plan is considered to have adopted an individually designed plan. The procedures stated in Rev. Proc. 80-30 and Notice 83-12, 1983-2 C.B. 412, relating to the issuance of determination letters for individually designed plans, will then apply to the plan as adopted by the employer.

.03 *Anti-Cutback Provisions*—Master or prototype plans must specifically provide for the protections of sections 411(a)(10) and (d)(6) of the Code in the event that the employer amends the plan in any manner such as revising the options selected on the adoption agreement or adopting a new master or prototype plan. In the case of a master or prototype plan that does not contain vesting for all years at least as favorable to participants as that provided in section 416(b) in the event a plan is not top-heavy, such plan must specifically provide that the vesting that occurs while the plan is top-heavy will not be cut back if the plan ceases to be top-heavy.

.04 *Adopting Employer Modification to Satisfy Sections 415 and 416*—Master or prototype plans must provide that the plan provisions may be amended by overriding plan language completed by the employer in the adoption agreement where such language is necessary to satisfy section 415 or 416 of the Code because of the required aggregation of multiple plans under these sections. (In the event of such an amendment the adopting employer must obtain a determination letter in order to continue reliance on the plan's qualified status.)

.05 *Defined Contribution Section 415 Aggregation*—Plan language must be incorporated that aggregates all defined contribution master and prototype plans to satisfy section 415(c) of the Code. Acceptable language is provided in the Service's Listing of Required Modifications and may be obtained by writing to the Commissioner of Internal Revenue, Washington, DC 20224, Attention OP:E:EP:RQ:1.

.06 *Top-heavy Requirements*—Except to the extent described in section 7.03 relating to paired plans, each plan must either provide that all the additional requirements applicable to top-heavy plans (described in section 416 of the Code) apply at all times or provide that such requirements apply automatically if the plan is top-heavy regardless of how the adoption agreement is completed. In any case where the latter option is chosen, all the requirements for determining whether the plan is top-heavy must be included in the plan. See Questions T-25 and T-26 in section 1.416-1 of the Proposed Income Tax Regulations, 48 F.R. 10868, 1983-1 C.B. 832, 840.

.07 *Additional Top-heavy Minimums to Satisfy Section 415(e)*—Each plan must provide automatically or by optional provisions the additional minimums described in section 416(h)(2)(A) of the Code.

.08 *Plan Language Required in Money Purchase Plans Receiving Waivers*—Each money purchase master or prototype plan (including target benefit plans) must provide either standard language (obtainable

as described in section 5.05) that satisfies Rev. Rul. 78-223, 1978-1 C.B. 125, in the event of a waiver of the minimum funding requirements or that an employer may amend the plan by adding overriding plan provisions in the adoption agreement in the event of a waiver of the minimum funding requirement under section 412(d) of the Code.

.09 *Provision in Adoption Agreement on Extent of Reliance*—In order to avoid unnecessary confusion as to the scope of an opinion letter, sponsoring organizations must include in the adoption agreement of all master or prototype plans (other than standardized form and paired plans), in close proximity to the signature blank, a statement that adopting employers may not rely on an opinion letter issued by the National Office with respect to the qualification of that plan and should apply to the appropriate key district for a determination letter in order to obtain reliance. Standardized form and paired plans must also include a similar statement in the adoption agreement that the adopting employer may not rely on the opinion letter issued by the National Office and should apply for a determination letter if the employer maintains or later adopts any plan in addition to the standardized form plan or paired plans. The adoption agreement must state that it is to be used with one and only one specific basic plan document.

.10 *Definition of Employee/Sections 414(b), (c), (m), and (n)*—Each master or prototype plan must include a definition of employee as any employee of the employer maintaining the plan or of any other employer aggregated under section 414(b), (c), or (m) of the Code. The definition of employee shall also include any individual deemed under section 414(n) of the Code to be an employee of any employer described in the previous sentence.

.11 *Definition of Service/Sections 414(b), (c), (m) and (n)*—Each master or prototype plan must specifically credit all service with any employer aggregated under section 414(b), (c), or (m) of the Code as service with the employer maintaining the plan. In addition, in the case of an individual deemed under section 414(n) of the Code to be the employee of any employer described in the previous sentence, service with such employer must be credited to such individual.

.12 *Specific Non-TEFRA Requirements*—In addition to other substantive requirements, master or prototype plans must comply with the requirements of the Revenue Rulings and Notices listed below:

1 Rev. Rul. 79-90, 1979-1 C.B. 155 (statement in plan of basis for determining actuarial equivalence),

2 Rev. Rul. 81-211, 1981-2 C.B. 98 (requiring full vesting at normal retirement age rather than at normal retirement date),

3 Notice 82-7, 1982-1 C.B. 357 (amendments to comply with the requirements under section 414(m) of the Code),

4 Notice 82-9, 1982-1 C.B. 358 (amendments to comply with final regulations under section 415 of the Code prior to amendment by TEFRA), and

5 Notice 82-23, 1982-2 C.B. 752 (amendments to comply with final regulations on suspension of benefits).

SEC. 6. STANDARDIZED FORM PLANS

.01 *Reliance*—An employer adopting a standardized form plan or paired plans has reliance, except as provided in section 6.02, if the provisions of section 15.011 of Rev. Proc. 80-30, as modified by section 18.02 of this revenue procedure, are satisfied.

.02 *Non-Reliance by Employer Maintaining More than One Plan*—Except in the case of one combination of paired plans, an employer may not rely on opinion letters for standardized form plans without obtaining a determination letter if the employer maintains at any time, or has maintained at any time, any other plan, including a standardized form plan, that was qualified or determined to be qualified covering some of the same participants.

.03 *Sharing Basic Plan Document By Standardized and Non-Standardized Plans*—A sponsor may establish a basic plan document that applies to both a standardized form plan and a plan that is not a standardized form plan. Such plans may differ only by the different adoption agreements. For example, the adoption agreement for the plan that is not a standardized form plan may have additional coverage options.

SEC. 7. SPECIAL REQUIREMENTS FOR PAIRED PLANS

.01 *Limits of Section 415(e) Must Be Provided in Defined Benefit Plan Only*—The benefits under a defined benefit plan in a combination of paired plans must be limited by the requirements of section 415(e) of the Code relating to the aggregation of defined benefit and defined contribution plans. Adjustments to satisfy the requirements of section 415(e) may only be provided in the defined benefit plan with respect to benefits thereunder.

.02 *Section 416(h) Adjustment to Section 415(e) Limits*—Paired plans that include a defined benefit plan must compute the denominators of defined benefit and defined contribution fractions in a manner satisfying section 416(h)(1) of the Code unless the requirements of section 416(h)(2) are satisfied. Paired plans providing the additional section 415(e) limits must provide, regardless of how the adoption agreement is completed, the additional top-heavy minimums described in section 416(h)(2)(A) and provide that the higher section 415(e) limits will not apply if the plan is super top-heavy as described in question T-24 in section 1.416-1 of the Proposed Income Tax Regulations, 48 F.R. 10868, 1983-1 C.B. 832, 838. In testing for super top-heavy, all the requirements of questions T-25 and T-26 in section 1.416-1 of the proposed regulations must be included in the plan.

.03 *Coordination of Minimum Benefits and Contributions Under Top-Heavy Plans*—Paired plans, subject to the limits of section 415 of the Code, may provide duplication of the minimum benefits and contributions in each of the plans being paired. The paired plans (when they become top-heavy) may, however, provide minimum contributions and

benefits that are not duplicative. In that case, only two methods may be used:

1 The defined benefit plan must provide the 2% (3% if the additional section 415(e) limit is used) defined benefit minimum for all its participants. The defined contribution plan must provide the defined contribution minimum for participants in the defined contribution plan who are not participants in the paired defined benefit plan, or

2 The defined contribution plan must provide a contribution not less than 5% (7½% if the additional section 415(e) limit is used) with respect to any participant who is a participant in a paired defined benefit plan and a contribution not less than 3% (4% if the additional section 415(e) limit is used) for any participant who is not a participant in the paired defined benefit plan. The defined benefit plan must provide the 2% minimum (3% if the additional section 415(e) limit is used) with respect to any participant who is not in the defined contribution plan or who does not receive the entire defined contribution allocation.

.04 *Pairing Provisions Must be in the Basic Plan Document*—In the case of paired plans, all provisions necessary to coordinate the plans must be set forth in the basic plan document and not in the adoption agreement.

.05 *Sponsor Limited to One Set of Paired Basic Plan Documents*—A sponsor may not adopt more than one set of paired basic plan documents. Such set is limited to two different basic plan documents: one for defined benefit and one for defined contribution. The pairing of defined contribution plans requires only one basic plan document such as a profit-sharing plan and a money purchase plan containing the identical basic plan document and two different adoption agreements. A sponsor may provide a pairing of defined benefit and defined contribution plans in such a manner that with two different basic plan documents and three adoption agreements, an adopting employer may adopt a profit-sharing plan, a money purchase plan, and a defined benefit plan.

SEC. 8. OPINION LETTERS-SCOPE

.01 *Issuance Only to Appropriate Sponsors*—Opinion letters will be issued only to sponsoring organizations and do not constitute rulings or determinations as to either the qualification of the plans as adopted by particular employers or, in the case of prototype plans, the exempt status of related trusts or custodial accounts.

.02 *Nonapplicability of this Procedure to IRAs and SEPs*—Opinion letters will not be issued under this revenue procedure for prototype plans intended to meet the requirements for individual savings programs or simplified employee pension programs under section 408 of the Code (see Rev. Proc. 75-6, 1975-1 C.B. 646, Rev. Proc. 76-32, 1976-2 C.B. 634, and Rev. Proc. 80-17, 1980-1 C.B. 621).

.03 *Areas Not Covered by Opinion Letters*—Opinion letters will not be issued for:

1 Collectively-bargained plans (section 413(b) of the Code);

2 Stock bonus plans;

3 Plans containing a cash or deferred arrangement as described in section 401(k) of the Code;

4 Bond purchase plans;

5 Employee stock ownership plans (see Rev. Proc. 75-48, 1975-2 C.B. 583);

6 Pooled fund arrangements contemplated by Rev. Rul. 81-100, 1981-1 C.B. 326;

7 Annuity contracts under section 403(b) of the Code;

8 Pattern plans (see Rev. Proc. 76-15, 1976-1 C.B. 553);

9 Field prototype plans (see Rev. Proc. 77-23, 1977-2 C.B. 530);

10 Defined contribution plans (except for target benefit plans) under which the test for prohibited discrimination under section 401(a)(4) of the Code is made by reference to benefits rather than contributions;

11 Plans that involve integration with Social Security benefits except for plans that define annual compensation to be all of each employee's compensation (such plans may, however, limit the dollar amount of compensation that will be considered) that would be subject to taxation under section 3101(a) of the Code without the dollar limitation of section 3121(a)(1);

12 Plan described in section 414(k) of the Code (relating to a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant);

13 Target benefit plans that integrate with Social Security benefits using the offset method of integration;

14 Profit-sharing plans that allocate contributions or forfeitures to the account of any participant in any manner other than on the basis of compensation;

15 Governmental plans described in section 414(d) of the Code;

16 Church plans described in section 414(e) of the Code that have not made the election provided by section 410(d).

SEC. 9. OPINION LETTERS—INSTRUCTIONS TO SPONSORING ORGANIZATIONS

.01 *National Office Issues Opinion Letters*—The National Office will, upon the request of a sponsoring organization, issue an opinion letter as to the acceptability under section 401 of the Code of the form of a master or prototype plan and any related trust or custodial account.

.02 *Forms and Address for Requesting Opinion Letters*—A request for an opinion letter relating to a master or prototype plan must be submitted on the current version (revision of February 1984 or more current date when subsequently revised) of Form 4461, Application for Approval of Master or Prototype Defined Contribution Plan, or Form 4461-A, Application for Approval of Master or Prototype Defined Benefit Plan, as appropriate, regardless of whether the plan is designed to include self-employed individuals. The request is to be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224, Attention: OP:E:EP:RQ:E.

.03 *Replacement of Plans*—If the plan is intended to replace one or more other plans of the sponsoring

organization, the sponsoring organization must identify the replaced plan(s) by the file folder number(s).

.04 *Separate Master or Prototype Plan Required for Different Categories of Plans*—An application for a master or prototype plan shall not contain any combination of profit-sharing, money purchase (other than target benefit), target benefit, non-integrated defined benefit, or integrated defined benefit plan features. However, separate defined contribution plans may have the same basic plan document. Similarly, separate integrated and non-integrated defined benefit plans may have the same basic plan document. In the case where plans share the same basic plan document, the provisions of such basic plan document must be word for word identical.

.05 *Additional Information May Be Requested*—The Service may, at its discretion, require any additional information that it deems necessary.

.06 *Inadequate Submissions*—The Service will return, without further action, plans which are not in substantial compliance with the qualification requirements or plans that are so deficient that they cannot be reviewed in a reasonable amount of time. A plan will not be considered to be in substantial compliance if, for example, it omits any of the TEFRA requirements set forth below, or merely incorporates these requirements by reference to the applicable Code section. The Service will not consider these plans until after they are revised, and they will be treated as new requests as of the date they are resubmitted. The following are some examples of TEFRA requirements the omission of which will cause a plan to be regarded as not being in substantial compliance:

1 Section 401(a)(9) of the Code, as amended by section 242 of TEFRA, relating to required distributions from qualified plans (see Notice 83-23, 1983-2 C.B. 418).

2 Section 415 of the Code, as amended by section 235 of TEFRA, relating to lower contribution and benefit limits for qualified plans. (See Notice 83-10, 1983-1 C.B. 536, for guidelines in meeting these requirements.)

3 Section 416 of the Code, as added by section 240 of TEFRA, containing special rules for top-heavy plans. (See section 1.416-1 of the Proposed Income Tax Regulations, 48 F.R. 10868, 1983-1 C.B. 832,833, for guidance in meeting the top-heavy requirements.)

4 If the plan is an integrated defined contribution plan, section 401(1) of the Code, as added by section 249 of TEFRA, relating to nondiscriminatory coordination with Social Security benefits. (See Rev. Rul. 83-110, 1983-2 C.B. 70, for guidance in meeting this requirement.)

5 Section 414(m) of the Code, including section 414(m)(5), as added by section 236 of TEFRA.

6 Section 414(n) of the Code, as added by section 248 of TEFRA.

7 Section 401(c) and (d) of the Code, as amended by sections 237 and 238 of TEFRA, unless the plan precludes participation by self-employed individuals.

.07 *Material Furnished to Adopting Employers*—A sponsoring organization must furnish each adopting employer with a copy of the approved plan, copies of any subsequent amendments, and the most recently issued Internal Revenue Service opinion letter.

.08 *Nonidentification of Questionable Issues May Cause Delay*—If the plan document submitted as part of an opinion letter request contains a provision that gives rise to an issue for which contrary authorities exist, failure to disclose and distinguish significant contrary authorities may result in requests for additional information, which will delay action on the request (see section 7.06 of Rev. Proc. 83-36).

.09 *Material Furnished to Key District Offices*—A copy of the approved master or prototype plan and the Internal Revenue Service opinion letter must be furnished by the sponsoring organization to each Internal Revenue Service key district office in whose jurisdiction there are employers who adopt the plan. The sponsoring organization must also furnish key district offices with a copy of all amendments subsequently approved as to form by the National Office.

SEC. 10. AMENDMENTS

.01 *Opinion Letters for Sponsor Amendments*—A sponsoring organization may amend its previously approved plan (including any related trust or custodial account) and the National Office will entertain a request for a written opinion as to the acceptability, for purposes of sections 401, 403, and 501(a) of the Code, of the form of the plan as amended. If the plan is being amended for the first time to comply with TEFRA, the procedures set forth in section 9 must be followed. Otherwise, the sponsoring organization must submit Form 4461 or Form 4461-A, as applicable, to the National Office, together with a copy of the amendment(s), and a cover letter summarizing the changes to the plan effected by such amendment(s).

.02 *No Opinion Letters for Certain Amendments*—No opinion letter will be issued regarding the effect of amendment solely covering the following:

1 Amendments to conform a plan to the requirements of section 402(a) of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, relating to named fiduciaries.

2 Amendments to conform a plan to requirements of section 503 of ERISA, relating to claims procedures.

3 Amendments that merely adjust the maximum limitations under section 415 of the Code to reflect annual cost-of-living increases, other than amendments that add an automatic cost-of-living adjustment provision to the plan.

Any amendment noted above will not affect the status of a favorable opinion letter previously issued with respect to a plan. The Service will not accept any requests for opinion letters regarding such amendments.

.03 *Required Plan Restatement*—No more than four consecutive amendments may be submitted without restating the plan. Furthermore, amendments to initially comply with TEFRA must restate the plan. The Service may, at its discretion, require

plan restatement at any time that it deems necessary.

SEC. 11. DETERMINATION LETTER PROCEDURES

Except as provided in section 6, approval by the Service of the form of a master or prototype plan under this revenue procedure does not constitute a determination that an employer who adopts the plan will have a qualified plan. Therefore, such an adopting employer should request a determination letter in accordance with the procedures set forth in Rev. Proc. 80-30.

SEC. 12. EFFECT OF PRIOR SERVICE APPROVAL

.01 *Continued Reliance/Proper Amendment by Sponsor*—The reliance obtained by prior adopters of master or prototype plans for which favorable opinion or determination letters were received under the procedures in effect before the effective date of this revenue procedure will continue for plan years beginning after December 31, 1983, only if: (1) the sponsoring organization submits the plan or a replacement plan to the Service with the provisions required by section 5 on or before December 31, 1984, and (2) unless subject to section 12.03, the employer adopts the amendments or replacement plan and, except as provided in section 6, requests a determination letter on or before the later of (a) the last day of the twelfth calendar month from the time the Service issues an opinion letter with respect to such plan, or (b) the end of any remedial amendment period provided by regulations under section 401(b) of the Code. Such amendments must be effective as of the beginning of the first plan year commencing after December 31, 1983, except for amendments described in section 5.12, which must be effective as provided in the respective revenue rulings and notices.

.02 *Lists of Plans to be Published by the Service*—The Service will publish in the Internal Revenue Bulletin

1 Periodically, after June 30, 1984, a list of the sponsoring organizations and their related plans which have been submitted in accordance with this procedure, and

2 Quarterly, after the first list is published, the list of sponsoring organizations and their related plans (included in the list in paragraph 1) which (a) receive favorable opinion letters (and the respective date issued), (b) receive unfavorable opinion letters, or (c) withdraw their requests for opinion letters.

.03 *Continued Reliance/No Proper Amendment by Sponsor*—A previously adopting employer whose master or prototype plan is not included in the list described in subsection .021 that contains those plans that have been properly submitted by December 31, 1984, or whose plan is included in one of the lists described in subsection .022(b) or (c) may either (a) amend its plan to satisfy the requirements of section 5 in which case the plan will be treated as individually designed, or (b) adopt another master or prototype plan with TEFRA amendments which has been the subject of a favorable opinion letter from the Service under this revenue procedure and, if appropriate, request a determination letter with respect to that plan. In either case, the adoption date shall not be later than the last day of the month which is six months after the month of publication of such list.

SEC. 13. APPROVED PLANS—MAINTENANCE OF APPROVED STATUS

.01 *Revocation of Opinion Letter by the Service*—An opinion letter found to be in error or not in accord with the current views of the Service may be revoked. Revocation may be effected by a notice to the sponsoring organization to which the letter was originally issued, or by a regulation, revenue ruling or other statement published in the Internal Revenue Bulletin.

.02 *Subsequent Required Amendments*—An approved master or prototype plan must be amended to retain its approved status if any provisions therein fail to meet the requirements of law, regulations, or other rules and guidelines affecting qualification that become effective subsequent to the issuance of an opinion letter.

.03 *Amendments Following Revenue Rulings*—An opinion letter will not be adversely affected by the publication of a revenue ruling if an amendment conforming the plan to the requirement of the revenue ruling is made by the sponsoring organization within one year after publication of the revenue ruling in the Internal Revenue Bulletin to be effective for all adopting employers for their plan years beginning within such one year period.

SEC. 14. WITHDRAWAL OF REQUESTS

.01 *Notifications and Effect*—A sponsoring organization may withdraw its request for an opinion letter at any time prior to the issuance of such letter by notifying the National Office in writing of such withdrawal. The sponsoring organization must also notify each employer who adopted the plan that the request has been withdrawn. Such an employer will be deemed to have an individually designed plan to which Rev. Proc. 80-30 applies.

.02 *Service Retains Information*—Even though a request is withdrawn, the National Office will retain all correspondence and documents associated with that request and will not return them to the sponsoring organization. The National Office may furnish its views concerning the qualified status of the plan to District Directors who have or will have audit jurisdiction of the returns of any employers who have adopted the plan.

SEC. 15. ABANDONED PLANS

.01 *Notification to the Service*—A sponsoring organization should notify the National Office in writing of an approved master or prototype plan that is no longer used by any employer and that the sponsoring organization no longer intends to offer for adoption. Such written notification should be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224, Attention: OP:E:EP:RQ:E, and should refer to the file folder number appearing on the latest opinion letter issued.

.02 *Notification to Employers*—A sponsoring organization that intends

to abandon an approved master or prototype plan that is in use by any adopting employer must inform each adopting employer that the form of the plan has been terminated and that the employer may not continue to rely on the plan's opinion letter. After so informing all adopting employers, the sponsoring organization should notify the National Office in accordance with the subsection .01 above.

SEC. 16. SPECIAL PROVISIONS RELATED TO TEFRA

.01 *Delayed Submissions*—No applications for approval of master and prototype plans under this revenue procedure may be submitted prior to the expiration of 90 days after the effective date of this revenue procedure. Any such application will be returned.

.02 *Nonprocessing of Non-TEFRA Master and Prototype Plans*—Effective immediately no master or prototype (new plan or amendment) will be processed if the new plan or amendment does not satisfy TEFRA. Furthermore, all pending cases (both new plans and amendments) will be returned.

SEC. 17. EXPERIMENTAL ONE-TIME MASS SUBMITTER PROGRAM

.01 *Opinion Letters Issued to Mass Submitters*—Notwithstanding anything to the contrary, opinion letters will be issued to any entity whether or not such entity is a sponsoring organization if such entity can establish that there are at least 10 sponsoring organizations who will sponsor the identical master or prototype plans. The list of sponsoring organizations must be included in the submission. Such opinion letters will only apply to the mass submitter and may be made available by the mass submitter to an adopting employer only if the mass submitter is also a sponsoring organization defined in section 4.06. All other sponsoring organizations must obtain an opinion letter.

.02 *Reduced Procedural Requirements for Sponsoring Organizations Which Use Mass Submitter Plans*—A sponsoring organization of a master or prototype plan of a mass submitter must obtain an opinion letter. The request for the opinion letter must be submitted by the mass submitter on behalf of the sponsoring organization and must contain a declaration by the mass submitter under penalty of perjury that the sponsoring organization has adopted a particular, word for word identical, master or prototype plan of the mass submitter, which plan must be identified by the letter serial number and date of the opinion letter issued to the mass submitter with respect to that plan. If the sponsoring organization is sponsoring the identical plan, a copy of the plan need not be submitted. However, the mass submitter on behalf of the sponsoring organization must complete Part I, Items 1-17, of the forms described in section 9.02. Upon receipt of the request for an opinion letter, described above, the Service will, as soon as clerically feasible, issue an opinion letter to the sponsoring organization. After 10 sponsoring organizations have adopted the identical plan, other sponsoring organizations may adopt the plan with minor modifications. In that case the request must contain, in addition to the material described above, a copy of the plan for which that mass submitter received the opinion letter with the minor modifications inserted in a manner that is easily identifiable as well as a statement indicating the purpose and effect of each change. The mass submitter must submit the request on behalf of the sponsoring organization and must certify under penalty of perjury that the plan of the sponsoring organization except for the delineated changes is word for word identical to the plan upon which the mass submitter received a favorable opinion letter. The Service will review the changes on a priority basis and issue an opinion letter to the sponsoring organization as soon as possible.

.03 *Expeditious Processing Accorded Mass Submitter Plans*—Mass submitter plans, including the adoption of approved mass submitter plans by sponsoring organizations, will be accorded more expeditious processing than master and prototype plans submitted by non-mass submitters.

.04 *Applicability*—This section is not applicable to restatements or replacements of plans for which a favorable opinion letter has been issued in accordance with this procedure.

SEC. 18. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 80-29 is hereby superseded.

.02 Section 15.01 of Rev. Proc. 80-30 is modified by renumbering paragraph 4 as 2 after replacing paragraphs 1, 2 and 3 with the following:

1 A standardized form plan or paired plans as defined in sections 4.07 and 4.08 of Rev. Proc. 84-23 provided that:

(a) The sponsoring organization of such plan or plans has a currently valid favorable opinion letter from the National Office,

(b) The employer has followed the terms of the plan(s), and the coverage and contributions or benefits under the plan(s) are not more favorable for officers, owners or highly compensated employees than for other employees,

(c) The employer has properly notified all interested parties of the adoption of the plan(s) in accordance with sections 7 and 8, above, and

(d) The employer has not received, within 120 days after the date of adoption of the plan(s), notice from the Service that the plan(s) will not be treated as qualified pursuant to this subsection. (In this regard, see section 4.14, above.)

SEC. 19. EFFECTIVE DATE

This revenue procedure is effective March 19, 1984, the date it is published in the Internal Revenue Bulletin.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 84-24

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide requirements for the preparation of transmittal documents for annual information returns (Forms 1099, Statement for Recip-

ients series; W-2G, Statement for Certain Gambling Winnings; and 5498, Individual Retirement Arrangement Information) and to estabish guidelines for the proper use of names and taxpayer identification numbers on such transmittals.

SEC. 2. BACKGROUND

.01 Information returns, whether filed on paper documents or on magnetic media, must be accompanied by transmittal documents. For magnetic media submissions, the transmittal document is Form 4804, Transmittal of Information Returns Reported on Magnetic Media. For transmittal of Forms 1099-R or W-2G on paper documents, the required transmittal document is Form W-3G, Transmittal of Certain Information Returns. For all other 1099 series returns and Forms 5498 filed on paper documents, the required transmittal is Form 1096, Annual Summary and Transmittal of U.S. Information Returns.

.02 For purposes of this revenue procedure, a transmittal document and its related information returns is a transmittal. One or more transmittals filed together is a shipment.

.03 Additional procedures concerning the preparation of magnetic media returns, transmittal documents, transmittals and shipments are contained in the revenue procedures for magnetic media reporting of information returns.

.04 Additional instructions concerning the preparation of paper document returns are contained in the instructions on Forms 1096 and W-3G.

SEC. 3. GENERAL GUIDELINES FOR PREPARATION AND USE OF TRANSMITTAL DOCUMENTS

.01 Separate transmittals are required when a payer is filing more than one type of information return on paper documents.

.02 One transmittal is required for all information returns included on magnetic media. If a transmitter is submitting information returns for more than one payer, the transmittal will be continued by attaching Forms 4802, Multiple Payer Transmittal for Magnetic Media Reporting.

.03 Correction documents are not permitted on the same transmittal as original documents.

.04 Separate transmittals are required if a payer files some information returns on magnetic media and other information returns on paper documents.

.05 Separate transmittals are required if a payer files some information returns directly and files other returns through a service bureau or agent or files returns through several service bureaus or agents.

.06 Payers, service bureaus, or agents filing information returns on paper documents may include several transmittals in a single shipment. In the case of service bureaus or agents, the shipment may come from several payers as long as each payer is clearly identified.

SEC. 4. PROVISIONS FOR MULTIPLE TRANSMITTALS

.01 Multiple transmittals may be filed at the option of the payer when magnetic media information returns are prepared at multiple business locations or by different segments of the payer's organization and cannot be conveniently consolidated into a single transmittal.

.02 Multiple transmittals may be filed at the option of the payer when the same type of information return is prepared on paper documents at multiple locations or by different segments of the payer's organization and cannot be conveniently consolidated into a single transmittal.

SEC. 5. PAYER'S TAXPAYER IDENTIFICATION NUMBER (TIN)

.01 The same payer TIN must be used on all transmittals; i.e., the same TIN must appear on all transmittal documents and information returns filed by a payer, regardless of whether such transmittals are filed from more than one location or segment of the payer's organization.

.02 The following must be used on transmittal documents and information returns:

(a) For taxable trade or business payers, the TIN used on the payer's tax returns (Exception: Sole proprietors must use their Employer Identification Number (EIN) unless they are not required to have an EIN and then they must use their Social Security Number (SSN)),

(b) For non-profit organizations, the TIN used on the payer's Form 990 return,

(c) For governmental bodies, the TIN issued to the headquarters organization having financial reporting responsibilities, and

(d) For individuals not engaged in a trade or business, their SSN.

.03 The payer must use the same TIN on transmittal documents and information returns each year returns are filed.

.04 A parent corporation and its subsidiary corporations are separate payer entities and must submit appropriate transmittals for each corporation under its own name and TIN. See Revenue Ruling 65-303, 1965-2 C.B. 434.

.05 Payer TINs on the information returns filed with the Internal Revenue Service must be identical to those on the statements issued by the payers to recipients of such payments.

SEC. 6. PAYER'S NAME AND ADDRESS

.01 The payer must use the same name each year on transmittal documents and information returns. The name must be consistent with the name contained on the income tax return, exempt organization return, or other return filed under the payer's TIN (see Section 5 above).

.02 When multiple transmittals are filed because information returns are prepared at different business locations or by different segments of the payer's organization, the payer must provide two name lines on the transmittal document.

(a) The first name line of the payer contains the primary name of the payer entity (see Section 6.01 above). For governmental bodies, the primary name is that of the federal, state, or local agency.

(b) The second name line must identify the specific business

locations or segment of the organization preparing the transmittal document and information return and must be consistent each year. (The second name line will be helpful to payees in identifying the source of payment and will be helpful to payers in resolving questions on transmittals referred to them by the Service).

.03 The following examples illustrate the name, address, and TIN to be used on multiple transmittal documents and information returns by payers.

(a) Able Industries
EIN: 01-0101010
Main Office
333 Main Street
Mapleville, MO 33333

(b) Able Industries
EIN: 01-0101010
Shareholder Relations Dept.
333 Main Street
Mapleville, MO 33333

(c) Able Industries
EIN: 01-0101010
Western Office
222 Metropolitan Avenue
Millvilee, UT 22222

(d) Able Industries
EIN: 01-0101010
Floral Products Division
444 Tulip Street
Megalopolis, PA 44444

(e) U.S. Department of Land
EIN: 02-0202020
Headquarters Office
3142 B Street, S.W.
Washington, D.C. 55555

(f) U.S. Department of Land
EIN: 02-0202020
Elmwood Office
2413 Rose Street
Elmwood, GA 66666

(g) State Dept. of Education
EIN: 03-0303030
Headquarters Office
111 Maple Street
Elmwood, AL 77777

(h) State Dept. of Education
EIN: 03-0303030
State University of Pineville
Pineville, AL 88888

.04 For individuals engaged in a trade or business with a "doing business as" (dba) name, the individual payer must provide two name lines on the transmittal document. The first name line must be the name shown on the individual's income tax return. The second name line must be the "dba" name.

.05 The following examples illustrate the name, address, and TIN to be used by sole proprietors.

(a) Person with a dba name, who has an EIN:
John Oak EIN: 04-0404040
Maple City Auto Repair
123 Main Street
Maple City, NC 11111

(b) Person with a dba name and not required to have an EIN:
Jane Apple SSN: 999-99-9999
Hometown Accounting Service
25 Cherry Street
Rosewood, OR 99999

(c) Person who has EIN and does not use a dba name::
Mary Orchid EIN: 05-0505050
822 Sycamore Road
Orange City, ND 55555

(d) Person not required to have an EIN and does not use a dba name:
Tom Plum SSN: 111-11-1111
55 Pine Street
Beechdale, MS 77777

.06 Payers' names on the information returns filed with the Service must be identical to those on the statements issued by the payers to the recipients of such payments.

SEC. 7. TRANSMITTAL BY SERVICE BUREAUS AND AGENTS

.01 A service bureau or agent must prepare transmittals using the same procedures as payers.

.02 A service bureau or agent preparing information returns for more than one payer on magnetic media must prepare a Form 4804 and attach a separate Form 4802 continuation sheet for each payer. The revenue procedures on magnetic media submissions contain further instructions for filing these transmittal documents and related information returns.

.03 When service bureaus or agents file paper document transmittal Forms 1096 or W-3G on behalf of payers, the following requirements apply:

(a) The payer's TIN, name, and address appearing on transmittal documents and information returns must be that of the payer and not that of the service bureau.

(b) The service bureau or agent's name and address may be included on paper transmittal documents and information returns if: (1) its name and address are clearly identified, (2) it has the authority to sign and signs the transmittal document, and (3) the payer wants the Service to contact the agent on questions concerning the transmittal. To do this the service bureau or agent will substitute its name and address for the payer's name and address beginning with the second name line. In this case, the second name line should begin with the abbreviation "c/o". For example, the XYZ Bank prepares Form 1099-DIV returns for M Corporation. The name, address and TIN on Form 1096 should be:
M Corporation
Payer TIN: 11-1111111
c/o XYZ Bank
1010 Main Street
Anytown, N.Y. 12121

.04 The preparation, signing and filng of transmittal documents with information returns by service bureaus or agents does not relieve the payer of the liability for any penalties for not filing a correct, complete, and timely return on the appropriate transmittal documents, Forms 1096, 4804, and/or W-3G.

SEC. 8. SERVICE CONTACTS WITH PAYERS

.01 The Service will direct inquiries related to transmittal documents and information returns to the payer whose name and TIN are on the documents. When multiple transmittals are filed (see Section 5.02), inquiries will include the second name line and address to enable the payer to identify the location or segment of the organization in order to resolve the inquiry.

.02 When appropriate, the Service will direct inquires to the service bu

reau or agent that prepared and transmitted the return (see Section 7.03). If the inquiry is not resolved, it will then be referred by the Service to the payer as provided in Section 8.01.

.03 The preparation and filing of multiple transmittal documents with information returns by different locations and segments of the payer's organization does not relieve the payer of the liability for any penalties for not filing a correct, complete, and timely return on the appropriate transmittal documents, Forms 1096, 4804, and/or W-3G. The sum of all transmittals by the components of the organization are the responsibility of the trade or business as one entity.

SEC. 9. EFFECTIVE DATE

This revenue procedure is effective beginning with shipments and transmittals due after December 31, 1983, for payments during 1983.

SEC. 10. EFFECT ON OTHER DOCUMENTS

Rev. Procs. 63-29, 1963-2 C.B. 768, and 66-48, 1966-2 C.B. 1256, are superseded.

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26 CFR 601.204: Changes in accounting period and in methods of accounting.
(Also Part I, Sections 442, 1362, 1378; 1.442-1, 18.1362-1, 18.1378-1.)

Rev. Proc. 84-25

SECTION 1. PURPOSE

This revenue procedure provides that the Internal Revenue Service will recognize as valid certain corporations' elections to be S corporations under section 1362 of the Internal Revenue Code, under the limited circumstances described below.

SECTION 2. CORPORATIONS AFFECTED

.01 This revenue procedure applies only to small business corporations (as defined in section 1361(b) of the Code) that meet the following four conditions:

(a) The corporation filed an election to be an S corporation on Form 2553 with the appropriate Service Center during the period beginning after October 19, 1982, and ending before January 26, 1983.

(b) The corporation failed to file before March 16, 1983, a request to retain (or adopt) a fiscal year, that is, a taxable year ending other than on December 31. (See section 18.1378-1(b)(3)(ii) of the Temporary Income Tax Regulations.)

(c) The corporation received a written notification from the Service Center that the corporation's election to be an S corporation is ineffective by reason of the corporation's failure to file the request described in subparagraph (b), above, before March 16, 1983; and

(d) The corporation either (1) decides to adopt a calendar year beginning with the short taxable year ending December 31, 1982, or to change to a calendar year ending December 31, 1982, provided it meets the qualification for change set forth in section 18.1378-1(b)(1), or (2) selects a fiscal year that meets the specific circumstances described in section 4 of Rev. Proc. 83-25, 1983-1 C.B. 689 for approval of a fiscal year.

SECTION 3. PROCEDURE

01. The Service will recognize as valid the election to be an S corporation that was filed by a corporation described in subsection 2.01, provided, within 90 days after the publication of this revenue procedure, the corporation files with the appropriate Service Center a statement to be associated with its S corporation election indicating the following:

1. The statement "FILED UNDER REV. PROC. 84-25".

2. Employer Identification Number.

3. A representation that the four conditions in section 2 of this revenue procedure apply to the corporation.

4. If section 2.01(d)(2) of this revenue procedure applies (that is, if the corporation selects a tax year ending other than on December 31), one of the representations set forth in section 7.01(4) of Rev. Proc. 83-25, whichever is applicable, to verify that the corporation meets the conditions in section 4 of Rev. Proc. 83-25.

5. The selected tax year of the corporation and whether that selection represents an adoption, retention, or change of an accounting period, and

6. The selected tax year of all shareholders.

7. A representation that the corporation's books (i.e. records which clearly and adequately reflect income on the basis of an annual accounting period) were or will be closed as of the last day of the short period establishing a new tax year.

.02 If, pursuant to this revenue procedure, a corporation's election to be an S corporation is effective for a taxable year that has ended and the return for such taxable year is past due, the corporation must file a Form 1120S for that taxable year, and the corporation's shareholders must file amended income tax returns (Form 1040X, if applicable) that include their shares of income, gain, loss, deduction, or credit in accordance with the S corporation rules. These returns, if required, must be filed within 90 days of the date of publication of this revenue procedure. A copy of the statement required by section 3.01 must be attached to the Form 1120S.

SECTION 4. EFFECTIVE DATE

This revenue procedure shall be effective only for S corporation elections made after October 19, 1982, but before January 26, 1983.

SECTION 5. INQUIRIES

Inquiries concerning this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention CC:C:C, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103; 1.103-14.)

Rev. Proc. 84-26

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth guidelines under which the Internal Revenue Service will issue an advance ruling on whether a portion of the proceeds of obligations to be issued by a state or political subdivision of a state that will be part of a reserve or replacement fund

will be "reasonably required" within the meaning of section 103(c)(4)(B) of the Internal Revenue Code and section 1.103-14(d) of the Income Tax Regulations.

SEC. 2. BACKGROUND

.01 Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state. Section 103(c)(1) provides that, with certain exceptions, any arbitrage bond will not be treated as an obligation described in section 103(a)(1).

An arbitrage bond is any obligation that is part of an issue all or a major portion of the proceeds of which are reasonably expected to be used to acquire securities that will produce a yield over the term of the issue that is materially higher than the yield on such issue.

.02 Section 103(c)(4)(B) of the Code provides that an obligation shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of the issue of which such obligation is a part may be invested in securities or other obligations that are part of a reasonably required reserve or replacement fund. The amount of the bond proceeds invested in securities or other obligations that is part of a reasonably required reserve or replacement fund shall not exceed 15 percent of the proceeds of the issue unless the issuer establishes that a higher amount is necessary.

.03 Section 1.103-14(d)(2) of the regulations generally provides that if an amount in excess of 15 percent of the original face amount of the issue is invested in a reserve or replacement fund, such excess will be considered to be invested in a reasonably required reserve or replacement fund if (i) the issuer applies for a ruling that the specific reserve or replacement fund is necessary, and (ii) a ruling to that effect is subsequently issued to the governmental unit.

.04 Issuers of municipal bonds may not use the "15 percent of bond proceeds" referred to in section 103(c)(4)(B) of the Code and section 1.103-14(d)(1) of the regulations as a safe harbor for the establishment of reserve or replacement funds. Example (2) of section 1.103-13(b)(5)(v) illustrates that an issuer of municipal bonds may not use bond proceeds to establish a reserve fund equal to 15 percent of the bond proceeds if the amount reasonably required for such reserve fund is equal to only 8 percent of the bond proceeds. That example concludes that the over-issuance provisions of section 1.103-13(b)(5)(iv) apply and the bonds are arbitrage bonds. The over-issuance provisions apply because the proceeds of the issue exceed the amount necessary for the governmental purpose of the issue by the 7 percent difference between the 15 percent amount used and the 8 percent amount required. Any portion of an issue issued solely for the purpose of investing such portion at a materially higher yield, as less than a major portion, is not issued for a governmental purpose.

SEC. 3. APPLICATION

.01 Requests for advance rulings concerning reserve or replacement funds will be considered by the Service, and the determination of whether such funds are "reasonably required" within the meaning of section 103(c)(4)(B) of the Code and section 1.103-14(d) of the regulations will be made based on all facts and circumstances.

.02 The Service ordinarily will not issue a favorable advance ruling that reserve or replacement funds are "reasonably required" within the meaning of section 103(c)(4)(B) of the Code and section 1.103-14(d) of the regulations if such funds exceed the lesser of (1) maximum annual debt service or (2) one and one-quarter times the average annual debt service, regardless of whether the reserve or replacement funds are more or less than 15 percent of the original face amount of the issue. The Service ordinarily will not issue a favorable advance ruling that a reserve or replacement fund is reasonably required within the meaning of section 103(c)(4)(B) if the bonds are "general obligation" bonds. A request for an advance ruling that reserve or replacement funds are "reasonably required" within the meaning of section 103(c)(4)(B), when such funds exceed the lesser of (1) maximum annual debt service, or (2) one and one-quarter times the average annual debt service, or when such funds are established in connection with an issue of "general obligation" bonds, must set forth the rare and unusual circumstances that would require such reserve or replacement funds.

.03 The requester must comply with requirements of Rev. Proc. 79-4, 1979-1 C.B. 483; as amplified by Rev. Proc. 79-12, 1979-1 C.B. 492; as amplified by Rev. Proc. 80-1, 1980-1 C.B. 579, and any other applicable revenue procedures that relate to submission to the Service of requests for ruling.

SEC. 4. EFFECTIVE DATE

This revenue procedure shall be effective with respect to advance rulings regarding required reserve or replacement funds for municipal obligations to be sold after April 2, 1984.

SEC. 5. INQUIRIES

Inquiries with respect to this revenue procedure should refer to its number and should be addressed to the Commissioner of Internal Revenue, Attention: CC:IND:S, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 163, 446, 451, 461, 481, 1381; 1.163-1, 1.446-1, 1.451-1, 1.461-1, 1.481-1, 1.1381-1.)

Rev. Proc. 84-27

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to provide a mandatory procedure for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation.

This revenue procedure applies to lenders and borrowers who report interest income or who claim interest deductions with respect to loans using the Rule of 78's method, other than

for consumer loans coming within the administrative exception in Rev. Proc. 83-40, 1983-1 C.B. 774, and other than for loans covered by the procedures set forth in Rev. Proc. 84-28. Rev. Proc. 84-28 sets forth a mandatory procedure for changing the method with respect to loans for which the interest computed under the Rule of 78's exceeds the loan payments during any year of the term of the loan. For consumer loans described in Rev. Proc. 83-40, the change is not mandatory. However, taxpayers proposing to change their method for such loans for any tax year must do so by complying with the provisions of Rev. Proc. 84-30.

SEC. 2. BACKGROUND

.01 The Rule of 78's is described in Rev. Rul. 83-84, 1983-1 C.B. 97, as a method of allocating interest on a loan among time periods during the term of the loan. Under this method, the amount of interest allocable to each period is determined by multiplying the total interest payable over the life of the indebtedness by a fraction, (a) the numerator of which is the number of periods remaining on such indebtedness at the time the calculation is made and (b) the denominator of which is the sum of the periods' digits for the term of the indebtedness.

.02 Rev. Rul. 83-84 indicates that the Rule of 78's represents a purely mechanical formula for allocating interest among periods. Because interest is earned by the lender by application of the effective rate of interest over the term of the loan, any agreement between a borrower and a lender that provides that interest is earned in another manner, such as under the Rule of 78's computation, lacks economic substance since it fails to reflect the true cost of borrowing. Rev. Rul. 83-84 indicates further that no tax effect will be given to the Rule of 78's provision.

.03 Rev. Rul. 83-84 states that an agreement between a borrower and a lender with respect to any one year of a loan is not independent of the agreement with respect to any other year of the loan. In general, the substance of a loan agreement is that the same rate of interest applies to each tax year of the loan, regardless of any contrary formulas that may be stated in the agreement. The amount of interest attributable to the use of money for each period between payments is determined by applying the "effective rate of interest" on the loan to the "unpaid balance" of the loan for that period. The unpaid balance of a loan is the amount borrowed plus interest earned minus amounts paid. The effective rate of interest is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of values received to the amount and timing of payments made, and is thus a reflection of the cost of the amount borrowed for the time it is actually available. *See* Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 553 (1982), 1982-2 C.B. 600, 639; S. Rep. No. 97-494 (Vol. 1), 97th Cong., 2d Sess. 209 (1982); Supplement I to Regulation Z issued by the Federal Reserve System, 12 CFR Sections 226.6 and 226.40 (1979). Therefore, the effective rate of interest, which is a uniform rate over the term of the loan and is based on the amount of the loan and the repayment schedule provided in the loan agreement, when applied to the unpaid balance of the indebtedness for a given period, will produce the true cost of that indebtedness for that period. This true cost of borrowing is sometimes referred to as the economic accrual of interest. (For purposes of this revenue procedure, the economic accrual of interest is hereinafter referred to as the "prescribed method.")

.04 Rev. Proc. 83-40 states that in a typical short-term consumer loan transaction, the Internal Revenue Service will accept the Rule of 78's method for computing the borrower's interest deduction and the lender's interest income as a matter of administrative convenience. The administrative exception for short-term consumer loans applies only when there is a self-amortizing loan that requires level payments, at regular intervals at least annually, over a period not in excess of five years (with no balloon payment at the end of the loan term), and when the loan agreement between the borrower and the lender provides that interest is earned, or upon the prepayment of the loan interest is treated as earned, in accordance with the Rule of 78's method. As indicated above under "PURPOSE AND SCOPE", any change in method of accounting regarding loans described in Rev. Proc. 83-40 is not a mandatory change. However, taxpayers proposing to change their method for such loans must do so by complying with the provisions of Rev. Proc. 84-30.

.05 Section 446(e) of the Internal Revenue Code and section 1.446-1(e) of the Income Tax Regulations provide that in order to change a method of accounting for federal income tax purposes the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain such consent an application must be filed within 180 days after the beginning of the tax year in which the taxpayer desires to make the change. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

.06 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

SEC. 3. APPLICATION

.01 *Consent.* In accordance with section 1.446-1(e)(3)(ii) of the regulations, the 180-day rule is waived and under section 1.446-1(e)(2)(i) consent is hereby granted to taxpayers to change a method of accounting with

respect to interest on indebtedness from the method of computing interest income and deductions using the Rule of 78's method to the "prescribed method." See section 2.03 above. Such consent is granted for the first or second tax year *ending* on or after December 31, 1983, and the change shall be made in accordance with the provisions of this revenue procedure, including the adjustment under section 481(a) of the Code described in section 3.03 below.

.02 *Year for change.* Pursuant to the consent granted in section 3.01, both the lender and borrower to whom this revenue procedure applies and who are using the Rule of 78's method of accounting for computing interest income and deductions must change such method of accounting to the "prescribed method" on their federal income tax returns. The taxpayer has the choice of making the change on the federal income tax return filed for either the first or second tax year ending on or after December 31, 1983.

.03 *Section 481(a) adjustment.* An adjustment is required to prevent amounts of income and deduction from being duplicated within the meaning of section 481 of the Code and the regulations thereunder when the change in method of accounting is made pursuant to the provisions set forth in this revenue procedure. Such adjustment, whether positive or negative, referred to as the "section 481(a) adjustment," shall be taken into account in computing taxable income and in computing corporate earnings and profits. As to taxable income, the adjustment is made in the manner provided in sections 3.04-3.07 below. As to corporate earnings and profits, the adjustment is made in the manner provided in Rev. Proc. 79-49, 1979-2 C.B. 528. The change in method of accounting shall be considered to be a change in method of accounting initiated by the taxpayer.

.04 *Period for positive section 481(a) adjustment.*

1 When the section 481(a) adjustment results in an increase in taxable income and the change to the "prescribed method" is made in accordance with section 3.02, the period for taking into account the section 481(a) adjustment referred to in section 3.03 (adjustment period) is generally to be determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made in the preceding year.

(b) When (a) above does not apply and 67 percent or more of the amount of the section 481(a) adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change, the highest percent attributable to the 1, 2, or 3-tax year period will be taken into account ratably over a 3-tax year period beginning with the year of change. Any remaining balance will be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has continuously used the Rule of 78's method. However, the total adjustment period shall not exceed six tax years. This subparagraph, 3.04 1(b), only applies if the taxpayer has used the Rule of 78's method for more than three tax years. If the Rule of 78's method has been used for no more than four tax years, 75 percent shall be substituted for 67 percent. An amount attributable to the 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made at the beginning of the preceding 1, 2, or 3-tax year period.

(c) In all other situations in which (a) and (b) above do not apply, the section 481(a) adjustment will be taken into account ratably over the number of years (not to exceed six) the taxpayer has continuously used the Rule of 78's method.

2 In applying sections 3.04 1(a) or (b), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period immediately preceding the year of change, the taxpayer may reasonably estimate the amount and attach and sign (or have signed by an officer who has personal knowledge of the facts) the following statement to the Form 3115, Application for Change in Accounting Method:

Under penalty of perjury, I hereby certify that:

(a) the books and records of (name of the taxpayer) do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 3.04 1(b) of Rev. Proc. 84-27.

(b) Based on the information that is contained in the records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (indicate "is" or "is not," as the case may be) attributable to the tax year immediately preceding the year of change, and 67 percent (or 75 percent in applicable cases) or more of the section 481(a) adjustment for the year of change (indicate "is" or "is not," as the case may be) attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change.

3 A cooperative within the meaning of section 1381(a) of the Code shall take the total amount of the section 481(a) adjustment into account in computing taxable income for the year of change.

.05 *Change in subsequent year for positive section 481(a) adjustment.* If the taxpayer fails to change to the "prescribed method" in accordance with the consent granted in section 3.01 of this revenue procedure, consent is hereby granted to taxpayers to change to the "prescribed method" for tax years subsequent to the re-

quired tax years set forth in section 3.02. The change must be made on the taxpayer's timely filed federal income tax return for such subsequent year. The section 481(a) adjustment will be taken into account ratably over the number of years the taxpayer has continuously used the Rule of 78's method, not to exceed three tax years.

.06 *Period for negative section 481(a) adjustment.*

1 When the section 481(a) adjustment results in a decrease in taxable income and the change to the "prescribed method" is made in accordance with section 3.02, the period for taking into account the section 481(a) adjustment referred to in section 3.03 (adjustment period) is generally to be determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of of change (first preceding year), the total adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made in the preceding year.

(b) In all other situations, the section 481(a) adjustment will be taken into account ratably over the number of years (not to exceed three) the taxpayer has continuously used the Rule of 78's method.

2 A cooperative within the meaning of section 1381(a) of the Code shall take the total amount of the section 481(a) adjustment into account in computing taxable income for the year of change.

.07 *Change in subsequent year for negative section 481(a) adjustment.* If the taxpayer fails to change to the "prescribed method" in accordance with the consent granted in section 3.01 of this revenue procedure, consent is hereby granted to taxpayers to change to the "prescribed method" for tax years subsequent to the required tax years set forth in section 3.02. The change must be made on the taxpayer's timely filed federal income tax return for such subsequent year. The section 481(a) adjustment will be taken into account ratably over the number of years the taxpayer has continuously used the Rule of 78's method, not to exceed six tax years.

.08 *Net Operating Loss Carryovers and Net Operating Losses.*

1 No part of any (consolidated or separate) net operating loss carryover (NOL carryover) available at the beginning of the year of change may be used as an offset against the portion of the positive section 481(a) adjustment taken into account in the year of change. This condition will not apply to tax years subsequent to the year of change.

2 Any portion of any net operating loss arising in the year of change or in any subsequent year in the adjustment period that is attributable to the negative section 481(a) adjustment may not be carried to those 3 tax years preceding the year of change, to which section 172 of the Code otherwise would require it first to be carried.

.09 *Investment credit or any other credits.* No part of any (consolidated or separate) investment credit carryover or any other credit carryover available at the beginning of the year of change may be used to reduce the federal income tax liability resulting from, or attributable to, the inclusion in income of a portion of the section 481(a) adjustment in the year of change. This restriction does not apply, however, to a credit arising in the year of change.

.10 *Ceasing to engage in the trade or business.*

(a) With respect to a corporation:

If a corporate taxpayer ceases to engage in the trade or business to which the section 481(a) adjustment (section 3.03) relates at any time prior to the expiration of the adjustment period, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. *See* Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into account in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if the cessation is the result of a transaction to which section 381 of the Code applies, but in that case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(b) With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708 of the Code) to which the section 481(a) adjustment (section 3.03) relates at any time prior to the expiration of the adjustment period, the balance of the section 481(a) adjustment not previously taken into account in computing the partnership's income or deductions shall be taken into account in the year of cessation. A partnership ceasing to engage in the trade or business includes the incorporation of the trade or business in a transaction to which section 351 applies (*see* Rev. Rul. 77-264, 1977-2 C.B. 187).

(c) With respect to a sole proprietor:

If a sole proprietor ceases to engage in the trade or business to which the section 481(a) adjustment (section 3.03) relates at any time prior to the expiration of the adjustment period, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in the year of cessation. A sole proprietor ceasing to engage in the trade of business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies (*see* Rev. Rul. 77-264). A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprie-

torship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is taken into account by the partnership as though there had been no change in ownership (*see* Rev. Rul. 66-206, 1966-2 C.B. 206).

SEC. 4. RECORDS

Taxpayers must maintain adequate records so that the Service may, upon examination, verify the data concerning the change in method of accounting.

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change from the Rule of 78's method to the "prescribed method" without complying with all the conditions of this revenue procedure will be deemed to have made the change without obtaining the consent of the Commissioner.

SEC. 6. MANNER OF EFFECTING CHANGE

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting for either their first or second tax year *ending* on or after December 31, 1983, pursuant to the provisions set forth in this revenue procedure by filing a current Form 3115, Application for Change in Accounting Method, in duplicate. The original of the Form 3115 shall be attached to the taxpayer's timely filed federal income tax return. However, if the taxpayer chooses to make the change for the first tax year ending on or after December 31, 1983, the taxpayer may make the change on an amended return for such year filed no later than the extended time prescribed in section 6081 of the Code and regulations thereunder whether or not the taxpayer has, in fact, been granted an extension of time for filing its income tax return for such year. For example, a domestic corporation, whose tax year ends on December 31st, may effect the change described in this revenue procedure on the original timely filed return for either 1983 or 1984, or on an amended return for the 1983 tax year filed no later than September 15, 1984. Similarly, an individual, whose tax year ends on December 31st, may effect the change described in this revenue procedure on the original timely filed return for either 1983 or 1984, or on an amended return for the 1983 tax year filed no later than August 15, 1984. At the time the original of the Form 3115 is filed with the federal income tax return, a copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of the Internal Revenue Service, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In addition to the information required on Form 3115, the taxpayer must provide (1) a computation of the section 481(a) adjustment and (2) the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. The National Office will sample the Form 3115's to determine whether the requirements of this revenue procedure have been followed. The National Office or the District Director may advise the taxpayer of required adjustments to the change in method of accounting for interest income and deductions.

.02 Taxpayers described in section 3.05 or section 3.07 must also follow the procedures set forth in section 6.01 regarding the place for filing of the original and the copy of the Form 3115 with respect to the tax year for which the change to the "prescribed method" is made. Such taxpayers must also furnish with the Form 3115 the additional information set forth in section 6.01 above regarding the section 481(a) adjustment and its adjustment period.

.03 In order to assist in the processing of these changes in method of accounting and to ensure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of Page 1 of Form 3115: "FILED UNDER REV. PROC. 84-27".

SEC. 7. EXAMPLES

Example A

A taxpayer, that uses the accrual method of accounting and reports its income on a calendar year basis, borrowed $100,000 on January 1, 1980, payable in 10 annual installments of $17,698 each. The total interest on the loan will be $76,980 (10 x $17,698 = $176,980; $176,980 − $100,000 = $76,980). The terms of the loan state that interest is earned by the lender in accordance with the Rule of 78's computation, and beginning in 1980 the taxpayer computed its annual interest deduction using the Rule of 78's. The effective rate of interest is 12 percent. Commencing with 1980 and continuing through 1983, the taxpayer used the Rule of 78's method for computing interest deductions and deducted a total of $47,587 in interest during those four years. If the taxpayer had used the "prescribed method" for computing its deductions for interest during those four years, the total interest deduction would have been $43,558. The difference in the interest deduction using the two methods is $4,029. The following table shows the interest computed under the two methods for the first four years.

Table

Years	*Economic accrual of interest (Prescribed Method)*	*Rule of 78's*
1980	12,000	13,996
1981	11,316	12,597
1982	10,550	11,197
1983	9,692	9,797

The taxpayer chose to make the change to the "prescribed method" on its tax return for 1984, rather than the return for 1983. Therefore, with the taxpayer's timely filed federal income tax return for the fifth year (1984), the taxpayer filed a Form 3115 in accordance with the provisions set forth in sections 3 and 6.01 of this revenue procedure. By changing to the "prescribed method" commencing with the fifth year of the loan and continuing to use that method, the taxpayer will eventually receive a double deduction for interest in the amount of $4,029. Thus, under section 481(a) of the Code, an adjustment is necessary solely by reason of the change in method of accounting in order to prevent the $4,029 from being duplicated, i.e., taken again as a deduction. If the taxpayer had made the change to the "prescribed method" for the tax years 1981, 1982, or 1983, the amount of the adjustment would have been $1,996, $3,277, or $3,924, respectively. The percent of the section 481(a) adjustment attributable to the 1, 2 or 3-tax year period preceding the year of change is determined as follows:

1-tax year period	
Adjustment as of January 1, 1984.	$ 4,029
Less: hypothetical adjustment as of January 1, 1983	3,924
Amount attributable to 1-tax year period.....	$ 105
Percent of adjustment attributable to 1-tax year period: 105 / 4,029	= 2.6%

2-tax year period	
Adjustment as of January 1, 1984.	$ 4,029
Less: hypothetical adjustment as of January 1, 1982	3,277
Amount attributable to 2-tax year period.....	$ 752
Percent of adjustment attributable to 2-tax year period: 752 / 4,029	= 18.7%

3-tax year period	
Adjustment as of January 1, 1984.	$ 4,029
Less: Hypothetical adjustment as of January 1, 1981	1,996
Amount attributable to 3-tax year period	$ 2,033

Percent of adjustment attributable to 3-tax year period: 2,033 / 4,029 = 50.5%

Because less than 75 percent of the adjustment is attributable to the 1983, the 1982, and the 1981 tax years, section 3.04 1(c) of this revenue procedure requires that an adjustment under section 481(a) in the amount of $4,029 be taken into account as an item of gross income ratably over four tax years, the number of tax years that the taxpayer has used the Rule of 78's method.

Example B

The facts are the same as in Example A except that the taxpayer entered into three loans each for $100,000 with identical terms to the loan described in Example A. The first loan was entered into on January 1, 1979, and the other two loans were entered into on January 1, 1981. The following table shows the interest computed using the "prescribed method" and using the Rule of 78's method for the five years that the taxpayer computed its annual interest deduction using the Rule of 78's method.

Table

Year	*Economic accrual of interest (Prescribed Method)*			*Rule of 78's*		
	1st loan	*2nd & 3rd loans*	*Total*	*1st loan*	*2nd & 3rd loans*	*Total*
1979	12,000		12,000	13,966		13,966
1980	11,316		11,316	12,597		12,597
1981	10,550	24,000	34,550	11,197	27,932	39,129
1982	9,692	22,632	32,324	9,797	25,194	34,991
1983	8,731	21,100	29,831	8,398	22,394	30,792

During the five years the taxpayer deducted a total of $131,475 in interest based on the Rule of 78's method. If the taxpayer has used the "prescribed method" for computing its deductions for interest during those five years, the total interest deduction would have been $120,021. The difference in the interest deduction using the two methods is $11,454.

With the taxpayer's timely filed federal income tax return for the sixth year (1984), the taxpayer filed a Form 3115 in accordance with the provisions set forth of section 3 and 6.01 of this revenue procedure. By changing to the prescribed method commencing with the sixth year and continuing to use that method, the taxpayer will eventually receive a double deduction for interest in the amount of $11,454. Thus, under section 481(a) of the Code, an adjustment is necessary solely by reason of the change in method of accounting in order to prevent the $11,454 from being duplicated, i.e., taken again as a deduction. If the taxpayer had made the change to the "prescibed method" for the tax year 1981, 1982, or 1983, the amount of the adjustment would have been $3,247, $7,826, or $10,493, respectively. The percent of the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period preceding the year of change is determined as follows:

1-tax year period	
Adjustment as of January 1, 1984.	$11,454
Less: hypothetical adjustment as of January 1, 1983	10,493
Amount attributable to 1-tax year period	$ 961

Percent of adjustment attributable to 1-tax year period: 961 / 11,454 = 8.4%

2-tax year period	
Adjustment as of January 1, 1984.	$11,454
Less: hypothetical adjustment as of January 1, 1982	7,826
Amount attributable to 2-tax year period	$ 3,628

Percent of adjustment attributable to 2-tax year period: 3,628 / 11,454 = 31.7%

3-tax year period	
Adjustment as of January 1, 1984.	$11,454
Less: hypothetical adjustment as of January 1, 1981	3,247
Amount attributable to 3-tax year period	$ 8,207

Percent of adjustment attributable to 3-tax year period: 8,207 / 11,454 = 71.7%

In this example, the percent of the section 481(a) adjustment attributable to the 3-tax year period preceding the year of change is more than 67 percent and represents the highest percent of the adjustment attributable to any one of the 1, 2, or 3-tax year periods preceding the year of change. Under the provisions of section 3.04 1(b) of this revenue procedure, the actual section 481(a) adjustment for 1984 of $11,454 shall be taken into account in the amount of $2,737.51 in 1984, 1985, and 1986 (71.7 percent times $11,454 divided by 3, for each of the 3 years) and $1,620.74 in 1987 and 1988 (the remainder from the $11,454 adjustment taken ratably in the two remaining years that the taxpayer used the Rule of 78's method).

Example C

The taxpayer, a commercial bank that reports its income on a calendar year basis, has used the Rule of 78's method to compute interest income on many of its loans for eleven years. Interest income reported by the taxpayer did not exceed the loan payments received by the taxpayer with respect to any loans for which the taxpayer used the Rule of 78's method. In accordance with section 3.02 of this revenue procedure, the taxpayer must change to the "prescribed method" for loans with terms in excess of five years by filing the original of the Form 3115 with its timely filed federal income tax return for either 1983 or 1984, or with an amended return for 1983 filed no later than September 15, 1984. The taxpayer's application must comply with the procedures set forth in section 6.01 of this revenue procedure. The period for taking into account the negative section 481(a) adjustment for 1984 is determined under section 3.06 1 of this revenue precedure. However, the total adjustment period may not exceed three tax years.

Example D

The facts are the same as Example C except that the taxpayer ignores the mandatory requirement of section 3.02 of this revenue procedure, i.e., the taxpayer does not change to the "prescribed method" for either 1983 or 1984. If the taxpayer changes to the "prescribed method" for any year subsequent to 1984, it must comply with sections 3.07 and 6.02 of this revenue procedure and its section 481(a) adjustment must be taken into account ratably over six tax years. See section 3.07.

SEC. 8. MISCELLANEOUS

Where a taxpayer's change in method of accounting falls within the scope set forth in section 1 of this revenue procedure, that taxpayer must use this revenue procedure to effectuate such change in method of accounting and may not use the provisions of Rev. Proc. 80-51, 1980-2 C.B. 818. Thus, the original of the application for permission to change the method of accounting described in this revenue procedure, if filed with the National Office under the general provisions of Rev. Proc. 80-51, will not be considered a valid application. Any such original applications erroneously filed with the National Office will be returned without processing and with instructions to comply with this revenue procedure.

SEC. 9. ALTERNATIVE PROCEDURE FOR CERTAIN INDIVIDUAL BORROWERS

Individual borrowers, who previously reported interest expense based upon the Rule of 78's method, may have difficulty computing the amount of interest that economically accrues in order to comply with the provisions of this revenue procedure. Many of these taxpayers may qualify to use the alternative procedure, contained in Rev. Proc. 84-29, for computing allowable interest deductions. One of the requirements that must be met in order to qualify for the alternative procedure contained in Rev. Proc. 84-29 is that the proceeds of the loan were not used for investment purposes or to purchase items in connection with a trade or business. See Rev. Proc. 84-29 for complete details.

SEC. 10. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue,

Attention CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 163, 446, 451, 461, 481, 1381; 1.163-1, 1.446-1, 1.451-1, 1.461-1, 1.481-1, 1.1381-1.)

Rev. Proc. 84-28

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to provide a mandatory procedure for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation.

This revenue procedure applies to lenders and borrowers, who report interest income or who claim interest deductions with respect to loans using the Rule of 78's method, for those loans in which the interest computed using the Rule of 78's *exceeds* the loan payments during any year of the term of the loan. See Rev. Proc. 84-27 for a mandatory procedure for changing the method with respect to loans, which are not described in Rev. Proc. 83-40, 1983-1 C.B. 774, and for which the interest computed under the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-30 with respect to consumer loans coming within the administrative exception of Rev. Proc. 83-40. For consumer loans described in Rev. Proc. 83-40, the change is not mandatory. However, taxpayers proposing to change their method of accounting for such loans for any tax year must do so by complying with the provisions of Rev. Proc. 84-30.

SEC. 2. BACKGROUND

.01 The Rule of 78's is described in Rev. Rul. 83-84, 1983-1 C.B. 97, as a method of allocating interest on a loan among time periods during the term of the loan. Under this method, the amount of interest allocable to each period is determined by multiplying the total interest payable over the life of the indebtedness by a fraction, (a) the numerator of which is the number of periods remaining on such indebtedness at the time the calculation is made and (b) the denominator of which is the sum of the periods' digits for the term of the indebtedness.

.02 Rev. Rul. 83-84 indicates that the Rule of 78's represents a purely mechanical formula for allocating interest among periods. Because interest is earned by the lender by application of the effective rate of interest over the term of the loan, any agreement between a borrower and a lender that provides that interest is earned in another manner, such as under the Rule of 78's computation, lacks economic substance because it fails to reflect the true cost of borrowing. Rev. Rul. 83-84 indicates further that no tax effect will be given to the Rule of 78's provision.

.03 Rev. Rul. 83-84 states that an agreement between a borrower and a lender with respect to any one year of a loan is not independent of the agreement with respect to any other year of the loan. In general, the substance of a loan agreement is that the same rate of interest applies to each tax year of the loan, regardless of any contrary formulas that may be stated in the agreement. The amount of interest attributable to the use of money for each period between payments is determined by applying the "effective rate of interest" on the loan to the "unpaid balance" of the loan for that period. The unpaid balance of a loan is the amount borrowed plus interest earned minus amounts paid. The effective rate of interest is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of values received to the amount and timing of payments made, and is thus a reflection of the cost of the amount borrowed for the time it is actually available. *See* Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 553 (1982), 1982-2 C.B. 600, 639; S. Rep. No. 97-494 (Vol. 1), 97th Cong., 2d Sess. 209 (1982); Supplement I to Regulation Z issued by the Federal Reserve System, 12 CFR Sections 226.6 and 226.40 (1979). Therefore, the effective rate of interest, which is a uniform rate over the term of the loan and is based on the amount of the loan and the repayment schedule provided in the loan agreement, when applied to the unpaid balance of the indebtedness for a given period, will produce the true cost of that indebtedness for that period. This true cost of borrowing is sometimes referred to as the economic accrual of interest. (For purposes of this revenue procedure the economic accrual of interest is hereinafter referred to as the "prescribed method.")

.04 Rev. Proc. 83-40 states that in a typical short-term consumer loan transaction, the Internal Revenue Service will accept the Rule of 78's method for computing the borrower's interest deduction and the lender's interest income as a matter of administrative convenience. The administrative exception for short-term consumer loans applies only when there is a self-amortizing loan that requires level payments, at regular intervals at least annually, over a period not in excess of five years (with no balloon payment at the end of the loan term), and when the loan agreement between the borrower and the lender provides that interest is earned, or upon the prepayment of the loan interest is treated as earned, in accordance with the Rule of 78's method. As indicated above under "PURPOSE AND SCOPE", any change in method of accounting regarding loans described in Rev. Proc. 83-40 is not a mandatory change. However, taxpayers proposing to change their method for such loans must do so by complying with the provisions of Rev. Proc. 84-30.

.05 Section 446(e) of the Internal Revenue Code and section 1.446-1(e) of the Income Tax Regulations provide that in order to change a method of accounting for federal income tax purposes the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain such consent an application must be filed within 180 days after the beginning of the tax year in which the taxpayer desires to make the change. Section 1.446-1(e)(3)(ii) authorizes the Commis-

sioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

.06 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

SEC. 3. APPLICATION

.01 *Consent.* In accordance with section 1.446-1(e)(3)(ii) of the regulations, the 180-day rule is waived and under section 1.446-1(e)(2)(i) consent is hereby granted to taxpayers to change a method of accounting with respect to interest on indebtedness from the method of computing interest income or deductions using the Rule of 78's method to the "prescribed method." See section 2.03 above. Such consent is granted for the first tax year *ending* on or after December 31, 1983, and the change shall be made in accordance with the provisions of this revenue procedure, including the adjustment under section 481(a) of the Code described in section 3.03 below.

.02 *Year of change.* Pursuant to the consent granted in section 3.01, both the lender and borrower to whom this revenue procedure applies and who are using the Rule of 78's method of accounting for computing interest income or deductions must change such method of accounting to the "prescribed method" on their federal income tax returns for the first tax year *ending* on or after December 31, 1983.

.03 *Section 481(a) adjustment.* An adjustment is required to prevent amounts of income and deduction from being duplicated within the meaning of section 481 of the Code and the regulations thereunder when the change in method of accounting is made pursuant to the provisions set forth in this revenue procedure. Such adjustment, whether positive or negative, referred to as the "section 481(a) adjustment," shall be taken into account in computing taxable income and in computing corporate earnings and profits. As to taxable income, the adjustment is made in the manner provided in sections 3.04 - 3.07 below. As to corporate earnings and profits, the adjustment is made in the manner provided in Rev. Proc. 79-49, 1979-2 C.B. 528. The change in method of accounting shall be considered to be a change in method of accounting initiated by the taxpayer.

.04 *Period for positive section 481(a) adjustment.*

1 When the section 481(a) adjustment results in an increase in taxable income and the change to the "prescribed method" is made in accordance with section 3.02, the period for taking into account the section 481(a) adjustment referred to in section 3.03 (adjustment period) is generally to be determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made in the preceding year.

(b) When (a) above does not apply and 67 percent or more of the amount of the section 481(a) adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change, the highest percent attributable to the 1, 2, or 3-tax year period will be taken into account ratably over a 3-tax year period beginning with the year of change. Any remaining balance will be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has continuously used the Rule of 78's method. However, the total adjustment period shall not exceed six tax years. This subparagraph, 3.04 1(b), only applies if the taxpayer has used the Rule of 78's method for more than three tax years. If the Rule of 78's method has been used for no more than four tax years, 75 percent shall be substituted for 67 percent. An amount attributable to the 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made at the beginning of the preceding 1, 2, or 3-tax year period.

(c) In all other situations in which (a) and (b) above do not apply, the section 481(a) adjustment will be taken into account ratably over the number of years (not to exceed six) the taxpayer has continuously used the Rule of 78's method.

2 In applying sections 3.04 1(a) or (b), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period immediately preceding the year of change, the taxpayer may reasonably estimate the amounts and attach and sign (or have signed by an officer who has personal knowledge of the facts) the following statement to the Form 3115, Application for Change in Accounting Method:

Under penalty of perjury, I hereby certify that:

(a) the books and records of (name of the taxpayer) do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 3.04 1(b) of Rev. Proc. 84-28.

(b) Based on the information that is contained in the records, to the best

of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (indicate either "is" or "is not," as the case may be) attributable to the tax year immediately preceding the year of change, and 67 percent (or 75 percent in applicable cases) or more of the section 481(a) adjustment for the year of change (indicate "is" or "is not," as the case may be) attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change.

3 A cooperative within the meaning of section 1381(a) of the Code shall take the total amount of the section 481(a) adjustment into account in computing taxable income for the year of change.

.05 *Change in subsequent year for positive section 481(a) adjustment.*

1 Under certain circumstances, a taxpayer who has a positive section 481(a) adjustment and who does not change to the "prescribed method" for the first tax year ending on or after December 31, 1983, may not use this revenue procedure to make the change for a later year. The provisions of this revenue procedure are not available to such a taxpayer who has been contacted in any manner by a representative of the Service for the purpose of scheduling an examination of its federal income tax return(s). If a taxpayer has not been contacted by the Service for the purpose of scheduling an examination of its return(s), consent is hereby granted to the taxpayer to change to the "prescribed method" for tax years subsequent to the required tax year set forth in section 3.02. The change must be made on the taxpayer's timely filed federal income tax return for such subsequent year.

2 The section 481(a) adjustment will be taken into account ratably over a number of years, which depends on the number of years that the section 481(a) adjustment would have been taken into account *if* the taxpayer had made the change for the first tax year ending on or after December 31, 1983. If the taxpayer had made the change for the first tax year ending on or after December 31, 1983, and if the section 481(a) adjustment would have been taken into account over (a) four through six tax years, (b) three tax years, or (c) two or less tax years, then, when the taxpayer makes the change for a subsequent tax year, the number of years over which the section 481(a) adjustment is taken into account shall be (a) three tax years, (b) two tax years, or (c) one tax year, respectively. See Examples C and D, contained in section 7 of this revenue procedure.

.06 *Period for negative section 481(a) adjustment.*

1 When the section 481(a) adjustment results in a decrease in taxable income and the change to the "prescribed method" is made in accordance with section 3.02, the period for taking into account the section 481(a) adjustment referred to in section 3.03 (adjustment period) is generally to be determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made in the preceding year.

(b) In all other situations, the section 481(a) adjustment will be taken into account ratably over the number of years (not to exceed three) the taxpayer has continuously used the Rule of 78's method.

2 A cooperative within the meaning of section 1381(a) of the Code shall take the total amount of the section 481(a) adjustment into account in computing taxable income for the year of change.

.07 *Change in subsequent year for negative section 481(a) adjustment.* If the taxpayer fails to change to the "prescribed method" in accordance with the consent granted in section 3.01 of this revenue procedure, consent is hereby granted to change to the "prescribed method" for tax years subsequent to the required tax year set forth in section 3.02. The change must be made on the taxpayer's timely filed federal income tax return for such subsequent year, and the section 481(a) adjustment will be taken into account ratably over the number of years the taxpayer continuously has used the Rule of 78's method, not to exceed six tax years.

.08 *Under examination.* This revenue procedure does not apply to a lender or a borrower who uses the Rule of 78's method and whose reported interest income or claimed interest deduction exceeds the loan payments made during any of the tax years of the loan, if an issue concerning the amount of reported interest income or claimed interest deduction has been raised and is pending on April 2, 1984, in connection with the examination of the taxpayer's federal income tax return. In such situations, the provisions of section 481 of the Code will be applied by the examining agent, i.e., those adjustments necessary to make the change in method will be taken into account in one tax year.

.09 *Net Operating Loss Carryovers and Net Operating Losses.*

1 No part of any (consolidated or separate) net operating loss carryover available at the beginning of the year of change may be used as an offset against the portion of the positive section 481(a) adjustment taken into account in the year of change. This condition will not apply to tax years subsequent to the year of change.

2 Any portion of any net operating loss arising in the year of change or in any subsequent year in the adjustment period that is attributable to the negative section 481(a) adjustment may not be carried to those 3 tax years preceding the year of change, to which section 172 of the Code otherwise would require it first to be carried.

.10 *Investment credit or any other credits.* No part of any (consolidated or separate) investment credit carryover or any other credit carryover available at the beginning of the year of change may be used to reduce the federal income tax liability resulting

from, or attributable to, the inclusion in income of a portion of the section 481(a) adjustment in the year of change. This restriction does not apply, however, to a credit arising in the year of change.

.11 *Ceasing to engage in the trade or business.*

(a) With respect to a corporation:

If a corporate taxpayer ceases to engage in the trade or business to which the section 481(a) adjustment (section 3.03) relates at any time prior to the expiration of the adjustment period, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. *See* Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into account in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if the cessation is the result of a transaction to which section 381 of the Code applies, but in that case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(b) With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708 of the Code) to which the section 481(a) adjustment (section 3.03) relates at any time prior to the expiration of the adjustment period, the balance of the section 481(a) adjustment not previously taken into account in computing the partnership's income or deductions shall be taken into account in the year of cessation. A partnership ceasing to engage in the trade or business includes the incorporation of the trade or business in a transaction to which section 351 applies (*see* Rev. Rul. 77-264, 1977-2 C.B. 187).

(c) With respect to a sole proprietor:

If a sole proprietor ceases to engage in the trade or business to which the section 481(a) adjustment (section 3.03) relates at any time prior to the expiration of the adjustment period, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in the year of cessation. A sole proprietor ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies (*see* Rev. Rul. 77-264). A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprietorship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is taken into account by the partnership as though there had been no change in ownership (*see* Rev. Rul. 66-206, 1966-2 C.B. 206).

SEC. 4. RECORDS

Taxpayers must maintain adequate records so that the Service may, upon examination, verify the data concerning the change in method of accounting.

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change from the Rule of 78's method to the "prescribed method" without complying with all the conditions of this revenue procedure will be deemed to have made the change without obtaining the consent of the Commissioner.

SEC. 6. MANNER OF EFFECTING THE CHANGE

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting for their first tax year *ending* on or after December 31, 1983, pursuant to the provisions set forth in this revenue procedure by filing a current Form 3115, Application for Change in Accounting Method, in duplicate. The original of the Form 3115 shall be attached to the taxpayer's timely filed federal income tax return for such year, or to an amended return for such year filed no later than the extended time period prescribed in section 6081 of the Code and the regulations thereunder whether or not the taxpayer has, in fact, been granted an extension of time for filing its income tax return for such year. For example, a domestic corporation, whose tax year ends December 31, 1983, must effect the change described in this revenue procedure on the original timely filed return for 1983, or on an amended return for the 1983 tax year filed no later than September 15, 1984. Similarly, an individual, whose tax year ends December 31, 1983, must effect the change described in this revenue procedure on the timely filed return for 1983, or on an amended return for the 1983 tax year filed no later than August 15, 1984. At the time the original of the Form 3115 is filed with the federal income tax return, a copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue Service, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In addition to the information required on Form 3115, the taxpayer must provide (1) a computation of the section 481(a) adjustment and (2) the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. The National Office will sample the Form 3115's to determine whether the requirements of this revenue procedure have been followed. The National Office or the District Director may advise the taxpayer of required adjustments to the change in method of accounting for interest income and deductions.

.02 Taxpayers described in section 3.05 or section 3.07 must also follow the procedures set forth in section 6.01 regarding the place for filing of the original and the copy of the Form 3115 with respect to the tax year for which the change to the "prescribed method" is made. Such taxpayers must also furnish with the Form 3115

the additional information set forth in section 6.01 above regarding the section 481(a) adjustment and its adjustment period.

.03 In order to assist in the processing of these changes in methods of accounting and to ensure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of Page 1 of Form 3115: "FILED UNDER REV. PROC. 84-28".

SEC. 7. EXAMPLES

Example A.

LP, a limited partnership that uses the accrual method of accounting and reports its income on a calendar year basis, borrowed $100,000 on January 1, 1977, payable in 30 annual installments of $12,414 each. The total interest on the loan will be $272,420 (30 × 12,414 = $372,420; $372,420 − $100,000 = $272,420). The terms of the loan state that interest is earned by the lender in accordance with the Rule of 78's computation, and the taxpayer computed its annual interest deduction for six years using the Rule of 78's. The effective rate of interest is 12 percent. The table appearing in the "Law and Analysis" section of Rev. Rul. 83-84 describes the overall transaction. During the six years *LP* deducted a total of $96,665 in interest based on the Rule of 78's method. If *LP* had used the "prescribed method" for computing its deductions for interest during those six years, the total interest deduction would have been $71,124. The difference in the interest deduction using the two methods is $25,541. The following table shows the interest computed under the two methods for the first six years.

Table
Economic accrual of interest

Years	*(Prescribed Method)*	*Rule of 78's*
1977	$12,000	$17,575
1978	11,950	16,990
1979	11,895	16,404
1980	11,832	15,818
1981	11,763	15,232
1982	11,684	14,646

With *LP*'s timely filed federal income tax return for the seventh year (1983), *LP* filed a Form 3115 in accordance with the provisions set forth in sections 3 and 6.01 of this revenue procedure. By changing to the "prescribed method" commencing with the seventh year of the loan and continuing to use that method, *LP* will eventually receive a double deduction for interest in the amount of $25,541. Thus, under section 481(a) of the Code, an adjustment is necessary solely by reason of the change in method of accounting in order to prevent the $25,541 from being duplicated, i.e., taken again as a deduction. If *LP* had made the change to the "prescribed method" for the tax years 1980, 1981, or 1982, the amount of the adjustment would have been $15,124, $19,110, or $22,579, respectively. The percent of the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period preceding the year of change is determined as follows:

1-tax year period

Adjustment as of January 1, 1983.	$25,541	
Less: hypothetical adjustment as of January 1, 1982	22,579	
Amount attributable to 1-tax year period	$ 2,962	
Percent of adjustment attributable to 1-tax year period:	$ 2,962 / 25,541	= 11.6%

2-tax year period

Adjustment as of January 1, 1983.	$25,541	
Less: hypothetical adjustment as of January 1, 1981	19,110	
Amount attributable to 2-tax year period	$ 6,431	
Percent of adjustment attributable to 2-tax year period:	6,431 / 25,541	= 25.2%

3-tax year period

Adjustment as of January 1, 1983.	$25,541	
Less: hypothetical adjustment as of January 1, 1980	15,124	
Amount attributable to 3-tax year period	$10,417	
Percent of adjustment attributable to 3-tax year period:	10,417 / 25,541	= 40.8%

Because less than 67 percent of the adjustment is attributable to the 1982, the 1981, and the 1980 tax years, section 3.04 1(c) of this revenue procedure requires that an adjustment under section 481(a) in the amount of $25,541 be taken into account as an item of gross income ratably over six tax years (⅙ each year) beginning with the year of change.

Example B

The facts are the same as Example A except that *LP*'s federal income tax returns filed for 1980 and 1981 were under examination by the Service and an issue concerning the amount of a claimed interest deduction has been raised and is pending on April 2, 1984. Since *LP*'s claimed interest deductions for the years under examination ($15,818 and $15,232) exceeded the actual loan payments of $12,414 during each of those years, this revenue procedure does not apply to it. The provisions of section 481 of the Code will be applied by the examining agent to change *LP*'s method of accounting for interest as of January 1, 1980. See section 3.08 of this revenue procedure.

Example C

The facts are the same as Example A except that *LP* ignores the mandatory requirement of section 3.02 of this revenue procedure, i.e., the taxpayer does not change to the "prescribed method" for 1983. If *LP* has not been contacted by the Service for purposes of scheduling an examination, *LP* may change to the "prescribed method" for any year *subsequent* to 1983 by complying with sections 3.05 and 6.02 of this revenue procedure. The section 481(a) adjustment must be taken into account ratably over three tax years. See section 3.05 2.

Example D

LP, a limited partnership that uses the accrual method of accounting and reports its income on a calendar year basis, borrowed money on January 1, 1981. The terms of the loan state that interest is earned by the lender in accordance with the Rule of 78's computation, and the taxpayer computed its annual interest deduction for two years using the Rule of 78's method. If *LP* had made the change to the "prescribed method" for its 1983 tax year, the amount of the section 481(a) adjustment would have been taken into account ratably over two years (one-half in 1983 and one-half in 1984). *LP* does not change to the "prescribed method" for 1983. If *LP* has not been contacted by the Service for purposes of scheduling an examination, *LP* may change to the "prescribed method" for any year *subsequent* to 1983 by complying with sections 3.05 and 6.02 of this revenue procedure. The total section 481(a) adjustment must be taken into account in the year of change. See section 3.05 2.

SEC. 8. MISCELLANEOUS

Where a taxpayer's change in method of accounting falls within the scope set forth in section 1 of this revenue procedure, that taxpayer must use this revenue procedure to effectuate such change in method of accounting and may not use the provisions of Rev. Proc. 80-51, 1980-2 C.B. 818. Thus, the original of the application for permission to change the method of accounting described in this revenue procedure, if filed with the National Office under the general provisions of Rev. Proc. 80-51, will not be considered a valid application. Any such original applications erroneously filed with the National Office will be returned without processing and with instructions to comply with this revenue procedure.

SEC. 9. ALTERNATIVE PROCEDURE FOR CERTAIN INDIVIDUAL BORROWERS

Individual borrowers, who previously reported interest expense based upon the Rule of 78's method, may have difficulty computing the amount of interest that economically accrues in order to comply with the provisions of this revenue procedure. Many of these taxpayers may qualify to use the alternative procedure, contained in Rev. Proc. 84-29, for computing allowable interest deductions. One of the requirements that must be met in order to qualify for the alternative procedure contained in Rev. Proc. 84-29 is that the proceeds of the loan were not used for investment purposes or to purchase items in connection with a trade or business. See Rev. Proc. 84-29 for complete details.

SEC. 10. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the

Commissioner of Internal Revenue, Attention CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 163, 446, 461; 1.163-1, 1.446-1, 1.461-1.)

Rev. Proc. 84-29

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a simplified procedure for individual borrowers to compute current and future years' interest deductions with respect to certain loans, when they have been reporting interest deductions in accordance with the Rule of 78's computation.

SEC. 2. SCOPE

.01 This revenue procedure may be used only if *all* of the following conditions are met:

(1) the borrower is an individual taxpayer who uses the cash receipts and disbursements method of accounting and who reports income on a calendar year basis;

(2) the proceeds of the loan were used for personal items (that is, not for investment purposes or to purchase items in connection with a trade or business);

(3) the amount of principal originally borrowed on the loan did not exceed $50,000;

(4) the taxpayer has claimed interest deductions based upon the Rule of 78's method on a federal income tax return;

(5) the interest deductions claimed by the taxpayer during any tax year did not exceed the amount of payments made on the loan during the tax year;

(6) the loan was in existence on January 1, 1984, and the loan requires periodic payments at least annually; and

(7) the loan was not a short-term consumer loan described in Rev. Proc. 83-40, 1983-1 C.B. 774. See section 3.04 of this revenue procedure for a brief discussion of Rev. Proc. 83-40.

.02 Taxpayers who meet all the requirements set forth in section 2.01 of this revenue procedure may choose *either* to follow the procedure in this revenue procedure *or* to follow the procedure in either Rev. Proc. 84-27 or Rev. Proc. 84-28, whichever is applicable. Rev. Proc. 84-27 provides a mandatory procedure for changing an accounting method from the Rule of 78's method for loans that are not described in Rev. Proc. 83-40 and for which the interest computed under the Rule of 78's does not exceed the loan payments during any year of the term of the loan. Rev. Proc. 84-28 provides a mandatory procedure for changing an accounting method from the Rule of 78's method for loans, for which the interest computed under the Rule of 78's exceeds the loan payments during any year of the term of the loan.

.03 Taxpayers who do not meet all the requirements set forth in section 2.01 of this revenue procedure must follow the procedure in Rev. Proc. 84-27 or Rev. Proc. 84-28, whichever is applicable.

.04 Taxpayers whose loans come within the administrative exception contained in Rev. Proc. 83-40 may continue to use the Rule of 78's method for computing their deductions for interest expense with respect to those loans. If taxpayers want to change their method of accounting for such loans, they must do so by complying with the provisions of Rev. Proc. 84-30.

SEC. 3. BACKGROUND

.01 The Rule of 78's is described in Rev. Rul. 83-84, 1983-1 C.B. 97, as a method of allocating interest on a loan among time periods during the term of the loan. Under this method, the amount of interest allocable to each period is determined by multiplying the total interest payable over the life of the indebtedness by a fraction, (a) the numerator of which is the number of periods remaining on such indebtedness at the time the calculation is made and (b) the denominator of which is the sum of the periods' digits for the term of the indebtedness.

.02 Rev. Rul. 83-84 indicates that the Rule of 78's represents a purely mechanical formula for allocating interest among periods. Because interest is earned by the lender by application of the effective rate of interest over the term of the loan, any agreement between a borrower and a lender that provides that interest is earned in another manner, such as under the Rule of 78's computation, lacks economic substance because it fails to reflect the true cost of borrowing. Rev. Rul. 83-84 indicates further that no tax effect will be given to the Rule of 78's provision.

.03 Rev. Rul. 83-84 states that an agreement between a borrower and a lender with respect to any one year of a loan is not independent of the agreement with respect to any other year of the loan. In general, the substance of a loan agreement is that the same rate of interest applies to each tax year of the loan, regardless of any contrary formulas that may be stated in the agreement. The amount of interest attributable to the use of money for each period between payments is determined by applying the "effective rate of interest" on the loan to the "unpaid balance" of the loan for the period. The unpaid balance of a loan is the amount borrowed plus interest earned minus amounts paid. The effective rate of interest is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of values received to the amount and timing of payments made, and is thus a reflection of the cost of the amount borrowed for the time it is actually available. *See* Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 553 (1982), 1982-2 C.B. 600, 639; S. Rep. No. 97-494 (Vol. 1), 97th Cong., 2d Sess. 209 (1982); Supplement I to Regulation Z issued by the Federal Reserve System, 12 CFR Sections 226.6 and 226.40 (1979). Therefore, the effective rate of interest, which is a uniform rate over the term of the loan and is based on the amount of the loan and the repayment schedule provided in the loan agreement, when applied to the unpaid balance of the indebtedness for a given period, will produce the true cost of that indebtedness for that period. This true cost of borrowing is

sometimes referred to as the economic accrual of interest.

.04 Rev. Proc. 83-40 states that in a typical short-term consumer loan transaction, the Service will accept the Rule of 78's method for computing the borrower's interest deduction and the lender's interest income as a matter of administrative convenience. The administrative exception for short-term consumer loans applies only when there is a self-amortizing loan that requires level payments, at regular intervals at least annually, over a period not in excess of five years (with no balloon payment at the end of the loan term), and when the loan agreement between the borrower and the lender provides that interest is earned, or upon the prepayment of the loan interest is treated as earned, in accordance with the Rule of 78's method.

.05 Rev. Proc. 84-27 and Rev. Proc. 84-28 provide mandatory procedures for taxpayers to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's. These revenue procedures apply to lenders and borrowers on loans which are not short-term consumer loans covered by the administrative exception contained in Rev. Proc. 83-40.

.06 Some individual taxpayers, who previously reported interest expense based upon the Rule of 78's method, may have difficulty computing the amount of interest that economically accrues in order to comply with the provisions of Rev. Proc. 84-27 and Rev. Proc. 84-28. Therefore, the Service will accept, as a matter of administrative convenience, an alternative procedure for computing current and future years' interest deductions.

SEC. 4. APPLICATION

.01 The alternative procedure for computing deductions for interest expense is as follows:

(1) take the total amount of finance charge over the life of the loan that was disclosed to the borrower by the lending institution at the beginning of the loan;

(2) subtract from (1) the total of the amounts of interest that the lender has reported to the borrower to have been paid through December 31st of the year prior to the year the change is made;

(3) find the column on the table in section 5 of this revenue procedure that corresponds to the number of years (full and partial) remaining in the loan term as of January 1st of the year the change is made; and

(4) determine the amount of interest deduction in the year of change and each subsequent year by multiplying the appropriate figure from the table in section 5 by the amount computed in (2) above.

.02 The taxpayer can choose to begin using this procedure either for the 1983 or 1984 tax year, by claiming the interest deduction computed in the manner described in section 4.01 on the taxpayer's timely filed federal income tax return for the year chosen. However, the taxpayer may begin to use the alternative procedure for the 1983 tax year on an amended return for such year filed no later than August 15, 1984. The taxpayer cannot use the alternative procedure if the taxpayer has previously complied with the provisions of Rev. Proc. 84-27 or Rev. Proc. 84-28.

.03 In the year of change and each subsequent year, the taxpayer must indicate near the claimed interest deduction on the taxpayer's federal income tax return: "Interest computed under Rev. Proc. 84-29."

SEC. 5. TABLE

	NUMBER OF YEARS REMAINING IN LOAN TERM														
Annual Multiplier	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Year of change	1.00	.64	.46	.35	.29	.24	.20	.17	.15	.13	.12	.11	.10	.09	.08
1st year after change		.36	.34	.30	.25	.22	.19	.16	.15	.13	.12	.11	.10	.09	.08
2nd year after change			.20	.22	.21	.19	.17	.16	.14	.13	.12	.11	.10	.09	.08
3rd year after change				.13	.16	.16	.15	.14	.13	.12	.11	.10	.09	.09	.08
4th year after change					.09	.12	.13	.13	.12	.12	.11	.10	.09	.09	.08
5th year after change						.07	.10	.11	.11	.11	.10	.09	.09	.08	.08
6th year after change							.06	.08	.09	.09	.09	.09	.09	.08	.08
7th year after change								.05	.07	.08	.08	.08	.08	.08	.08
8th year after change									.04	.06	.07	.07	.07	.07	.07
9th year after change										.03	.05	.06	.07	.07	.07
10th year after change											.03	.05	.06	.06	.06
11th year after change												.03	.04	.05	.06
12th year after change													.02	.04	.05
13th year after change														.02	.03
14th year after change															.02

SEC. 6. EXAMPLE

On January 1, 1979, an individual taxpayer borrowed $10,000 to purchase a boat that the taxpayer will use for pleasure. The loan is payable in equal annual installments of $1,770 on December 31st of each year for ten years. The terms of the loan state that interest is earned in accordance with the Rule of 78's method. The total finance charge over the term of the loan is $7,700. The lender has previously informed the taxpayer that the taxpayer's interest was $1,400 for 1979, $1,260 for 1980, $1,120 for

1981, and $980 for 1982. Thus, the total interest deduction that the taxpayer has claimed through December 31, 1982, is $4,760. The taxpayer can choose to use the alternative procedure beginning in either 1983 or 1984. The taxpayer chooses to use the alternative procedure for computing the taxpayer's interest deductions beginning in 1983. Using the alternative procedure, the total finance charge of $7,700 minus previously deducted interest of $4,760 leaves a balance of $2,940. There are six years remaining in the loan term. Using the figures from the column for six years, the interest deductions are computed as follows:

Year	Factor From Column 6		Interest Remaining at Beginning of Year of Change		Interest Deduction
1983	.24	X	$2,940	=	$705.60
1984	.22	X	2,940	=	646.80
1985	.19	X	2,940	=	558.60
1986	.16	X	2,940	=	470.40
1987	.12	X	2,940	=	352.80
1988	.07	X	2,940	=	205.80

26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 163, 446, 451, 461, 481, 1381; 1.163-1, 1.446-1, 1.451-1, 1.461-1, 1.481-1, 1.1381-1.)

Rev. Proc. 84-30

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to provide an expeditious procedure for taxpayers to obtain consent to change their method of accounting for interest on indebtedness when they have been reporting interest income or deductions in accordance with the Rule of 78's computation.

This revenue procedure applies to lenders and borrowers who report interest income or who claim interest deductions using the Rule of 78's method with respect to consumer loans described in Rev. Proc. 83-40, 1983-1 C.B. 774. See Rev. Proc. 84-27, which provides a mandatory procedure for changing an accounting method from the Rule of 78's method for loans that are not described in Rev. Proc. 83-40 and for which the interest computed under the Rule of 78's does not exceed the loan payments during any year of the term of the loan. See Rev. Proc. 84-28, which provides a mandatory procedure for changing an accounting method from the Rule of 78's method for loans, for which the interest computed under the Rule of 78's exceeds the loan payments during any year of the term of the loan.

SEC. 2. BACKGROUND

.01 The Rule of 78's is described in Rev. Rul. 83-84, 1983-1 C.B. 97, as a method of allocating interest on a loan among time periods during the term of the loan. Under this method, the amount of interest allocable to each period is determined by multiplying the total interest payable over the life of the indebtedness by a fraction, (a) the numerator of which is the number of periods remaining on such indebtedness at the time the calculation is made and (b) the denominator of which is the sum of the periods' digits for the term of the indebtedness.

.02 Rev. Rul. 83-84 indicates that the Rule of 78's represents a purely mechanical formula for allocating interest among periods. Because interest is earned by the lender by application of the effective rate of interest over the term of the loan, any agreement between a borrower and a lender that provides that interest is earned in another manner, such as under the Rule of 78's computation, lacks economic substance because it fails to reflect the true cost of borrowing. Rev. Rul. 83-84 indicates further that no tax effect will be given to the Rule of 78's provision.

.03 Rev. Rul. 83-84 states that an agreement between a borrower and a lender with respect to any one year of a loan is not independent of the agreement with respect to any other year of the loan. In general, the substance of a loan agreement is that the same rate of interest applies to each tax year of the loan, regardless of any contrary formulas that may be stated in the agreement. The amount of interest attributable to the use of money for each period between payments is determined by applying the "effective rate of interest" on the loan to the "unpaid balance" of the loan for that period. The unpaid balance of a loan is the amount borrowed plus interest earned minus amounts paid. The effective rate of interest is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of values received to the amount and timing of payments made, and is thus a reflection of the cost of the amount borrowed for the time it is actually available. *See* Conf. Rep. No. 97-760, 97th Cong., 2d Sess. 553 (1982), 1982-2 C.B. 600, 639; S. Rep. No. 97-494 (Vol. 1), 97th Cong., 2d Sess. 209 (1982); Supplement I to Regulation Z issued by the Federal Reserve System, 12 CFR Sections 226.6 and 226.40 (1979). Therefore, the effective rate of interest, which is a uniform rate over the term of the loan and is based on the amount of the loan and the repayment schedule provided in the loan agreement, when applied to the unpaid balance of the indebtedness for a given period, will produce the true cost of that indebtedness for that period. This true cost of borrowing is sometimes referred to as the economic accrual of interest. (For purposes

of this revenue procedure the economic accrual of interest is hereinafter referred to as the "prescribed method.")

.04 Rev. Proc. 83-40 states that in a typical short-term consumer loan transaction, the Internal Revenue Service will accept the Rule of 78's method for computing the borrower's interest deduction and the lender's interest income as a matter of administrative convenience. The administrative exception for short-term consumer loans applies only when there is a self-amortizing loan that requires level payments, at regular intervals at least annually, over a period not in excess of five years (with no balloon payment at the end of the loan term), and when the loan agreement between the borrower and the lender provides that interest is earned, or upon the prepayment of the loan interest is treated as earned, in accordance with the Rule of 78's method.

.05 Section 446(e) of the Internal Revenue Code and section 1.446-1(e) of the Income Tax Regulations provide that in order to change a method of accounting for federal income tax purposes the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain such consent an application must be filed within 180 days after the beginning of the tax year in which the taxpayer desires to make the change. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

.06 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

SEC. 3. APPLICATION

.01 *Consent.* In accordance with section 1.446-1(e)(3)(ii) of the regulations, the 180-day rule is waived and under section 1.446-1(e)(2)(i) consent is hereby granted to taxpayers to change a method of accounting with respect to interest on indebtedness from the method of computing interest income and deductions using the Rule of 78's method to the "prescribed method." See section 2.03 above. Such consent is granted for any tax year ending on or after December 31, 1983, for which the taxpayer requests a change (i.e., year of change) by filing a current Form 3115 in the manner described in section 6 and by otherwise complying with the provisions of this revenue procedure.

.02 *Section 481(a) adjustment.* An adjustment is required to prevent amounts of income and deduction from being duplicated within the meaning of section 481 of the Code and the regulations thereunder when the change in method of accounting is made pursuant to the provisions set forth in this revenue procedure. Such adjustment, whether positive or negative, referred to as the "section 481(a) adjustment," shall be taken into account in computing taxable income and in computing corporate earnings and profits. As to taxable income, the adjustment is made in the manner provided in section 3.03 below. As to corporate earnings and profits, the adjustment is made in the manner provided in Rev. Proc. 79-49, 1979-2 C.B. 528. The change in method of accounting shall be considered to be a change in method of accounting initiated by the taxpayer.

.03 *Section 481 adjustment period.*

1 When the change to the "prescribed method" is made in accordance with section 3.01, the period for taking into account the section 481(a) adjustment referred to in section 3.02 (adjustment period) is generally to be determined as follows:

(a) When the entire amount of the section 481(a) adjustment is attributable to the tax year immediately preceding the year of change (first preceding year), the total adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the tax year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made in the preceding year.

(b) When (a) above does not apply and 67 percent or more of the amount of the section 481(a) adjustment is attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change, the highest percent attributable to the 1, 2, or 3-tax year period will be taken into account ratably over a 3-tax year period beginning with the year of change. Any remaining balance will be taken into account ratably over an additional period equal to the remainder of the number of tax years the taxpayer has continuously used the Rule of 78's method. However, the total adjustment period shall not exceed six tax years. This subparagraph, 3.03 1(b), only applies if the taxpayer has used the Rule of 78's method for more than three tax years. If the Rule of 78's method has been used for no more than four tax years, 75 percent shall be substituted for 67 percent. An amount attributable to the 1, 2, or 3-tax year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the change to the "prescribed method" had been made at the beginning of the preceding 1, 2, or 3-tax year period.

(c) In all other situations in which (a) and (b) above do not apply, the section 481(a) adjustment will be taken into account ratably over the number of years (not to exceed six) the taxpayer has continuously used the Rule of 78's method.

2 For an example of the application of the rules prescribed in this revenue procedure, see section 7.

3 In applying sections 3.03 1(a) or (b), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period immediately preceding the year of change, the taxpayer may reasonably estimate the amount and attach and sign (or have signed by an officer who has personal knowledge of the facts) the following statement to the Form 3115, Application for Change in Accounting Method:

Under penalty of perjury, I hereby certify that:

(a) the books and records of (name of the taxpayer) do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change as required by section 3.03 1(b) of Rev. Proc. 84-30.

(b) Based on the information that is contained in the records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (indicate "is" or "is not," as the case may be) attributable to the tax year immediately preceding the year of change, and 67 percent (or 75 percent in applicable cases) or more of the section 481(a) adjustment for the year of change (indicate "is" or "is not," as the case may be) attributable to the 1-tax year period, 2-tax year period, or 3-tax year period immediately preceding the year of change.

4 A cooperative within the meaning of section 1381(a) of the Code shall take the total amount of the section 481(a) adjustment into account in computing taxable income for the year of change.

.04 *Net Operating Loss Carryovers and Net Operating Losses.*

1 No part of any (consolidated or separate) net operating loss carryover (NOL carryover) available at the beginning of the year of change may be used as an offset against the portion of the positive section 481(a) adjustment taken into account in the year of change. This condition will not apply to tax years subsequent to the year of change.

2 Any portion of any net operating loss arising in the year of change or in any subsequent year in the adjustment period that is attributable to the negative section 481(a) adjustment may not be carried to those 3 tax years preceding the year of change, to which section 172 of the Code otherwise would require it first to be carried.

.05 *Investment credit or any other credits.* No part of any (consolidated or separate) investment credit carryover or any other credit carryover available at the beginning of the year of change may be used to reduce the federal income tax liability resulting from, or attributable to, the inclusion in income of any part of the section 481(a) adjustment in the year of change. This restriction does not apply, however, to a credit arising in the year of change.

.06 *Ceasing to engage in the trade or business.*

(a) With respect to a corporation:

If a corporate taxpayer ceases to engage in the trade or business to which the section 481(a) adjustment (section 3.02) relates at any time prior to the expiration of the adjustment period referred to in section 3.03, the taxpayer shall take into account in that year the balance of the adjustment not previously taken into account in computing taxable income. *See* Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into account in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if the cessation is the result of a transaction to which section 381 of the Code applies, but in that case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(b) With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708 of the Code), to which the section 481(a) adjustment (section 3.02) relates, at any time prior to the expiration of the adjustment period referred to in section 3.03, the balance of the section 481(a) adjustment not previously taken into account in computing the partnership's income or deductions shall be taken into account in the year of cessation. A partnership ceasing to engage in the trade or business includes the incorporation of the trade or business in a transaction to which section 351 applies (*see* Rev. Rul. 77-264, 1977-2 C.B. 187).

(c) With respect to a sole proprietor:

If a sole proprietor ceases to engage in the trade or business, to which the section 481(a) adjustment (section 3.02) relates, at any time prior to the expiration of the adjustment period referred to in section 3.03, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in the year of cessation. A sole proprietor ceasing to engage in the trade of business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies (*see* Rev. Rul. 77-264). A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprietorship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is taken into account by the partnership as though there had been no change in ownership (*see* Rev. Rul. 66-206, 1966-2 C.B. 206).

.07 *Conformity.* Taxpayers electing to change from the Rule of 78's method to the "prescribed method" under this revenue procedure must keep their books and records, including financial statements and statements for credit purposes, for the year of change and for later years on the "prescribed method"

.08 *Reporting to borrowers.* If a lender changes from the Rule of 78's method to the "prescribed method"

under this revenue procedure and if the lender reports to the borrower the amount of interest that the borrower has paid during a year, the lender must continue to use the Rule of 78's computation in reporting the amount of interest to the borrower with respect to loans in existence at the beginning of the year of change.

SEC. 4. RECORDS

Taxpayers must maintain adequate records so that the Service may, upon examination, verify the data concerning the change in method of accounting.

SEC. 5. COMPLIANCE WITH CONDITIONS

Taxpayers making a change from the Rule of 78's method to the "prescribed method" without complying with all the conditions of this revenue procedure will be deemed to have made the change without obtaining the consent of the Commissioner.

SEC. 6. MANNER OF EFFECTING THE CHANGE

.01 Taxpayers to which this revenue procedure applies may effect the change in their methods of accounting for any tax year ending on or after December 31, 1983, pursuant to the provisions set forth in this revenue procedure by filing a current Form 3115, Application for Change in Accounting Method, in duplicate. The original of the Form 3115 shall be attached to the taxpayer's timely filed federal income tax return for the tax year that the taxpayer requests a change in method. For example, a domestic corporation whose tax year ends on December 31, 1983, may effect the change described in this revenue procedure for the 1983 tax year on a timely filed return, no later than September 15, 1984. At the same time a copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue Service, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In addition to the information required on Form 3115, the taxpayer must provide (1) a computation of the section 481(a) adjustment and (2) the period over which the section 481(a) adjustment will be taken into account and the basis for such conclusion. The National Office will sample the Form 3115's to determine whether the requirements of this revenue procedure have been followed. The National Office or the District Director may advise the taxpayer of required adjustments to the change in method of accounting for interest income and deductions.

.02 In order to assist in the processing of these changes in method of accounting and to ensure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of Page 1 of Form 3115: "FILED UNDER REV. PROC. 84-30".

SEC. 7. EXAMPLE

For 11 years a financial institution, that reports its income on a calendar year basis, has used the Rule of 78's method for reporting interest income for loans that have terms of 5 years or less and that are described in Rev. Proc. 83-40. The taxpayer wants to change to the "prescribed method" of reporting interest for the tax year ending on December 31, 1983. In each year 1976 through 1982, the taxpayer made 10 loans of $10,000 each payable in 5 annual installments. For the loans made in 1976, 1977, and 1978, the annual payment was $2,638 for each loan. The total interest on each of these loans was $3,190 (5 × $2,638 = $13,190; $13,190 − $10,000 = $3,190). The effective rate of interest was 10 percent. For the loans made in 1979 and subsequent years, the annual payment was $2,774 for each loan. The total interest on each of these loans was $3,870 (5 × $2,774 = $13,870; $13,870 − $10,000 = $3,870). The effective rate of interest was 12 percent. The terms of all these loans state that interest is earned by the lender in accordance with the Rule of 78's computation. All loans made during 1978 and earlier years had been paid off by January 1, 1983. During the four years (1979 through 1982), for which there were still loans outstanding as of January 1, 1983, the taxpayer included a total of $103,200 as interest computed under the Rule of 78's method. If the taxpayer had used the "prescribed method" for computing its interest income during those four years, the total interest income would have been $99,940. The difference in interest income using the two methods is $3,260. Table 1 shows the interest computed under the Rule of 78's method, and Table 2 shows the interest computed under the "prescribed method."

With the taxpayer's timely filed federal income tax return for 1983, the taxpayer filed a current Form 3115 in accordance with the provisions set forth in sections 3 and 6.01 of this revenue procedure. By changing to the "prescribed method" commencing with the 1983 tax year and continuing to use that method, the taxpayer will eventually have a double inclusion of interest income in the amount of $3,260. Thus, under section 481(a) of the Code, an adjustment is necessary solely by reason of the change in method of accounting in order to prevent the $3,260 from being duplicated, i.e., included again in income. If the taxpayer had made the change to the "prescribed method" for the tax years 1980, 1981, or 1982, the amount of the adjustment would have been $2,550, $2,880, or $3,140 respectively (see Table 3 for the computations). The percent of the section 481(a) adjustment attributable to the 1, 2, or 3-tax year period preceding the year of change is determined as follows:

1-tax year period		
Adjustment as of January 1, 1983.		$ 3,260
Less: hypothetical adjustment as of January 1, 1982		3,140
Adjustment attributable to 1-tax year period		$ 120
Percent of adjustment attributable to 1-tax year period:	120 / 3,260	= 3.7%

2-tax year period		
Adjustment as of January 1, 1983.		$ 3,260
Less: hypothetical adjustment as of January 1, 1981		2,880
Amount attributable to 2-tax year period		$ 380
Percent of adjustment attributable to 2-tax year period:	380 / 3,260	= 11.7%

(Continued on page 487)

Table 1*—Rule of 78's

YEAR	Interest income on loans entered into during: 1976	1977	1978	1979	1980	1981	1982	1/1/83**	Interest income for year on loans open as of: 1/1/82	1/1/81	1/1/80
1976	$10,630										$10,630
1977	8,510	$10,630								$10,630	19,140
1978	6,380	8,510	$10,630						$10,630	19,140	25,520
1979	4,250	6,380	8,510	$12,900				$ 12,900	21,410	27,790	32,040
1980	2,130	4,250	6,380	10,320	$12,900			23,220	29,600	33,850	
1981	0	2,130	4,250	7,740	10,320	$12,900		30,960	35,210		
1982	0	0	2,130	5,160	7,740	10,320	$12,900	36,120			
								$103,200	$96,850	$91,410	$87,330

* This table assumes that all loans were made at the beginning of each year.
** All loans made during 1978 and earlier were paid off by 1/1/83.

Table 2*—Economic accrual of interest (Prescribed method)

YEAR	Interest income on loans entered into during: 1976	1977	1978	1979	1980	1981	1982	1/1/83**	Interest income for year on loans open as of: 1/1/82	1/1/81	1/1/80
1976	$10,000										$10,000
1977	8,360	$10,000								$10,000	18,360
1978	6,560	8,360	$10,000						$10,000	18,360	24,920
1979	4,580	6,560	8,360	$12,000				$12,000	20,360	26,920	31,500
1980	2,400	4,580	6,560	10,110	$12,000			22,110	28,670	33,250	
1981	0	2,400	4,580	7,990	10,110	$12,000		30,100	34,680		
1982	0	0	2,400	5,630	7,990	10,110	$12,000	35,730			
								$99,940	$93,710	$88,530	$84,780

* This table assumes that all loans were made at the beginning of each year.
** All loans made during 1978 and earlier were paid off by 1/1/83.

Table 3—Calculations of Adjustments

	Section 481(a) adjustment as of: 1/1/83	Hypothetical adjustments as of: 1/1/82	1/1/81	1/1/80
Rule of 78's	$103,200	$96,850	$91,410	$87,330
Prescribed method	99,940	93,710	88,530	84,780
Difference	$ 3,260	$ 3,140	$ 2,880	$ 2,550

	3-tax year period
Adjustment as of January 1, 1983.	$ 3,260
Less: Hypothetical adjustment as of January 1, 1980	2,550
Amount attributable to 3-tax year period	$ 710

Percent of adjustment attributable to 3-tax year period: $\frac{710}{3,260} = 21.8\%$

Because less than 67 percent of the adjustment is attributable to the 1982, the 1981, and the 1980 tax years, section 3.03 1(c) of this revenue procedure requires that an adjustment under section 481(a) in the amount of $3,260 be taken into account as a deduction from gross income ratably over six tax years (⅙ each year) beginning with the year of change.

SEC. 8. MISCELLANEOUS

.01 Where a taxpayer's change in method of accounting falls within the scope set forth in section 1 of this revenue procedure, that taxpayer must use this revenue procedure to effectuate such change in method of accounting and may not use the provisions of Rev. Proc. 80-51, 1980-2 C.B. 818. Thus, the original of the application for permission to change the method of accounting (Form 3115) described in this revenue procedure, if filed with the National Office under the general provisions of Rev. Proc. 80-51, will not be considered a valid application. Any such original applications erroneously filed with the National Office will be returned without processing and with instructions to comply with this revenue procedure.

.02 Notwithstanding the provisions of section 8.01 above, if, prior to April 2, 1984, a taxpayer timely filed a form 3115 with the Commissioner to change from the Rule of 78's method to the "prescribed method" and filed its federal income tax return for the requested year of change, the taxpayer may comply with this revenue procedure by attaching a Form 3115 to an amended return for that year and by otherwise complying with the conditions of this revenue procedure. The amended return must be filed no later than the extended time prescribed in section 6081 of the Code and the regulations thereunder whether or not the taxpayer has, in fact, been granted an extension of time for filing its income tax return (for example, no later than September 15, 1984, for a domestic corporation whose tax year ends December 31, 1983).

SEC. 9. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.602: Forms and instructions.
(Also Part I, Section 4997; 51.4997-2.)

Rev. Proc. 84-31

PART A — GENERAL

SEC. 1. PURPOSE AND NATURE OF CHANGES

The purpose of this revenue procedure is to update Rev. Proc. 82-69, 1982-2 C.B. 854, concerning the requirements and conditions for filing annual information returns for Windfall Profit Tax on magnetic tape instead of on paper returns. Specifications for filing Form 6248, Annual Information Return of Windfall Profit Tax are contained in this procedure. For Tax Year 1983 the following changes have been included in this revenue procedure:

.01 In Part B, Section 1, the provision for 6250 BPI tape density has been added for both EBCDIC and ASCII recording modes.

.02 In Part B, Section 3, the option to use 80 or 120 positions in the header and trailer labels has been added.

.03 In Part B, a new Section 4 has been added which is a table of valid state abbreviations and zip codes. The table is to be used in the "G" and "H" records.

.04 In Part B, Section 6.03, additional information regarding signed decimal data is provided.

.05 In Part B, Section 6, for the Type of Producer in positions 349-351 of the Producer/Recipient "H" record, a new code of Zero has been added to indicate that the type of producer cannot be determined.

.06 In Part B, Section 6, for the Producer Status in positions 352 to 354 of the Producer/Recipient "H" record, two new codes have been added. Code 0 (Zero) indicates that the status cannot be determined, and Code 8 indicates a Trust Beneficiary.

.07 In Part B, Section 6, a new twelve position field has been added in order to enter the total number of barrels of exempt stripper well oil. This field is located in positions 617 through 628 of the Producer/Recipient "H" record.

.08 In Part B, Section 6, the following "H" record fields have the rate in the title changed from "27½" to "25":

Number of Barrels Newly Discovered 25% Rate (positions 965-976)

Tax Liability Newly Discovered 25% Rate (positions 1013-1024)

SEC. 2. APPLICATION FOR MAGNETIC MEDIA REPORTING

.01 For the purpose of this revenue procedure only, the first purchasers, filers, and payers are equivalent to each other, and are considered to be the person making the payments. The producer, recipient, or payee is the receiver of the payments. The transmitter is the organization preparing the tape file. Payers or transmitters who decide to file information returns on magnetic tape must complete Form 4419, Application for Magnetic Media Reporting of Information Returns. Instructions for completing the application appear on the reverse side of the form.

.02 The Internal Revenue Service (IRS) will act on an application and notify the applicant of authorization to file within 30 days of receipt of the application. No magnetic tape returns may be filed with the IRS until au-

thorization to file is received.

.03 The IRS will assist new filers with their initial magnetic tape submission by reviewing test tapes in advance of the filing season. Approved payers or transmitters who wish to submit test tapes should contact the magnetic media coordinator at the Service Center where the application was filed. A list of the Service Center addresses is provided in Section 10.

.04 Once authorization to file on magnetic tape has been granted to a payer or transmitter, it will remain in effect in succeeding years, provided that all the requirements of this revenue procedure are met and there are no equipment changes by the filer. If a filer discontinues filing on magnetic tape, a new application must be filed before this method of filing may be resumed.

SEC. 3. FILING OF TAPE REPORT

.01 A magnetic tape reporting package, which includes all the necessary transmittals, labels, and instructions, will be mailed to all approved filers between October and December of each year.

.02 Payers may submit a portion of their information returns on magnetic tape and the remainder on paper forms provided there is no duplicate filing. The magnetic tape records and paper forms must be filed at the same location, but in separate shipments. A Form 6248-T, Summary and Transmittal of Windfall Profit Tax, must accompany paper submissions and a Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must accompany magnetic tape submissions.

.03 The affidavit which appears on Forms 6248-T and Form 4804 must be signed by the payer. However, one of the following, the transmitter, service bureau, or disbursing agent may sign the affidavit on behalf of the payer if three conditions are met. The conditions are that the Agent must:

a. have the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under state law;

b. have the responsibility (either oral, written or implied) conferred on it by the payer to request the taxpayer identifying numbers of payees reported on magnetic tape or paper returns; and

c. sign the affidavit and add the caption "From: (name of payer)".

.04 Although a duly authorized agent signs the affidavit, the payer is held responsible for the accuracy of the Form 4804 and will be liable for penalties for failure to comply with filing requirements.

.05 The preceding requirements also apply to paper filers submitting Form 6248-T. The failure of duly authorized "agents" of paper filers to comply with filing requirements for Form 6248-T and attachments does not relieve the payers of any penalties that may arise as a result of such failure to comply.

.06 If a portion of the returns is submitted on paper documents, include a statement on the Form 6248-T that the remaining returns are being filed on magnetic tapes. Please note that Form 6248-T instructions normally apply to filing of information returns on paper; however, filers of magnetic tape must review the Form 6248-T instructions and file Form 6248-T if appropriate.

SEC. 4. FILING DATES

.01 Magnetic tape reporting to the IRS for Forms 6248 is on a calendar year basis.

.02 The dates prescribed for filing paper returns with the Internal Revenue Service will also apply to magnetic tape filing. Tapes must be submitted to the service center by April 30. Copies required to be furnished to the producer or other recipients must be furnished by March 31.

SEC. 5. EXTENSIONS OF TIME TO FILE

.01 If a payer or transmitter is unable to submit the tape file by the date prescribed in Section 4.02 above, a letter requesting an extension must be filed before April 30. The letter should be sent to the attention of the magnetic media coordinator at the service center which will receive the tape file (see Part A, Section 10, below). The request should include the estimated number of returns which will be filed late, the reason for the delay, and the date by which the returns will be filed.

.02 If an extension is granted by the IRS, a copy of the letter granting the extension must be attached to the transmittal Form 4804 when the file is submitted.

SEC. 6. PROCESSING OF TAPE RETURNS

.01 The IRS will process tax information from the tapes. Tapes which are timely received by the IRS will be returned to the filer within six months of receipt.

.02 All tapes submitted must conform totally to this revenue procedure. If tapes are unprocessable, they will be returned to the filer for correction. Corrected tapes must be filed with the IRS as soon as possible. Corrected files will be returned by the IRS within six months of receipt.

SEC. 7. CORRECTED RETURNS, SUBSTITUTE FORMS AND COMPUTER-GENERATED FORMS

.01 If returns must be corrected or amended, approved magnetic media filers should make every attempt to provide such corrections on tape. The filer must contact the magnetic media coordinator for format and shipping instructions. A corrected Form 4804 must accompany the shipment and be marked "Magnetic Media Correction" on the top margin of the form. Corrected or amended Form 6248 data must be filed in accordance with Revenue Procedure 83-86.

.02 If corrections are not submitted on tape, payers must submit them on official Forms 6248 (Copy A). Approved substitutes or computer-generated forms that are exact facsimiles of the official form (except for minor page size or print style deviations) may be submitted without obtaining prior IRS approval before using the form. In all other cases, IRS approval must be obtained before the substitute or computer-generated form can be used. Revenue procedures containing specifications for paper returns are available from most IRS offices.

.03 Requests for approval of a computer-generated or substitute form should be sent to the following address with a copy of the proposed form:
Internal Revenue Service
Attn: Substitute Forms Program
Room 7037 D:R:R:I
1111 Constitution Avenue N.W.
Washington, D.C. 20224

.04 Form 6248 instructions are to be followed when paper returns are filed to correct returns submitted on magnetic media. The caption "Magnetic Media Correction" must appear on the top right corner of the form. Corrections must be sent to the attention of the magnetic media coordinator where the original tape file was filed.

SEC. 8. TAXPAYER IDENTIFICATION NUMBERS

.01 Under Section 6109 of the Internal Revenue Code, recipients of income are required to furnish Taxpayer Identification Numbers (TINs) to the payer whether or not the payee is required to file a tax return.

.02 Payers are expected to keep to a minimum those statements submitted without TINs. It is particularly important that correct Social Security and Employer Identification Numbers for payees be provided on magnetic media or paper forms submitted to the IRS.

.03 For each omission of a required TIN, Section 6676 of the Internal Revenue Code imposes a $50 penalty, unless the payer or payee responsible for furnishing the number establishes reasonable cause for not having done so.

.04 The TIN to be furnished depends primarily upon the manner in which the account is maintained or set up on the record of the payer. The number to be provided must be that of the owner of record. If the account is recorded in more than one name, furnish the TIN and name of one of the holders of the record. For those engaged in a trade or business (including employee trusts, retirement systems, etc.) the TIN is the Employer Identification Number (EIN), without hyphens. For individuals, it is a Social Security Number (SSN), without hyphens.

.05 Sole proprietors who are payers should show their Employer Identification Number and/or their Social Security Number in the Filer/Transmitter "G" Record. The tables provided in .06 below should help to determine the number to be furnished to the IRS.

.06 Any person required to file an information return that is based, in whole or in part, upon information received from another person MUST include the Taxpayer Identifying Number of that person on the return. The tables below will help determine the number to be furnished to the IRS.

Table 1. Guidelines for Social Security Numbers

If the producer/ recipient is:	In tape positions 2-10 of the Producer/Recipient "H" Records, enter the SSN of:	In tape positions 20-339 of the Producer/ Recipient "H" Record, enter the name of:
1. An individual	The individual	The individual
2. A joint account of two or more individuals, a husband and wife or adult and minor	The actual or principal owner of the account	The individual whose SSN is entered
3. An account in the name of the guardian or committee for a designated ward, minor, or incompetent person	The ward, minor, or incompetent person	The individual whose SSN is entered
4. A custodian of a minor (Uniform Gifts to Minors Act)	The minor	The minor
5. a. The usual revocable savings trust account (grantor is also trustee)	The grantor-trustee	The grantor-trustee
b. So-called trust account that is not a legal or valid trust under State Law	The actual owner	The actual owner

Table 1. Guidelines for Social Security Numbers—Continued

If the producer/ recipient is:	In tape positions 2-10 of the Producer/Recipient "H" Records, enter the SSN of:	In tape position 20-339 of the Producer/ Recipient "H" Record, enter the name of:
6. A sole proprietor	The owner	The owner
7. A grantor trust described in Section 1.671-4(b) of the Income Tax Regulations	The grantor	The grantor

Table 2. Guidelines for Employer Identification Numbers

If the producer/ recipient is:	In tape positions 11-19 of the Producer/Recipient "H" Record, enter EIN of:	In tape positions 20-339 of the the Producer/Recipient "H" Record, enter the name of:
1. A valid trust, estate or pension trust	Legal entity (Do not furnish the identifying number of the personal representative or trustee unless the legal entity itself is designated in the account title)	The legal trust, estate or pension trust
2. A corporation	The corporation	The corporation
3. A religious, charitable or educational organization	The organization	The organization
4. A partnership held in the name of the business	The partnership	The partnership
5. An association, club, or other tax-exempt organization	The organization	The organization
6. A broker or registered nominee	The broker or nominee	The broker or nominee
7. An account with the Department of Agriculture in the name of a public entity (such as a state or local government, school district or prison that receives agriculture program payments)	The public entity	The public entity

SEC. 9. EFFECT ON PAPER RETURNS

.01 Magnetic tape reporting of the information return listed in Section 1 above applies only to the original (Copy A).

.02 Payers are permitted considerable flexibility in designing the copy of the information return to be furnished to the payee. The payer may combine the information return data with other reports or financial or commercial notices, or expand them to include other information. This is permissable so long as all required information present on the official form is included and the payees' copies are conducive to proper reporting of income on tax returns. Payers must include the message "This information is being furnished on Form 6248 to the Internal Revenue Service" on the recipients' copies.

.03 If a portion of the returns are reported on magnetic tape and the remainder are reported on paper forms, those returns not submitted on magnetic tape must be filed on official Forms 6248.

SEC. 10. ADDITIONAL INFORMATION

Requests for additional copies of this revenue procedure or for additional information on tape reporting should be addressed to the attention of the magnetic media coordinator of one of the following:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
P.O. Box 486
Holtsville, N.Y. 11742

(c) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(d) Internal Revenue Service
Atlanta Service Center
Post Office Box 47421
Doraville, GA 30362

(e) Internal Revenue Service
Memphis Service Center
P.O. Box 1900
Memphis, TN 38101

(f) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
Covington, KY 41019

(g) Internal Revenue Service
Kansas City Service Center
2306 E. Bannister Road Stop 43
Kansas City, MO 64131

(h) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

(i) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
Ogden, UT 84409

(j) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

PART B. — MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 The magnetic tape specifications contained in this part prescribe the required format and contents of the records to be included in the file. These specifications must be adhered to unless deviations have been specifically granted by the IRS in writing.

.02 In most instances, the IRS will be able to process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 7 channel BCD (binary coded decimal) with
(1) Either Even or Odd Parity and
(2) A density of 556 or 800 BPI

(b) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with
(1) Odd Parity and
(2) A density of 800, 1600, or 6250 BPI

(c) 9 channel ASCII (American Standard Coded Information Interchange) with
(1) Odd Parity and
(2) A density of 800, 1600, or 6250 BPI

.03 All compatible tape files must have the following characteristics:

(a) Type of tape - ½ inch Mylar base, oxide coated; and
(b) Interrecord Gap - ¾ inch.

.04 IRS programs are capable of accommodating some minor deviations. Filers who can substantially conform to these specifications, but do require some minor deviations, must contact the magnetic media coordinator at the service center where the file will be submitted. Under no circumstances may tapes deviating from the specifications in this revenue procedure be submitted without prior written approval from the IRS.

SEC. 2. RECORD LENGTH

.01 The tape records prescribed in these specifications may be blocked or unblocked, subject to the following:

(a) A block must not exceed 14,500 tape positions.

(b) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9's. Do not pad a block with blanks.

(c) All records except the Header and Trailer Labels, may be blocked.

.02 All records, other than Header and Trailer records, must be 1450 characters long.

SEC. 3. OPTIONS FOR FILING

.01 For filing convenience, this procedure contains two options for using Header Labels and Filer/Transmitter "G" Records. For the purposes of this procedure the following conventions must be used:

Header Label:

1. Payers may use standard headers, however they begin with 1 HDR, HDR1, HDR2, VOL1 or VOL2.

2. Consist of either 80 or 120 positions each.

Trailer Label:

1. Standard trailer labels may be used, however they must begin with 1EOR, 1EOF, EOR1, EOF1.

2. Consist of either 80 or 120 positions each.

Record Mark:

1. Special character used to separate blocked records on tape.

2. Can be written only at the end of a record or block.

3. For odd parity tapes, use BCD bit configuration 011010 ("A82").

Tape Mark:

1. Used to signify the physical end of the recording on tape.

2. Must be even parity, BCD con-

figuration 001111 ("8421").

3. May follow the header label(s) and precede and/or follow the trailer label(s).

Option 1: When using this option, a correct Filer/Transmitter "G" Record, described in Sec. 4 below, is required as the first record on each reel. Filers using this option may have Header Labels preceding the "G" Record, however, headers are not required. The reel sequence number must appear in positions 3-5 of each "G" Record and must be incremented by 1 on each tape reel of the file after the first reel.

Option 2: Requires a Header Label as the first record on each reel. The Header Label must contain the reel sequence number and it must be incremented by 1 on each reel. The "G" Record will contain the location of the reel sequence number in the Header Label. If your system generates a four digit reel sequence number, ignore the first digit when determining the location of the reel sequence in the "G" Record.

Example 1: If your Header Label reel sequence is four digits (e.g., 0001) and is in positions 28-31, enter 29 as the location in positions 3 and 4 of the "G" Record and also enter an "X" in position 5 of the "G" Record.

Example 2: If your Header Label reel sequence number is 3 digits (e.g., 001) and is in position 10-12, enter 10 as the location in positions 3 and 4 of the "G" Record. This option requires a Trailer Label at the end of each reel. Also, ignore the "J" Record instructions in this part if you use option 2.

SEC. 4. STANDARD STATE ABBREVIATIONS AND ZIP CODES

The following table gives the list of valid state abbreviations and zip codes to be used in the "G" and (in the case of zip codes) "H" records. The valid abbreviations for the U.S. territories American Samoa, Guam, Puerto Rico and the Virgin Islands are also included. If the producer lives in a foreign country, then a period followed by a blank (".b") should be entered in the two position state field and blanks should be entered for Zip Code. The table lists the only valid data entries for state information.

Table 3. STATE ABBREVIATIONS and ZIP CODES

Alabama	AL	350nn-369nn
Alaska	AK	995nn-999nn
American Samoa	AS	(Blank)
Arizona	AZ	850nn-865nn
Arkansas	AR	716nn-729nn, 75501
California	CA	900nn-966nn
Colorado	CO	800nn-816nn
Connecticut	CT	060nn-069nn, 02891, 10573
Delaware	DE	197nn-199nn
Dist. of Columbia	DC	200nn-205nn
Florida	FL	320nn-340nn
Georgia	GA	300nn-319nn, 37317
Guam	GU	969nn
Hawaii	HI	967nn-968nn
Idaho	ID	832nn-838nn
Illinois	IL	600nn-606nn, 609nn-629nn
Indiana	IN	460nn-479nn
Iowa	IA	500nn-528nn
Kansas	KS	660nn-679nn
Kentucky	KY	400nn-427nn, 45275
Louisiana	LA	700nn-714nn, 71749
Maine	ME	039nn-049nn, 03801
Maryland	MD	206nn-219nn, 200nn, 203nn
Massachusetts	MA	010nn-027nn
Michigan	MI	480nn-499nn, 55617
Minnesota	MN	550nn-567nn
Mississippi	MS	386nn-397nn
Missouri	MO	630nn-658nn
Montana	MT	590nn-599nn
Nebraska	NE	680nn-693nn
Nevada	NV	890nn-898nn
New Hampshire	NH	030nn-038nn, 04037
New Jersey	NJ	070nn-089nn
New Mexico	NM	870nn-884nn
New York	NY	090nn-098nn, 100nn-149nn
North Carolina	NC	270nn-289nn
North Dakota	ND	580nn-588nn
Ohio	OH	430nn-458nn
Oklahoma	OK	730nn-749nn
Oregon	OR	970nn-979nn
Pennsylvania	PA	150nn-196nn
Puerto Rico	PR	007nn-009nn
Rhode Island	RI	028nn-029nn, 02701
South Carolina	SC	290nn-299nn
South Dakota	SD	570nn-577nn
Tennessee	TN	370nn-385nn, 35740, 42041
Texas	TX	750nn-799nn, 73949, 88021
Utah	UT	840nn-847nn
Vermont	VT	050nn-059nn
Virginia	VA	220nn-246nn, 200nn, 203nn
Virgin Islands	VI	008nn
Washington	WA	980nn-994nn
West Virginia	WV	247nn-268nn
Wisconsin	WI	530nn-549nn, 49936

Table 3. STATE ABBREVIATIONS AND ZIP CODES (continued)

Wyoming	WY	820nn-831nn	Foreign Ctry	.b	Blank

FOOTNOTES: "n" denotes any numeric digit; "b" denotes a blank

SEC. 5. FILTER/TRANSMITTER "G" RECORD

This record identifies the filer and the transmitter of the tape file and provides parameters for the processing of the succeeding records. The IRS computer programs rely on the parameters supplied in this record in the processing of the tape file.

The number of "G" Records appearing on a tape reel will depend on the number of Filers for whom data is present. A transmitter may include Producer "H" Records for more than one Filer on a tape reel, however, each series of separate Filer/Producer "H" Record(s) must be preceded by a "G" Record. All "G" Records must be 1,450 characters in length.

RECORD NAME: FILER/TRANSMITTER "G" RECORD

Tape Position	Field Type	Length	Description and Remarks
1	Record Type	1	Enter "G".
2	Filing Year	1	Must be the rightmost digit of the year for which WPT data is being reported (e.g., if data is for 1983 enter a 3). This number must be incremented each year.
3-5	Reel Sequence Number	3	Sequential number of the reel within the tape file upon which this record appears (see explanation of Option 1 and Option 2 filing). Position 5 must contain an X if you are using option 2.
6-9	"G" Record Length	4	Enter 1450.
10-13	"H" Record Length	4	Enter 1450.
14-17	"I" Record Length	4	Enter 1450.
18	Type of Account Filer's TIN	1	This field is used to identify the data in tape positions 19-27 as either an EIN (Employer Identification Number) or an SSN (Social Security Number). Use one of the following codes as appropriate. 1. Use the digit 0 if the number provided is an SSN. 2. Use the digit 1 if the number provided is an EIN. 3. Use the digit 2 if it is not known if the number provided is an SSN or EIN. 4. Use the digit 3 if no number is provided (positions 19-27 should be blank filled in this case).
19-27	Filer's Taxpayer Identification Number	9	Enter the taxpayer identifying number of the filer (SSN or EIN as appropriate). If no TIN is provided leave blank.
28-67	Filer's Name	40	Enter the name of the Filer as used in normal business. Abbreviate any extraneous data other than the name as necessary. Left justify and fill with blanks.
68-102	Filer's Street Address	35	Enter the street address of the Filer. Left justify and fill with blanks.
103-115	Filer's City	13	Enter the city of the Filer. Left justify and blank fill.
116-117	Filer's State	2	Enter the two digit abbreviation of the Filer's state. (See Table of valid State Abbreviations in Part B, Section 4.)

RECORD NAME: FILER/TRANSMITTER "G" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
118-122	Filer's Zip	5	Enter the Zip Code of the Filer. If Zip Code of the Filer is not known this field must be blank. (See also the Zip Code ranges by State in the Table in Part B, Section 4.)
123-126	Reserved Field	4	Reserved for IRS use. Enter blanks.
127	Corrected Indicator	1	Enter a 1 (one) if the documents being filed are corrected documents. Otherwise enter a 0 (zero).
128-178	Reserved	51	Reserved for IRS use. Enter blanks.
179-183	Transmitter Control Code	5	Enter the 5 digit transmitter control code assigned by IRS.
184	Transmitter Code	1	If the filer of these Forms 6248 and the transmitter are the same, enter the digit 0 in this location and blank fill the rest of the record. If they are not the same, enter the digit 1 and supply the information indicated.
185-193	Reserved	9	Reserved for IRS use. Blank fill.
194-233	Transmitter's Name [1]	40	Enter the name of the Transmitter. Left justify and blank fill.
234-268	Transmitter's Street Address [1]	35	Enter the street address of the transmitter. Left justify and blank fill.
269-281	Transmitter's City [1]	13	Enter City of Transmitter. Left Justify and Blank fill.
282-283	Transmitter's State [1]	2	Enter abbreviation of state of transmitter.
284-288	Transmitter's Zip Code [1]	5	Enter Zip Code of Transmitter.
289-1450	Reserved	1162	Reserved for IRS use. Blank fill.

[1] If file is being transmitted by Filer, then the Transmitter Name, Street Address, City, State and Zip Code can be blank filled.

SEC. 6. PRODUCER/RECIPIENT "H" RECORD

.01 This record is used to provide the information contained in Parts I, II, III, IV, and V of Form 6248. All "H" Records must be of the same fixed length. Records may be blocked or unblocked. A block may not exceed 14,500 positions. Do not pad unused blocks with blank records, fill with 9's. Blank fill any field for which a data entry is not present.

.02 All amount fields in this section should be expressed in whole dollars without decimals. All quantities of oil should be expressed in whole barrels without decimals or fractions.

.03 Amount fields and barrel fields may be signed or unsigned. Unsigned fields will always be considered positive. If signed decimal data is used, the rightmost (units) position of the field must be used to carry the sign of the field (negative or positive) as an overpunch character. This is the *only* format permissable for the entry of signed decimal data. If your computer system cannot conform to this standard, or if you have any questions about entering data in this format, please contact the magnetic media coordinator at the IRS Service Center in which you intend to file (See Part A, Section 10).

.04 All "H" Records must be 1450 characters long.

RECORD NAME: PRODUCER/RECEIPT "H" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Enter "H".
2-10	Producer's SSN	9	Enter Social Security Number of Producer, without hyphens, if available. Otherwise, blank fill.

Tape Position	Field Title	Length	Description and Remarks
11-19	Producer's EIN	9	Enter Employer Identification Number of Producer, without hyphens, if available. Otherwise, blank fill.
NOTE:	The following 8 fields are for the Producer Name/Address information. If your name/address fields contain less than 40 characters, do not pack information from more than one of your name/address fields into any one of the following name/address fields. If your name/address fields are longer than 40 characters each, contact the magnetic media coordinator at your regional Service Center (see Part A Section 10 of this document) for instructions on entering the data. You are encouraged, but not required, to use the 2 character state abbreviations.		
20-59	Producer's 1st Name/ Address Line	40	Enter data from your first Name/Address field for this Producer.
60-99	Producer's 2nd Name/ Address Line	40	Enter data from your second Name/Address field for this Producer.
100-139	Producer's 3rd Name/ Address Line	40	Enter data from your third Name/Address field for this Producer. If no data is present enter blanks.
140-179	Producer's 4th Name/ Address Line	40	Enter data from your fourth Name/Address field for this Producer. If no data is present enter blanks.
180-219	Producer's 5th Name/ Address Line	40	Enter data from your fifth Name/Address field for this Producer. If no data is present, enter blanks.
220-259	Producer's 6th Name/ Address Line	40	Enter data from your sixth Name/Address field for this Producer. If no data is present, enter blanks.
260-299	Producer's 7th Name/ Address Line	40	Enter data from your seventh Name/Address field for this Producer. If no data is present, enter blanks.
300-339	Producer's 8th Name/ Address Line	40	Enter data from your eighth Name/Address field for this Producer. If no data is present, enter blanks.
340-344	Producer Zip Code	5	Enter the Zip Code of the Producer (See Part B, Section 4).
345-348	Reserved	4	Reserved for IRS use.
349-351	Type of Producer	3	Use up to 3 of the codes below to indicate the Type of Producer. Use at least one of the codes. Left justify and blank fill. *Type of Producer* — *Code* (Unable to determine) — 0 Individual — 1 Partnership — 2 Corporation — 3 Estate — 4 Trust — 5 US Citizen or Entity, or Resident Alien — 6 Resident of US Possession — 7 Foreign Citizen or Non-Resident Alien — 8
352-354	Producer Status	3	Use up to 3 of the following codes to indicate the status of the producer. Use at least one code. Left justify and blank fill. *Producer Status* — *Code* (Unable to determine) — 0 Independent Producer — 1 Member of "related group" — 2 Producer with no withholding — 3

Tape Position	Field Title	Length	Description and Remarks
			Producer Status — *Code* Royalty Owner — 4 Integrated Oil Company — 5 Operator — 6 Working Interest — 7 Trust Beneficiary — 8
355-364	Exempt Tier One	10	Enter the number of barrels of Exempt Tier One Oil. Enter in Whole Barrels, right justified and zero filled.
365-374	Exempt Tier Two	10	Enter the number of barrels of Exempt Tier Two Oil. Enter in Whole Barrels, right justified and zero filled.
375-384	Exempt Newly Discovered	10	Enter the number of barrels of Exempt Newly Discovered Oil. Enter in Whole Barrels, right justified and zero filled.
385-394	Exempt Incremental Tertiary	10	Enter the number of barrels of Exempt Incremental Tertiary oil. Enter in Whole Barrels, right justified and zero filled.
395-404	Exempt Heavy	10	Enter the number of barrels of Exempt Heavy Oil. Enter in Whole Barrels, right justified and zero filled.
405-414	Total Barrels	10	Enter the total number of barrels of exempt oil. Enter in Whole Barrels, right justified and zero filled.
415-419	Type of Exempt Oil	5	Use up to 4 of the following codes to indicate the type of exempt oil. Left justify and blank fill. *Type of Exempt Oil* — *Code* Qualified Governmental Interests — 1 Qualified Charitable Interests — 2 Exempt Indian Oil — 3 Exempt Alaskan Oil — 4 Reserved — 5
420-429	Qualified Royalty 1st Quarter	10	Enter the number of certified barrels of Qualified Royalty Owner oil removed in the first calendar quarter. Enter in Whole Barrels, right justified and zero filled.
430-439	Qualified Royalty 2nd Quarter	10	Enter the number of certified barrels of Qualified Royalty Owner oil removed in the second calendar quarter. Enter in Whole Barrels.
440-449	Qualified Royalty 3rd Quarter	10	Enter the number of certified barrels of Qualified Royalty Owner oil removed in the third calendar quarter. Enter in Whole Barrels.
450-459	Qualified Royalty 4th Quarter	10	Enter the number of certified barrels (in Whole Barrels) of Qualified Royalty owner oil removed in the fourth calendar quarter.
460-469	Total Qualified Royalty	10	Enter the total number of certified barrels (in Whole Barrels) of Qualified Royalty owner oil.
470-604	Reserved	135	Reserved for IRS use. Blank fill.
605-616	Number of Barrels Other Oil Removed 70% Rate	12	Enter the number of barrels (in Whole Barrels) of Tier One Oil other than Sadlerochit Oil, subject to the 70% Tax rate, removed during the tax year.

Tape Position	Field Title	Length	Description and Remarks
617-628	Exempt Stripper Well Oil	12	Enter the total number of barrels (in Whole Barrels) of exempt stripper well oil.
629-652	Reserved	24	Reserved for IRS use. Blank fill.
653-664	Tax Liability Other Oil Removed 70% Rate	12	Enter the tax liability (in Dollars only) for Tier One Oil other than Sadlerochit Oil, subject to the 70% tax rate, removed during the tax year.
665-676	Number of Barrels Other Oil Removed 50% Rate	12	Enter the number of barrels (in Whole Barrels) of Tier One Oil other than Sadlerochit Oil, subject to the 50% Tax rate, removed during the tax year.
677-712	Reserved	36	Reserved for IRS use. Blank fill.
713-724	Tax Liability Other Oil Removed 50% Rate	12	Enter the tax liability (in Dollars only) for Tier One Oil other than Sadlerochit Oil, subject to the 50% tax rate, removed during the tax year.
725-736	Number of Barrels Sadlerochit Oil Removed 70% Rate	12	Enter the number of barrels (in Whole Barrels) of Tier One Sadlerochit Oil, subject to the 70% tax rate, removed during the tax year.
737-772	Reserved	36	Reserved for IRS use. Blank fill.
773-784	Tax Liability Sadlerochit Oil Removed 70% Rate	12	Enter the tax liability (in Dollars only) for Tier One Sadlerochit Oil, subject to the 70% tax rate, removed during the tax year.
785-796	Number of Barrels Sadlerochit Oil Removed 50% Rate	12	Enter the number of barrels (in Whole Barrels) of Tier One Sadlerochit Oil, subject to the 50% tax rate, removed during the tax year.
797-832	Reserved	36	Reserved for IRS use. Blank fill.
833-844	Tax Liability Sadlerochit Oil Removed Rate	12	Enter the tax liability (in Dollars only) for Tier One Sadlerochit Oil, subject to the 50% tax rate, removed during the tax year.
845-856	Number Barrels Tier Two 60% Rate	12	Enter the number of barrels (in Whole Barrels) of Tier Two Oil subject to a 60% tax rate, removed this tax year.
857-892	Reserved	36	Reserved for IRS use. Blank fill.
893-904	Tax Liability Tier Two 60% Rate	12	Enter the tax liability (in Dollars only) for the Tier Two Oil, subject to a 60% tax rate, removed this tax year.
905-916	Number Barrels Tier Two 30% Rate	12	Enter the number of barrels (in Whole Barrels) of Tier Two Oil, subject to a 30% tax rate, removed this tax year.
917-952	Reserved	36	Reserved for IRS use. Blank fill.
953-964	Tax Liability Tier Two 30% Rate	12	Enter the tax liability (in Dollars only) for the Tier Two Oil, subject to a 30% tax rate, removed this tax year.
965-976	Number of Barrels Newly Discovered 25% Rate	12	Enter the number of barrels (in Whole Barrels) of Newly Discovered Oil, taxed at the 25% rate, removed this tax year.
977-1012	Reserved	36	Reserved for IRS use. Blank fill.

Tape Position	Field Title	Length	Description and Remarks
1013-1024	Tax Liability Newly Discovered 25% Rate	12	Enter the tax liability (in Dollars only) for the Newly Discovered Oil, taxed at the 25% rate, removed this tax year.
1025-1036	Number of Barrels Incremental 30% Rate	12	Enter the number of barrels (in Whole Barrels) of Incremental Tertiary Oil, taxed at the 30% rate, removed this tax year.
1037-1072	Reserved	36	Reserved for IRS use. Blank fill.
1073-1084	Tax Liability Incremental 30% Rate	12	Enter the tax liability (in Dollars only) for the Incremental Tertiary Oil, taxed at the 30% rate, removed this tax year.
1085-1096	Number of Barrels Heavy 30% Rate	12	Enter the number of barrels (in Whole Barrels) of Heavy Oil, taxed at the 30% rate, removed this tax year.
1096-1132	Reserved	36	Reserved for IRS use. Blank fill.
1133-1144	Tax Liability Heavy 30% Rate	12	Enter the tax liability (in Dollars only) for the Heavy Oil, taxed at the 30% rate, removed this tax year.
1145-1156	Total Barrels	12	Enter the total number of barrels (in Whole Barrels) of oil removed this tax year for all classes of taxable crude oil.
1157-1168	Total Tax Liability	12	Enter the total tax liability (in Dollars only) for all oil, removed this tax year.
1169-1180	Tax Withheld Oil Removed This Tax Year	12	Enter the amount (in Dollars only) of Windfall Profit Tax withheld with respect to oil removed during the tax year.
1181-1192	Underwithheld Tax	12	Enter the amount (in Dollars only) of Windfall Profit Tax underwithheld, if any. If no underwithholding zero fill this field.
1193-1204	Overwithheld Tax	12	Enter the amount (in Dollars only) of Windfall Profit Tax overwithheld, if any. If no overwithholding, zero fill this field.
1205-1216	WPT Withheld From Payments	12	Enter the amount (in Dollars only) of Windfall Profit Tax withheld from payments made during this tax year, regardless of when the liability for the tax arose.
1217-1219	Originator(s) of 1st Form 6248 Indicator	3	Enter the total number of originators for this Form (Right Justified and zero filled). If none, zero fill.
1220-1259	Originator's Name (Person furnishing Form 6248 information to payer/filer/ first purchaser	40	If the information on this Form 6248 is based on information from another Form 6248, enter the name of the person who furnished you with Form 6248. Left justify and blank fill. If not present, blank fill.
1260-1268	Originator's TIN	9	If available, enter the TIN of the originator. If no data is available, blank fill.
1269-1308	Second Originator's Name	40	If the information on this Form 6248 is based on information compiled from 2 or more Forms 6248, enter the name of the second person who furnished you with a Form 6248. If not present, blank fill.
1309-1317	Second Originator's TIN	9	If available, enter the TIN of the second originator. If no data is available, blank fill.

RECORD NAME: PRODUCER/RECIPIENT "H" RECORD (continued)

Tape Position	Field Title	Length	Description and Remarks
1318-1357	Third Originator's Name	40	If the information on this form is based on information compiled from 3 or more Forms 6248, enter the name of the third person who furnished you with a Form 6248. If not relevant, blank fill.
1358-1366	Third Originator's TIN	9	If available, enter the TIN of the third originator. If no data is available, blank fill.
1367-1372	Preparation Date	6	Enter the date of preparation of this form. If unknown, blank fill.
1373-1382	Owners I.D.	10	Enter up to 10 characters of your account number for the owner/producer. If no data, blank fill.
1383-1450	Reserved	68	Reserved for IRS use. Blank fill.

SEC. 7. END OF FILER "I" RECORD

.01 The end of Filer "I" Record is a summary record for a given Filer. This record must be 1450 characters long.

.02 The "I" Record will contain the number of documents transmitted for each individual Filer. The "I" record must be written after the last Producer "H" Record for each Filer. For each "G" Record on the file there must be a corresponding "I" Record.

.03 The "I" Record cannot be followed by a Tape Mark.

RECORD NAME: END OF FILER "I" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Enter "I".
2-7	Number of 6248s for This Filer	6	Enter the number of "H" Records for this Filer. This number should also be shown on Form 4804, Box 13. Right justify, Zero fill.
8-47	Filer's Name	40	Enter the name of the Filer. Use the same name as shown on the Filer/Transmitter "G" Record. Left justify, blank fill.
48	Type of Account Filer's TIN	1	This position is used to identify the data in tape positions 49 thru 57 as either an EIN or SSN. Use one of the following codes as appropriate. 1) use the digit 0 if the number provided is an SSN. 2) use the digit 1 if the number provided is an EIN. 3) use the digit 2 it it is not known whether the number provided is an SSN or EIN. 4) use the digit 3 if no number is provided (positions 49-57 should be blank filled in this case).
49-57	Filer's Account Number	9	Enter the Taxpayer Identifying Number of the Filer (SSN or EIN as appropriate). If no TIN is provided, leave blank.
58-69	Filer's Total Tax Liability	12	Enter the sum of the Filer's total tax liability (Part IV, Line 1). This amount should be shown on Form 4804, Box 16, Total Payment Amount for each Filer. This field may be signed or unsigned decimal data, in Dollars only.
70-1450	Reserved		Reserved for IRS use. Blank fill to end of record.

SEC. 8. END OF REEL "J" RECORD

.01 The End of Reel "J" Record will be present for option 1 only. It must be 1450 characters long.

.02 Write this record when the end of the normal writing area of the reel has been reached, but all the records of the file have not been written. This record indicates that there are additional reels in the file.

.03 Each "J" Record must contain a count of Forms 6248 reported on all "H" Records not summarized in the preceding "I" Record on the Reel.

.04 If you do not wish to use a "J" Record, or your system is unable to generate it, you may delete it; however, the last "H" Record on the tape 'MUST' be followed by a Tape Mark.

RECORD NAME: END OF REEL "J" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Enter "J".
2-7	Number of 6248's	6	Enter the number of "H" Records not summarized in a previous "I" Record. Right justify, Zero fill.
8-30	Reserved	23	Zero Fill.
31-1450	Reserved		Reserved for IRS use. Blank fill.

SEC. 9. END OF TRANSMISSION "K" RECORD

.01. The "K" Record is a summary of the number of Filers and the number of tapes in the entire file.

.02. This record should be written after the last "I" Record in the file.

.03. Only a Tape Mark or a Tape Mark and Trailer Labels may follow the "K" Record.

.04. The "K" Record must be 1450 characters long.

RECORD NAME: END OF TRANSMISSION "K" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Enter "K".
2-5	Number of Filers	4	Enter the number of Filers in the transmission. Right justify and zero fill.
6-8	Number of Tapes	3	Enter the total number of tapes in the transmission. Right justify and zero fill.
9-30	Reserved	22	Enter zeros.
31-1450	Reserved		Enter blanks.

SEC. 10. TAPE LAYOUTS-OPTION 1

(Reel Sequence Number is in the "G" Record)

The following chart shows, by type of file, the record types to be used in the first two and the last three records to be written on a tape.

Type of File	1st record type	2nd record type	2nd from last record type	Next to last record type	Last record type
Single Filer, single reels	G	H	H	I	K
Single Filer, multiple reels:					
Reel 1	G	H	H	H	J(TM) [1]
Last Reel	G	H	H	I [2]	K
Multiple Filers, single reel:					
First Filer	G	H	H	H	I
Subsequent Filers	G	H	H	H	I
Final Filer	G	H	H	I	K

Type of File	1st record type	2nd record type	2nd from last record type	Next to last record type	Last record type
Multiple Filers, Multiple Reels: First Filer's records split between reel 1 and reel 2; Second Filer's records split between reel 2 and reel 3:					
Reel 1:					
Filer 1	G	H	H	H	J(TM) [1]
Reel 2:					
Filer 1	G	H	H	H	I [2]
Filer 2	G	H	H	H	J(TM) [1]
Reel 3:					
Filer 2	G	H	H	H	I [2]
Filer 3	G	H	H	H	I
Reel 4: Last Filer	G	H	H	I	K
Multiple Filers, single transmitter, separate files for each filer:					
File 1: Filer 1: Last reel	G	H	H	I	K
File 2: Filer 2:					
Reel 1	G	H	H	H	J(TM) [1]
Last Reel	G	H	H	I [2]	K
File 3: Filer 3: Last reel	G	H	H	I	K

[1] If your system can not produce the End of Reel "J" Record, the final "H" Record on an intermediate reel can be followed by a Tape Mark.

[2] Must contain the "Number of 6248's" summarizing all "H" Records on this and previous reels for this Filer, not summarized on a previous "I" record.

SEC. 11. TAPE LAYOUTS-OPTION 2

(Reel Sequence Number is in the Header Label)

Where the Header Label is the first record, the following chart shows, by type of file, the record types to be used in the 2nd and 3rd records, where the header label is the first record, and the last three records written on a tape reel prior to the Trailer label.

Type of File	2nd record type	3rd record type	2nd from last record type	Next to last record type	Last record type
Single Filer, single reel	G	H	H	I	K
Single Filer, multiple reels:					
First Reel	G	H	H	H	H
Last Reel	H	H	H	I [1]	K
Multiple Filers, single reel:					
First Filer	G	H	H	H	I
Subsequent Filers	G	H	H	H	I
Final Filer	G	H	H	I	K
Multiple Filers, multiple reels; first Filer's records split between reel 1 and reel 2; second Filer's records split between reel 2 and reel 3:					
Reel 1:					
Filer 1	G	H	H	H	H
Reel 2:					
Payer 1	H	H	H	H	I [1]
Payer 2	G	H	H	H	H
Reel 3:					
Payer 2	H	H	H	H	I [1]
Payer 3	G	H	H	H	I
Reel 4:					
Payer 4	G	H	H	I	K
Multiple Filers, single Transmitter, separate files for each Filer:					
File 1: Filer 1: Last reel (could be multiple reel)	H	H	H	I [1]	K

Type of File	2nd record type	3rd record type	2nd from last record type	Next to last record type	Last record type
File 2: Filer 2:					
Reel 1	G	H	H	H	H
Last Reel	H	H	H	I [1]	K

[1] Must contain the "Number of 6248's" summarizing all "H" records on this and previous reels for this Filer not summarized in a previous "I" record.

SEC. 12. EFFECT ON OTHER DOCUMENTS

Rev. Proc 82-69 is superseded.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-32

SECTION 1. BACKGROUND

Rev. Proc. 84-22, page 449, this Bulletin, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 84-22 is entitled, Areas Under Extensive Study in Which Rulings of Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

SEC. 2. PROCEDURE

Rev. Proc. 84-22 is amplified by adding the following to section 5:

Section 162.-Trade or Business Expenses.

Whether payments paid or accrued by a corporation to an exempt organization as described in section 501(c)(7), (c)(9), (c)(17) or (c)(20) of the Internal Revenue Code, are deductible under section 162.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on April 9, 1984, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURE

Rev. Proc. 84-22 is amplified.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 84-33

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide an optional method for an authorized transfer/paying agent to report and deposit amounts withheld for payers under the statutory provisions of backup withholding.

SEC. 2. BACKGROUND

.01 Section 31.3504-1(a) of the Employment Tax Regulations provides that applications for authorization to act as agent with respect to wages under Chapter 24 of the Code shall be filed with the district director or director of a service center with whom the agent, on approval of the application, will file returns.

.02 Rev. Proc. 70-6, 1970-1 C.B. 420, describes the procedure to be followed in applying for authorization to act as agent for employers under section 3504 of the Code for purposes of chapters 21, 22, 24 and 25 with respect to acts required of employers under the federal employment tax statutes.

.03 Section 3406 of the Internal Revenue Code provides that under certain circumstances, payers of payments reportable under sections 6041, 6041A, 6042, 6044, 6045, 6049, and 6050A shall deduct and withhold tax of 20 percent of the payments. Section 3406(a) defines the four conditions that trigger the backup witholding requirements.

[1] Also released in News Release IR-84-43 dated March 28, 1984.

.04 Section 3406(h)(10) of the Code provides that for purposes of Chapter 24, payments which are subject to backup withholding under section 3406 shall be treated as if they were wages paid by an employer to an employee and any amounts withheld shall be treated as if they were income tax withholding under section 3402.

SEC. 3. SCOPE AND OBJECTIVE

.01 Current rules provide, in sections 35a.9999-1, 2 and 3 of the Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983, that the person who is required by the applicable Code sections to file the information returns is the person (payer) required to do the backup withholding. Thus, a transfer/paying agent who actually makes the reportable payments and withholds on behalf of such payers must deposit the withheld amounts separately for each payer using that payer's taxpayer identification number (TIN) and must notify each payer of the withholding and deposits made on the payer's behalf. The payer, in turn, is required to report the backup withholding on the same Form 941, Employer's Quarterly Federal Tax Return, or Form 941-E, Quarterly Return of Withheld Federal Income Tax, filed by the payer with respect to its own employees.

.02 However, in lieu of the provision in 3.01 above, a transfer/paying agent may report and deposit backup withholding amounts for payers under the agent's TIN if the agent complies with the procedures listed below.

SEC. 4. APPLICATION

.01 A transfer/paying agent making the election under 3.02 above must take the actions specified below:

.02 The agent must apply for authorization, in writing, to the Director of the Internal Revenue Service Center with whom the agent intends to file the returns involved.

(a) The application must be accompanied by a Form 2678, Employer Appointment of Agent under Section 3504, completed by each payer for whom the agent is to act. (Form 2678 is available at any Internal Revenue Service district or local office.) Even if the agent has already filed a Form 2678 for another purpose, a new Form 2678 from each payer is required under this optional procedure.

(b) The agent must enter "BACKUP WITHHOLDING" in red above the service center address area of Form 2678. The name and TIN of both the payer and the agent must be entered on the form. See Exhibit 1 for an example of a properly completed Form 2678. If the agent does not have a TIN, a properly completed Form SS-4, Application for Employer Identification Number must accompany the application for authorization.

(c) One application for authorization may be filed to cover more than one payer as long as a properly completed Form 2678 from each payer is attached.

(d) The application will be approved by letter to the agent from the service center director. Approval is effective as of the date of the letter.

(3) If the agreement to act as an agent is terminated for any payer(s) for whom a Form 2678 was filed, the agent must revoke the Form 2678 by notifying the Director of the Internal Revenue Service Center, by sending a letter with the name(s) of the payer(s) to be revoked and a statement that the originally filed Form 2678 is no longer in effect.

.03 Filing of Tax Returns

(a) The agent must file a single tax return (Form 941) for each tax period, regardless of the number of payers for whom the agent is acting.

(b) The return must include the backup withholding amounts for all liable payers as well as for the agent, if the agent is liable for any on its own account.

(c) The agent's name and TIN must be used on the tax return as well as on any Federal Tax Deposit (FTD) coupons.

(d) See Rev. Proc. 84-11, page 414, this Bulletin, for instructions on filing Form 941 on magnetic media.

.04 Filing of Information Returns and Transmittals—If the agent submits a Form 2678 electing this option, all information returns and transmittals must be completed as specified below, whether or not backup withholding is required to be reported.

(a) If the information returns are filed on magnetic media:

(1) A separate transmittal, Form 4804, Transmittal of Information Returns Reported on Magnetic Media, must be filed for each payer.

(2) Enter the agent's name, address and TIN in box 5 of Form 4804.

(3) See Rev. Proc. 83-48, 1983-2 C.B. 420 for instructions on magnetic media filing of information returns.

(b) If the information returns are filed on paper:

(1) A separate transmittal document, Form 1096, Annual Summary and Transmittal of U.S. Information Returns, or Form W-3G (if appropriate), Transmittal of Certain Information Returns must be filed for each payer. See Exhibits 2 and 3 for examples of properly completed forms.

(2) The transmittal document must have the payer's name and the agent's name (in care of—c/o) and the agent's address in the address area of the form.

(3) For both forms, enter three slashes (/ / /) before the payer's name to identify the document as being filed by an agent.

(4) Enter the agent's TIN in the lower right hand portion of the title area on Form 1096. Enter the agent's TIN in the blank box on Form W-3G.

(5) Enter the payer's TIN in the block for Employer Identification Number (EIN) on Form 1096. Enter the payer's TIN in the identifying number block on Form W-3G.

(6) For the Forms 1099 attached to the transmittal, enter the payer's name followed by the agent's name (in care of—c/o) and the agent's address in the name and address area of the form. See Exhibit 4 for an example of a properly completed form. The only exception is on Form 1099-R, Statement for Recipients of Total Distributions from Profit-sharing, Retirement Plans, Individual Retirement Arrangements, etc. For this form, enter the agent's name directly to the right of the printed words "Street Address". See Exhibit 5 for an example of a properly completed form.

(7) For all Forms 1099, enter the payer's TIN in the space for Federal identifying number.

SEC. 5. GENERAL

.01 The agent must maintain records that will disclose the full amount of interest, dividends, patronage dividends and other reportable payments reported and tax withheld for each payer and each recipient.

.02 In accordance with section 3504 of the Code, all provisions of the law and regulations (including penalties) applicable with respect to a payer will be applicable to the agent, and despite the acts performed by the agent pursuant to authority granted under Section 3504, the payer will remain subject to all provisions of the law and regulations (including penalties).

SEC. 6. INQUIRIES

Inquiries concerning this revenue procedure should refer to its number and should be addressed to the Director, Internal Revenue Service Center, serving the district in which the agent is located.

SEC. 7. EFFECT ON OTHER DOCUMENTS

This revenue procedure amplifies Revenue Procedures 70-6, 83-48 and 84-24.

SEC. 8. EFFECTIVE DATE

This revenue procedure is effective for returns for taxable periods beginning after December 31, 1983.

Exhibit 1

Form **2678**
(Rev. August 1983)

Department of the Treasury – Internal Revenue Service

Employer Appointment of Agent

Under Section 3504 of the Internal Revenue Code

OMB Clearance No.
1545-0748

1. BACKUP WITHHOLDING

Director, Internal Revenue Service Center
1040 Waverly Avenue
Holtsville, NY 11799

Instructions

Employer: Please complete this form and give it to the agent.

Agent: Please attach a request for authority to do all that is required of the employer for wages you pay on the employer's behalf. *(See applicable chapters of Subtitle C of the Internal Revenue Code.)* Furnish the form and the request to the Director of the Internal Revenue Service Center where you file your returns.

2. Employer's name
XYZ Corporation

3. Employer's address *(Number and street, city, town or post office, State and ZIP code)*
2780 Tiger St.
Baltimore, Md. 21212

4. Employer identification number
99-9999999

5. Agent's name
EFG Bank & Trust Co.

6. Agent's address *(Number and street, city, town or post office, State and ZIP code)*
1173 Tuna Drive
Baltimore, Md. 21212

7. Agent's employer identification number
11-1111111

8. Date appointment became effective
1/1/84

The agent named above has been appointed to pay wages to our employees. This appointment is effective on the date shown in item 8.

Under section 3504 of the Internal Revenue Code, please authorize this agent to do all that is required under Chapters _____ of Subtitle C of the Code for the wages this agent pays.

It is understood that the agent and the employer are subject to all provisions of law and regulations *(including penalties)* which apply to employers.

Signature

Date
1/1/84

By *(Indicate whether the person signing is an owner, partner, member of firm, fiduciary, or a corporate officer. If a corporate officer, please give title.)*
President

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Form **2678** (Rev. 8-83)

Exhibit 2

☐ 6969 For Official Use Only

Please Do Not Staple

Form 1096
Department of the Treasury
Internal Revenue Service

Annual Summary and Transmittal of U.S. Information Returns

11-1111111

OMB No. 1545-0108

1984

Type or machine print PAYER'S name
///XYZ Corporation
c/o EFG Bank & Trust Co.
Street address
1173 Tuna Drive
City, State and ZIP code
Baltimore, MD 21212

Enter in Box 1 or 2 below the identifying number you used as the payer on the attached information returns. Do not fill in both Boxes 1 and 2.

1 Employer identification number	2 Social security number
99-9999999	
3 Total number of documents	**4 Number without taxpayer ID numbers**
10	

Regular 1099's and 5498's									Nominee/Middleman 1099's							
1099 ASC 84	1099 B 79	1099 DIV 91	1099 G 86	1099 INT 92	1099 MISC 95	1099 OID 96	1099 PATR 97	5498 28	1099 ASC 84	1099 B 79	1099 DIV 91	1099 G 86	1099 INT 92	1099 MISC 95	1099 OID 96	1099 PATR 97
☐	☐	☐	☐	☒	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

Under penalties of perjury, I declare that I have examined this return, including accompanying documents and to the best of my knowledge and belief, they are true, correct, and complete. In the case of documents without recipients' identifying numbers I have complied with the requirements of the law in attempting to secure such numbers from the recipients.

Signature ▶ _____ Title ▶ President Date ▶ 1/1/85

Please return this entire page to the Internal Revenue Service.

Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Notice to Payers

Purpose of this Form.—Use this form to transmit Forms 1099 and 5498 to the Internal Revenue Service. However, use Form W-3G to transmit Form 1099-R.

Enter your name, address, and taxpayer identifying number (TIN) in the spaces provided on the form. Individuals not in a trade or business should enter their social security number in box 2; sole proprietors and all others should enter their employer identification number in box 1. However, sole proprietors who are not required to have an employer identification number should enter their social security number in box 2.

Do not submit more than one type of Form 1099 or submit Forms 5498 and Forms 1099 with the same Form 1096.

In box 3, enter the number of documents attached to Form 1096 and check the appropriate box to indicate the type of Form 1099 (or 5498) you are transmitting.

If you are transmitting Forms 1099 as a nominee or middleman for payments you received on behalf of another person, check the appropriate box on the lower right half of this form. If you are required to file both regular Forms 1099 or 5498 and Forms 1099 as a middleman or nominee, use a separate Form 1096 for each category.

If you have one type of Form 1099 (or 5498) that includes forms with TIN's of recipients and others with no TIN's, you may submit them with one Form 1096 if they are bundled separately. Show the total number of documents being transmitted in box 3. Also, show the number of forms without TIN's in box 4.

For more information about where and when to file, etc., see the separate instructions for Form 1096.

If you are filing a Form 1096 for corrected information returns mark over the "X" in the box at the top left corner of this form.

Exhibit 3

☐ 8888

For Official Use Only

Type or machine print PAYER'S name	1 PAYER'S identifying number	2 Enter the number of Forms W-2G transmitted	OMB No. 1545-0238
/// XYZ Corporation c/o EFG Bank & Trust Co.	99-9999999		**1984**
Street address	3 Enter the number of Forms 1099-R transmitted	4 Total Federal income tax withheld	Transmittal of **Certain Information Returns**
1173 Tuna Drive	10	$460.00	
City, State and ZIP code	5 Enter number without taxpayer identifying number		**Copy for Internal Revenue Service Center**
Baltimore, MD 21212		11-1111111	

Under penalties of perjury, I declare that I have examined this return, and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law in attempting to secure such numbers from the recipients.

Signature ▶ ..... Title ▶ President ..... Date ▶ 1/1/85 .....

Form **W-3G**

Department of the Treasury — Internal Revenue Service

Please return this entire page to the Internal Revenue Service Center address for your State as listed below.

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Instructions for Form W-3G

Who Must File.—Payers of gambling winnings for which a **Form W-2G**, Statement for Recipients of Certain Gambling Winnings, is required and payers of certain death benefits or total distributions (those that close the account) from a pension plan, annuity, or individual retirement arrangement for which a **Form 1099-R**, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, Individual Retirement Arrangements, etc., is required, must file Form W-3G, Transmittal of Certain Information Returns, with Forms W-2G or Forms 1099-R.

When to File.—File Forms W-3G with Forms W-2G and 1099-R by February 28 of the calendar year following the calendar year in which payment is made.

Where to File.—(Do not file with the Social Security Administration.)

If your principal business, office or agency, or legal residence in the case of an individual, is located in ▼	Use the following Internal Revenue Service Center address ▼
New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	1040 Waverly Avenue Holtsville, NY 11799
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	310 Lowell Street Andover, MA 01810
Alabama, Florida, Georgia, Mississippi, South Carolina	4800 Buford Highway Chamblee, GA 30341
Michigan, Ohio	201 West Second Street Covington, KY 41019
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	3651 S. Interregional Highway Austin, TX 78740
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	1160 W. 1200 South Street Ogden, UT 84404
Illinois, Iowa, Missouri, Wisconsin	2306 E. Bannister Road Kansas City, MO 64131
California, Hawaii	5045 E. Butler Avenue Fresno, CA 93727
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	3131 Democrat Road Memphis, TN 38110
Delaware, District of Columbia, Maryland, Pennsylvania	11601 Roosevelt Boulevard Philadelphia, PA 19154

If you have no legal residence, principal place of business, or principal office or agency in any Internal Revenue district, file your return with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, PA 19154.

Magnetic Media Reporting.—IRS encourages filing information returns on magnetic tape, diskette, or disk pack. Revenue Procedures for Magnetic Media Reporting are available at Internal Revenue service centers and district offices. Information reported on Forms W-2G and 1099-R may be reported on the same tape or disk submission.

Undeliverable Forms.—Any copies of Form W-2G or Form 1099-R which, after a reasonable effort, cannot be delivered to a winner or recipient should be kept as a part of your records for four years.

Payer's Identifying Number.—Your payer's identifying number is your Employer Identification Number.

Shipping and Mailing.—Payers should group returns of the same type and forward them in separate groups.

Completing the Form.—Enter the number of forms being transmitted in the appropriate box (Box 2 for W-2G, Box 3 for 1099-R). Enter in Box 4 the total Federal income tax withheld on the forms covered by this transmittal.

If you are sending many forms, you may send them in conveniently-sized packages. On each package write your name and identifying number. Number the packages consecutively and place Form W-3G in package number one. At the top of Form W-3G show the number of packages. Postal regulations require forms and packages to be sent by first class mail.

Corrected Returns.—Use a separate Form W-3G for corrected returns and mark over the "X" in the checkbox next to the number in the top left corner of the form. If a Form 1099-R is prepared incorrectly, do not cut and separate the forms on the page. Simply mark over the "X" in the checkbox to the left of the word "VOID" appearing in the top left corner of the form and prepare a new form for those voided. On corrected Forms 1099-R mark over the "X" in the checkbox appearing next to the number in the top left corner of the form. On corrected Forms W-2G center the words "CORRECTED RETURN" in the space at the top of the return above "For Official Use Only," and mark an "X" in the box next to the number in the left corner of the form. For paper forms correcting data previously submitted on magnetic tape, diskette, or disk pack, print "CORRECTED RETURN - MAGNETIC MEDIA" on the bottom of the transmittal Form W-3G and mark the checkbox on the Form W-3G and on each Form W-2G or 1099-R. Complete all required data boxes on a corrected return, since it supersedes the information previously reported. Also, statements issued to recipients or winners should be identified as "CORRECTED."

General Instructions for Payers of Gambling Winnings

Instructions for Form W-2G

Who Must File.—The requirements for filing Form W-2G, Statement for Recipients of Certain Gambling Winnings, depend on the type of gambling and are listed separately following these general instructions.

If a recipient fails to furnish a payer of gambling winnings with a correct taxpayer identification number, a payer is required to withhold 20% of the proceeds and report this amount on Form W-2G. This is referred to as backup withholding. It applies to any gambling situation of reportable winnings for which there are no regular withholding requirements.

(Continued on page 2)

Exhibit 4

☐ 9292 ☐ VOID For Official Use Only

Type or machine print PAYER'S name XYZ Corporation c/o EFG Bank & Trust Co. Street address 1173 Tuna Drive City, State, and ZIP code Baltimore, MD 21212 Federal identifying number 99-9999999	1 Earnings from savings and loan associations, credit unions, bank deposits, bearer certificates of deposit, etc. $100.00 2 Amount of forfeiture 3 Federal income tax withheld $20.00 4 Foreign tax paid (if eligible for foreign tax credit) 5 Foreign country or U.S. possession	OMB No.1545-0112 **1984** Statement for Recipients of **Interest Income** For Paperwork Reduction Act Notice and instructions for completing this form, see Instructions for Form 1096. **Copy A For Internal Revenue Service Center**
Type or machine print RECIPIENT'S name (first, middle, last) Pete George Cougar Street address 534 Ocean Drive City, State, and ZIP code Baltimore, MD 21212	Recipient's identifying number 888-88-8888	

Form **1099-INT** Department of the Treasury - Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

Exhibit 5

☐ 9898 ☐ VOID For Official Use Only

Type or machine print PAYER'S name XYZ Corporation Street address c/o EFG Bank & Trust Co. 1173 Tuna Drive City, State, and ZIP code Baltimore, MD 21212 Federal identifying number 99-9999999	1 Amount includible as income (Add boxes 2 and 3) $2,300.00 3 Ordinary income $1,500.00 5 Employee contributions to profit-sharing or retirement plans	2 Capital gain (For lump-sum distributions only) $800.00 4 Federal income tax withheld $460.00 6 Net unrealized appreciation in employer's securities	OMB No.1545-0119 **1984** Statement for Recipients of **Total Distributions from Profit-sharing, Retirement Plans, Individual Retirement Arrangements, etc.** For Paperwork Reduction Act Notice and instructions for completing this form, see Form W-3G. **Copy A For Internal Revenue Service Center**
Type or machine print RECIPIENT'S name (first, middle, last) Pete George Cougar Street address 534 Ocean Drive City, State, and ZIP code Baltimore, MD 21212	Recipient's identifying number 888-88-8888 8 IRA, SEP or DEC distributions This does ☐ does not ☒ qualify as a lump-sum distribution. Your percentage of total distribution.▶ % Death benefit exclusion does ☐ or does not ☐ apply.	7 Category of distribution 9 Other: $ %	

Form **1099-R** Department of the Treasury - Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, Section 442; 1.442-1.)

Rev. Proc. 84-34

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a procedure whereby certain corporations may expeditiously obtain approval of a change of their annual accounting period.

SEC. 2. BACKGROUND

.01 Section 1.442-1(a)(1) of the Income Tax Regulations provides that a taxpayer must obtain prior approval from the Commissioner for a change of a taxpayer's annual accounting period or the change must be authorized under the regulations.

.02 Section 1.442-1(b)(1) of the regulations provides that in order to secure prior approval of a change of a taxpayer's annual accounting period, the taxpayer must file an application on Form 1128, Application for Change in Accounting Period, with the Commissioner of Internal Revenue, Washington, D.C. on or before the 15th day of the second calendar month following the close of the taxpayer's short tax year. Section 1.442-1(b)(1) also provides that approval will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions and adjustments under which the change will be effected.

.03 Section 1.442-1(c)(1) of the regulations provides a special rule for certain corporations by which a corporation may change its annual accounting period without the prior approval of the Commissioner if all the conditions in section 1.442-1(c)(2) are satisfied, certain filing requirements are met, and the corporation is not of the type described in sections 1.442-1(c)(4) and (5), or section 1.860-1.

.04 Section 1.442-1(c)(2) of the regulations provides that certain corporations may change their annual accounting periods without the prior approval of the Commissioner if:

(1) the corporation has not changed its annual accounting period within the ten calendar year period ending with the calendar year that includes the beginning of the short period required to effect the change of accounting period;

(2) the short period required to effect the change of annual accounting period is not a tax year in which the corporation has a net operating loss as defined in section 172 of the Internal Revenue Code;

(3) the taxable income of the corporation for the short period required to effect the change in accounting period is, if placed on an annual basis, 80 percent or more of the taxable income of the corporation for the tax year immediately preceding the short period;

(4) the corporation, if it had a special status (as defined in section 1.442-1(c)(2)(iv) of the regulations) either for the short period or for the tax year immediately preceding the short period, must have the same special status for both the short period and such tax year; and

(5) the corporation does not attempt to make an S corporation election (under section 1362 of the Code) that purports to initially become effective for the tax year immediately following the short period.

SEC. 3. SCOPE

This revenue procedure applies to a corporation that:

(1) can not satisfy all the conditions of section 1.442-1(c)(2) of the regulations regarding a change of an annual accounting period without the prior approval of the Commissioner;

(2) has not changed its annual accounting period at any time within the ten calendar years ending with the calendar year that includes the beginning of the short period required to effect the change of annual accounting period;

(3) is not a (a) member of a partnership, (b) beneficiary of a trust or an estate, or (c) shareholder of a DISC (Domestic International Sales Corporation);

(4) is not an S corporation (as defined in section 1361 of the Code) and does not attempt to make an S corporation election that purports to initially become effective for the tax year immediately following the short period;

(5) is not a DISC (as defined in section 992(a)(1) of the Code);

(6) is not a controlled foreign corporation (as defined in section 957 of the Code);

(7) is not a foreign corporation that meets the stock ownership requirements of a foreign personal holding company (as defined in section 552 of the Code);

(8) is not a tax exempt organization; and

(9) is not a cooperative (as defined in section 1381(a) of the Code).

SEC. 4. APPLICATION

.01 In accordance with section 1.442-1(a)(1) and 1.442-1(b)(1) of the regulations, approval is hereby granted under the specific circumstances described below to those corporations not excluded by section 3 of this revenue procedure to change their annual accounting periods. Approval is granted beginning with the short period required to effect the change. The corporation must complete and file a current Form 1128 in the manner described in section 6 of this revenue procedure and otherwise comply with the provisions of this revenue procedure.

.02 Corporations desiring to change their annual accounting period pursuant to this revenue procedure must comply with the following conditions.

(1) The short period required to effect the change in annual accounting period shall begin with the day following the close of the old tax year and shall end with the day preceding the first day of the new tax year.

(2) The books of the corporation must be closed as of the last day of the new tax year. Returns for subsequent years must be made on the basis of a full 12-months or 52-53 weeks ending on the last day of the new tax year. The corporation must

compute its income and keep its books and records (including financial reports and statements for credit purposes) on the basis of the new tax year.

(3) Taxable income of the corporation for the short period must be annualized and the tax computed in accordance with the provisions of section 443(b) of the Code and section 1.443-1(b) of the regulations.

(4) If the short period required to effect the change of annual accounting period is a tax year in which the corporation has a net operating loss, the net operating loss is to be deducted ratably over a 6-year period beginning with the first tax year after the short period unless the corporation meets one of the following exceptions:

(a) If the net operating loss resulting from the short period is $10,000 or less, the net operating loss can be carried back or carried over in accordance with section 172(b) of the Code; or

(b) If the net operating loss resulting from a short period of 9 months or longer is greater than $10,000 and is less than the net operating loss for a full 12-month period beginning with the first day of the short period, the net operating loss can be carried back or carried over in accordance with section 172(b) of the Code.

(5) If there is an unused investment credit or any other credit for the short period, the corporation must carry the unused credit(s) forward. Unused credit(s) from the short period may not be carried back.

SEC. 5. COMPLIANCE WITH CONDITIONS

.01 In accordance with section 1.442-1(b)(1) of the regulations, approval of a change of a taxpayer's annual accounting period will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions and adjustments under which the change will be effected. In connection with the change of a corporation's annual accounting period pursuant to this revenue procedure, all such terms, conditions, and adjustments are as set forth herein.

.02 Corporations changing their annual accounting period pursuant to this revenue procedure without complying with or satisfying all the conditions of this revenue procedure will be deemed to have initiated the change in annual accounting period without the consent of the Commissioner.

.03 In the case of changes in annual accounting periods by members of affiliated groups that file consolidated tax returns, each member of the affiliated group must be eligible to use the provisions of this revenue procedure and comply with its conditions.

SEC. 6. MANNER OF EFFECTING THE CHANGE

.01 Corporations desiring to change their annual accounting period pursuant to the provisions of this revenue procedure must complete and file a current Form 1128 with the Director, Internal Revenue Service Center where the corporation files its income tax return.

.02 The application must be filed on or before the 15th day of the second calendar month following the close of the short period for which a return is required in order to effect the change of annual accounting period. Unless a letter is received by the corporation from the Director of the Internal Revenue Service Center denying approval because the Form 1128 is either not timely filed, or does not comply with the provisions of this revenue procedure, it may be assumed that the change has been approved. The corporation must attach a copy of the application to the return filed for the short period.

.03 In order to assist in the processing of the change in annual accounting period and to ensure proper handling, reference to this revenue procedure shall be made a part of the Form 1128 by either typing or legibly printing the following statement at the top of page 1 of the Form 1128: "FILED UNDER REV. PROC. 84-34.

.04 The signature of the person requesting the change in annual accounting period must appear in the space provided for it on the Form 1128. An officer must sign on behalf of a corporation. If an agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of correspondence concerning the request, or to perform any other act(s) regarding the application on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. Taxpayer's representatives without a power of attorney to represent the taxpayer as indicated in this subsection will not be given any information about the application. See section 6103 of the Code. If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a current Form 1128 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See section 1.1502-77 of the regulations.

SEC. 7. EFFECTIVE DATE

This revenue procedure shall be effective for changes in annual accounting period where the short period ends on or after April 23, 1984.

SEC. 8. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention: CC:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6031, 6231, 6698; 1.6031-1.)

Rev. Proc. 84-35

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 81-11, 1981-1 C.B. 651, to conform to the small partnership provisions of section 6231(a)(1)(B) of the Internal Revenue Code. Rev. Proc. 81-11 sets forth the procedures under which partnerships with 10 or fewer partners will not be subject to the penalty imposed by section 6698 for failure to file a partnership return.

SEC. 2. BACKGROUND

.01 Section 6031(a) of the Code

provides that every partnership must make a return for each taxable year including all information that the Secretary may by forms and regulations prescribe.

.02 Section 402 of the Tax Equity and Fiscal Responsibility Act of 1982, 1982-2 C.B. 462, 585, added sections 6221 through 6232 to the Code to provide that the tax treatment of partnership items must be determined at the partnership level. For purposes of these sections, section 6231(a)(1)(A) defines "partnership" to mean any partnership required to file a return under section 6031(a) except as provided in section 6231(a)(1)(B).

.03 Section 6231(a)(1)(B) of the Code provides an exception to the definition of "partnership" for small partnerships. In general, the term "partnership" does not include a partnership if the partnership has 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and each partner's share of each partnership item is the same as such partner's share of every other item. A husband and wife, and their estates, are treated as one partner for this purpose.

.04 Section 6698 of the Code imposes a penalty if any partnership required to file a return under section 6031 fails to file a timely return, or files a return that fails to show the information required by that section, unless the failure is due to reasonable cause.

.05 The Conference Committee Report concerning section 6698 of the Code states:

> The penalty will not be imposed if the partnership can show reasonable cause for failure to file a complete or timely return. Smaller partnerships (those with 10 or fewer partners) will not be subject to the penalty under this reasonable cause test so long as each partner fully reports his share of the income, deductions, and credits of the partnership. . . .

H.R. Rep No. 95-1800 (Conf. Report), 95th Cong., 2d Sess. 221 (1978), 1978-3 C.B. (Vol. 1) 521, 555. See also H.R. Rep. No. 95-1445, 95th Cong., 2d Sess. 75 (1978), 1978-3 C.B. (Vol. 1) 181, 249, and S. Rep. No. 95-1263, 95th Cong., 2d Sess. 106 (1978), 1978-3 C.B. (Vol. 1) 315, 403, which contain similar statements.

SEC. 3. REQUIRED PROCEDURES

.01 A domestic partnership composed of 10 or fewer partners and coming within the exceptions outlined in section 6231(a)(1)(B) of the Code will be considered to have met the reasonable cause test and will not be subject to the penalty imposed by section 6698 for the failure to file a complete or timely partnership return, provided that the partnership, or any of the partners, establishes, if so requested by the Internal Revenue Service, that all partners have fully reported their shares of the income, deductions, and credits of the partnership on their timely filed income tax returns.

.02 Partnerships having a trust or corporation as a partner, tier partnerships, and partnerships where each partner's interest in the capital and profits are not owned in the same proportion, or where all items of income, deductions, and credits are not allocated in proportion to the prorata interests, do not come within the exception provisions of section 6231(a)(1)(B) of the Code and, are subject to the penalty imposed by section 6698.

.03 Although a partnership of 10 or fewer partners may not be automatically excepted from the penalty imposed by section 6698 of the Code under section 3.01, the partnership may show other reasonable cause for failure to file a complete or timely partnership return.

.04 In determining whether a partner has fully reported the partner's share of the income, deductions, and credits of the partnership, for purposes of section 3.01, all the relevant facts and circumstances will be taken into account. In making this determination, the nature and materiality of any error or omission will be considered. For example, although an isolated clerical error normally reflects no more than mere inadvertence, such an error may be of such magnitude that the partner will not be considered to have fully reported. If the error or omission results in a de minimis understatement of the net amount payable with respect to any income tax, the penalty will not be asserted. However, if the error or omission results in a material understatement of the net amount payable with respect to any income tax, the partner generally will not be considered to have fully reported and the penalty will be applied.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 81-11 is modified and superseded.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective for returns required to be filed after June 22, 1984.

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26 CFR 601.201: Rulings and determining letters.
(Also Section 7871.)

Rev. Proc. 84-36

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a list of subdivisions of Indian tribal governments that are to be treated as political subdivisions of states for specified purposes under the Internal Revenue Code for a two-year period.

SEC. 2. BACKGROUND

.01 The Indian Tribal Governmental Tax Status Act of 1982, (Title II of Pub. L. No. 97-473, 96 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1983-1 C.B. 510, 511]) added certain provisions to the Code that pertain to the status of Indian tribal governments. For two years beginning in 1983, Indian tribal governments (or subdivisions thereof) will be treated as states (or political subdivisions thereof) for specified federal tax purposes. For example, under new section 7871 of the Code interest on public activity bonds issued during the years 1983 and 1984 by a tribal government may be tax exempt, and a tribal government will

be entitled to exemption from certain excise taxes. Also, charitable contributions made in 1983 and 1984 to or for the use of a tribal government may be deductible under federal gift and estate tax laws. Charitable contributions made during a taxpayer's tax years beginning in 1983 and 1984 may be deductible under the federal income tax laws.

.02 The term "Indian tribal government" is defined under section 7701(a)(40) of the Code (as amended) to mean the governing body of any tribe, band, community, village or group of Indians, or (if applicable) Alaska Natives, that is determined by the Secretary of the Treasury, after consultation with the Secretary of the Interior to exercise governmental functions. Section 7871(d) of the Code provides that for purposes of section 7871, a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the Secretary of the Treasury determines (after consultation with the Secretary of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

.03 A list of Indian tribal entities that exercise governmental functions for purposes of section 7871 of the Code has been published as Revenue Procedure 83-87, 1983-2 C.B. 606.

SEC. 3. APPLICATION

The following list sets forth subdivisions of Indian tribal governments which have been determined to qualify for treatment as political subdivisions of states for specified purposes under section 7871 of the Code.

SEC. 4. LIST

SUBDIVISIONS OF INDIAN TRIBAL GOVERNMENTS THAT QUALIFY FOR TREATMENT AS POLITICAL SUBDIVISIONS OF STATES FOR PURPOSES OF TITLE II OF PUB. L. NO. 97-473:

Arapahoe Tribe of the Wind River Reservation, Wyoming
1. Northern Arapahoe Educations Trust

Assiniboine and Sioux Tribes of the Fort Peck Indian Reservation, Montana
1. Fort Peck Tribal Enterprise
2. Fort Peck Housing Authority
3. Fort Peck Transportation System

Bad River Band of Lake Superior Chippewa Indians of the Bad River Reservation, Wisconsin
1. Bad River Housing Authority

Bay Mills Indian Community of the Sault Ste. Marie Band of Chippewa Indians, Michigan
1. Bay Mills Housing Authority
2. Bay Mills Community Water Committee

Blackfeet Tribe of the Blackfeet Indian Reservation of Montana
1. Napi Educational Services, Inc.
2. Blackfeet Tribal Health Board, Inc.
3. Blackfeet Oil and Gas Tax Commission
4. Blackfeet Indian Housing Authority
5. Blackfeet Community College

Chemehuevi Indian Tribe of the Chemehuevi Reservation, California
1. All Mission Indian Housing Authority

Chickasaw Nation of Oklahoma
1. Chickasaw Housing Authority

Choctaw Nation of Oklahoma
1. Choctaw Housing Authority

Cocopah Tribe of Arizona
1. Cocopah Housing Authority

Colorado River Indian Tribes of the Colorado River Reservation, Arizona and California
1. Colorado River Indian Housing Authority
2. Colorado River Sewage System Joint Venture

Confederated Salish and Kootenai Tribes of the Flathead Reservation, Montana
1. Flathead Reservation Area Comprehensive Alcoholism Program
2. Salish-Kootenai Community College
3. Salish-Kootenai Housing Authority

Confederated Tribes of the Chehalis Reservation, Washington
1. Chehalis Housing Authority

Confederated Tribes of the Umatilla Reservation, Oregon
1. Umatilla Housing Authority

Confederated Tribes of the Warm Springs Reservation of Oregon
1. Warm Springs Housing Authority

Confederated Tribes and Bands of the Yakima Indian Nation of the Yakima Reservation, Washington
1. Yakima Housing Authority

Duckwater Shoshone Tribe of the Duckwater Reservation, Nevada
1. Shoshone Joint Housing Authority

Eastern Band of Cherokee Indians of North Carolina
1. Qualla Housing Authority

Ely Indian Colony of Nevada
1. Ely Indian Housing Authority

Fort Belknap Indian Community
1. Fort Belknap Housing Authority
2. Fort Belknap Tribal Utilities Commission

Fort McDermitt Paiute Shoshone Tribe
1. Fort McDermitt Housing Authority

Fort Mojave Indian Tribe of Arizona
1. Fort Mojave Tribal Housing Authority

Gila River Pima-Maricopa Indian Community of the Gila River Indian Reservation of Arizona
1. Gila River Housing Authority

Hualapai Tribe of the Hualapai Indian Reservation, Arizona
1. Hualapai Housing Authority

Keweenaw Bay Indian Community of Chippewa Indians of the L'Anse Reservation, Michigan
1. Keweenaw Bay Indian Community Educational Committee
2. Ojibwa Housing Authority

Lac Courte Oreilles Band of Lake Superior Chippewa Indians of the Lac Courte Oreilles Reservation of Wisconsin
1. Lac Courte Oreilles Community College
2. Lac Courte Oreilles Housing Authority
3. Lac Courte Oreilles Utilities Commission

Lac du Flambeau Band of the Lake Superior Chippewa Indians of the Lac du Flambeau Reservation of Wisconsin
1. Lac du Flambeau Chippewa

Housing Authority
Lovelock Paiute Tribe of the Lovelock Indian Colony, Nevada
1. Lovelock Housing Authority
Lower Elwha Tribal Community of the Lower Elwha Reservation, Washington
1. Lower Elwha Housing Authority
Makah Indian Tribe of the Makah Reservation, Washington
1. Makah Housing Authority
Miccosukee Tribe of Indians of Florida
1. Miccosukee Corporation
Minnesota Chippewa Tribe, Minnesota
1. Bois Forte Reservation Business Committee
2. Bois Forte Housing Authority
3. Fond du Lac Reservation Business Committee
4. Fond du Lac Housing Authority
5. Grand Portage Reservation Business Committee
6. Grand Portage Housing Authority
7. Mille Lac Reservation Business Committee
8. Mille Lac Housing Authority
9. Leech Lake Reservation Business Committee
10. Leech Lake Housing Authority
11. White Earth Reservation Business Committee
12. White Earth Housing Authority
13. Minnesota Chippewa Tribal Home Loan Corporation
Mississippi Band of Choctaw Indians, Mississippi
1. Choctaw Board of Education
2. Choctaw Transit Authority
3. Choctaw Utility Commission
4. Chata Okla Community College
5. Mississippi Choctaw Housing Authority
Moapa Band of Paiute Indians of Nevada
1. Moapa Housing Authority
Navajo Tribe of Arizona
1. Navajo Community College
2. Navajo Housing Authority
3. Navajo Tribal Utility Authority
4. Navajo Skill Center
Nooksack Indian Tribe of Washington
1. Nooksack Indian Housing Authority
2. Nooksack Tobacco Control Tax Commission
Northern Cheyenne Tribe of Montana
1. Busby School Board
2. Labre School Board
3. Dull Knife Memorial College Board
4. Northern Cheyenne Board of Health
5. Northern Cheyenne Housing Authority
6. Northern Cheyenne Foundation
7. Northern Cheyenne Utility Commission
Oglala Sioux Tribe of the Pine Ridge Reservation, South Dakota
1. Eagle Nest District
2. Lacreek District
3. Medicine Root District
4. Pass Creek District
5. Pine Ridge Village
6. Porcupine District
7. Wounded Knee District
8. Wakpamni District
9. White Clay District
10. Oglala Sioux Community College
11. Oglala Sioux Tribal Public Safety Commission
Paiute Indian Tribe of Utah
1. Cedar City Band of Paiute Indians
2. Indian Peaks Band of Paiute Indians
3. Kanosh Band of Paiute Indians
4. Koosharem Band of Paiute Indians
5. Shivwits Band of Paiute Indians
Paiute Shoshone Tribe of the Fallon Reservation and Colony, Nevada
1. Fallon Housing Authority
2. Fallon Tribal Sanitation Board
Papago Tribe of the Sells, Gila Band and San Xavier Reservation, Arizona
1. Baboquivari District
2. Chukutkuk District
3. Gu Achi District
4. Gu Vo District
5. Hickiwan District
6. Pisinemo District
7. San Lucy District
8. San Xavier District
9. Schuk Toak District
10. Sells District
11. Sif Oidak District
Passamaquoddy Tribe of Maine
1. Pleasant Point Indian Housing Authority
2. Indian Township Housing Authority
Pawnee Indian Tribe of Oklahoma
1. Pawnee Tribal Development Corporation
Penobscot Tribe of Maine
1. Indian Island Housing Authority
Pueblo of Isleta
1. Isleta Elementary School Board
Pyramid Lake Paiute Tribe of Nevada
1. Pyramid Lake Housing Authority
2. Pyramid Lake High School
Quechan Tribe of the Fort Yma Reservation, California
1. Quechan Housing Authority
Quileute Tribe of the Quileute Reservation, Washington
1. Quileute Port Authority
2. Quileute School Board
Quinault Tribe of the Quinault Reservation, Washington
1. Quinault Housing Authority
Reno-Sparks Indian Colony, Nevada
1. Reno-Sparks Housing Authority
Rosebud Sioux Tribe of the Rosebud Reservation, South Dakota
1. Sicangu Oyate Ho, Inc.
2. Sinte Gleska College
3. Rosebud Water and Sewer Commission
4. Rosebud Housing Authority
Saginaw Chippewa Indian Tribe of Michigan
1. Saginaw Chippewa Housing Authority
2. Saginaw Chippewa Indian Health Board
San Carlos Apache Tribe
1. San Carlos Housing Authority
Sault Ste. Marie Tribe of Chippewa Indians of Michigan
1. Ameek Construction Company
2. Sault Ste. Marie Senior Citizens Committee, Inc.
3. Sault Ste. Marie Indian Housing Authority
Seminole Tribe of Florida
1. Seminole Tribal Housing Authority
2. Seminole Tribe of Florida, Inc.
Seneca Nation of New York
1. Seneca Nation Housing Authority

2. Seneca Educational Foundation
3. Catarraugus Reservation Volunteer Fire Department

Shoshone-Bannock Tribes of the Fort Hall Reservation of Idaho
1. Fort Hall Housing Authority

Shoshone-Paiute Tribes of the Duck Valley Reservation, Nevada
1. Duck Valley Housing Authority

Skokomish Indian Tribe of Washington
1. Skokomish Housing Authority

Squaxin Tribe of Washington
1. Southern Puget Inter-Tribal Housing Authority
2. Southern Puget Tribal Planning Agency

St. Regis Band of Mohawk Indians of New York
1. St. Regis Indian Housing Authority

Te-Moak Bands of Western Shoshone Indians of Nevada
1. Battle Mountain Band Council
2. Elko Band Council
3. South Fork Band Council
4. Wells Band Council
5. Te-Moak Housing Authority

Three Affiliated Tribes of the Fort Berthold Reservation, North Dakota
1. Fort Berthold Housing Authority

Tulalip Tribes of the Tulalip Reservation, Washington
1. Tulalip Housing Authority

Turtle Mountain Band of Chippewa Indians, North Dakota
1. Couture, Ingebretson and Ojibwa School Boards
2. Turtle Mountain Community College
3. Turtle Mountain Parks and Recreation Board
4. Turtle Mountain Public Utilities Commission

Ute Indian Tribe of Unitah and Ouray Reservation, Utah
1. Ute Indian Housing Authority

Walker River Paiute Tribe of Nevada
1. Walker River Housing Authority

Washoe Tribe of Nevada and California
1. Washoe Housing Authority

White Mountain Apache Tribe of the Fort Apache Indian Reservation, Arizona
1. White Mountain Apache Housing Authority

Yerington Paiute Tribe of Nevada
1. Yerington Housing Authority

Yomba Shosone Tribe of Nevada
1. Yomba Housing Authority

Zuni Tribe of New Mexico
1. Zuni Housing Authority
2. Zuni Conservation Enterprise

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26 CFR 601.201: Rulings and determination letters.
(Also Section 7871.)

Rev. Proc. 84-37

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidance as to the manner in which a governmental unit of an Indian tribe or a political subdivision of an Indian tribal government not included among those listed in Revenue Procedures previously published by the Service can request a determination qualifying it for treatment as a state or a political subdivision of a state as provided under section 7871 of the Internal Revenue Code.

SEC. 2. BACKGROUND

.01 The Indian Tribal Governmental Tax Status Act of 1982, (Title II of Pub. L. No. 97-473, 96 Stat. 2605, 2607-11, as amended by Pub. L. No. 98-21, 97 Stat. 65, 87 [1983-1 C.B. 510, 511]) added certain provisions to the Code that pertain to the status of Indian tribal governments. For two years beginning in 1983, Indian tribal governments (or subdivisions thereof) will be treated as states (or political subdivisions thereof) for specified federal tax purposes. For example, under new section 7871 of the Code interest on public activity bonds issued during the years 1983 and 1984 by a tribal government may be tax exempt, and a tribal government will be entitled to exemption from certain excise taxes. Also, charitable contributions made in 1983 and 1984 to or for the use of a tribal government may be deductible under federal gift and estate tax laws. Charitable contributions made during a taxpayer's tax years beginning in 1983 and 1984 may be deductible under the federal income tax laws.

.02 The term "Indian tribal government" is defined under section 7701(a)(40) of the Code (as amended) to mean the governing body of any tribe, band, community, village or group of Indians, or (if applicable) Alaska Natives, that is determined by the Secretary of Treasury, after consultation with the Secretary of the Interior, to exercise governmental functions. Section 7871(d) of the Code provides that, for purposes of section 7871, a subdivision of an Indian tribal government shall be treated as a political subdivision of a state if (and only if) the Secretary of the Treasury determines (after consultation with the Secretary of the Interior) that such subdivision has been delegated the right to exercise one or more of the substantial governmental functions of the Indian tribal government.

.03 Three generally accepted sovereign powers of states are the power to tax, the power of eminent domain and the police power. *See* Rev. Rul. 77-164, 1977-1 C.B. 20; Rev. Rul. 77-165, 1977-1 C.B. 21; and Rev. Rul. 61-181, 1961-2 C.B. 21. Section 7871(d) of the Code provides that a subdivision of an Indian tribal government shall be treated as a political subdivision of a state under certain circumstances. A subdivision of an Indian tribal government that has been delegated one of the generally accepted sovereign powers may qualify as a political subdivision of a state for purposes of 7871(d) of the Code.

04. A list of Indian tribal entities that exercise governmental functions for purposes of section 7871 of the Code has been published as Revenue Procedure 83-87, 1983-2 C.B. 606.

.05 A list of Indian tribal subdivisions has been published as Rev. Proc. 84-36, page 510, this Bulletin.

SEC. 3. APPLICATION

.01 If a tribal entity or tribal subdivision is not included in Rev. Proc. 83-87 or Rev. Proc. 84-36, a request for recognition as such should be submitted in the form of an application for a private letter ruling in accordance with Rev. Proc. 84-1.

.02 All determinations will be made based on all the facts and circumstances. Each request should in-

clude an explanation how the entity satisfies the statutory definition of an Indian tribal government or to what extent the entity has been delegated one or more of the sovereign powers that would qualify it as an Indian tribal subdivision. Each request should also provide the actual or approximate date on which such entity satisfied the statutory definition of an Indian tribal government or was delegated one or more of the sovereign powers of an Indian tribal government. The explanation should be sufficiently detailed to show to the satisfaction of the Commissioner that the entity in question qualifies as a governmental unit of an Indian tribe or a political subdivision of an Indian tribal government.

.03 Each determination will specify whether or not the entity qualifies as an Indian tribal government (or subdivision thereof) and the date on which such determination is effective for purposes of section 7701 and 7871 of the Code.

.04 Requests for determination that an Indian tribal government qualifies for treatment as a state or that a subdivision of an Indian tribal government qualifies for treatment as a political subdivision of a state as provided under section 7871 of the Code should be sent to Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, Room 6545, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 84-38

SECTION 1. PURPOSE

This Revenue Procedure establishes a handling and shipping charge for processing requests for bulk quantities of tax forms. This charge only applies to those engaged in the preparation of tax returns for private gain.

SEC. 2. CHARGES

.01 Charges for tax forms will be established on the basis of each 100 printed units ordered. The schedule of charges for handling and shipping bulk quantities of tax forms will be based on a rate of $1.00 per hundred printed units, or fraction thereof. A 10% discount will be applied to any bulk order for tax forms postmarked on or before the discount deadline date specified in Publication 1045; however, all orders for tax forms will be subject to a minimum charge of $3.00.

.02 No charge will be made to a bank, post office, public library or other organization for any quantity of forms and instructions intended for the convenience and use of the taxpayer, so long as such organization is not engaged in the preparation of tax returns for private gain.

.03 Single copies of Publications 17 and 334 will be provided without charge. Multiple copies of either publication will not be provided to individuals or organizations except where the Regional Commissioner or District Director determines that such distribution will further the interests of taxpayer service or education. A user charge of $.50 per copy will apply to all approved multiple copy requests. Regional Commissioners, District Directors and appropriate National Office officials may continue to provide multiple copies without charge for use in IRS-sponsored programs (e.g. Understanding Taxes and VITA). Priority must be given to filling single copy requests for Publications 17 and 334. Requests for bulk quantities of either publication which jeopardize the Service's ability to respond on a timely basis to such single copy demand should not be honored. For individuals who wish for their own purposes to print copies of Publication 17 or 334, IRS will provide page negatives of either publication for a user charge of $3.00 per page negative.

.04 All user charges will be commensurate with the prevailing postage and handling costs and will be established by the Assistant Commissioner (Support and Services).

.05 Publication 1045 will contain Form 2333, Tax Practitioner Cost Workup Sheet. The instructions on Form 2333 outline the handling and shipping charges for processing bulk orders of tax forms.

.06 Checks made payable to the "Internal Revenue Service" should be submitted with Form 2333.

SEC. 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 82-54, 1982-2 C.B. 845, is superseded.

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26 CFR 601.201: Ruling and determination letters.

Rev. Proc. 84-39

SECTION 1. BACKGROUND

Rev. Proc. 84-22, page 449, this Bulletin, contains in section 4 a list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which ruling or determination letters will not ordinarily be issued.

SEC. 2. PROCEDURE

Section 4.0115 of Rev. Proc. 84-22 is modified to read as follows:

Section 341.—Collapsible Corporations.—Whether a corporation will be considered to be a "collapsible corporation," that is, whether it was "formed or availed of" with the view of certain tax consequences. However, ruling requests will be considered on this matter when the enterprise (1) has been in existence for at least 20 years or has clearly demonstrated that it has realized a substantial part of the taxable income to be derived from the manufacturing, constructing, producing, or purchasing of property as defined in section 341(b)(1)(A) of the Code and as described in Rev. Rul. 72-48, 1972-1 C.B. 102, (2) has had an aggregate change in the shareholders' interests of not more than 10 percent during that period (except for transfers among family members, as defined in section 267(c)(4), or redemptions of stock to pay death taxes pursuant to section 303), and (3) has conducted substantially the same trade or business during that period. The period referred to in (2) and (3) above is the lesser of 20 years of corporate existence or the period in which the enterprise has realized a substantial part of the taxable income from activities defined in section 341(b)(1)(A).

SEC. 3. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 84-22 is modified.

SEC. 4. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on April 30, 1984, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

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26 CFR 601.401: Employment taxes. (Also Part I, Section 3121; 31.3121(b)(8)-2, 31.3121(k)-1.)

Rev. Proc. 84-40

Rev. Proc. 67-35, 1967-2 C.B. 662, which sets forth procedures under sections 3121(b)(8)(B) and 3121(k) of the Internal Revenue Code for the filing of certificates to elect social security coverage by organizations described in section 501(c)(3), is obsolete, effective with respect to services performed after December 31, 1983. Social security coverage for employees of such organizations will be mandatory and not elective after December 31, 1983, due to the repeal of sections 3121(b)(8)(B) and 3121(k) by section 102 of the Social Security Amendments of 1983, 1983-2 C.B. 309, 311.

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26 CFR 601.602: Tax forms and instructions. (Also Part I, Sections 3402, 6001, 6361; 31.3402(b)-1, 31.3402(f)(5)-1, 31.3402(h)(4)-1, 31.3402(p)-1, 31.6001-5.)

Rev. Proc. 84-41

PART "A" GENERAL

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to provide the requirements and conditions for submitting certain Forms W-4, Employee's Withholding Allowance Certificates, on magnetic tape instead of filing paper returns. All employers are required to send to the Internal Revenue Service copies of all Forms W-4 submitted by their employees who claim the following:

(a) 15 or more withholding allowances, or

(b) exempt status and usually earn more than $200 a week at the time the Form W-4 was filed.

Forms W-4 information may be filed on magnetic tape and sent monthly to the Service.

SEC. 2. APPLICATION FOR MAGNETIC MEDIA REPORTING

.01 Tape reporting is not restricted to employers with the ability to submit all their information on magnetic tape; a combination of tape records and paper documents is acceptable as long as there is no duplication or omission of documents.

.02 Employers or transmitters who desire to file statements in the form of magnetic tape must first file a letter of application or Form 4419, Application for Magnetic Media Reporting of Information Returns. This letter or form should be addressed to the attention of the Magnetic Media Coordinator of one of the following service centers:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
Post Office Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(d) Internal Revenue Service
Atlanta Service Center
Post Office Box 47-421
Doraville, GA 30362

(e) Internal Revenue Service
Memphis Service Center
Post Office Box 1900
Memphis, TN 38101

(f) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
Covington, KY 41019

(g) Internal Revenue Service
Kansas City Service Center
Post Office Box 24551
2306 E Bannister Road
Stop 43
Kansas City, MO 64131

(h) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

(i) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
Ogden, UT 84409

(j) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

The letter of request must contain the following:

(a) Name, address, and employer identification number of the person, organization, or entity making the request.

(b) Name, title, and telephone number of the person to contact regarding the request.

(c) Estimate of the number of Forms W-4 to be reported in tape format, and the number, if any, expected to be reported on copies of paper Forms W-4.

(d) Type and nature of equipment to be used to prepare the tape; i.e., manufacturer and model of the mainframe and tape drives, tape width (½", ¾", etc.), density (characters per inch), recording code (BCD, Excess 3, Octal, etc.).

(e) Signature of the official responsible for the preparation and submission of Forms W-4 to the Service.

.03 The Service will act on applications and notify applicants of authorization to file or of disapproval within 30 days of receipt of an application. No magnetic tape returns may be filed with the Service until authorization to file is received.

.04 Only employers or transmitters using equipment compatible with the Service's equipment will have their applications approved. Compatible tape characteristics are shown in PART "B" Section 1.01.

.05 In general, once authorization to file on magnetic tape has been granted, such approval will continue in effect in succeeding years, providing that the requirements of this Revenue Procedure are met and there are no equipment changes by the employer or transmitter. However, new applications are required whenever any of the following situations arise:

(a) If the users change from equip-

ment producing compatible tapes.

(b) If the users submit tapes that are not listed as compatible.

(c) If the users discontinue tape reporting for one or more quarters, then decide to resume this method of reporting.

SEC. 3. FILING DATES

.01 Magnetic tape reporting to the Service must be quarterly (monthly reporting is encouraged), following the quarter ending due dates below:

Period Covered	Due Date
Jan. 1 thru March 31	April 30
Apr. 1 thru June 30	July 31
July 1 thru Sept. 30	October 31
Oct. 1 thru Dec. 31	January 31

SEC. 4. FILING OF MAGNETIC MEDIA REPORTS

.01 Packaging, shipping, and mailing instructions will be provided by the Service to all approved filers within 45 days of the granting of approval. A magnetic tape reporting package, which includes all necessary transmittals and labels, will be mailed to all approved filers.

.02 Employers or transmitters may submit a portion of their Forms W-4 information on magnetic tape and the remainder on paper forms, provided there is NO DUPLICATE FILING. The magnetic tape records and paper forms must be filed at the same location, i.e., the appropriate service center, but in separate shipments. A Service-provided transmittal Form 6466 must accompany all magnetic tape shipments to the service center. (For all paper Forms W-4 sent to IRS, employers or transmitters must supply a cover letter which included the employer's name, address, employer identification number, and number of Forms W-4 being submitted.)

.03 The affidavit which appears on the Service-provided Form 6466 for tape submission must be signed by the employer, the transmitter, service bureau, or disbursing agent who must:

(a) have the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under State law; and

(b) have the responsibility (either oral, written, or implied) conferred on it by the employer to request taxpayer identifying numbers of employees reported on magnetic tape or paper returns; and

(c) sign the affidavit and add the caption "For: (name of employer)."

.04 Although a duly authorized agent signs the affidavit, the employer is held responsible for the accuracy of Forms W-4 contained on magnetic tape.

SEC. 5. PROCESSING OF MAGNETIC MEDIA STATEMENTS

.01 The magnetic tape specifications contained in Part B of this Revenue Procedure must be strictly adhered to. If files are unprocessable, they will be returned to the filer for correction and resubmission of tapes or for submission of copies of paper Forms W-4. Corrected files must be filed with the Service as soon as possible. If the delay will be more than two weeks, contact the Service Center Magnetic Media Coordinator for instructions.

.02 The Service will copy the information from the original tapes and will return the original tapes to the employer. Normally tapes will be returned either within three months after the quarterly due date for submission to the Service, or within three months after actual receipt of acceptable tapes, whichever is later.

SEC. 6. EFFECT ON PAPER DOCUMENTS

.01 Magnetic tape reporting to the Service eliminates the need for submission of copies of paper Forms W-4. However, employers must maintain the original Form W-4 for their records.

.02 If only a portion of the statements is reported on magnetic tape and the remainder is reported on paper forms, those paper statements must be filed on the prescribed forms.

SEC. 7. ADDITIONAL INFORMATION

Request for additional copies of this Revenue Procedure or for additional information on tape reporting of Forms 941, 1099, 5498, or 1042S should be addressed to the attention of the Magnetic Media Coordinator of the appropriate Internal Revenue Service Center listed in Section 2.02 above.

PART "B" MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. Usually, the Service will be able to process, without translation, any compatible tape file. To be compatible, a tape file must meet all of the following specifications:

(a) Type of Tape—½ inch Mylar base, oxide coated

(b) Recording Density—556 or 800 bits per inch (BPI)

(c) Parity—Even or Odd

(d) Interrecord gap—¾ inch

(e) Recording Code—7 channel binary coded decimal (BCD)

.02 Conversion facilities are currently available for the following tapes:

(a) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with

(1) Odd Parity

(2) 800, 1600, or 6250 Densities

(b) 9 channel ASCII (American Standard Coded Information Interchange) with

(1) Odd Parity

(2) 800, 1600, or 6250 Densities

.03 Although the Service can process, after translation, tapes created at 6250 BPI, it is preferred that filers submit 1600 BPI tapes if possible.

.04 The employer or the transmitter must affix an external label to each tape with the following information:

(a) Name of Transmitter

(b) Number of data records on that reel

(c) Density (556, 800, 1600, or 6250 BPI)

(d) Channel (7 or 9)

(e) Parity (odd or even)

(f) Manufacturer and model of main frame and tape drives

(g) Sequence number of reel, and total number of reels in the file (i.e., 1 of 3, 2 of 4)

.05 All records, including Header

and Trailer Labels (if used), must be transmitted at the same density.

.06 Do not submit an employee W-4 record without the required employer identification information. Every record must contain both employee and employer data.

SEC. 2. LABEL CONVENTIONS

.01 Header Labels, Trailer Labels, Record Marks, and Tape Marks are all optional. They may be used as required by the transmitter's equipment or programming. If used they must conform to the following standards:

(a) Header Labels

(1) Transmitters may use standard headers, provided they begin with 1HDR, HDR1, VOL1, or VOL.2.

(2) Header labels may not exceed 80 characters in length.

(b) Trailer Labels

(1) Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.

(2) Trailer labels may not exceed 80 characters in length.

(c) Record Marks

(1) Special character used to separate blocked records on tape.

(2) Can be written only at the end of a record or block.

(3) For odd parity tapes, use BCD bit configuration of 011010; for even parity use 111010.

(4) All records are of uniform length; therefore, record marks are not necessary on this file.

(d) Tape Marks

(1) Used to signify the physical end of the recording on tape.

(2) Tape marks, if used, must be BCD configuration 001111 in even parity.

(3) May follow the header label and precede and/or follow the trailer label.

SEC. 3. RECORD LENTH AND BLOCKING

.01 Tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

(a) All data records are of a fixed length of 400 positions.

(b) All records may be blocked, except header and trailer labels.

(c) If blocking is used (more than one record per block) the desired blocking factor is ten records per block. At no time may a block contain more then 4,000 characters, but a smaller block size may be used if necessary. If sufficient records are not available for a full block, the remainder should be "padded" with 9's to fill all unused positions. Do not pad the block with blanks, or create blank records.

RECORD NAME: W-4 MAGNETIC TAPE RECORD

Tape Position	*Field Title*	*Length*	*Description & Remarks*
1-9	Employee Social Security Number (SSN)	9	Required. Must be the valid 9-digit number assigned to the employee. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9's, or ALL ZEROES.
10-44	Employee Name Line 1	35	Required. Enter the name of the employee whose SSN appears in tape positions 1-9. Enter the complete name in the following order: first name, middle name (if present), and surname. (Use initials for the first and middle names where necessary to insure that the entire employee surname fits in tape positions 10-44). If fewer than 35 characters are required, left justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, HYPHENS, BLANKS. A MINIMUM OF ONE AND A MAXIMUM OF TWO CARETS ( ). (1) A blank must be surrounded by alphas or continued to the end of the field (e.g., ab—b, aba). (2) Hyphens must be surrounded by alphas and must never occur in the first position of a name unless immediately followed by a caret. A hyphen in the first position is to identify an employee with surname only. (3) A caret is used to define an internal name control. It must immediately precede the employee surname in place of the blank. A second caret is used to separate a suffix from the surname (e.g., JOHN J. BLACK: BILL OAK JR: AMY FERN BROWN DECD).
45-79	Employee Name Line 2	35	Optional. This line is designated for an "in care of" (c/o) situation. Left justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS NUMERICS, AMPERSAND, HYPHENS, AND SLASHES. Note: Same exceptions as mentioned in employee name line 1. A percent sign (%) is not valid, use c/o if necessary.

Tape Position	*Field Title*	*Length*	*Description & Remarks*
80-114	Employee Street Address	35	Required. Enter street address of employee. Left justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES. Position one is an alpha or numeric, multiple blanks are continued to the end of the field; hyphens and slashes are surrounded by alphas; ampersands are surrounded by blanks.
115-139	Employee City	25	Required. Enter city of employee. Left justify and fill unused positions with blanks. If foreign address, enter city and country. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AND HYPHENS. Position one is an alpha or numeric, hyphens are surrounded by alphas, or numerics or continued to the end of the field.
140-141	Employee State	2	Required. Enter state of employee; must be one of the following:

State	Code
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Guam	GU
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Kentucky	KY
Louisiana	LA
Maine	ME
Maryland	MD
Massachusetts	MA
Michigan	MI
Minnesota	MN
Mississippi	MS
Missouri	MO
Montana	MT
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH
Oklahoma	OK

Tape Position	Field Title	Length	Description & Remarks

State	Code
Oregon	OR
Pennsylvania	PA
Puerto Rico	PR
Rhode Island	RI
South Carolina	SC
South Dakota	SD
Tennessee	TN
Texas	TX
Utah	UT
Vermont	VT
Virgin Islands	VI
Virginia	VA
Washington	WA
West Virginia	WV
Wisconsin	WI
Wyoming	WY
Foreign Address	XX

142-146	Employee ZIP Code	5	Required. Enter zip code of employee. Fill with blanks if unavailable. ALLOWABLE CHARACTERS ARE FIVE (5) NUMERICS OR FIVE (5) BLANKS. Enter first five (5) digits if more than five digits are present.
147	Marital Status	1	Required. Enter appropriate code from the table below:

Martial Status Designated	Code
Single	S
Married	M
Married, withhold at single rate	W
No marital status designated	A

148	Exempt Status	1	Required. Enter "E" if employee claims exempt status; otherwise, blank.
149	Student Status	1	Required. If full-time student status is claimed, enter the alpha "Y"; if not, enter the alpha "N". If no entry, enter the alpha "B".
150-151	Allowances	2	Required. Must be a two (2) digit numeric field corresponding to the number of allowances claimed by employee. (It is not necessary to file this W-4 with IRS if the number of allowances is less than fifteen (15) and exempt status is not claimed.) If no entry, or employee claimed exempt status, enter zeroes. If entry is greater than 99, enter 99.
152-158	Additional Amount of Withholding	7	Required. Enter numerics only. Enter the additional amount of withholding each pay period. Field is dollars and cents. Right justify and zero fill. Do not enter dollar signs, commas, decimal points, or negative numbers. If no entry, zero-fill.
159-163	Number of W-4's Submitted	5	Required. This field is a running total of all W-4's submitted by the employer. The first W-4 on the file must start with the value of one (1); increment by one (1) for each subsequent W-4 thereafter. Values should be right justified and zero filled.
164-169	W-4 Date	6	Required. Enter date located on signature line of W-4. If no date entered, generate current system date. Format as MMDDYY where MM = 01-12, DD = 01-31 and YY = 82, 83, etc.

Tape Position	Field Title	Length	Description & Remarks
			Exempt Status W-4 (1983 and subsequent)—Compare 'year effective date' on Line 6B to signature date. If year entered on Line 6B is later than signature date, use W-4 date as a 01/01 receipt for subsequent calendar year (e.g., Line 6B of Form W-4 shows an exempt status date of 1984 but signature date is 10/30/83, use 01/01/84 as Form W-4 date).
170-178	Employer Identification Number	9	Required. The 9 digit number assigned to the employer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9's or ALL ZEROES.
179-213	Employer Name Line 1	35	Required. Enter the name of the employer as it appears on your employment tax forms (e.g., Form 941). Any extraneous information must be deleted from this name line. Left justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS NUMERICS, AMPERSAND, HYPHENS AND SLASHES. Position one is an alpha or numeric; multiple blanks are continued to the end of the field; hyphens and slashes are surrounded by alphas, ampersands are surrounded by blanks.
214-248	Employer Name Line 2	35	Optional. If the employer name requires more space than is available in Employer Name Line 1, enter the remaining portion of the name in this field. Left justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES. Position one is an alpha or numeric; multiple blanks are continued to the end of field; hyphens and slashes are surrounded by alphas, ampersands are surrounded by blanks.
249-283	Employer Name Line 3	35	Optional. If the employer name requires more space than is available in Employer Name Lines 1 and 2, enter the remaining portion of the name in this field. Left justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES. Position one is an alpha or numeric; multiple blanks are continued to the end of the field; hyphens and slashes are surrounded by alphas, ampersands are surrounded by blanks.
284-318	Employer Name Line 4	35	Optional. If the employer name requires more space than is available in Employer Name Lines 1, 2, and 3 enter the remaining portion of the name in this field. Left justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES. Position one is an alpha or numeric; multiple blanks are continued to the end of the field; hyphens and slashes are surrounded by alphas, ampersands are surrounded by blanks.
319-353	Employer Street Address	35	Required. Enter street address of employer. Left justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES. Position one is an alpha or numeric; multiple blanks are continued to the end of the field; hyphens and slashes are surrounded by alphas, ampersands are surrounded by blanks.

Tape Position	*Field Title*	*Length*	*Description / Remarks*
354-378	Employer City	25	Required. Enter city of employer. Left justify and fill unused positions with blanks. If foreign address, enter city and country. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AND HYPHENS. Position one is an alpha or numeric, hyphens are surrounded by alphas, blanks are surrounded by alphas or numerics or continued to the end of the field.
379-380	Employer State	2	Required. Enter State Code of Employer. Must be one of the state abbreviations shown above in the state abbreviation table for Employee State (Tape Positions 140-141).
381-385	Employer ZIP Code	5	Required. Enter ZIP Code of Employer. ALLOWABLE CHARACTERS ARE FIVE (5) NUMERICS OR FIVE (5) BLANKS. Enter first five (5) digits if more than five digits are present.
386-390	Transmitter Control	5	Required. Enter 5-digit Code (TCC) Transmitter Control code assigned by the IRS.
391	"BLANK" Representation	1	Required. Enter character used to represent a blank.
392	"HYPHEN" Representation	1	Required. Enter character used to represent a hyphen.
393	"SLASH" Representation	1	Required. Enter character used to represent a slash.
394	"AMPERSAND" Representation	1	Required. Enter character used to represent a ampersand.
395	"CARET" Representation	1	Required. Enter character used to represent a caret.
396-400	IRS USE	5	Blanks.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 80-8, 1980-1 C.B. 592, is superseded.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 351; 368; 1.351-1; 1.368-2.)

Rev. Proc. 84-42

SECTION 1. BACKGROUND

.01 Rev. Proc. 77-37, 1977-2 C.B. 568, sets forth certain operating rules of the Internal Revenue Service pertaining to issuing ruling letters and in determining whether it should decline to issue ruling letters.

.02 Rev. Proc. 84-22, page 449, this Bulletin, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 84-22 is entitled, Areas Under Extensive Study in which Rulings or Determination Letters Will Not Be Issued Until the Service Resolves the Issue Through Publication of a Revenue Ruling, Revenue Procedure, Regulations or Otherwise.

SEC. 2. PROCEDURE

.01 Section 3.03 of Rev. Proc. 77-37 is amplified to read as follows:

In transactions under sections 368(a)(1)(A), 368(a)(1)(B), 368(a)(1)(C), 368(a)(1)(D), 368(a)(1)(E), and 351 of the Code, it is not necessary that all the stock which is to be issued in exchange for the requisite stock or property, be issued immediately provided (1) that all the stock will be issued within 5 years from the date of transfer of assets or stock for reorganizations under sections 368(a)(1)(A), 368(a)(1)(C), 368(a)(1)(D), and 368(a)(1)(E), or within 5 years from the date of the initial distribution in the case of transactions under sections 368(a)(1)(B) and 351; (2) there is a valid business reason for not issuing all the stock immediately, such as difficulty in determining the value of one or both of the corporations involved in the transaction; (3) the maximum number of shares which may be issued in the exchange is stated; (4) at least 50

ercent of the maximum number of hares of each class of stock which nay be issued is issued in the initial listribution; (5) the agreement evi- lencing the right to receive stock in he future prohibits assignment (ex- cept by operation of law) or if the agreement does not prohibit assign- ment, the right must not be evidenced by negotiable certificates of any kind and must not be readily marketable; (6) such right can give rise to the re- ceipt only of additional stock of the corporation making the underlying listribution; (7) such stock issuance will not be triggered by an event the occurrence or nonoccurrence of which is within the control of share- holders; (8) such stock issuance will not be triggered by the payment of additional tax or reduction in tax paid as a result of a Service audit of the shareholders or the corporation either (a) with respect to the reorganization or section 351 transaction in which he contingent stock will be issued, or (b) when the reorganization or section 351 transaction in which the contin- gent stock will be issued involves per- sons related within the meaning of section 267(c)(4) of the Code; and (9) he mechanism for the calculation of he additional stock to be issued is ob- ective and readily ascertainable. Stock issued as compensation, royal- ies or any other consideration other han in exchange for stock or assets will not be considered to have been eceived in the exchange. Until the fi- al distribution of the total number of shares of stock to be issued in the xchange is made, the interim basis of he stock of the issuing corporation eceived in the exchange by the share- holders (not including that portion of ach share representing interest) will e determined, pursuant to section 58(a), as though the maximum num- er of shares to be issued (not includ- ng that portion of each share repre- enting interest) has been received by he shareholders.

In connection with item 3.03(8) bove, the Service reserves the right o refuse to rule if, based on all the acts and circumstances of a case, it is etermined that the principal purpose f the triggering mechanism is the re- uction in federal income taxes (see section 3.02(1) of Rev. Proc. 84-22, page 449, this Bulletin.

.02 Section 3.06 of Rev. Proc. 77-37 is amplified to read as follows:

In transactions under section 368(a)(1)(A), 368(a)(1)(B), 368(a)(1)(C), 368(a)(1)(D), 368(a)(1)(E), and 351 of the Code, a portion of the stock issued in exchange for the requisite stock or property may be placed in escrow by the exchanging shareholders, or may be made subject to a condition pursuant to the agreement, or plan of reorganization or of the transaction, for possible return to the issuing corporation under specified conditions provided (1) there is a valid business reason for establishing the arrangement; (2) the stock subject to such arrangement appears as issued and outstanding on the balance sheet of the issuing corporation and such stock is legally outstanding under applicable state law; (3) all dividends paid on such stock will be distributed currently to the exchanging shareholders; (4) all voting rights of such stock (if any) are exercisable by or on behalf of the shareholders or their authorized agent; (5) no shares of such stock are subject to restrictions requiring their return to the issuing corporation because of death, failure to continue employment, or similar restrictions; (6) all such stock is released from the arrangement within 5 years from the date of consummation of the transaction (except where there is a bona fide dispute as to whom the stock should be released); (7) at least 50 percent of the number of shares of each class of stock issued initially to the shareholders (exclusive of shares of stock to be issued at a later date as described in .01 above) is not subject to the arrangement; (8) the return of stock will not be triggered by an event the occurrence or nonoccurrence of which is within the control of shareholders; (9) the return of stock will not be triggered by the payment of additional tax or reduction in tax paid as a result of a Service audit of the shareholders or the corporation either (a) with respect to the reorganization or section 351 transaction in which the escrowed stock will be issued, or (b) when the reorganization or section 351 transaction in which the escrowed stock will be issued involves persons related within the meaning of section 267(c)(4) of the Code; and (10) the mechanism for the calculation of the number of shares of stock to be returned is objective and readily ascertainable.

In connection with item 3.06(9) above, the Service reserves the right to refuse to rule if, based on all the facts, and circumstances of a case, it is determined that the principal purpose of the triggering mechanism is the reduction in federal income taxes (see section 3.02(1) of the Rev. Proc. 84-22, page 449, this Bulletin).

.03 Rev. Proc. 84-22 is hereby modified by deleting section 5.18 which reads "Section 368.-Definitions Relating to Corporate Reorganization.-The tax consequences of a transaction intended to qualify as a reorganization under section 368(a)(1)(E) of the Code when the plan of reorganization provides for the use of contingent or escrow stock arrangements, and where the share adjustment is triggered by an event the occurrence or non-occurrence of which is within the control of the shareholders or is triggered by a Service audit of the shareholders or the corporation."

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on May 14, 1984, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 77-37 is amplified and Rev. Proc. 84-22 is modified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-43

SECTION 1. BACKGROUND

Rev. Proc. 84-22, page 449, this Bulletin, provides a list of those areas of the Internal Revenue Code under

the jurisdiction of the Associate Chief Counsel (Technical) in which rulings or determination letters will not be issued. A list of those areas is set forth in section 3 of the Rev. Proc.

SEC. 2. PROCEDURE

Rev. Proc. 84-22 is hereby modified by deleting from section 3.01 the following subsection:

"25 Section 351.—Transfers to Controlled Corporation.—

(a) That this section applies to a transfer by a shareholder of stock in one corporation (acquired) to another corporation (acquiring), in an exchange otherwise qualifying for treatment under this section, if the exchange is part of a larger transaction that fits a pattern common to acquisitive reorganizations, and after the transaction the acquiring corporation has control of the acquired corporation (within the meaning of section 368(c)), unless there is a continuing interest through stock ownership in the acquiring corporation on the part of the former shareholders of the acquired corporation that is equal in value to at least 50 percent of the value of all of the stock of the acquired corporation outstanding immediately before the overall transaction. For purposes of this determination, liabilities assumed or liabilities to which the property transferred is subject will be considered to be part of the total consideration received. See Rev. Rul. 80-284, 1980-2 C.B. 117, and section 3.02 of Rev. Proc. 77-37, 1977-2 C.B. 568, 569.

(b) That this section applies to a transfer by a corporation (acquired) of a substantial portion of its assets to another corporation (acquiring), in an exchange otherwise qualifying for treatment under this section, if the exchange is part of a larger transaction that fits a pattern common to acquisitive reorganizations, unless there is a continuing interest through stock ownership in the acquiring corporation on the part of the acquired corporation or shareholders of the acquired corporation that is equal in value to at least 50 percent of the value of all of the stock of the acquired corporation outstanding immediately before the overall transaction. For purposes of this determination, liabilities assumed or liabilities to which the property transferred is subject, will be considered to be part of the total consideration received. In addition, for purposes of this revenue procedure, an acquired corporation shall be deemed to have transferred a substantial portion of its assets if the transferred assets constitute 15 percent or more of its gross assets. See Rev. Rul. 80-285, 1980-2 C.B. 119, and section 3.02 of Rev. Proc. 77-37.

SEC. 3. EFFECTIVE DATE

This revenue procedure is effective May 7, 1984.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 84-22 is modified. See Rev. Rul. 84-71, page 106, this Bulletin, which revoked Rev. Rul. 80-284 and Rev. Rul. 80-285.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6011, 6041, 6047, 6051, 6071, 6081, 6091; 1.6041-1, 1.6047-1, 31.6051-1, 31.6051-2, 31.6071(a)-1, 31.6081(a)-1.)

Rev. Proc. 84-44

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to state the requirements of the Internal Revenue Service (IRS) and the Social Security Administration (SSA) relating to substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements. The IRS provides a six-part Form W-2 and W-2P set. The official Form W-3 is provided as a two-part set.

.02 This revenue procedure supersedes Rev. Proc. 83-46, 1983-1 C.B. 780.

SEC. 2. GENERAL RULES FOR FILING FORMS W-2 AND W-2P

.01 *Employers and payers* (hereafter and where applicable collectively referred to as payers) with computer capability are encouraged to use magnetic media for filing Forms W-2 (Copy A) and W-2P (Copy A) with the SSA. Requests for additional information concerning magnetic media filing should be directed to either the Regional IRS Magnetic Media Coordinator or to the Regional SSA Magnetic Media Coordinator. Since many states and localities accept Forms W-2 and W-2P on magnetic media, savings may be obtained if a similar medium is used for filing with both the SSA and state or local agencies. Magnetic media users can design their own statements to give to employees, pensioners, annuitants, recipients of retired pay, recipients of IRA (Individual Retirement Account) payments, and recipients of disability income (hereafter and where applicable collectively referred to as payees). Statements designed by payers *must* comply with the requirements of Section 5 below.

.02 The following Technical Information Bulletins (TIB) contain the specifications and procedures for filing Forms W-2 (Copy A) and W-2P (Copy A) data on magnetic media directly with SSA.

1 TIB-4a—Magnetic Tape Reporting, "Submitting FICA Wage and Tax Data to the Social Security Administration Form W-2 (Copy A);

2 TIB-4b—Magnetic Tape Reporting, "Submitting Annuity, Pension, Retired Pay or IRA Payments to the Social Security Administration" Form W-2P (Copy A);

3 TIB-4c—Diskette Reporting, "Submitting FICA Wage and Tax Data to the Social Security Administration" Form W-2 (Copy A).

Copies of these publications are available at any IRS Service Center; IRS District Office; and SSA, (Reports Preparation Section, P.O. Box 2317, Baltimore, Maryland 21203); or by contacting the Regional SSA Magnetic Media Coordinator.

.03 Payers not using magnetic media must file Copy A of Form W-2 or Copy A of Form W-2P with SSA on either an official form or a privately printed substitute paper form meeting the specifications shown below.

.04 Payers using magnetic media are cautioned to obtain the most recent Technical Information Bulletins

and supplements due to possible changes in the specifications and procedures.

SEC. 3. GENERAL RULES FOR FILING FORM W-3

.01 Employers and payers (hereafter and where applicable collectively referred to as payers) required to file Forms W-2 or W-2P *must* transmit Forms W-2 or W-2P with Form W-3.

.02 Form W-3 must be the same width (i.e., 7 inches, 7.5 inches, or 8 inches) as the Forms W-2 or W-2P filed.

.03 Payers using magnetic media must transmit magnetic media Forms W-2 or W-2P with Form 6559, Transmittal Report of Magnetic Media Filing, along with either Form 6560, Employer Summary of Form W-2 Magnetic Media, or Form 6561, Payer Summary of Form W-2P Magnetic Media Pension Information. SSA will provide these forms to all approved magnetic media filers.

SEC. 4. PAPER SUBSTITUTES FOR FORMS W-2 (COPY A), W-2P (COPY A), AND W-3

.01 Paper substitutes *conforming* to the specifications contained in this revenue procedure must be privately printed without the prior approval of the IRS. Proposed substitutes *not conforming totally* to these specifications *must* be submitted by letter to the Commissioner of the IRS, Attention: D:R:R:I, 1111 Constitution Ave., N.W., Washington, DC 20224, for consideration. These requests should contain an explanation of the specific need for the deviations and the number of Forms W-2, W-2P, and/or W-3 to be printed.

.02 Forms W-2, W-2P, and W-3 are subject to annual review and possible change. Payers are cautioned against overstocking supplies of privately printed substitutes.

.03 Copies of the official form for the reporting year may be obtained from any IRS office. The IRS provides only cut sheet sets with no carbon interleaves for Forms W-2, W-2P, and W-3.

.04 Substitute Forms W-2, W-2P, and W-3 transmitted to the SSA should generally contain only data provided to payees and summary data as requested by the form's instructions.

.05 Substitute Forms W-2, W-2P, and W-3 may be redesigned as to the spacing for state and local tax data *as long* as the vertical and horizontal spacing for all federal payment and data boxes are in compliance with the specifications contained herein.

.06 The sizes for the ballot boxes on all Forms W-2 (Copy A), W-2P (Copy A), and W-3 are as follows:

1 For Forms W-2, ballot boxes must be 8-point boxes.

2 For Forms W-2P, ballot boxes must be 8-point boxes.

3 For Forms W-3, ballot boxes must be 8-point boxes.

NOTE: More than 50% of the applicable ballot box must be covered by an "X".

SEC. 5. REQUIREMENTS FOR SUBSTITUTE FORMS FURNISHED TO PAYEES (COPIES B, C, AND 2 OF FORMS W-2 AND W-2P)

.01 All payers, including those filing Copy A using magnetic media, must furnish payees with at least two statements. The dimensions of these copies may be expanded from the dimensions of the official form to allow space for conveying additional information such as withholding from pay for health insurance, union dues, bonds, charity, etc. This may permit the payer to eliminate other statements or notices which would otherwise be furnished to payees. The maximum allowable dimensions are:

1 depth should be no more than five inches;

2 width no more than eight inches.

.02 The paper for all copies should be white. The substitute Copy B (or its equal), that payees are instructed to attach to their Federal income tax return, must be at least 24-pound paper (basis 17 x 22-1000), while the other copies furnished the payee should be at least 18-pound paper (basis 17 x 22-1000).

.03 Chemical transfer paper is *permitted* only if the following standards are met:

1 All copies must be clearly legible;

2 All copies must have the capability to be photocopied;

3 Fading must not be of such a degree as to preclude legibility and the ability to photocopy.

In general, black chemical transfer inks are preferred; other colors are permitted only if the above standards are met. "Spot carbons" are *not permitted.*

.04 Interleaved carbon must meet the requirements specified in .03 above.

NOTE: Chemical transfer paper is permitted for additional payee copies.

.05 Substitute forms for payees need contain only the payment boxes and captions that are applicable (in any desired sequence). Other boxes contained on the official form may be omitted, except that in all cases the payee name, address and social security number must be present. Payment boxes and captions that are applicable must be clearly identified, using where possible the same wording as on the official form. On Form W-2, Copy B, payers *are required* to identify the amount of Federal income tax withheld as "Box 9" and the amount of Wages, tips, other compensation as "Box 10." On Form W-2P, Copy B, payers *are required* to identify the taxable amount as "Box 10" and the amount of Federal income tax withheld as "Box 11." These aforementioned payment boxes on Copy B *are required* to be outlined in bold 2-point rule (see Exhibit M). Note: Captions in boxes previously identified as FICA tax withheld, FICA wages, and FICA tips on Form W-2 *must* be identified as Social Security tax withheld, Social Security wages, and Social Security tips as shown on the official Form W-2. If the form contains additional data (e.g., savings bonds withholding, retirement withholding, payroll savings, etc.), there should be a special highlighting of the areas pertaining to (1) Federal income tax withheld, (2) Wages, tips, and other compensation, and (3) Advance EIC payment.

.06 For substitute forms for payees (Copies B, C, and 2 of Forms W-2

and Copies B, C, and 2 of Forms W-2P), the following requirements must be met:

1 All copies of Forms W-2 and W-2P must contain the form title. For Form W-2, the title is "Form W-2 Wage and Tax Statement". For Form W-2P, the title is "Form W-2P Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments".

2 If the substitute forms are *not labelled* as to the disposition of the copies, then written notification must be provided to each payee as specified below:

(a) The first copy of the form should be filed with the employee's (or recipient's) Federal tax return.

(b) The second copy of the form should be for the employee's (or recipient's) records.

(c) If applicable, the third copy of the form should be filed with the employee's State, City, or Local income tax return.

3 If the substitute forms are *labelled*, then the forms must contain the applicable description:

(a) "Copy B, to be filed with employee's Federal tax return", "Copy C, for employee's records", and the designation "Form W-2 Department of the Treasury—Internal Revenue Service", or

(b) "Copy B, file with recipient's Federal tax return", "Copy C, for recipient's records", and the designation "Form W-2P Department of the Treasury—Internal Revenue Service".

(c) The reference to the Department of the Treasury—Internal Revenue Service should be omitted from other copies provided in the set.

4 Instructions similar to those contained on the back of Copy C of the official form should be provided to each employee (recipient). For Form W-2, the Social Security (FICA) rates applicable for the current tax year must:

(a) appear either on the front or the back of the copy (Copy C) retained by the employee; or

(b) be communicated to the employee via a separate statement. Note: If you are a Federal employer, you must provide the current rate for hospital insurance benefits (Medicare) for Federal employees.

5 Such substitutes are acceptable and payees should be advised that substitute wage and tax statements are acceptable for filing with their Federal income tax returns.

SEC. 6. REQUIREMENTS FOR SUBSTITUTE "PRIVATELY PRINTED" FORMS W-2 (COPY A), FORMS W-2P (COPY A), AND FORMS W-3 THAT PAYERS SUBMIT TO THE SSA

.01 Payers may file privately printed substitute Forms W-2 and W-2P with the SSA (hereafter referred to as a substitute Copy A). Payers may file privately printed substitute Forms W-3 with the SSA (hereafter referred to as a substitute W-3). The substitute form must be an exact replica of the official repro-proof with respect to layout and contents. Spot carbons are *not permitted* for Copy A or for Form W-3 filed with SSA. The dimensions of a substitute form may differ as far as width (see Section 6.05 below) and the printing of the Government Printing Office (GPO) symbol must be deleted (see Section 6.12 below). The specifications and allowable tolerances for the Copy A of substitute Forms W-2 and W-2P are provided in Exhibits A, B, D, E, F, and G respectively. The specifications and allowable tolerances for Forms W-3 are provided in Exhibits C, H, and I.

NOTE: *Printers of Forms W-2 or W-2P that are wider than 7 inches must provide Forms W-3 that are of the same width as the Forms W-2 or W-2P (i.e. 7½" width Forms W-3 with 7½" width Forms W-2 or W-2P; 8" width Forms W-3 with 8" width Forms W-2 or W-2P).*

.02 Color and quality of paper.

Paper for copy A and for Form W-3, (cut sheets and continuous pinfeed forms), to be filed with SSA, as specified by JCP 0-25, dated November 29, 1978, must be: White 100% bleached chemical wood, optical character recognition (OCR) bond produced in accordance with the following specifications:

NOTE: Reclaimed fiber in any percentage is permitted, provided the requirements of this standard are met.

1 Acidity: pH value, average, not less than 4.5
2 Basis Weight 17 x 22
1000 cut sheets 40
Metric equivalent—g/m2 75
A Tolerance of ± 5 pct. shall be allowed.
3 Stiffness: Average, each direction, not less than—milligrams 50
4 Tearing strength: Average, each direction, not less than—grams 40
5 Opacity: Average, not less than—percent 82
6 Thickness: Average—
inch__0.0038
Metric equivalent—
mm__0.097
A tolerance of + 0.0005 inch (0.0127 mm) shall be allowed.
Paper shall not vary more than 0.0004 inch (0.0102 mm) from one edge to the other.
7 Porosity: Average, not less than—seconds 10
8 Finish (smoothness): Average, each side—seconds 20-55
For information only, the Sheffield equivalent—units 170-100
9 Dirt: Average, each side, not to exceed—parts per million 8

.03 All printing will be in red OCR dropout ink, as specified, except for the '22222', '55555', or '33333' at the top of the form and the descriptive information at the bottom (see Exhibits J, K, and L) which will be printed in nonreflective black ink. All other printing will be in red OCR dropout ink with or comparable to the specifications below. The screened area of any substitute form (Copy A of Form W-2 and W-2P, and the Form W-3 that is sent to SSA) should generally correspond to that present on the official form. Vertical rules require screening of .05 inches on each side of an inside rule. Horizontal screening should follow the standard format and allow for typewriter spacing. All screened areas are to be printed in the red OCR dropout ink. The numbered captions are printed as a solid with no

screened background. (See Exhibits) Printing in red OCR dropout ink other than those listed below must be cleared by contacting: Manager of Media Support, Recognition Equipment, Inc., P.O. Box 222307, Dallas, Texas 75222; telephone number 214-438-8611, extension 1416. The red OCR dropout ink specifications already approved by Recognition Equipment, Inc., are:

Ink Manufacturer	*Red Ink Identification No.*
Gans Ink Co.	CS-310
General Printing Inks Div. (Sun Chemical Corp.)	SS-40B
Ink Masters, Inc. (Chicago)	B-6056
Inmont Canada, Ltd.	4T-39605
Lorilleux Lefranc	U-17410
Sinclair & Valentine (U.S.)	J-24893
Toyo Ink Company	OMR-57

.04 Topography—Type must be substantially identical in size and shape with corresponding type on the official form. NOTE: The form identifying number must be in OCR A font.

1 On Copy A of Forms W-2 and W-2P and for Form W-3, all the perimeter rules must be 1-point (0.014 inch), while all other rules must be one half point (0.007 inch).

2 Vertical rules must be parallel to the left edge of the document; horizontal rules parallel to the top edge.

.05 Dimension—Three official Forms W-2, W-2P (Copy A) or one official Form W-3 are contained on a single page which is 7 inches wide (exclusive of any snap-stubs) by 11 inches deep. The width of privately printed substitute pages must be 7 inches, 7 ½ inches, or 8 inches exclusive of any left or right snap-stubs, or pin-feed holes, although adherence to the size of the official page is preferred. If a 7 inch form is produced, the image must be an exact copy of the official repro-proof. If the width of the substitute page is increased, the width of specified fields on the substitute page must be increased in accordance with Exhibits D, E, F, G, H, and I. The top margins and the right margin must be ¼ inch plus or minus .0313 inch and must be free of all printing. For Forms W-2, the combination width of Box 1, "Control number", and the box containing the form identifying number must always be 2.2 inches. For Forms W-2P and W-3, the combination width of Box 1, "Control Number", and the box containing the form identifying number must always be 2.15 inches.

1 When the width of Copy A is increased to 8 inches, exclusive of any left or right snap-stubs or pin-feed holes, the form identifying number must be shown as 222 for Form W-2, 555 for Form W-2P, or 333 for Form W-3. This number tells the scan equipment used by SSA which information document it is reading, the width size and the position of individual data fields (see Exhibits D, F, and H).

2 When the width of Copy A is increased to 7 ½ inches, exclusive of any left or right snap-stubs or pin-feed holes, the form identifying number must be shown as 2222 for Form W-2, 5555 for Form W-2P, or 3333 for Form W-3. This number tells the scan equipment used by the SSA which information document it is reading, the width size and the position of individual data fields (see Exhibits E, G, and I).

.06 The depth of the individual image on a page (for Form W-2 and W-2P) must be the same (3 ⅓ inches) as that of the official repro-proof. The depth of the Form W-3 on a page must be 3.37 inches.

.07 The words *"Do Not Cut or Separate Forms on This Page"* must be printed in red OCR dropout ink between the three Forms W-2 or W-2P (Copy A) (see Exhibits A and B) and must also be present on 7 ½ inch and 8 inch wide substitute Forms W-2 or W-2P. Perforations are required on all copies (except Copy A) to enable the separation of individual forms.

.08 The words "For Paperwork Reduction Act Notice, see back of Copy D" *must* be printed on the Forms W-2 or W-2P (Copy A) (see Exhibits A and B for format and location) and *must* also be present on 7 ½ inch and 8 inch wide substitute Forms W-2 or W-2P.

.09 The OMB Number *must* be printed on *each* ply of Form W-2, W-2P, and W-3 (see Exhibits A, B, and C for format and location) and *must* also be present on 7 ½ inch and 8 inch wide substitute Forms W-2, W-2P, or W-3.

.10 The words *"Please return this entire page to the Social Security Administration address for your State as listed below"* as well as the list of SSA addresses *must* be printed on all Forms W-3 (see Exhibit C) whether Forms W-3 are 7 inches wide, 7 ½ inches wide, or 8 inches wide.

.11 The Paperwork Reduction Act Notice must be printed on Form W-3 (see Exhibit C for format and location) whether Forms W-3 are 7 inches wide, 7 ½ inches wide, or 8 inches wide.

.12 *Privately printed continuous substitute Forms W-2 and W-2P (Copy A) must be perforated at each 11" (3-on) page depth. No perforations are allowed between the 3 ⅓" forms on a single copy page of Copy A.*

NOTE: Perforations are required between all the other individual copies (Copy 1, B, C, 2, and D) included in the set.

.13 The back of a substitute Copy A must be free of all printing.

.14 Spot carbons are *NOT permitted* for Copy A of Forms W-2 or W-2P or for Form W-3. Interleaved carbon must be of good quality to assure legibility of information on all parts to preclude smudging, and should be black (see Section 5.04).

.15 The use of "chemical transfer paper" on Copy A may be approved after review by IRS and SSA. Submit all requests with a minimum sample of 100 sheets of at least 20-lb. paper (17X22-1000) to: Internal Revenue Service, Attention: D:R:R:IM, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. The paper will be tested and the results reported to the requester.

.16 Printer's symbol—The GPO symbol must not be placed on substitute Copy A of Forms W-2 and W-2P. In the place of the GPO symbol, the Employer Identification Number (EIN) of the forms printer must be printed in the bottom margin on the

face of each individual sheet of Copy A. In addition, the EIN of the forms printer must be printed on the face of the Form W-3 which is filed with SSA.

.17 All printers of substitute or privately printed Forms W-2, W-2P, or W-3 are requested to provide 3 copies of each version of each form to SSA, P.O. Box 2317, Baltimore, Maryland 21235. Paper substitutes conforming to the specifications contained in this procedure may be sent to SSA directly. Paper substitutes requiring IRS consideration and approval should be sent to SSA only after IRS approval has been granted.

SEC. 7. ADDITIONAL INSTRUCTIONS

.01 Arrangement of assembly—Except as provided below, if magnetic media is not used for filing with SSA, the substitute copies of Forms W-2 and W-2P assembly should be arranged in the same order as the official Forms W-2 and W-2P. Copy A first, followed sequentially by perforated sets (Copies 1, B, C, 2, and D). The substitute form to be filed with SSA by the payer must carry the designation Copy A.

1 Copy D for Employer or Payer. It is not required that privately printed substitute forms contain a copy to be retained by payers although payers must be prepared to verify or duplicate this information if it is requested by the IRS or SSA.

(a) If Copy D *is provided* for the employer or payer, instructions contained on the back of Copy D of the official form *must* appear on the back of the substitute form Copy D.

(b) If Copy D *is not provided* for the employer or payer, instructions contained on the back of Copy D of the official form *must* be furnished on a separate statement to the employer or payer.

2 Additional Copies. Except as provided in the arrangement of the official assemblies, additional copies which may be prepared by payers shall not be placed ahead of the copy "For employee's records," Copy C (Form W-2) or "For Recipient's Records," Copy C (W-2P).

3 Notice to Employees. Instructions similar to those contained on the back of Copy C of the official form should be provided to each employee (recipient). For Form W-2, the social security (FICA) rates applicable for the current tax year must:

(a) appear either on the front or the back of the copy (Copy C) retained by the employee; or

(b) be communicated to the employee via a separate statement.

Note: If you are a Federal employer, you must provide the current rate for hospital insurance benefits (Medicare) for Federal employees. The IRS recommends that the other text on the back of the official form Copy C be provided to the employee.

.02 All privately printed Forms W-2 and W-2P (Copy A) must have the tax year printed on the bottom face of each, using identical type to that of the official format.

.03 The substitute Copy B (or its equal), which the payee is instructed to attach to his/her Federal income tax return, must be at least 24-pound paper (basis 17 x 22-1000), while the other copies furnished the payee should be at least 18-pound paper (basis 17 x 22-1000).

.04 The OCR bond Form W-3 that is filed with SSA must have no printing on the reverse side.

.05 Instructions for Form W-3—Instructions similar to those provided as part of the official form must be provided as part of any substitute Form W-3.

.06 All privately printed Forms W-3 must have the tax year printed on the bottom face of each Form W-3, using identical type to that of the official format.

.07 The copy of the substitute Form W-3 which contains the instructions and is to be retained by the employer should be at least 18-pound paper (basis 17 x 22-1000).

SECTION 8. INSTRUCTIONS FOR PAYERS

.01 Only originals or ribbon copies of Copy A of Forms W-2 and W-2P and of Form W-3 may be filed. Carbon copies and photocopies are not acceptable.

.02 The Service requests the cooperation of the payers in typing or machine printing whenever possible and in providing good quality data entries on the forms, i.e., using black ribbon, inserting data in the middle of blocks, well separated from other printing and guidelines, and taking any other measures that will guarantee clear, sharp images. However, payers are not required to acquire equipment solely for the purpose of preparing these forms.

.03 The Employer Identification Number (EIN) may be entered anywhere in Box 2 along with the Payer's name and address on Copy A of Forms W-2 and W-2P. (If this is done, the EIN need not be entered in Box 3 of either Form W-2 or W-2P.) For Forms W-3, the EIN must be entered where prescribed by the Form W-3 Instructions.

.04 The payer's name, address and EIN may be pre-printed.

.05 State agencies—The amounts of wages paid and employee contributions withheld under a State-Federal Agreement, entered into pursuant to Section 218 of the Social Security Act, may be shown in the space on Form W-2 for Federal Insurance Contribution Act Wages and Employee Tax. In such cases, the identification number assigned by the Social Security Administration to the state (prefixed by 69) should be shown in the employer name and address area block on Form W-2. This "69" number may be pre-printed.

.06 The optional employer's state number may be pre-printed in the employer's (payer's) name, address, and ZIP code box. If this is done, Box 4 of Forms W-2 and W-2P need not be completed, so long as the applicable state taxing authority does not object.

.07 The preparation and filing instructions for Forms W-2 and W-2P are contained in the 1984 Instructions for Forms W-2 and W-2P. The preparation and filing instructions for Form W-3 are contained as part of the 1984 Form W-3 snap set assembly.

.08 To avoid confusion and questions by payees, payers are encouraged to delete the following items from copies of Forms W-2 and W-2P provided to payees:

(1) Form identifying number (e.g.,

22222, 55555);

(2) The words "subtotal" and "void" and their boxes;

(3) Any other captions or box number that would not be of any informational use to payees.

.09 Payers are encouraged to use IRS-supplied labels for affixing to all Forms W-3 filed with SSA.

SECTION 9. OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR SUBSTITUTE FORMS

Public Law 96-511 requires: (1) OMB approval of IRS tax forms, (2) that each form (all copies) show the OMB approval number and when appropriate, the form's expiration date, and (3) that the form (or it's instructions) state why IRS is collecting the information, how we will use it and whether it must be given to us. The official IRS forms will contain this information.

As it applies to substitute IRS forms this means:

1. All substitute forms (all copies) *must* show the OMB number and any expiration date as they appear on the official IRS form (see Exhibits A, B, and C).

2. The OMB number (and date) must use one of the following formats:

a. OMB No. XXXX-XXXX (preferred)

or

OMB # XXXX-XXXX

b. OMB No. XXXX-XXXX
Expires XXXXXX (mmddyy) (preferred)

or

OMB # XXXX-XXXX
Expires XXXXXX (mmddyy)

3. You must inform the users of your substitute forms of the reasons for IRS collection, use and requirements, as stated in the instructions for the IRS form.

4. The official OMB approval numbers (and expiration date) may be obtained from reproduction proofs, official IRS printed forms, or when approval is requested for a substitute form.

SECTION 10. REPRODUCTION PROOFS

.01 Order blanks for reproduction proofs are mailed annually to requestors of record, and on request to other users. Reproduction copies of Forms W-2 (Copy A), W-2P (Copy A), and W-3 (Page 1) each consists of two parts. Part 1 is line art, i.e., type and ink. Part 2 is a black solid which should be photographically screened by the user to allow a 10%-20% dot pattern when printed in red OCR dropout ink. In some cases where the production method requires the use of something other than a standard dot pattern, the printed value of part 2 must still be 10%-20%. Printers and others wishing to obtain reproduction proofs may send their requests to Internal Revenue Service, Attn: Distribution Manager, PM: S:FM:P—Room 1528, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

.02 A charge of $1 per page will be made for each reproduction proof regardless of page size. Invoices will be mailed after orders have been filled.

SECTION 11. EFFECT ON OTHER PROCEDURES

Rev. Proc. 83-46, 1983-1 C.B. 780, is superseded.

Exhibit A Form W-2

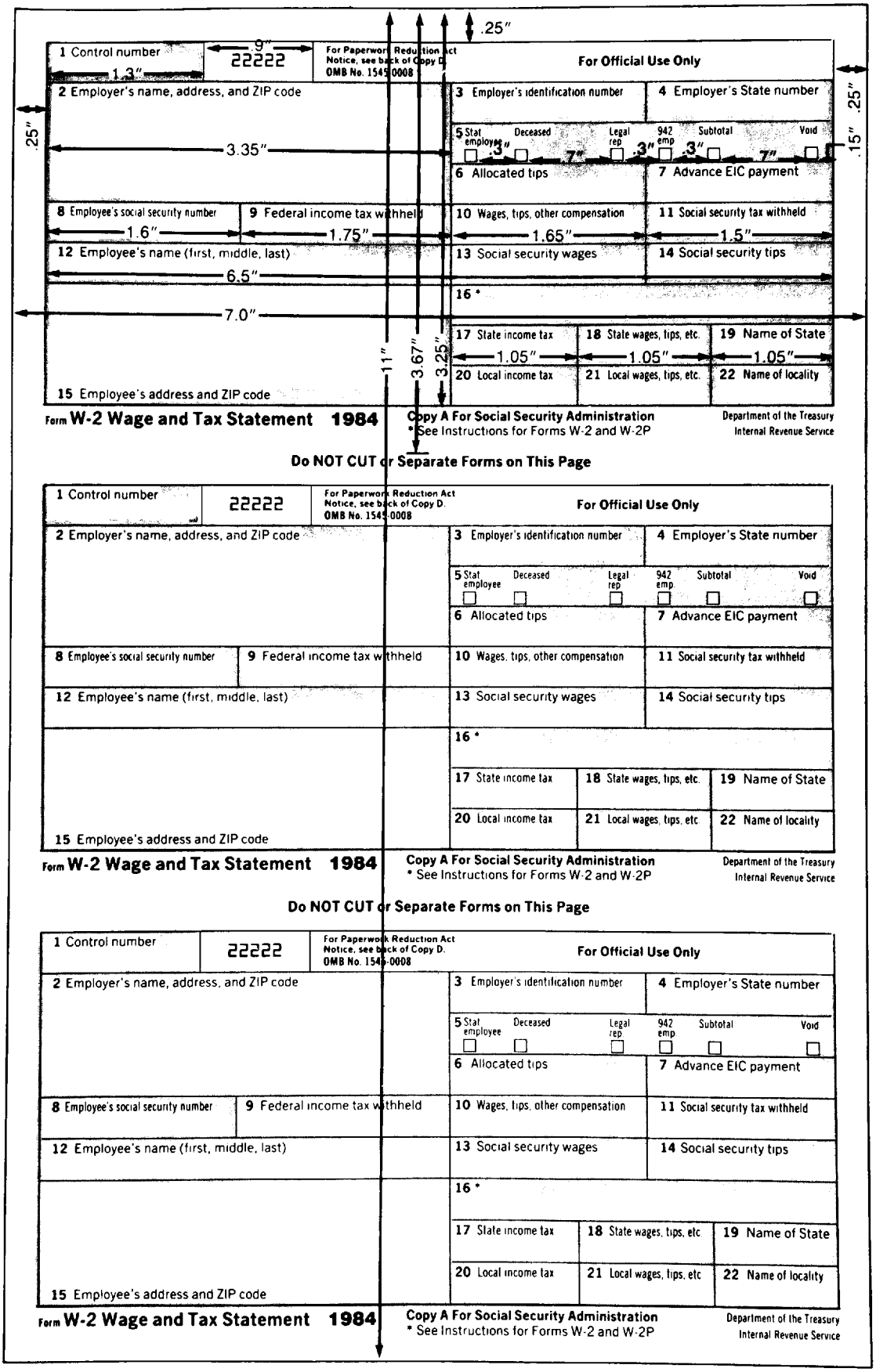


Exhibit B

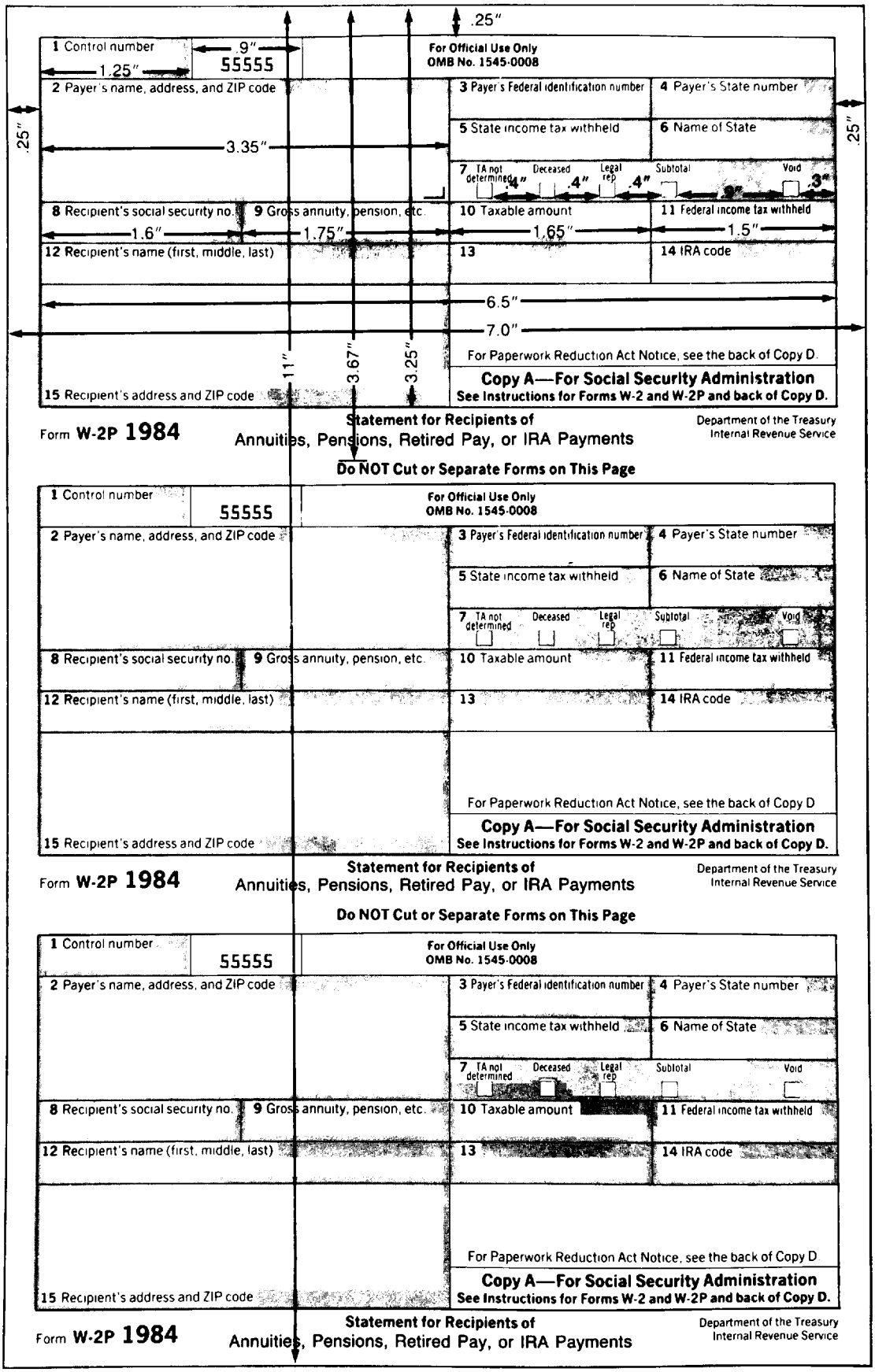
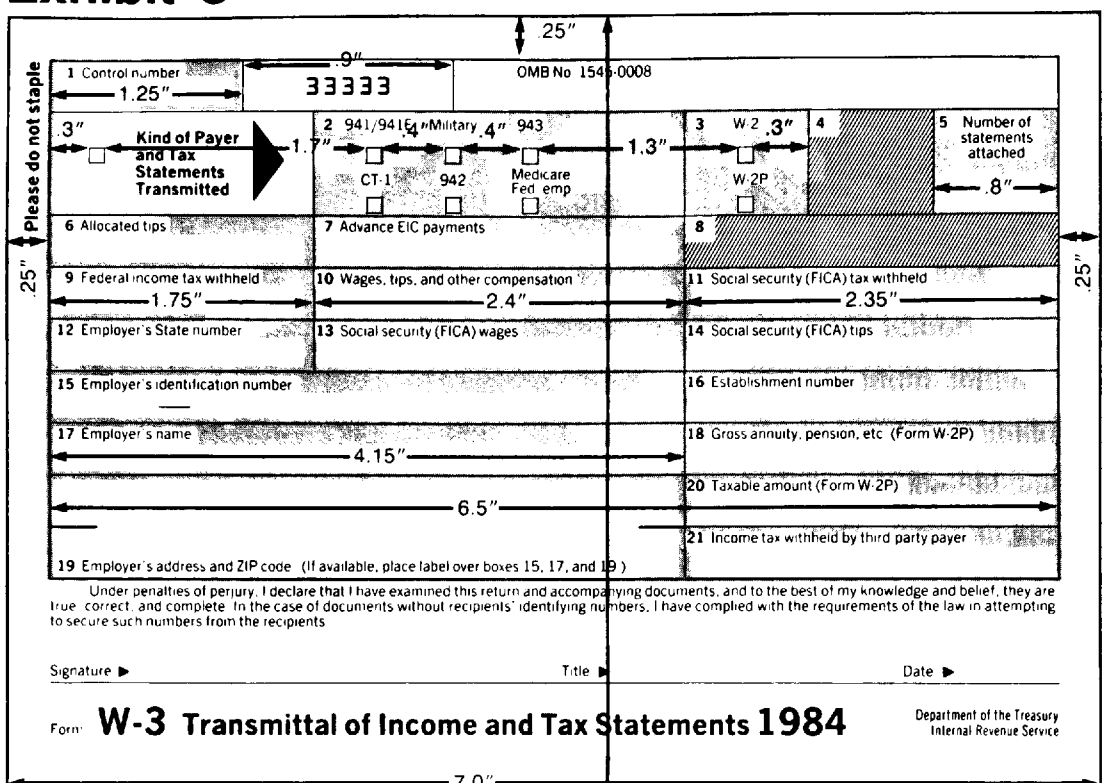

.25"
1 Control number
.9"
1.25"
55555
For Official Use Only
OMB No. 1545-0008
2 Payer's name, address, and ZIP code
3 Payer's Federal identification number
4 Payer's State number
5 State income tax withheld
6 Name of State
.25"
3.35"
.25"
7 TA not determined
Deceased
.4"
Legal rep
.4"
Subtotal
.4"
Void
.3"
8 Recipient's social security no.
9 Gross annuity, pension, etc.
10 Taxable amount
11 Federal income tax withheld
1.6"
1.75"
1.65"
1.5"
12 Recipient's name (first, middle, last)
13
14 IRA code
6.5"
7.0"
For Paperwork Reduction Act Notice, see the back of Copy D.
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.
11"
3.67"
3.25"
15 Recipient's address and ZIP code
Form W-2P 1984
Statement for Recipients of
Annuities, Pensions, Retired Pay, or IRA Payments
Department of the Treasury
Internal Revenue Service
Do NOT Cut or Separate Forms on This Page
1 Control number
55555
For Official Use Only
OMB No. 1545-0008
2 Payer's name, address, and ZIP code
3 Payer's Federal identification number
4 Payer's State number
5 State income tax withheld
6 Name of State
7 TA not determined
Deceased
Legal rep
Subtotal
Void
8 Recipient's social security no.
9 Gross annuity, pension, etc.
10 Taxable amount
11 Federal income tax withheld
12 Recipient's name (first, middle, last)
13
14 IRA code
For Paperwork Reduction Act Notice, see the back of Copy D
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.
15 Recipient's address and ZIP code
Form W-2P 1984
Statement for Recipients of
Annuities, Pensions, Retired Pay, or IRA Payments
Department of the Treasury
Internal Revenue Service
Do NOT Cut or Separate Forms on This Page
1 Control number
55555
For Official Use Only
OMB No. 1545-0008
2 Payer's name, address, and ZIP code
3 Payer's Federal identification number
4 Payer's State number
5 State income tax withheld
6 Name of State
7 TA not determined
Deceased
Legal rep
Subtotal
Void
8 Recipient's social security no.
9 Gross annuity, pension, etc.
10 Taxable amount
11 Federal income tax withheld
12 Recipient's name (first, middle, last)
13
14 IRA code
For Paperwork Reduction Act Notice, see the back of Copy D
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.
15 Recipient's address and ZIP code
Form W-2P 1984
Statement for Recipients of
Annuities, Pensions, Retired Pay, or IRA Payments
Department of the Treasury
Internal Revenue Service

Exhibit C

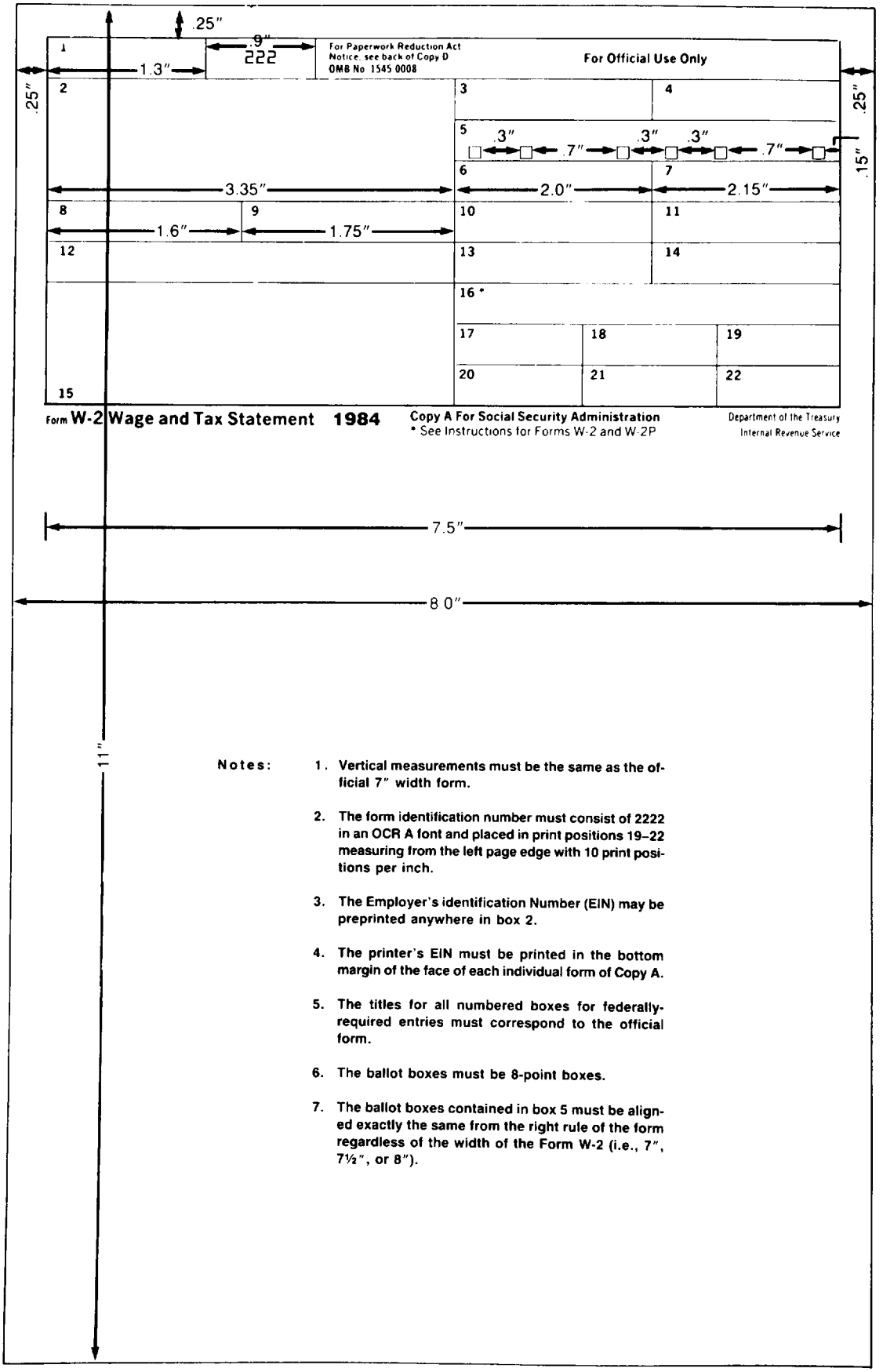


Please return this entire page to the Social Security Administration address for your State as listed below.

If your legal residence, principal place of business, office or agency is located in ▼	Use this address ▼
Alaka, Arizona, California, Colorado, Hawaii, Idaho, Iowa, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, Wyoming	Social Security Administration Salinas Data Operations Center Salinas, CA 93911
Alabama, Arkansas, Florida, Georgia, Illinois, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma, South Carolina, Tennessee, Texas	Social Security Administration Albuquerque Data Operations Center Albuquerque, NM 87180
Connecticut, Delaware, District of Columbia, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769
If you have no legal residence or principal place of business in any State	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

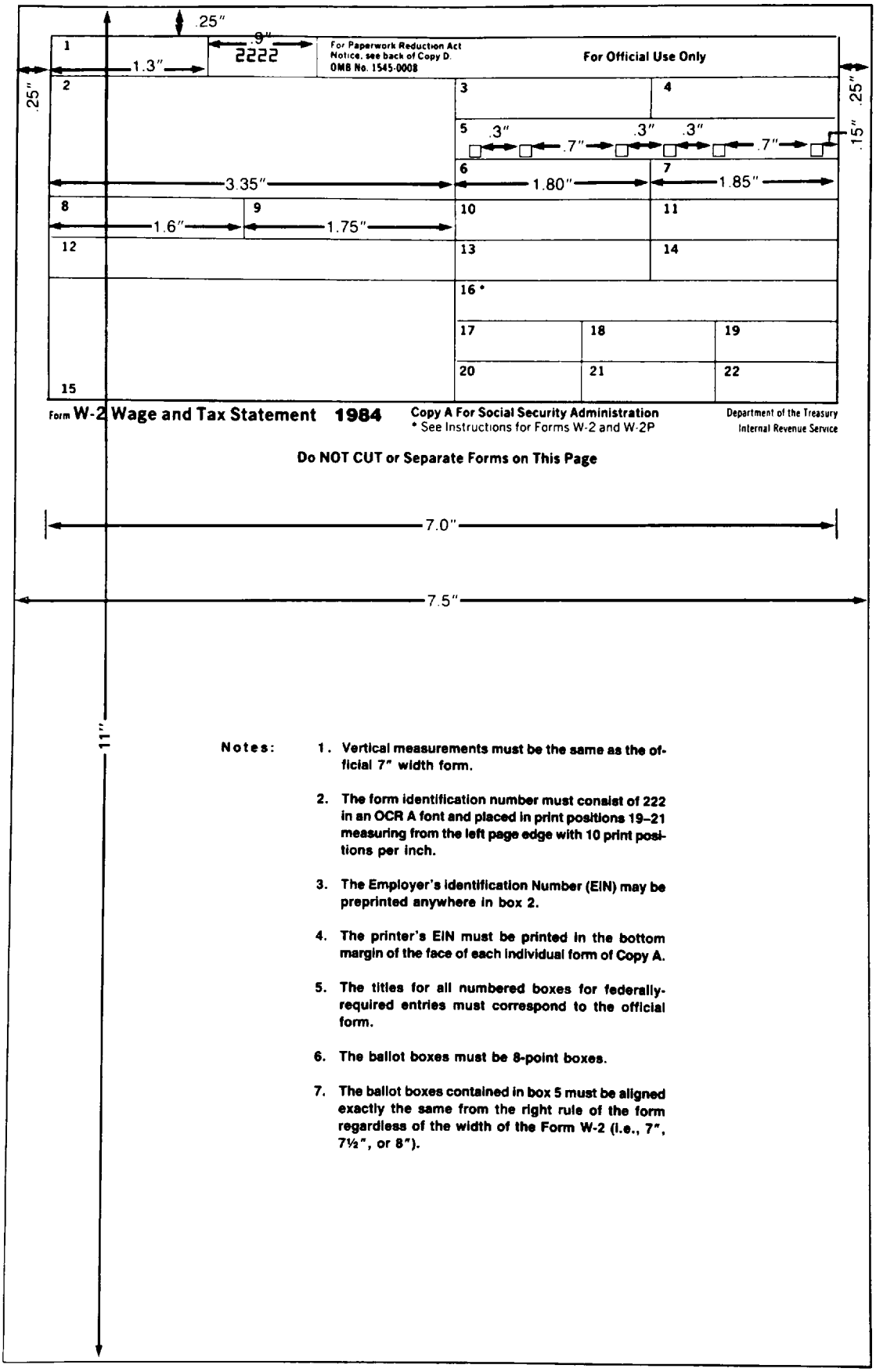
Exhibit D



Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 2222 in an OCR A font and placed in print positions 19–22 measuring from the left page edge with 10 print positions per inch.
3. The Employer's identification Number (EIN) may be preprinted anywhere in box 2.
4. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
5. The titles for all numbered boxes for federally-required entries must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in box 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2 (i.e., 7", 7½", or 8").

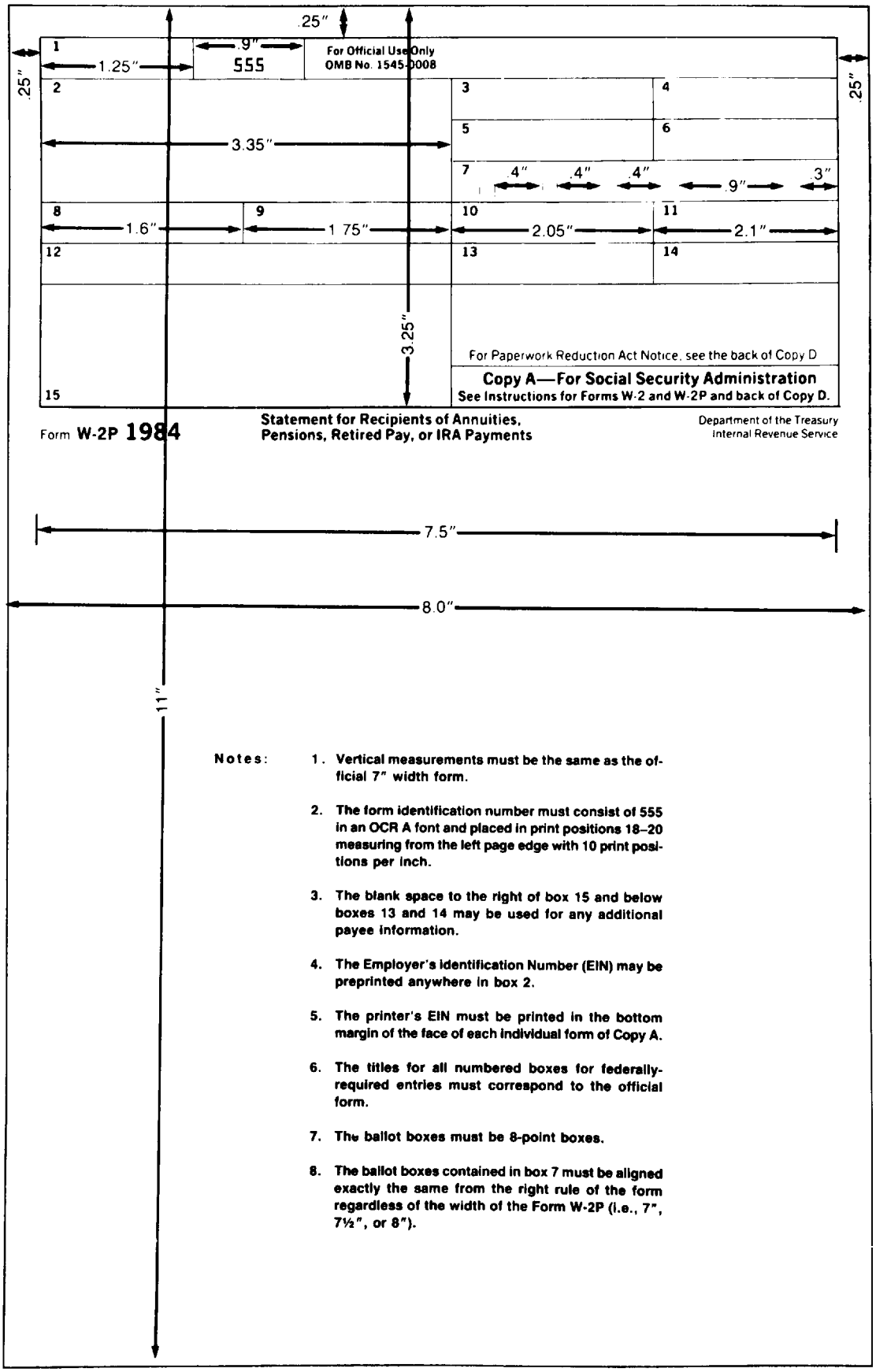
Exhibit E



Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 222 in an OCR A font and placed in print positions 19–21 measuring from the left page edge with 10 print positions per inch.
3. The Employer's identification Number (EIN) may be preprinted anywhere in box 2.
4. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
5. The titles for all numbered boxes for federally-required entries must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in box 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2 (i.e., 7", 7½", or 8").

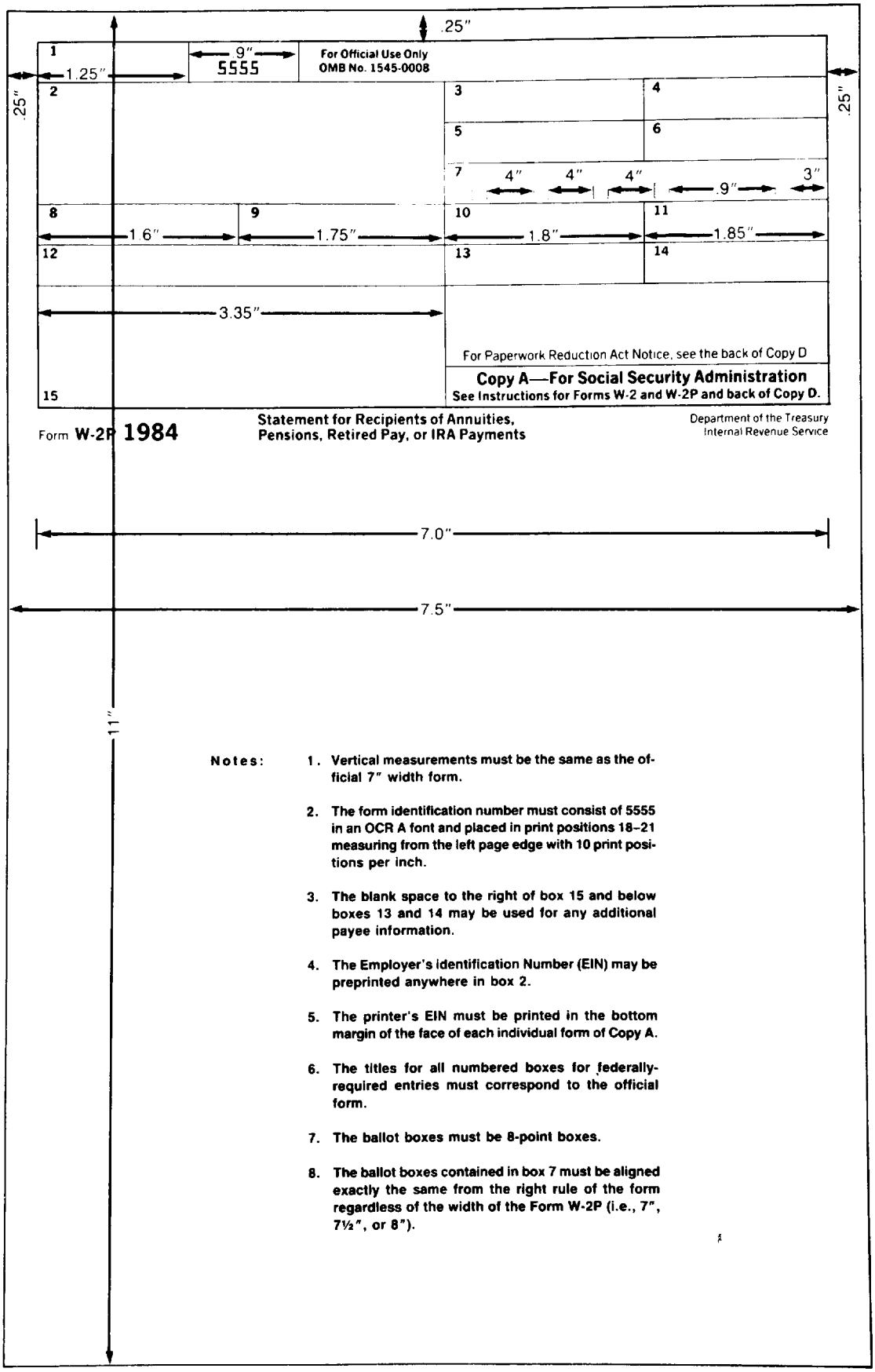
Exhibit F



Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 555 in an OCR A font and placed in print positions 18–20 measuring from the left page edge with 10 print positions per inch.
3. The blank space to the right of box 15 and below boxes 13 and 14 may be used for any additional payee information.
4. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.
5. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
6. The titles for all numbered boxes for federally-required entries must correspond to the official form.
7. The ballot boxes must be 8-point boxes.
8. The ballot boxes contained in box 7 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2P (i.e., 7", 7½", or 8").

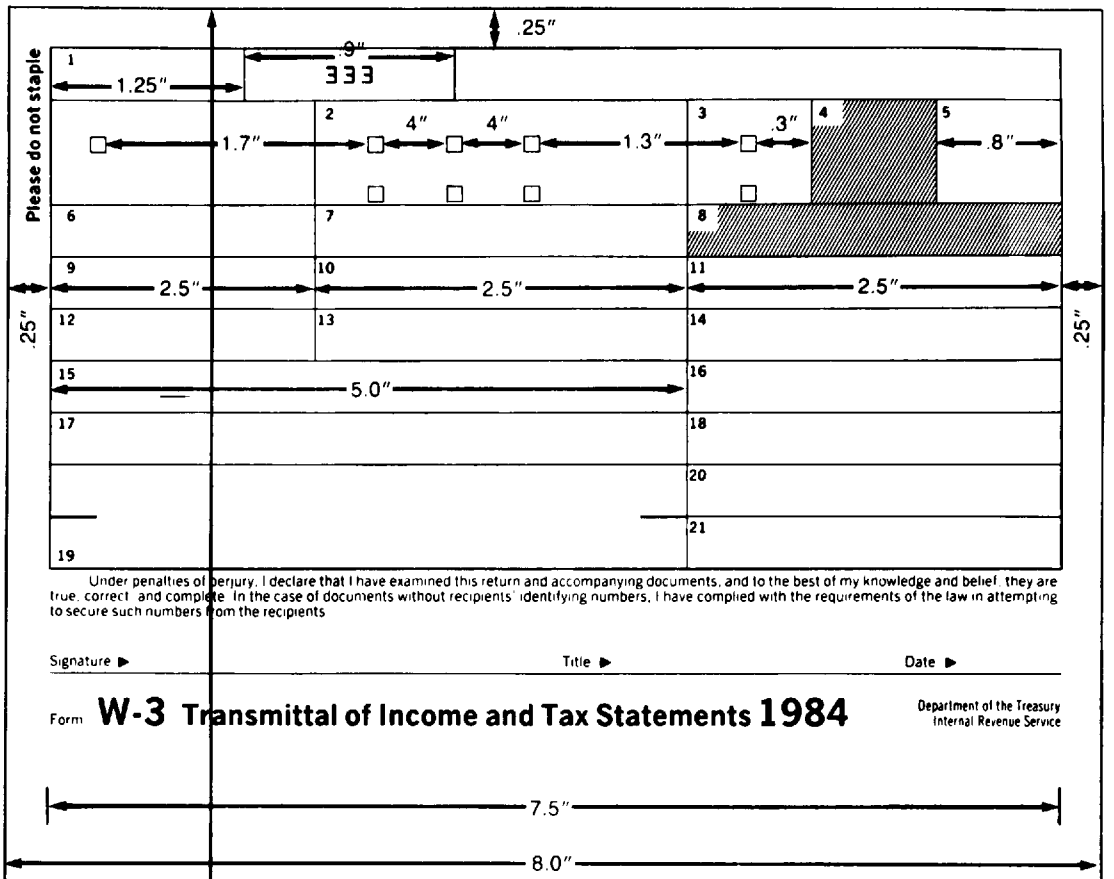
Exhibit G



Notes:

1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 5555 in an OCR A font and placed in print positions 18–21 measuring from the left page edge with 10 print positions per inch.
3. The blank space to the right of box 15 and below boxes 13 and 14 may be used for any additional payee information.
4. The Employer's identification Number (EIN) may be preprinted anywhere in box 2.
5. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
6. The titles for all numbered boxes for federally-required entries must correspond to the official form.
7. The ballot boxes must be 8-point boxes.
8. The ballot boxes contained in box 7 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2P (i.e., 7", 7½", or 8").

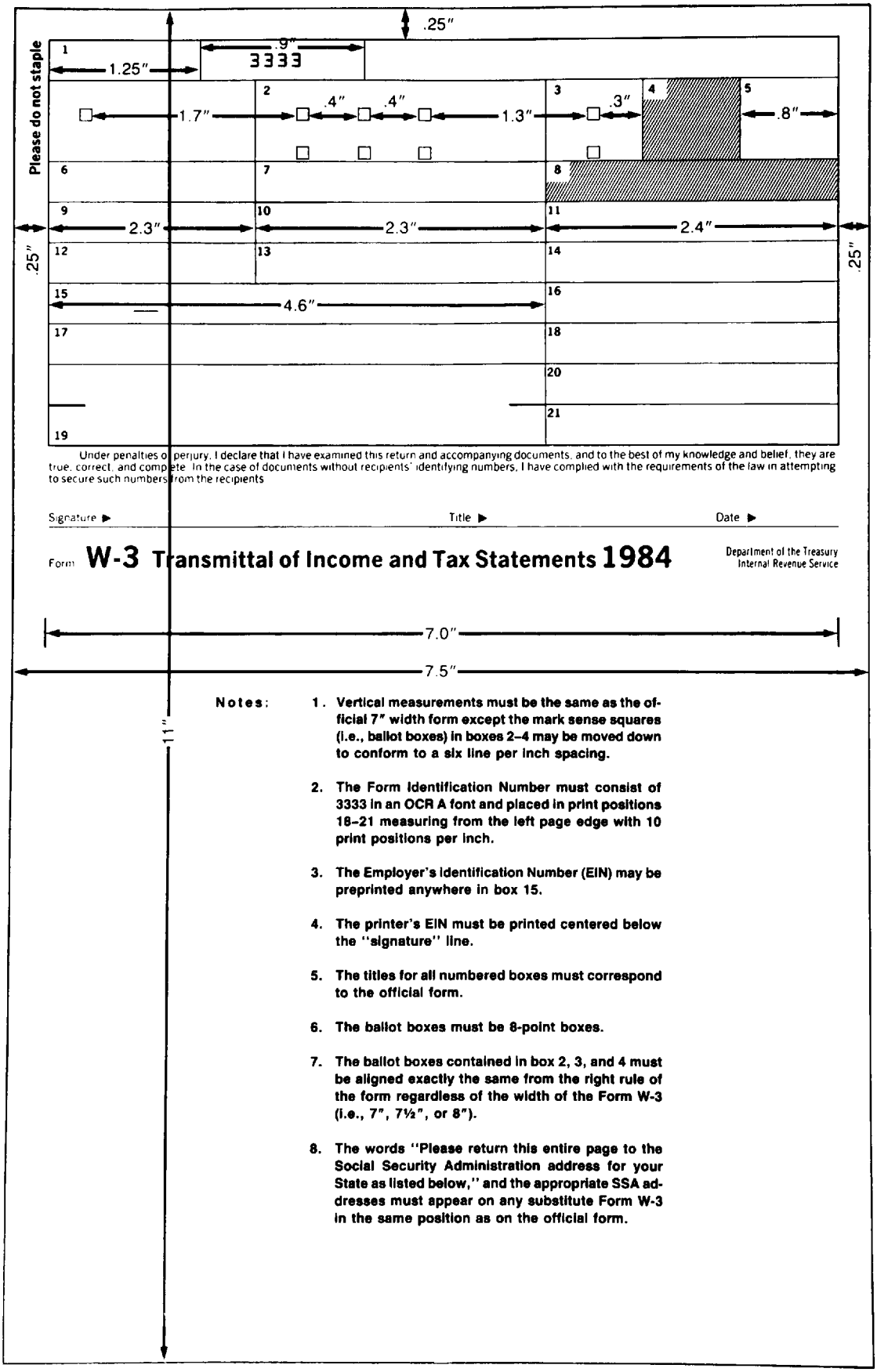
Exhibit H



Notes:

1. **Vertical measurements must be the same as the official 7" width form except the mark sense squares (i.e., ballot boxes) in boxes 2–4 may be moved down to conform to a six line per inch spacing.**
2. **The form identification number must consist of 333 in an OCR A font and placed in print positions 18–20 measuring from the left page edge with 10 print positions per inch.**
3. **The Employer's Identification Number (EIN) may be preprinted (in OCR A font) anywhere in box 15.**
4. **The printer's EIN must be printed centered below the "signature" line.**
5. **The titles for all numbered boxes must correspond to the official form.**
6. **The ballot boxes must be 8-point boxes.**
7. **The ballot boxes contained in box 2, 3, and 4 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-3 (i.e., 7", 7½", or 8").**
8. **The words "Please return this entire page to the Social Security Administration address for your State as listed below," and the appropriate SSA addresses must appear on any substitute Form W-3 in the same position as on the official form.**

Exhibit I



Notes:

1. **Vertical measurements must be the same as the official 7" width form except the mark sense squares (i.e., ballot boxes) in boxes 2–4 may be moved down to conform to a six line per inch spacing.**

2. **The Form Identification Number must consist of 3333 in an OCR A font and placed in print positions 18–21 measuring from the left page edge with 10 print positions per inch.**

3. **The Employer's Identification Number (EIN) may be preprinted anywhere in box 15.**

4. **The printer's EIN must be printed centered below the "signature" line.**

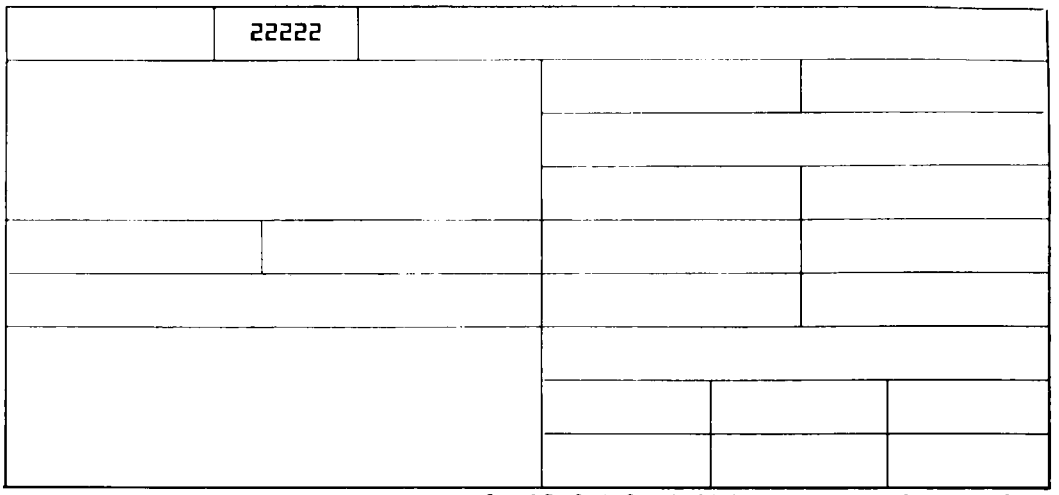
5. **The titles for all numbered boxes must correspond to the official form.**

6. **The ballot boxes must be 8-point boxes.**

7. **The ballot boxes contained in box 2, 3, and 4 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-3 (i.e., 7", 7½", or 8").**

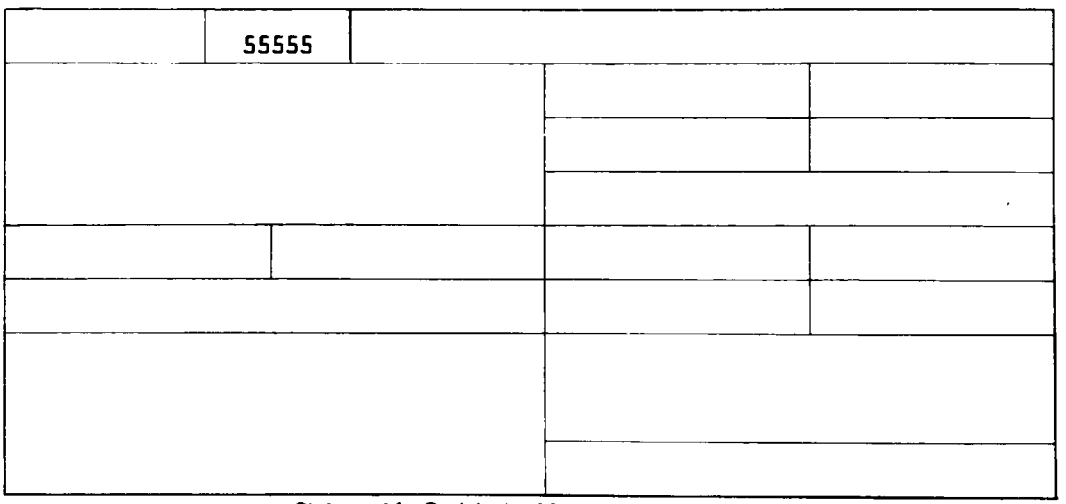
8. **The words "Please return this entire page to the Social Security Administration address for your State as listed below," and the appropriate SSA addresses must appear on any substitute Form W-3 in the same position as on the official form.**

Exhibit J - W-2



Form W-2 Wage and Tax Statement 1984 — Copy A For Social Security Administration * See Instructions for Forms W-2 and W-2P — Department of the Treasury Internal Revenue Service

Exhibit K - W-2P



Form W-2P 1984 — Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments — Department of the Treasury Internal Revenue Service

Exhibit L - W-3

1	33333			
	2	3	4	5
6	7	8		
9	10	11		
12	13	14		
15		16		
17		18		
		20		
19		21		

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and to the best of my knowledge and belief, they are true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law in attempting to secure such numbers from the recipients.

Signature ▶ Title ▶ Date ▶

Form W-3 Transmittal of Income and Tax Statements 1984

Department of the Treasury
Internal Revenue Service

Please return this entire page to the Social Security Administration address for your State as listed below.

If your legal residence, principal place of business, office or agency is located in ▼	Use this address ▼
Alaska, Arizona, California, Colorado, Hawaii, Idaho, Iowa, Minnesota, Missouri, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, Wyoming	Social Security Administration Salinas Data Operations Center Salinas, CA 93911
Alabama, Arkansas, Florida, Georgia, Illinois, Kansas, Louisiana, Mississippi, New Mexico, Oklahoma, South Carolina, Tennessee, Texas	Social Security Administration Albuquerque Data Operations Center Albuquerque, NM 87180
Connecticut, Delaware, District of Columbia, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769
If you have no legal residence or principal place of business in any State	Social Security Administration Wilkes-Barre Data Operations Center Wilkes-Barre, PA 18769

Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

Exhibit M

1 Control number	22222	For Paperwork Reduction Act Notice, see back of Copy D. OMB No. 1545-0008	For Official Use Only
2 Employer's name, address, and ZIP code		3 Employer's identification number	4 Employer's State number
		5 Stat employee ☐ Deceased ☐ Legal rep ☐ 942 emp ☐ Subtotal ☐ Void ☐	
		6 Allocated tips	7 Advance EIC payment
8 Employee's social security number	9 Federal income tax withheld	10 Wages, tips, other compensation	11 Social security tax withheld
12 Employee's name (first, middle, last)		13 Social security wages	14 Social security tips
		16 *	
		17 State income tax / 18 State wages, tips, etc / 19 Name of State	
		20 Local income tax / 21 Local wages, tips, etc / 22 Name of locality	
15 Employee's address and ZIP code			

Form **W-2 Wage and Tax Statement 1984** — **Copy A For Social Security Administration** — Department of the Treasury Internal Revenue Service

* See Instructions for Forms W-2 and W-2P

Do NOT CUT or Separate Forms on This Page

1 Control number	55555	For Official Use Only OMB No. 1545-0008	
2 Payer's name, address, and ZIP code		3 Payer's Federal identification number	4 Payer's State number
		5 State income tax withheld	6 Name of State
		7 TA not determined ☐ Deceased — Legal rep — Subtotal — Void —	
8 Recipient's social security no.	9 Gross annuity, pension, etc.	10 Taxable amount	11 Federal income tax withheld
12 Recipient's name (first, middle, last)		13	14 IRA code
		For Paperwork Reduction Act Notice, see the back of Copy D.	
15 Recipient's address and ZIP code		**Copy A—For Social Security Administration** See Instructions for Forms W-2 and W-2P and back of Copy D.	

Form **W-2P 1984** — **Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments** — Department of the Treasury Internal Revenue Service

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-45

SECTION 1. BACKGROUND

Rev. Proc. 84-22, page 449, this Bulletin, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 3 of Rev. Proc. 84-22 is entitled, Areas In Which Rulings Or Determination Letters Will Not Be Issued.

SECTION 2. PROCEDURE

Rev. Proc. 84-22 is amplified by adding the following to section 3:

Section 274—Disallowance of Certain Entertainment, Etc., Expenses—Whether a taxpayer who is traveling away from home on business may, in lieu of substantiating the actual cost of meals, deduct a fixed per-day amount for meal expenses that differs from the amount prescribed in Rev. Proc. 83-71, 1983-2 C.B. 590, or any later revenue procedure that modifies Rev. Proc. 83-71.

SECTION 3. EFFECTIVE DATE

This revenue procedure is effective for all ruling requests on hand in the National Office on May 29, 1984, the date that this revenue procedure is published in the Internal Revenue Bulletin, as well as all requests received thereafter.

SECTION 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 84-22 is amplified.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 501, 509, 521, 4942, 7428; 1.170A-1, 1.501(a)-1, 1.509(a)-1, 1.521-1, 53.4942(b)-1, 1.9100-1)

Rev. Proc. 84-46

SECTION 1. PURPOSE

This revenue procedure sets forth revised procedures with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Internal Revenue Code and with respect to revocation or modification of exemption rulings and determination letters, other than those subject to Rev. Proc. 80-30, 1980-1 C.B. 685, (relating to pension, annuity, profit-sharing, and stock bonus plans). This revenue procedure also supplements Rev. Proc. 76-34, 1976-2 C.B. 656, with respect to the effects of section 7428 on the classification of organizations under sections 509(a) and 4942(j)(3). See Rev. Proc. 80-27, 1980-1 C.B. 677, for procedures under which exemption may be recognized on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization. Also, see Rev. Proc. 72-5, 1972-1 C.B. 709, for information on applications for recognition of exemption filed by certain religious and apostolic organizations. Requests for rulings or determination letters generally are governed by the procedures outlined in Rev. Proc. 83-36, 1983-1 C.B. 763.

SEC. 2. NATURE OF CHANGES

This revenue procedure updates and restates the procedures previously set forth in Rev. Proc. 80-25, 1980-1 C.B. 667, relating to processing requests for exemption. Because protests of initial adverse rulings issued by the Exempt Organizations Technical Branch in the National Office are handled by that office, the term "protest" has been substituted for "appeal" with regard to those cases. In certain declaratory judgment cases, a request for relief under section 1.9100 of the Income Tax Regulations is an additional requirement for exhaustion of administrative remedies. The list of issues to which the declaratory judgment provisions of section 7428 of the Code apply has been clarified. Also, it is made clear that the standards for a substantially complete application apply not only to exemption applications on Form 1023 but others too, and to the notice requirement under section 508(a) as well as the 270 day period of section 7428(b)(2), and that although a substantially complete application may have been submitted, additional information may be necessary before a ruling or determination letter can be issued. An additional item is added to the list of information necessary for a substantially complete application form. Instances are listed in which a key District Director is not required to seek technical advice before proposing revocation of a National Office ruling or technical advice. Finally, section 14.01, dealing with revocation or modification of ruling or determination letters recognizing exemption, has been amended to make it clear that the determination of the effective date of revocation or modification is governed by the section 7805(b) relief procedures outlined in sections 14 and 17 of Rev. Proc. 83-36.

SEC. 3. GENERAL

.01 When used in this revenue procedure, the term "key District Director" means the District Director of one of the 10 key district offices for exempt organization matters.

.02 The term "determination letter" refers to a letter issued by a key District Director, or an Appeals Office in the case of an exemption application, in response to a written inquiry by an individual or an organization that applies to the particular facts involved, and to the principles and precedents previously announced by the National Office. This includes a letter issued on the basis of advice secured from the National Office pursuant to the procedures prescribed herein and in Rev. Proc. 80-26, 1980-1 C.B. 671. The term "ruling" refers to a letter issued by the National Office.

.03 The declaratory judgment provisions of section 7428 of the Code, with regard to this revenue procedure, apply to an actual controversy involving a determination by the Service or a failure by the Service to make a determination with respect to the initial or continuing qualification or classification of an organization under section 501(c)(3) (charitable, educational, etc.); 170(c)(2) (deductibility of contributions); 509(a) (private foundation status); or 4942(j)(3) (operating foundation status).

SEC. 4. FILING AND PROCESSING APPLICATIONS AND RECOGNITION OF EXEMPTIONS

An organization seeking recognition of exempt status under section 501 or 521 of the Code is required to file an application with the key District Director for the Internal Revenue District in which its principal place of business or principal office is located. The 10 key district offices that process the applications, the Internal Revenue districts covered by each, and the regional office designations are as follows:

Key District(s)	IRS Districts Covered
	CENTRAL REGION
Cincinnati	Cincinnati, Cleveland, Detroit, Indianapolis, Louisville, and Parkersburg
	MID-ATLANTIC REGION
Baltimore	Baltimore (which includes the District of Columbia and Office of International Operations); Pittsburgh, and Richmond
Newark	Newark, Philadelphia, and Wilmington
	MIDWEST REGION
Chicago	Aberdeen, Chicago, Des Moines, Fargo, Milwaukee, Omaha, St. Louis, St. Paul, and Springfield
	NORTH-ATLANTIC REGION
Brooklyn	Albany, Augusta, Boston, Brooklyn, Buffalo, Burlington, Hartford, Manhattan, Portsmouth, and Providence
	SOUTHEAST REGION
Atlanta	Atlanta, Birmingham, Columbia, Greensboro, Jackson, Jacksonville, and Nashville
	SOUTHWEST REGION
Dallas	Albuquerque, Austin, Cheyenne, Dallas, Denver, Houston, Little Rock, New Orleans, Oklahoma City, and Wichita
	WESTERN REGION
Los Angeles	Honolulu, Laguna Higuel, Los Angeles, and Phoenix
San Francisco	Reno, Salt Lake City, Sacramento, San Jose, and San Francisco
Seattle	Anchorage, Boise, Helena, Portland, and Seattle

SEC. 5. STANDARDS FOR ISSUING RULINGS OR DETERMINATION LETTERS WITH RESPECT TO EXEMPT STATUS

.01 A ruling or determination letter will be issued to an organization, provided its application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Any oral representation of additional facts or modification of facts as represented or alleged in the application for a ruling or determination letter must be reduced to writing over the signature of the taxpayer or authorized representative.

.02 Exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities; the anticipated sources of receipts; and the nature of contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued. In those cases where an organization is unable to describe fully its purposes and activities, a refusal to issue a ruling or determination letter will be considered an initial adverse determination from which administrative appeal or protest rights will be afforded.

.03 Where an application for recognition of exemption does not contain the required information, the application may be returned to the applicant without being considered on its merits with an appropriate letter of explanation. In the case of an application under section 501(c)(3) of the Code that is returned, the applicant will also be informed of the time within which the completed application must be resubmitted in order for the application to be considered as a timely notice within the meaning of section 508(a).

.04 A ruling or determination letter recognizing exemption will not ordinarily be issued if an issue involving the organization's exempt status under section 501 or 521 of the Code is pending in litigation or is under consideration within the Service.

.05 In the case of an application under section 501(c)(3) of the Code, the 270-day period referred to in section 7428(b)(2) will be considered by the Service to begin on the date a substantially completed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, is filed with or mailed to the appropriate key District Director. A substantially completed Form 1023 is one that:

1 is signed by an authorized individual;

2 includes an Employer Identification Number (EIN) or a completed Form SS-4, Application for Employer Identification Number;

3 includes information regarding previously filed federal income tax and exempt organization information returns;

4 includes a statement of receipts and expenditures and a balance sheet for the current year and the three preceding years (or the years the organization was in existence, if less than four years). If the organization has not yet commenced operations, or has not completed one accounting period, a proposed budget for two full accounting periods and a current statement of assets and liabilities will be acceptable;

5 includes a statement of proposed activities and a description of anticipated receipts and contemplated expenditures;

6 includes a copy of the organizing or enabling document that is signed by a principal officer or is accompanied by a written declaration signed by an officer authorized to sign for the organization certifying that the document is a complete and accurate copy of the original; and

7 if the organization is a corporation or unincorporated association and it has adopted by-laws, includes a copy that is signed or otherwise verified as current by an authorized officer.

.06 If a Form 1023 does not contain all of the items set out in section 5.05, it will not be further processed and may be returned to the applicant for completion. The 270-day period will not be considered as starting until the date the Form 1023 is refiled with or remailed to the Service with the requested information, or, if remailed and a postmark is not evident, on the date the Service receives a substantially completed Form 1023.

.07 The standards of section 5.05 for a substantially completed application form apply also to applications for recognition of exemption under other paragraphs of section 501(c) of the Code. They also apply to the notice requirement of section 508. Even though an application is considered substantially complete, more information may be required before a ruling or determination letter can be issued.

.08 If the application for recognition of exemption involves an issue where contrary authorities exist, failure to disclose and distinguish significant contrary authorities may result in requests for additional information, which will delay action on the application (see section 7.06 of Rev. Proc. 83-36).

SEC. 6. ISSUING RULINGS OR KEY DISTRICT DETERMINATION LETTERS WITH RESPECT TO EXEMPT STATUS

.01 Under the general procedures outlined in Rev. Proc. 83-36, key District Directors are authorized to issue determination letters involving applications for recognition of exemption under sections 501 and 521 of the Code.

.02 A key District Director will refer to the National Office those applications that present questions the answers to which are not specifically covered by statute or regulations, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. In addition, key District Directors will refer those applications that have been specifically reserved by revenue procedure and/or Internal Revenue Manual instructions for National Office handling for purposes of establishing uniformity or centralized control of designated categories of cases. The National Office will consider each such application, issue a ruling directly to the organization, and send a copy of the ruling to the key District Director.

.03 If at any time during the course of consideration of an exemption application the organization believes that its case involves an issue on which there is no published precedent or there is nonuniformity between districts, the organization should ask the key District Director to request technical advice from the National Office. See Rev. Proc. 80-26.

.04 If the key District Director proposes to recognize exemption of an organization to which the National Office had issued a previous contrary ruling or technical advice, the key District Director must seek technical advice from the National Office before issuing a determination letter. See Rev. Proc. 80-26.

SEC. 7. WITHDRAWAL OF APPLICATIONS

.01 The Applications for recognition of exemption under section 501 or 521 of the Code may be withdrawn, upon the written request of a principal officer or authorized representative of the organization, at any time prior to the issuance of the initial adverse ruling or determination letter. Even though the application is withdrawn, however, the application and all supporting documents will be retained by the Service and will not be returned to the organization.

.02 The Service will not consider the withdrawal of an application under section 501(c)(3) of the Code as either a failure to make a determination within the meaning of section 7428(a)(2) or as an exhaustion of administrative remedies within the meaning of section 7428(b)(2).

SEC. 8. NATIONAL OFFICE POST REVIEW OF DETERMINATION LETTERS

.01 Some determination letters issued by the key districts will be reviewed in the National Office by the Exempt Organizations Division, or the Corporation Tax Division (for cases under section 521 of the Code), to assure uniform application of the statutes or regulations, or rulings, opinions, or court decisions published in the Internal Revenue Bulletin.

.02 Where the National Office takes exception to a key district deter-

mination letter, the key District Director will be advised. If the organization disagrees with the exception taken, the file will be returned to the National Office. The referral will be treated as a request for technical advice and sections 6, 7, and 8 of Rev. Proc. 80-26 will be followed.

SEC. 9. PROTEST OF INITIAL ADVERSE RULING LETTERS

In the case of an initial adverse ruling letter from the National Office, the organization will be informed of the basis for the conclusion, of its right to file a protest within 30 days, and for a conference in the National Office. If a conference is requested, the conference procedures outlined in section 8 of Rev. Proc. 83-36, will be followed.

SEC. 10. APPEAL OF INITIAL ADVERSE DETERMINATION LETTERS

.01 Upon the issuance of an initial adverse determination letter or a letter proposing revocation or modification of exempt status, the key District Director will advise the organization of its right to appeal the determination by requesting Appeals Office consideration. To do this, the organization must submit to the key District Director within 30 days from the date of the letter, a statement of the facts, law, and arguments in support of its position. The organization must also state whether it wishes an Appeals office conference.

.02 Any determination letter issued on the basis of National Office technical advice may not be appealed to the Appeals Office on issues that were the subject of the technical advice.

.03 Upon receipt of an organization's request for Appeals office consideration, the key district will, if it maintains its position, forward the request and the case file to the Chief of the appropriate Appeals Office.

SEC. 11. CONSIDERATION AT THE APPEALS OFFICE

.01 The Appeals Office, after considering the organization's appeal and any additional information developed in conference, will advise the organization of its decision and issue the appropriate determination letter to the organization.

.02 Organizations should make full presentation of the facts, circumstances, and arguments at the initial level of consideration by the Appeals Office, since submission of additional facts, circumstances, and arguments may result in suspension of appeal procedures and referral of the case back to the key district for additional consideration. Any oral representation of additional facts or modification of facts originally represented or alleged must be reduced to writing.

.03 If the Appeals Office believes that an exemption or private foundation status issue is not covered by published precedent or that there is non-uniformity, the Appeals Office must request technical advice from the National Office. Unless the Appeals Office feels that the conclusions reached by the National Office should be reconsidered and promptly requests such consideration, the case will be disposed of by the Appeals Office on the basis of the decision in the technical advice memorandum. See Rev. Proc. 80-26.

.04 If at any time during the course of Appeals Office consideration, the organization believes that its case involves an issue on which there is no published precedent or there is non-uniformity between districts, the organization should ask the Appeals Office to request technical advice from the National Office. See Rev. Proc. 80-26.

.05 If the proposed disposition by the Appeals Office is contrary to a prior National Office technical advice or ruling concerning this organization, the proposed disposition will be submitted through the Office of the Regional Director of Appeals to the Assistant Commissioner (Employee Plans and Exempt Organizations), or, in a case under section 521 of the Code, to the Associate Chief Counsel (Technical). Unless the Appeals Office feels that the conclusions reached by the National Office should be reconsidered and promptly requests such consideration, the decision of the National Office will be followed by the Appeals Office. In any event, the Assistant Commissioner or the Associate Chief Counsel will make the final decision.

SEC. 12. EXHAUSTION OF ADMINISTRATIVE REMEDIES FOR DECLARATORY JUDGMENT PURPOSES

.01 Section 7428 of the Code, in part, requires that an organization seeking initial or continuing recognition of exemption under section 501(c)(3) must exhaust its administrative remedies by taking timely, reasonable steps to secure a determination prior to filing for declaratory judgment. Those steps and administrative remedies required to be exhausted within the Service are:

1 the filing of a substantially completed application Form 1023 pursuant to section 5.05 or the filing of a request for a determination of foundation status pursuant to Rev. Proc. 76-34;

2 in appropriate cases, requesting relief pursuant to section 1.9100 of the Income Tax Regulations regarding applications for extension of the time for making an election or application for relief from tax (see Rev. Proc. 79-63, 1979-2 C.B. 578);

3 the timely submission of all additional information requested by the Service to perfect an exemption application or request for determination of private foundation status; and

4 exhaustion of all administrative appeals available within the Service pursuant to sections 10 and 11 or protest of an initial adverse ruling pursuant to section 9 in National Office original jurisdiction exemption application cases.

.02 An organizaiton will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

1 the completion of the steps in section 12.01, and the sending by certified or registered mail of a notice of final determination; or

2 the expiration of the 270-day period described in section 7428(b)(2) of the Code in a case where the Service has not issued a notice of final determination and the organization has taken, in a timely manner, all reason-

able steps to secure a ruling or determination.

.03 The steps described in section 12.01 will not be considered completed until the Service has had a reasonable time to act upon the appeal or protest as the case may be.

.04 A notice of final determination to which section 7428 of the Code applies is a ruling or determination letter, sent by certified or registered mail, which holds that the organization is not described in section 501(c)(3) or 170(c)(2), is a private foundation as defined in section 509(a), is not a private operating foundation as defined in section 4942(j)(3), or is a public charity described in a part of section 509 or section 170(b)(1)(A) other than the part under which the organization requested classification.

SEC. 13. EFFECT OF RULINGS OR DETERMINATION LETTERS RECOGNIZING EXEMPTION

.01 A ruling or determination letter recognizing exemption is usually effective as of the date of formation of an organization if its purposes and activities during the period prior to the date of the ruling or determination letter were consistent with the requirements for exemption. However, for special rules regarding organizations formed after October 9, 1969, applying for recognition of exemption under section 501(c)(3) of the Code, see section 508(a) and Rev. Rul. 77-208, 1977-1 C.B. 153. If the organization is required to alter its activities or to make substantive amendments to its enabling instrument, the ruling or determination letter recognizing its exempt status will be effective as of the date specified therein. If a nonsubstantive amendment is made, exemption will ordinarily be recognized as of the date of formation. Examples of non-substantive amendments include correction of a clerical error in the enabling instrument or the addition of a dissolution clause where the activities of the organization prior to the ruling or determination are consistent with the requirements for exemption.

.02 A ruling or determination letter recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization.

SEC. 14. REVOCATION OR MODIFICATION OF RULINGS OR DETERMINATION LETTERS RECOGNIZING EXEMPTION

.01 A ruling or determination letter recognizing exemption may be revoked or modified by (1) a notice to the taxpayer to whom the ruling or determination letter originally was issued, (2) enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) issuance of temporary or final regulations, or (5) issuance of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin. The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which section 503 of the Code applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change. In cases where a ruling or determination letter was issued in error or is no longer in accord with the holding of the Service, when section 7805(b) relief is granted (see sections 14 and 17 of Rev. Proc. 83-36), retroactivity of the revocation or modification ordinarily will be limited to a date not earlier than that on which the original ruling or determination letter is modified or revoked.

.02 In the case of a revocation or modification, the appeal and conference procedures are the same as set out in sections 10 and 11, including the right of the organization to request that the key District Director or the Chief, Appeals Office, seek technical advice from the National Office. If the case involves a status issue on which the National Office had issued a previous contrary ruling or technical advice, the key District Director generally must seek technical advice from the National Office. The key District Director does not have to seek technical advice if the prior ruling or technical advice has been revoked by subsequent contrary published precedent or if the proposed revocation involves a subordinate unit of an organization that holds a group exemption letter issued by the National Office, the National Office ruling or technical advice was issued under the Internal Revenue Code of 1939 or prior revenue acts, or if the ruling was issued in response to Form 4653 Notification Concerning Foundation Status.

.03 The provisions of section 10 and 11 relating to appeal and conference rights before a final revocation notice is issued are not applicable to matters where delay would be prejudicial to the interests of the Internal Revenue Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government).

SEC. 15. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 80-25 is superseded. Sections 3.01, 3.04, 4.02, 6.02, 6.04, and 8.02 of Rev. Proc. 76-34 are modified.

SEC. 16. EFFECTIVE DATE

This revenue procedure is effective May 29, 1984, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 501, 508; 1.501(c)(3)-1, 1.508-1(a); 1.9100-1.)

Rev. Proc. 84-47

SECTION 1. PURPOSE

The purpose of the revenue procedure is to describe situations that involve the computation of the 15-

month period for notification under section 1.508-1(a)(2)(i) of the Income Tax Regulations where an organization makes nonsubstantive amendments to its governing instrument.

SEC. 2. BACKGROUND

01. Section 501(c)(3) of the Internal Revenue Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes. Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt. The organizational test is set forth in section 1.501(c)(3)-1(b).

02. Section 508(a) of the Code provides, with certain exceptions, that an organization organized after October 9, 1969, shall not be treated as an organization described in section 501(c)(3) unless, within the time prescribed in the regulations, it gives notice that it is applying for recognition of exempt status. Section 1.508-1(a)(2)(i) of the regulations provides that notice must be given 15 months from the end of the month in which the organization was organized. Notice is given by submitting a properly completed and executed Form 1023, Application for Recognition of Exemption, to the appropriate key District Director. Section 1.508-1(a)(2)(iii) provides that an organization shall be considered "organized" on the date it becomes an organization described in section 501(c)(3) (determined without regard to section 508(a)). Section 508(c) and section 1.508-1(a)(3) describe organizations such as churches, that are not subject to section 508(a) notice requirements.

.03 Section 13.01 of Rev. Proc. 84-46, page 541, this Bulletin, provides that a ruling or determination letter recognizing exemption is usually effective as of the date of formation of an organization of its purposes and activities during the period prior to the date of the ruling or determination letter were consistent with the requirements for exemption. If an organization is required to alter its activities or to make substantive amendments to its enabling instrument, the ruling or determination letter recognizing its exempt status will be effective as of the date the changes are made. It is the administrative practice of the Service to recognize exemption from the date of formation in situations where nonsubstantive amendments to an enabling document are subsequently made. For an example of a nonsubstantive change, see section 13.01, Rev. Proc. 84-46, page 541. Where only a nonsubstantive amendment is made, for purposes of the notice requirement of section 1.508-1(a)(2)(i), the organization will be considered organized, within the meaning of section 1.508-1(a)(2)(iii), on the date it is organized under appropriate state law. See Rev. Rul 75-290, 1975-2 C.B. 215.

SEC. 3. APPLICATION.

.01 The following examples illustrate the effective date for recognition of exemption under section 501(c)(3) of the Code where a nonsubstantive governing instrument amendment is made. To clarify its satisfaction of the organizational test, the applicant adds a specific dissolution clause to its governing instrument insuring preservation of its assets for charitable purposes. All examples assume that the organizations have otherwise complied with the requirements of section 501(c)(3) since their incorporation. All examples also assume that the organizations are not described in section 508(c).

1. An organization submits an application within 15 months from the end of the month in which it was organized. At the request of the Service, it makes a nonsubstantive amendment to its enabling instrument. Under these circumstances, the organization's exemption will be effective as of its date of incorporation because it filed notice within 15 months from the date it was deemed "organized" for section 501(c)(3) purposes.

2. An organization submits an application more than 15 months from the end of the month in which it was organized. The Service requests a nonsubstantive amendment to its enabling instrument and the amendment is made three months subsequent to the submission of an application for exemption. Under the circumstances, the organization will be recognized as exempt under section 501(c)(3) on the date it submitted its application, even though the amendatory action was completed later.

3. Two years after it was organized, an organization makes a nonsubstantive amendment to its enabling instrument. Within 15 months after the date of the amendment, the organization applies for exemption. Under these circumstances, the organization will be recognized as exempt effective as of the date it sent an application to the Service because it failed to file notice within 15 months from the end of the month in which it was organized under applicable state law.

02. The principles set forth in the three situations in 01. above are equally applicable to corporations, trusts, and unincorporated associations.

SEC. 4 EFFECT ON OTHER REVENUE PROCEDURES

Section 13.01 of Rev. Proc. 84-46 is amplified.

APPLICATIONS FOR EXTENSIONS OF THE TIME FOR FILING NOTICE UNDER SECTION 508(a)

The Service will give consideration to applying the Commissioner's discretionary authority under section 1.9100-1 of the regulations to extend the time for satisfying the notice requirement of section 508(a) of the Code.

Under section 1.9100-1 of the regulations the Commissioner has discretion, upon a showing of good cause by a taxpayer, to grant a reasonable extension of the time fixed by the regulations for making an election or application for relief in respect of tax under subtitle A of the Internal Revenue Code, provided:

(1) the time for making the election or application is not expressly prescribed by the statute;

(2) the request for the extension is filed with the Commissioner within a period of time the Commissioner considers reasonable under the circumstances; and

(3) it is shown to the Commissioner's satisfaction that granting the extension will not jeopardize the Government's interests.

Rev. Proc. 79-63, 1979-2 C.B. 578, sets forth information and representations that must be furnished by the taxpayer and some factors that will be taken into consideration in determin-

ing whether such extensions will be granted.

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26 CFR 601.201: Rulings and determination letters.
(Also Part 1, Sections 103, 103A, 7478; 1.103-1.)

Rev. Proc. 84-48

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to set forth procedures for the submission of requests for rulings to the Internal Revenue Service under sections 103 and 7478 of the Internal Revenue Code of 1954, and to update the procedures described in Rev. Proc. 79-4, 1979-1 C.B. 483. References in this Revenue Procedure to section 103 of the Code also refer to section 103A of the Code.

SEC. 2. BACKGROUND

.01 Section 7478 of the Code allows, under the conditions specified therein, the issuer (and only the issuer) of prospective obligations to petition the United States Tax Court for a declaratory judgment in a case of actual controversy involving a determination by the Service, or a failure by the Service, to make a determination, with respect to whether prospective obligations are described in section 103(a).

.02 The Tax Court may not issue a declaratory judgment or decree under section 7478 of the Code in any proceeding unless it determines that the issuer of the prospective obligations has exhausted all available administrative remedies within the Service.

.03 Any ruling request that is made by an issuer is subject to section 7478 of the Code and, accordingly, must be made in full compliance with this Revenue Procedure. Instructions for making a ruling request by parties other than the issuer of an obligation and for requesting rulings that do not address all possible tax issues under section 103 of the Code are set forth in Rev. Proc. 84-49.

SEC. 3. REQUESTS FOR RULINGS UNDER SECTION 103

.01 A request for a ruling under section 103 of the Code is to submitted and signed, under the penalty of perjury, 1) by an authorized officer of the issuer, or 2) in the case of a joint submission, by both an authorized officer of the issuer and a party with a material financial interest in the issuance of the governmental obligations.

.02 In those instances in which an authorized representative is retained, the request for a ruling must be submitted with powers of attorney that are properly executed and that are signed 1) by an authorized officer of the issuer, or 2) in the case of a joint submission, by both an authorized officer of the issuer and a party with a material financial interest in the issuance of the governmental obligations.

.03 Each request for a ruling must contain a complete and detailed statement of all facts relating to the prospective obligations, and must comply with the requirements of Revenue Procedure 84-1, page 342, this Bulletin, to the extent that Rev. Proc. 84-1 is not inconsistent with this Revenue Procedure. Each request for a ruling must be submitted in duplicate and must be accompanied by two copies of all relevant documents, including copies of state statutes, bond resolutions, bond indentures, leases, management contracts, output contracts and other agreements. However, relevant facts reflected in the documents submitted must be included in the body of the ruling request and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues specifying pertinent provisions. In addition, in order to assist the Internal Revenue Service in making the deletions required by section 6110(c) of the Code, each request for a ruling must be accompanied by a deletion statement submitted in accordance with section 601.201 of the Statement of Procedural Rules (26 CFR Part 601).

.04 Each request for a ruling must contain a statement of all reasons and legal authority that are pertinent in determining whether prospective obligations are described in section 103(a) of the Code. Thus, for example, a request for a ruling that interest on prospective obligations to provide an airport facility will be excludable from gross income under section 103(a) must contain a statement of facts, reasons, and legal authority that will enable the Service to determine whether the prospective obligations will be 1) issued by or on behalf of a state or local governmental unit, 2) industrial development bonds within the meaning of section 103(b)(2), 3) obligations which are issued as part of an issue substantially all of the proceeds of which will be used to provide facilities described in section 103(b)(4)(D), 4) obligations not held by persons described in section 103(b)(13), 5) in compliance with the maturity requirements of section 103(b)(14), 6) obligations that are not arbitrage bonds within the meaning of section 103(c)(2), 7) in registered form within the meaning of section 103(j), and 8) in compliance with the public approval requirements of section 103(k) and the information reporting requirement of section 103(l).

SEC. 4. ISSUING RULING LETTERS

.01 The 180-day period referred to in section 7478(b)(2) of the Code will be considered by the Service to begin on the date that a ruling request that complies with section 3 of this Revenue Procedure is received by the National Office of the Internal Revenue Service. Upon receipt of a request for a ruling, the Service will send a written acknowledgment to the requester. If a request for a ruling does not comply with all the requirements of section 3, it will not be processed further and the requester will be sent a letter that will point out the requirements that have not been met. The 180-day period will not be considered as starting until the date an amended request for ruling containing the additional information requested by the Service is received by the National Office of the Internal Revenue Service.

.02 Although the Service may initially determine that a request for a ruling complies with section 3 of this Revenue Procedure, and thus begin the 180-day period described above, the Service may, nevertheless, request additional information in support of a request for ruling. A failure to

timely submit additional information requested by the Service will be considered a failure to exhaust administrative remedies within the meaning of section 7478(b)(2) of the Code. Additional information or statements of legal authority will be considered timely submitted to the National Office of the Internal Revenue Service if the letter containing such information is sent within 30 days after the date the additional information is requested. The additional information or statements of legal authority must be signed and submitted in the manner set forth in section 3.01 of this Revenue Procedure.

.03 Any oral representation of additional facts or modification of the facts as represented or alleged in the request for ruling must be confirmed by letter to the National Office of the Internal Revenue Service under the penalty of perjury, within 7 days after the oral representation or modification, by the issuer, and in the case of a joint submission, by a party with a material financial interest and the issuer. Failure to submit a written statement of the oral representation of additional facts or modification of the facts within the time set forth in this subsection will be considered a failure to exhaust administrative remedies within the meaning of section 7478(b)(2) of the Code.

.04 Requests for rulings and additional correspondence or documents (including withdrawals of requests for rulings) submitted with respect to request for rulings will be considered to be sent to the National Office of the Interal Revenue Service if addressed to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, - SECTION 103 REQUEST, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

SEC. 5. WITHDRAWAL OF REQUESTS FOR RULINGS

.01 All withdrawals of requests for rulings must be sent in writing to the National Office of the Internal Revenue Service by the issuer or its authorized representative. A withdrawal will not be considered by the Service as a failure to make a determination within the meaning of section 7478(a)(2) of the Code or as an exhaustion of administrative remedies wihtin the meaning of section 7478(b)(2).

SEC. 6. EXHAUSTION OF ADMINISTRATIVE REMEDIES

.01 Section 7478 of the Code requires that an issuer must exhaust its administrative remedies by taking, in a timely manner, all reasonable steps to secure a determination. Those steps and administrative remedies required to be exhausted within the Service are:

1 The filing of a request for ruling that complies with section 3 of this Revenue Procedure; and

2 The timely submission, in writing, of all additional information of representation of additional facts or modification of facts requested by the Service to process a request for ruling.

.02 An issuer will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

1 The date that the Internal Revenue Service sends by certified or registered mail notice of an unfavorable determination that the prospective obligations are not described in section 103(a) of the Code; or

2 The expiration of the 180-day period described in section 7478(b)(2) of the Code, in a case in which the Service has not made a determination whether the prospective obligations are described in section 103(a), and the issuer has completed the steps in section 6.01 of this Revenue Procedure.

SEC. 7. NOTICE OF DETERMINATION

.01 A notice of determination to which section 7478 of the Code applies is an unfavorable ruling letter, sent by certified or registered mail, which holds that prospective obligations are not described in section 103(a) of the Code.

SEC. 8. INQUIRIES

.01 Inquiries with respect to this Revenue Procedure should refer to its number and should be addressed to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, 1111 Constitution Avenue, N.W., Washington, DC 20024.

SEC. 9. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supplements Rev. Proc. 84-1, and supersedes Rev. Proc. 79-4.

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26 CFR 601.201: Rulings and determination letters.
(Also Part 1, Sections 103, 103A, 7478; 1.103-1.)

Rev. Proc. 84-49

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to set forth the procedures for submission of requests for rulings to the Internal Revenue Service where section 103 of the Internal Revenue Code 1954 applies, in those instances where the requester of the ruling is other than the issuer of the prospective obligation, or in those instances where the issuer of an outstanding obligation makes a ruling request with respect to that obligation. See Rev. Proc. 84-48, for the procedures where the issuer of a prospective bond issue requests a ruling from the Service. References in this Revenue Procedure to section 103 of the Code also refer to section 103A of the Code.

SEC. 2. BACKGROUND

.01 Section 103(a) of the Code provides that gross income does not include interest on 1) the obligations of a state or political subdivision thereof, and 2) qualified scholarship funding bonds. Section 7478 allows the issuer of prospective obligations to petition the United States Tax Court for a declaratory judgment in a case of actual controversy involving a determination by the Service, or a failure by the Service to make a determination, with respect to whether prospective obligations are described in section 103(a). The Tax Court may not issue a declaratory judgment or decree under section 7478 in any proceeding unless it determines that the

issuer of the prospective obligations has exhausted all available administrative remedies within the Service. After obligations have been issued, the issuer is no longer eligible to petition the Tax Court for a declaratory judgment under section 7478 of the Code. The issuer may seek a ruling under this Revenue Procedure. See section 3.04, below.

.02 Historically, the Service has issued rulings under section 103 of the Code to an issuer of governmental obligations (issuer) and other parties with a material financial interest in the issuance. In addition, it has been the practice of the Service to issue rulings, in its discretion, that address only certain issues pertaining to whether an obligation is described in section 103(a). In the case of a ruling request that addressed only certain issues, the request would contain a statement of facts, reasons, and legal authority, together with supporting documents, that would discuss only the issue raised by the person requesting the ruling and would not address other issues pertaining to whether the obligations were described in section 103(a). In response to such requests, the Service might issue a ruling in which it would determine, for example, that a dock financed by governmental obligations was a facility described in section 103(b)(4)(D), but would not express an opinion with respect to whether the prospective obligations were otherwise described in section 103(a).

.03 However, to comply with the provisions of section 7478 of the Code, the Service has set forth procedures in Rev. Proc. 84-48 that preclude the issuance of a ruling to an issuer of prospective obligations (or to an issuer and another party in a joint submission) unless the issuer has submitted a statement of facts, reasons, and legal authority, together with supporting documents, that addresses all issues pertaining to whether the prospective obligations are described in section 103(a). See section 3.04 of Rev. Proc. 84-48. The reason for the requirements set forth in Rev. Proc. 84-48 is that, under section 7478, the issuer (and only the issuer) of the prospective obligations may ultimately petition the United States Tax Court to determine whether the prospective obligations are described in section 103(a). See section 2.01 of Rev. Proc. 84-48. Because that determination involves an examination of all issues pertaining to the status of the prospective obligations, the Service must in the ruling process examine and address all issues pertaining to whether the prospective obligations are described in section 103(a) to assure that the issuer has exhausted its administrative remedies.

.04 In the case of requests for rulings made by a person, other than the issuer, with a material financial interest in the issuance of governmental obligations, the Service will issue rulings whether such obligations are arbitrage bonds as defined in section 103(c)(2) of the Code in situations referred to in Rev. Proc. 84-50. Thus, for example, a party that has a material financial interest in the issue may request a ruling that a single computation of yield may be made pursuant to section 1.103-13(c)(1)(ii) of the regulations.

SEC. 3. APPLICATION

.01 In the case of requests for rulings made by a person other than the issuer, to which neither section 3.02 of Rev. Proc. 84-48 (joint submission) nor section 3.04 of this Revenue Procedure (requester subsequently joined by issuer) applies, the Service will continue to issue rulings that address a specific issue pertaining to whether the prospective obligations are described in section 103(a) of the Code. The Service also will issue rulings to these requesters that the prospective obligations are described in section 103(a). The requester must comply with the requirements of any other applicable Revenue Procedures, other than Rev. Proc. 84-48, that relate to submission to the Service of requests for ruling.

.02 In the case of requests for rulings by a person other than the issuer, the failure of the Service to issue a ruling or the issuance of an adverse ruling will not be considered by the Service as either a failure to make a determination within the meaning of section 7478(a)(2) of the Code or an exhaustion of administrative remedies by the issuer within the meaning of section 7478(b)(2).

.03 If, subsequent to the date a person other than the issuer requests a ruling, the issuer of the prospective obligations joins in the request, the Service will treat the request as a joint submission by the issuer and the original requester and the requirements set forth in Rev. Proc. 84-48 must be satisfied. The Service will notify in writing the joint requester of any additional information or documents required. In the case of requests for rulings that are subject to the provisions of this subsection, the 180-day period referred to in section 7478(b)(2) of the Code will be considered to begin on the later of the date the issuer joins in the request or the date set forth in section 4.01 of Rev. Proc. 84-48.

.04 In the case of requests for rulings made by an issuer after the issuance of the governmental obligation, the Service will continue to issue rulings that address one or more tax questions pertaining to whether the outstanding obligation is described in section 103(a) of the Code. The issuer requesting a ruling must comply with the requirements of any other Revenue Procedure, other than Rev. Proc. 84-48, that relate to the submission to the Service of requests for a ruling. If interest has been paid on the obligation, the Service will determine whether the subject of the request should be processed as a ruling request in the National Office or should be referred to the district director having jurisdiction over the matter.

SEC. 4. INQUIRIES

.01 Inquiries with respect to this Revenue Procedure should refer to its number and should be addressed to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:IND:S, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 5. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes Rev. Proc. 79-12.

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 103; 1.103-13.)

Rev. Proc. 84-50

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth procedures for the submission of requests to the Internal Revenue Service for a ruling to which section 103(c) of the Internal Revenue Code and sections 1.103-13, 1.103-14, and 1.103-15 of the Income Tax Regulations apply, in those instances in which the requester of the ruling is other than the issuer of the prospective obligations.

SEC. 2. BACKGROUND

.01 Section 103(a) of the Code provides that gross income does not include interest on 1) the obligations of a state or political subdivision thereof, and 2) qualified scholarship funding bonds. Section 103(c)(1) provides that, with certain exceptions, any arbitrage bond will not be treated as an obligation described in section 103(a)(1) or (2). An arbitrage bond is any obligation that is part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used to acquire securities that will produce a yield over the term of the issue that is materially higher than the yield on such issue.

.02 Sections 1.103-13, 1.103-14, and 1.103-15 of the regulations provide rules relating to whether bonds are arbitrage bonds as defined in section 103(c)(2) of the Code. Certain provisions of those regulations describe conditions under which an issuer of prospective obligations must obtain a ruling that such obligations will not be arbitrage bonds if certain actions proposed by the issuer are taken. For example, section 1.103-13(c)(1)(ii), relating to computation of yield, provides that in the case of governmental obligations, the computation must be made separately for each issue of obligations issued by a governmental unit, except that a single computation may be made for two or more issues if, before the issuance of the last issue, the issuer establishes to the satisfaction of the Commissioner that the single computation will not distort yield or otherwise tend to defeat the purposes of section 103(c).

There are also other situations, in addition to the example described above, under which an issuer must request a ruling pursuant to provisions of sections 1.103-13, 1.103-14 and 1.103-15 of the regulations that prospective obligations are not arbitrage bonds as defined in section 103(c)(2) of the Code.

.03 Rev. Proc. 84-48, sets forth procedures that preclude the issuance of a ruling to an issuer of prospective obligations unless the issuer has submitted a statement of facts, reasons, and legal authority, together with supporting documents that address all issues pertaining to whether the prospective obligations are described in section 103(a) of the Code. The reason for the requirements set forth in Rev. Proc. 84-48 is that, under section 7478, the issuer (and only the issuer) of the prospective obligations may ultimately petition the United States Tax Court to determine whether the prospective obligations are described in section 103(a).

.04 Rev. Proc. 84-49 compliments Rev. Proc. 84-48 and sets forth the procedures for submitting requests for ruling to which section 103 of the Code applies in those instances in which the requester is other than the issuer of the prospective obligations. Rev. Proc. 84-49 permits parties with a material financial interest in the prospective obligations to obtain rulings that address a specific issue pertaining to whether the prospective obligations are described in section 103(a). The Service also will issue rulings to such requesters that the prospective obligations are described in section 103(a).

SEC. 3. APPLICATION

.01 In the case of requests for rulings made by a person, other than the issuer, with a material financial interest in the issuance of governmental obligations, the Service will issue rulings whether such obligations are arbitrage bonds as defined in section 103(c)(2) of the Code in situations referred to in section 2.02 of this revenue procedure. Thus, for example, a party with a material financial interest in the issue may request a ruling that a single computation of yield may be made pursuant to section 1.103-13(c)(1)(ii) of the regulations. Such requests will be processed under Rev. Proc. 84-49 rather than Rev. Proc. 84-48.

.02 The requester must comply with the requirements of any other applicable revenue procedures, other than Rev. Proc. 84-48, that relate to the submission to the Service of requests for a ruling.

SEC. 4. INQUIRIES

Inquiries with respect to this revenue procedure should refer to its number and should be addressed to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention: CC:IND:S, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 5. EFFECT ON OTHER DOCUMENTS

This Revenue Procedure supersedes Rev. Proc. 80-1.

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26 CFR 145.1-7: Credit or refund in respect of floor stocks of tires, inner tubes, and tread rubber.

Rev. Proc. 84-51 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide an alternative method of determining the inventory of tires and inner tubes that were held by a dealer on January 1, 1984 for sale on, or in connection with, other articles sold by the dealer, and that qualify for a floor stocks refund of manufacturers excise tax.

SEC. 2. BACKGROUND

.01 Public Law No. 97-424 provided for the repeal of manufacturers excise taxes on the sale of highway-type tires weighing 40 pounds or less, non-highway tires, inner tubes, tread rubber and laminated tires, effective January 1, 1984. A manufacturer,

[1] Also released in News Release IR-84-66, dated June 5, 1984.

producer, or importer who paid the manufacturers tax imposed under section 4071(a) or (b) of the Internal Revenue Code with respect to tires, inner tubes, and tread rubber that were taxable before January 1, 1984 but not on or after that date, and which were held by a dealer as floor stocks on that date, is entitled to a credit or refund of that tax to the extent provided by, and subject to the conditions of, sections 522(a) and 523(b) of the Highway Revenue Act of 1982 and sections 145.1-1 and 145.1-7 of the Temporary Excise Tax Regulations.

.02 In general, a credit or refund is available if the manufacturer files a claim before October 1, 1984 and, in support of the claim, can show that it is based on requests received from dealers before July 1, 1984 and that the manufacturer has either reimbursed the dealers in the amount of the claim or has received from the dealers written consents to the allowance of the refund or credit.

.03 Section 145.1-1 of the regulations provides specific requirements to be met by dealers requesting reimbursement and manufacturers filing claims for refund. One requirement, in section 145.1-1(c)(3), is that the dealer's request be supported by an inventory statement signed by the dealer or by the dealer's authorized representative. The statement shall declare it is made under penalties of perjury and shall set forth the following information:

(i) The name and address of the dealer and of the claimant (except, if unknown to the dealer, the name and address of the claimant may be inserted by any person in the chain of distribution);

(ii) The identification numbers of the articles, such as their serial, stock, model, type, or class numbers, or some other suitable means of identification;

(iii) A brief description of the articles, such as their common names or designations;

(iv) The quantities of the articles held by the dealer as floor stocks;

(v) The gross vehicle weight rating of the vehicle, if applicable, unless such rating is indicated in the serial number of the article as shown on the inventory statement;

(vi) The employer identification number of the dealer;

(vii) A statement that no other request with respect to any article included in such inventory statement has been made; and

(viii) Such other information or computations as requested by the manufacturer.

The dealer may submit this request either directly to the claimant or through another dealer in the chain of distribution. Where a dealer addresses the request to the person whom, from markings on the article, the dealer presumes to be the claimant, the request may be treated as made to the actual claimant if the actual claimant accepts the dealer's request.

.04 Under section 145.1-7 of the regulations the term "dealer" includes a wholesaler, jobber, distributor, or retailer of vehicles who holds tires, inner tubes, or tread rubber for sale on, or in connection with, other articles sold by the retailer.

SEC. 3. PROCEDURE

.01 In the case of original equipment tires and inner tubes held for sale on January 1, 1984 on, or in connection with, a vehicle in a vehicle dealer's inventory, the vehicle dealer may submit the claim and supporting statements through the vehicle manufacturer to the tire manufacturer. As an alternative method of determining the inventory information required by the temporary regulations with respect to such original equipment tires and inner tubes, the vehicle dealer, with the consent of the vehicle manufacturer and the tire manufacturer, may submit, in lieu of an inventory of tires, a certified inventory of new vehicles held for sale on January 1, 1984.

.02 The vehicle manufacturer receiving the request will then determine the number and size of original equipment tires and inner tubes attributable to the dealer's new vehicle inventory. If the vehicle manufacturer purchased tires and inner tubes from more than one manufacturer, the vehicle manufacturer may apportion the tire inventory among those manufacturers in proportion to its purchases of each size and type of tire or inner tube from each tire manufacturer during the most recent four consecutive quarter or twelve consecutive month period ending before January 1, 1984 for which it has records available.

.03 Also, the vehicle manufacturer, with the consent of the tire manufacturer, may act as the tire manufacturer's agent for receipt of requests for reimbursement and may consolidate the requests and apportioned inventory statements for forwarding to the tire manufacturer.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective January 1, 1984.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 84-52

SECTION 1. BACKGROUND

Rev. Proc. 84-22, page 449, this Bulletin, contains in section 4 a list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which rulings or determination letters will not ordinarily be issued.

SEC. 2. PROCEDURE

Rev. Proc. 84-22 is modified by deleting from section 4.01 the following subsection:

12 Sections 304 and 357.—Redemption Through Use of Related Corporations; Assumption of Liability.—A transaction similar to that described in Rev. Rul. 80-240, 1980-2 C.B. 116, holding that sections 304(a)(1) and 357(a) of the Code are inapplicable because there was no assumption of liability, unless the taxpayer can satisfy the Internal Revenue Service that the liability was incurred by the taxpayer as a mere intermediary agent for the newly created corporate transferee. To establish this, the taxpayer must submit to the Internal Revenue Service documented evidence, composed at the time the liability was incurred, which indicates

that the unrelated lender had agreed to release the transferor-borrower from any and all obligation on the liability in favor of the corporate transferee. Further, the taxpayer must show, or represent to the Internal Revenue Service that the transfer and assumption actually occurred, or will actually occur within 12 months of the date the debt was incurred.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests dealing with transactions governed by section 304(b)(3) of the Code as enacted by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) (i.e., in general it will apply to transfers occuring after August 31, 1982, in taxable years ending after such date). The Service, will continue its present ruling policy on transactions described in section 4.0112 of Rev. Proc. 84-22 that are not governed by section 304(b)(3) as enacted by TEFRA.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 84-22 is modified.

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER H, PART 601—STATEMENT OF PROCEDURAL RULES

Miscellaneous Amendments

AGENCY: Internal Revenue Service; Treasury.

ACTION: Correction.

SUMMARY: This document contains a correction to the FEDERAL REGISTER publication beginning at 48 F.R. 15623 which set forth miscellaneous amendments to the statement of procedural rules, Part 601 of Title 26 of the Code of Federal Regulations.

EFFECTIVE DATE; The amendments that are the subject of this correction were effective April 12, 1983. The correction is effective on the same date.

FOR FURTHER INFORMATION CONTACT: Michel A. Dazé of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attn: CC:LR:T. Telephone 202-566-3458 (not a toll-free number.)

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 12, 1983, the FEDERAL REGISTER published miscellaneous amendments to the statement of procedural rules (48 F.R. 15623) [1983-1 C.B. 799]. The amendments were issued under the authority contained in 5 U.S.C. 301 and 552.

NEED FOR A CORRECTION

Subparagraph 1 of paragraph 4 of the miscellaneous amendments revised paragraph (d)(5) of §601.702. However, the revised text of paragraph (d)(5) incorrectly omitted the final sentence of that revised paragraph.

CORRECTION OF PUBLICATION

Accordingly, the publication of the miscellaneous amendments to the statement of procedural rules that was the subject of FR Doc. 83-9620 is corrected by adding to the end of the revised text of paragraph (d)(5) of §601.702 the sentence, "Information will not be disclosed, however, concerning any trade secrets, processes, operations, style of work, or apparatus, or confidential data or any other matter within the prohibition of 18 U.S.C. 1905."

GEORGE H. JELLY,
Director, Legislation and Regulations Division.

(Filed by the Office of the Federal Register on March 29, 1984, 8:45 a.m., and published in the issue of the Federal Register for March 30, 1984, 49 F.R. 12702)

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER H, PART 601—STATEMENT OF PROCEDURAL RULES

MISCELLANEOUS AMENDMENTS

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of Statement of Procedural Rules.

SUMMARY: This document contains miscellaneous amendments to the Statement of Procedural Rules (SPR). The SPR sets forth the procedural rules of the Internal Revenue Service for all taxes administered by the Service as well as certain rules that apply to the Bureau of Alcohol, Tobacco and Firearms. These amendments update the SPR and make certain changes in the Service's procedure.

DATE: The amendments are effective May 9, 1984.

FOR FURTHER INFORMATION CONTACT: Duane H. Pellervo of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3458, not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the SPR (26 CFR Part 601). The amendments are issued under the authority contained in 5 U.S.C. 301 and 552.

These amendments will be described in order of the sections of the SPR being amended.

SECTION 601.105(c)(2)(i): FIELD EXAMINATION

Procedures for reviewing unagreed field examination case files have been revised to eliminate, in some cases, mandatory technical review before the examination report and 30 day letter are sent to the taxpayer. In all cases, however, Centralized Services will perform a computational and procedural review before the report is sent to the taxpayer. The amendment conforms the SPR to this procedure.

SECTION 601.401(a)(3): EMPLOYMENT TAXES; COLLECTION METHODS

This amendment adds a cross-reference to Rev. Proc. 81-48, 1981-2 C.B. 623, which provides guidance in calculating an employee's wages when the employee tax under chapter 21 of the Code is paid by the employer without deducting that amount from the employee's pay. The revenue procedure reflects an amendment made by section 1141 of the Omnibus Reconciliation Act of 1980 [Pub. L. 96-499, 1980-2 C.B. 509], under which employee FICA taxes paid by the employer without deduction from pay are included in wages unless the wages are paid for domestic service or agricultural labor. See I.R.C. §3121(a)(6)(A) and 3306(b)(6)(A).

SECTION 601.502(b)(1)(iv) AND RELATED PROVISIONS: RECOGNITION OF ENROLLED ACTUARIES TO PRACTICE

Several amendments have been made to conform the SPR to Treasury Department Circular No. 230, 31 CFR §10.3(d), which provides that enrolled actuaries may practice before the Internal Revenue Service if they meet certain requirements. Such practice is limited to matters relating to specifically enumerated statutory provisions. A new subdivision is added to section 601.502(b)(1), and conforming amendments are made to sections 601.502(b)(5), 601.503(a) and (c), and 601.504(d)(2) and (e).

SECTION 601.502(b)(4): EMPLOYEES OF PERSONS RECOGNIZED TO PRACTICE

This section is amended to remove the inference that employees of persons recognized to practice can only receive from the Internal Revenue Service "information as to the status of tax cases." As amended, the section provides that "returns or return information" will be made available to the employee if the employer specifically designates the employee to receive such material, regardless of whether such material relates "to the status of tax cases." Language is also added to emphasize that the power of attorney or tax information authorization, if appropriate, must provide the representative with sufficient authority to designate the employee. Under an amendment to section 601.504(a) contained herein, a completed Form 2848 or general power of attorney is sufficient for this purpose, even absent specific authorization. A tax information authorization, however, must specifically authorize such a delegation.

SECTION 601.502(c)(1): REQUIREMENT OF POWER OF ATTORNEY

Two amendments have been made to conform the SPR to Form 2848 and the Instructions for Form 2848. Section 601.502(c)(1)(ii), which provides that a representative cannot execute a waiver of restriction on assessment or collection of a deficiency in tax without a power of attorney, is broadened to include offers of waiver. In addition, the requirement that authorized acts be specified in the power of attorney is deleted with respect to most of the functions for which a power of attorney is required, provided that Form 2848 or a general power of attorney employing similar authorizing language is used. (Form 2848 authorizes the attorney-in-fact "to perform any and all acts the principal(s) can perform" respecting the specified tax matters.) Specific authority is still required, however, in order to receive refund checks and sign returns. If the taxpayer wishes to prohibit the representative from performing any acts, including those for which a power of attorney is required, language to that effect should be included in the power of attorney.

SECTION 601.502(c)(2)(ii): REQUIREMENT OF A TAX INFORMATION AUTHORIZATION

Section 601.502(c)(2)(ii) is clarified by providing that a tax information authorization is not required if the representative has already filed a power of attorney in the matter which is "sufficient to permit the performance of" one or more acts for which a power of attorney is required. Prior to amendment, the section referred to a power of attorney filed by the representative "in order to perform" such acts.

SECTION 601.504(a): FORMAL REQUIREMENTS FOR POWERS OF ATTORNEY AND TAX INFORMATION AUTHORIZATIONS

Several clarifying and conforming amendments are made to this section. The requirement that tax matters to which the representative's authority extends must be specified is clarified by enumerating the specific information that must be included in the power of attorney or tax information authorization. In addition, the SPR is conformed to Form 2848 by providing that the power of attorney need not specify the acts the representative is authorized to perform. A completed Form 2848 or general power of attorney authorizing the representative to perform any and all acts the taxpayer can perform is sufficient, except that specific authority is still required in order to receive refund checks and sign returns. In accord with this amendment, the provision on substitution of representatives or delegation of authority to other representatives is revised to eliminate the requirement that such acts must be specifically authorized in the power of attorney. Such authority cannot be granted through a tax information authorization, however, unless specified therein. Since the provision stating that the power of attorney need not include the names of representatives who may be substituted (or to whom authority may be delegated) is unnecessary, it has been removed.

SECTION 601.506(a): NOTICES GIVEN RECOGNIZED REPRESENTATIVES

This section is amended by deleting the rule that notices and communications containing confidential information cannot be given to the taxpayer's representative unless the power of attorney or tax information authorization specifically authorizes the representative to receive such notices and communications. New language is added to provide that notices

will be sent to the representative first named on the power of attorney or tax information authorization if the taxpayer does not designate a representative to receive notices.

SECTION 601.702(f)(9): PREPAYMENT OF FEES

This amendment provides that the Revenue Service will require prepayment of search or duplication fees if previous fees have not been paid. In addition, payment of the previous fees may be required before new requests are honored. Generally, these rules apply if the person on behalf of whom a current request is made is the person on behalf of whom the prior request was made. With respect to both the current and prior requests, such person is deemed to be the person in whose name the request is (or was) made unless the request clearly indicates (or identified) another person as the principal.

EXECUTIVE ORDER 12291; PAPERWORK REDUCTION ACT OF 1980

The Commissioner of Internal Revenue has determined that this rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. The reporting requirement contained in §601.502(b)(1)(iv), as added by this document, has been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. The reporting requirement has been approved by OMB.

DRAFTING INFORMATION

The principal author of these amendments to the Statement of Procedural Rules is Duane H. Pellervo of the Legislation and Regulations, Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service participated in developing the amendments both on matters of substance and style.

* * * * *

Adoption of Amendments to Statement of Procedural Rules

Accordingly, 26 CFR Part 601 is amended as follows:

Paragraph 1. Section 601.105 is amended by removing the words "Review Staff" in paragraph (c)(2)(i) and by adding in their place the words "Centralized Services and, in some cases, Quality Review function".

Par. 2. Paragraph (a)(3) of §601.401 is revised by adding a new sentence after the second sentence, to read as set forth below.

§601.401 Employment taxes.

(a) *General.* ***

(3) *** Rev. Proc. 81-48, 1981-2 C.B. 623, provides guidelines for determining wages when the employer pays the employee tax imposed by chapter 21 without deducting the amount from the employee's pay. ***

* * * * *

Par. 3. Section 601.502 is revised as follows:

1. Paragraph (b)(1) is revised by removing "and" from the end of paragraph (b)(1)(iii), by adding a new paragraph (b)(iv) to read as set forth below, and by redesignating current paragraph (b)(1)(iv) as paragraph (b)(1)(v).

2. Paragraph (b)(1) is amended by adding, immediately before the sentence that follows the sentence redesignated by this document as paragraph (b)(1)(v), the following sentence: "The reporting requirement in §601.502(b)(1)(iv) has been assigned OMB Control Number 1545-0150."

3. Paragraph (b)(4) is amended by removing from the first sentence the words "information as to the status of tax cases" and by adding in their place the words "returns or return information (as defined in section 6103(b)(1) and (2))".

4. Paragraph (b)(4) is amended by removing from the second sentence the words "information as to the status of tax cases" and by adding in their place the words "such information".

5. Paragraph (b)(4) is revised by adding a new sentence to the end thereof, to read as set forth below.

6. Paragraph (b)(5) is amended by removing the words "or enrolled agent" in the first sentence and by adding in their place the words "enrolled agent, or enrolled actuary".

7. Paragraph (c)(1)(ii) is amended to read as set forth below.

8. Paragraph (c)(1) is revised by removing the sentence immediately following the sentence designated as paragraph (c)(1)(iv), and by adding in place of such sentence three new sentences, to read as set forth below.

9. Paragraph (c)(2)(ii) is amended by removing the words "in order to perform" and by adding in their place the words "which is sufficient to permit the performance of", and by adding a comma after the word "paragraph".

§601.502 Requirements for conference—recognition to practice and, in certain cases, power of attorney or tax information authorization.

* * * * *

(b) *Requirements to be met by taxpayer's representative in order to be recognized*—(1) ***

(iv) Subject to the limitations on authority to practice in §10.3(d)(1) of Circular No. 230, any individual who is enrolled as an actuary by the Joint Board for the Enrollment of Actuaries pursuant to 29 U.S.C. §1242, and who is not currently under suspension or disbarment from practice before the Revenue Service, and who files with the Revenue Service a written declaration that he or she is so currently qualified and is authorized to represent the particular party on whose behalf he or she acts; and

* * * * *

(4) *** The power of attorney or tax information authorization must provide the representative with sufficient authority to designate such employee.

* * * * *

(c) *Requirement of a power of attorney or a tax information authorization*—(1) ***

(ii) Execution of a waiver or offer of a waiver of restriction on assessment or collection of a deficiency in tax, or a waiver of notice of disallowance of a claim for credit or refund.

* * * * *

(iv) ***

Form 2848 or a general power of attorney given to a representative by a taxpayer, granting to the representative power to perform any and all acts that the taxpayer can perform, will meet the requirements for a power of attorney with respect to the acts specified in subdivisions (ii), (iii), and (iv) of this paragraph (c)(1). The right to receive refund checks and sign returns, however, must be specifically granted in Form 2848 or a general power of attorney. If the taxpayer wishes to exclude granting authority to perform any specific acts (including acts for which a power of attorney is required by this paragraph (c)), language excluding such acts should be inserted in the power of attorney. ***

* * * * *

Par. 4. Section 601.503 is amended as follows:

1. The third sentence of paragraph (a) is amended by removing the words "or an enrolled agent" and by adding in their place the words "an enrolled agent, or an enrolled actuary," and by removing the words "paragraph (b)(1)(i) and (ii), and (iii)" and by adding in their place the words "paragraph (b)(1)(i), (ii), (iii), and (iv)".

2. Paragraph (c) is amended by removing the words "or enrolled agent" and by adding in their place the words "enrolled agent, or enrolled actuary" and by removing the words "or (iii)" and by adding in their place the words "(iii), or (iv)".

Par. 5. Section 601.504 is revised as follows:

1. So much of paragraph (a) as precedes the sixth sentence is revised to read as set forth below.

2. Paragraph (d)(2) is amended by removing the words "or (iii)" and by adding in their place the words "(iii), or (iv)".

3. Paragraph (e) is amended by removing the words "or (iii)" and by adding in their place the words "(iii), or (iv)".

§601.504 Requirement for execution, attestation, acknowledgement or witnessing, and certification of copies of power of attorney and tax information authorization.

(a) *Formal requirements.* The use of technical language in the preparation of a power of attorney or a tax information authorization is not necessary, but the instrument should clearly express the taxpayer's intention as to the scope of the authority of the representative, and must show the type of tax involved, the federal tax form number, and the year(s) or period(s) involved. If the power of attorney or tax information authorization is being used for an estate tax matter, it must also show the date of death of the decedent. A power of attorney or tax information authorization thus may relate to more than one matter as, for example, a tax information authorization which relates to a taxpayer's income taxes for several different taxable years. If the taxpayer wishes to authorize the taxpayer's representative to perform one or more of the acts set forth in paragraph (c)(1) of §601.502 for which a power of attorney is required by the Revenue Service, the power of attorney must clearly specify which act or acts the representative is authorized to perform. In the alternative, a Form 2848 or general power of attorney authorizing the representative to perform any and all acts the taxpayer can perform with respect to the specified tax matters may be used. If this alternative is chosen, care should be taken to specifically exclude granting authority to perform any acts otherwise authorized by the power of attorney which the taxpayer does not wish to authorize. This alternative does not permit the representative to receive refund checks or sign returns unless such acts are specified in the Form 2848 or general power of attorney. This alternative does permit the taxpayer's representative, without a specific grant of authority, to make substitution of representatives or delegate authority to other representatives. (A tax information authorization, Form 2848-D, does not convey authority to make such substitution or delegation absent a specific grant of authority therein.) Such substitution or delegation, when it occurs, must be evidenced by a statement signed by the representative named in the power of attorney (or tax information authorization which specifically authorizes such substitution or delegation). ***

* * * * *

Par. 6. Paragraph (a) of §601.506 is revised as follows:

1. Paragraph (a) is revised by removing from the second sentence the words "and, except with respect to a ruling, which specifically authorizes the representative to receive such notices and communications."

2. Paragraph (a) is revised by removing the seventh and eighth sentences and by adding a new sentence in place of those sentences, to read as set forth below.

§601.506 Notice to be given to recognized representatives; delivery of refund checks to recognized representatives.

(a) *** In a case in which the taxpayer does not designate which representative is to receive notices, it will be the practice of the Revenue Service to give notices to the representative first named on the instrument which reflects the latest date. ***

* * * * *

Par. 7. Section 601.702 is revised by adding a new paragraph (f)(9), to read as set forth below.

§601.702 Publications and public inspection.

* * * * *

(f) *Fees for services.* ***

(9) *Prepayment of fees.* If previous search or duplication fees have not been paid by a person making a request for records, the Service will require an advance payment of fees before processing the request. In addition, payment of all outstanding fees may be required before current requests are honored. The "person making a request" for purposes of this paragraph (f)(9) is the person in whose name a request is made, except that if such person is making the request on behalf of another person whose identity is apparent on the face of the request (including attached documents), such other person is considered the "person making a request." The person who made the prior request with respect to which fees are outstanding is identified in the same manner.

* * * * *

These amendments to the Statement of Procedural Rules are issued under the authority contained in 5 U.S.C. 301 and 552.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 8, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 9, 1984, 49 F.R. 19648)

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Notice of Proposed Rulemaking

Withdrawal of Notice of Proposed Rulemaking

Qualified Pension, etc., Plans of Electing Small Business Corporations

EE-35-78

SUMMARY: This document withdraws the notice of proposed rulemaking, relating to qualified pension, profit-sharing, and stock bonus plans of electing small business corporations, that appeared in the Federal Register on Saturday May 6, 1972 (37 F.R. 9295). The notice is being withdrawn due to changes in the applicable tax law made by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. 97-248, 1982-2 C.B. 462].

FOR FURTHER INFORMATION CONTACT: Calder L. Robertson, Jr. of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington D.C. 20224, Attention: CC:LR:T (202-566-3422).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The notice of proposed rulemaking that is being withdrawn proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 62, 72, 401, 402, 403, 404, 405, 1371 and 1379, the Estate Tax Regulations (26 CFR Part 20) under section 2039, and the Gift Tax Regulations (26 CFR Part 25) under section 2517 of the Internal Revenue Code of 1954 (37 F.R. 9295). The amendments were proposed to conform the regulations to section 531(a) of the Tax Reform Act of 1969 (83 Stat. 654) [Pub. L. 91-172, 1969-3 C.B. 10, 107]. Proposed regulations set forth in paragraphs 1 and 2 of the notice of proposed rulemaking (proposing amendments to the regulations under Code section 62) were adopted by T.D. 7399, filed with the Federal Register on February 2, 1976 (41 F.R. 5099) [1976-1 C.B. 24].

Code sections 1379(a) and (b) were deleted by section 238(c) of TEFRA (Pub. L. 97-248, 96 Stat. 324) [1982-2 C.B. 462, 516], effective for taxable years beginning after December 31, 1983. In addition, Code sections 1379(c) and (d) (redesignated as Code sections 1379(a) and (b) by TEFRA) were effectively deleted by section 2 of the Subchapter S Revision Act of 1982 (Pub. L. 97-354, 96 Stat. 1669) [1982-2 C.B. 702], effective for taxable years beginning after December 31, 1983. Consequently, the proposed amendments are no longer necessary and are being withdrawn.

DRAFTING INFORMATION

The principal author of this document is Calder L. Robertson, Jr. of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this document, both in matters of substance and style.

* * * * *

Withdrawal of notice of proposed rulemaking

Accordingly, the proposed amendments to 26 CFR Parts 1, 20, and 25, relating to certain qualified pension, profit-sharing, and stock bonus plans of electing small business corporations, that were published in the Federal Register on May 6, 1972 (37 F.R. 9295, F.R. Doc. 72-6869) are hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 8, 1983, 8:45 a.m., and published in the issue of the Federal Register for December 9, 1983, 48 F.R. 55143)

Notice of Proposed Rulemaking

Cooperative Hospital Service Organizations

EE-44-78

SUMMARY: This document contains proposed regulations relating to the treatment of certain cooperative hospital service organizations. Changes to the applicable tax law were made by the Revenue and Expenditure Control Act of 1968 [Pub. L. 90-364, 1968-2 C.B. 715] and by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1)1]. The proposed regulations would provide the public with the guidance needed to comply with those Acts and would affect organizations seeking to qualify for tax exempt status as organizations described in section 501(e).

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 12, 1984. The amendments are proposed to be effective for taxable years ending after June 28, 1968, except that the provision of clinical services is effective for taxable years ending after December 31, 1976.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T(EE-44-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Harry Beker of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention CC:EE)(202-566-6212)(not a toll-free call).

SUPPLEMENTAL INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 170(b)(1)(A) and 501(e) of the Internal Revenue Code of 1954. These proposed amendments are to be issued to conform the regulations to section 109(a) of the Revenue and Expenditure Control Act of 1968 (82 Stat. 269)[Pub. L. 90-364, 1968-2 C.B. 715, 733] and section 1312(a) of the Tax Reform Act of 1976 (90 Stat.

1730) [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 206] and are issued under the authority contained in section 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805).

HISTORY

Prior to the enactment of section 501(e), the law as to the tax status of shared hospital service organizations was uncertain. The Service took the position that if two or more tax exempt hospitals created an entity to perform commercial services for them, that entity was not entitled to exemption. Rev. Rul. 54-305, 1954-2 C.B. 127. That position, however, was rejected in *Hospital Bureau of Standards and Supplies, Inc. v. United States*, 158 F. Supp. 560 (Ct. Cl. 1958). After expressly noting the uncertainty in the law and recognizing the ever increasing cost of hospital services, Congress enacted subsection (e) of section 501, effective for taxable years ending after June 28, 1968.

COOPERATIVE HOSPITAL SERVICE ORGANIZATIONS IN GENERAL

The purpose of section 501(e) is to exempt from taxation a cooperative organization which provides specified services to exempt hospitals. These cooperatives are organized and operated to achieve economies of scale for their patron-hospitals by performing administrative and other similar services on a joint basis and are afforded tax treatment which is similar to that of their patron-hospitals. Section 501(e) limits the services which such a cooperative may perform on a centralized basis to the following: data processing, purchasing warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel. In 1969, the Service emphasized that an organization seeking to qualify under section 501(e) may perform only one or more of these specifically enumerated services. Rev. Rul. 69-160, 1969-1 C.B. 147, held that a hospital service organization which performed laundry services for its patron-hospitals did not meet the requirements of section 501(e) and therefore did not qualify for exemption under any other provision of the Code. That position has been upheld in *HCSC-Laundry v. United States*, 450 U.S. 1 (1981). The proposed regulations therefore limit the activities of cooperative hospital service organizations solely to those specified in section 501(e) which is the exclusive and controlling section governing the exemption of such organizations.

The proposed regulations also require that the specified services must be performed solely for two or more patron-hospitals, all of which are recognized as exempt under section 501(c)(3) or owned by the United States or a State or one of its political subdivisions. The proposed regulations recognize, however, that the specified services may also be performed for other cooperative hospital service organizations meeting the requirements of section 501(e). Moreover, because a section 501(e) organization may only perform specified services for specified organizations, it cannot have unrelated business taxable income as defined in section 512 (other than that indicated in §1.501(e)-1(b)(4)).

The proposed regulations additionally require that the hospital service organization be organized and operated on a cooperative basis, that any capital stock be held by its patron-hospitals (no dividends, however, may be paid on such stock), and that the organization allocates or pays all net earnings to such patrons within 8½ months of the close of its taxable year. Allocations or payments must be made on the basis of the percentage of the services performed for each patron-hospital.

Although section 501(e)(2) requires that "all net earnings" be allocated or paid, the proposed regulations recognize that the retention of an amount for retiring indebtedness, expanding services or for other necessary purposes is not inconsistent with the requirements of section 501(e). In addition, although all outstanding capital stock of the organization must be held by its patron-hospitals, the proposed regulations recognize that not all patron-hospitals transacting business with the organization need have voting rights in the organization. However, the proposed regulations require that, where the organization has both voting and nonvoting patron-hospitals, the percentage of services done with nonvoting patrons may not exceed the percentage of services done with voting patrons. This provision is applicable to both stock and membership cooperatives so that either type of cooperative must do more than 50 percent of its business with voting patrons.

Conforming changes are also made under §1.170A-9(c)(1) and §1.501(k)-1 of the Income Tax Regulations.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this Regulation is not subject to review under Executive Order 12291 or the Treasury or Office of Management and Budget implementation of the Order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

PAPERWORK REDUCTION ACT

The requirement relating to collection of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service

requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Harry Beker of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

Accordingly, it is proposed to amend the Income Tax Regulations, 26 CFR Part 1, as follows:

Paragraph 1. Paragraph (c)(1) of §1.170A-9 is amended to read as follows:

§1.170A-9 Definition of section 170 (b)(1)(A) organization.

* * * * *

(c) *Hospitals and medical research organizations*—(1) *Hospitals.* An organization (other than one described in subparagraph (2) of this paragraph) is described in section 170 (b)(1)(A)(iii) if:

(i) It is a hospital, and

(ii) Its principal purpose or function is the providing of medical or hospital care or medical education or medical research.

The term "hospital" includes (a) Federal hospitals and (b) State, county, and municipal hospitals which are instrumentalities of governmental units referred to in section 170(c)(1) and otherwise come within the definition. A rehabilitation institution, outpatient clinic, or community mental health or drug treatment center may qualify as a "hospital" within the meaning of subdivision (i) of this subparagraph if its principal purpose or function is the providing of hospital or medical care. For purposes of this subdivision, the term "medical care" shall include the treatment of any physical or mental disability or condition, whether on an inpatient or outpatient basis, provided the cost of such treatment is deductible under section 213 by the person treated. An organization, all the accommodations of which qualify as being part of an "extended care facility" within the meaning of 42 U.S.C. 1395x(j), may qualify as a "hospital" within the meaning of subdivision (i) of this subparagraph if its principal purpose or function is the providing of hospital or medical care. For taxable years ending after June 28, 1968, the term "hospital" also includes cooperative hospital service organizations which meet the requirements of section 501(e) and §1.501(e)-1. The term "hospital" does not, however, include convalescent homes or homes for children or the aged, nor does the term include institutions whose principal purpose or function is to train handicapped individuals to pursue some vocation. An organization whose principal purpose or function is the providing of medical education or medical research will not be considered a "hospital" within the meaning of subdivision (i) of this subparagraph, unless it is also actively engaged in providing medical or hospital care to patients on its premises or in its facilities, on an inpatient or outpatient basis, as an integral part of its medical education or medical research functions. See, however, subparagraph (2) of this paragraph with respect to certain medical research organizations.

* * * * *

Par. 2. Section 1.501(e)-1 is redesignated as §1.501(k)-1.

Par. 3. The following new section is added immediately after §1.501(d)-1:

§1.501(e)-1 Cooperative hospital service organizations.

(a) *General rule.* Section 501(e) is the exclusive and controlling section under which a cooperative hospital service organization can qualify as a charitable organization. A cooperative hospital service organization which meets the requirements of section 501(e) and this section shall be treated as an organization described in section 501(c)(3), exempt from taxation under section 501(a), and referred to in section 170(b)(1)(A)(iii) (relating to percentage limitations on charitable contributions). In order to qualify for tax exempt status, a cooperative hospital service organization must—

(1) Be organized and operated on a cooperative basis,

(2) Perform, on a centralized basis, only one or more specifically enumerated services which, if performed directly by a tax exempt hospital, would constitute activities in the exercise or performance of the purpose or function constituting the basis for its exemption, and

(3) Perform such service or services solely for two or more patron-hospitals as described in paragraph (d) of this section.

(b) *Organized and operated on a cooperative basis*—(1) *In general.* In order to meet the requirements of section 501(e), the organization must be organized and operated on a cooperative basis (whether or not under a specific statute on cooperatives) and must allocate or pay all of its net earnings within 8½ months after the close of the taxable year to its patron-hospitals on the basis of the percentage of its services performed for each patron. For the recordkeeping requirements of a section 501(e) organization, see §1.521-1(a)(1).

(2) *Percentage of services defined.* The percentage of services performed for each patron-hospital may be determined on the basis of either the value or the quantity of the services provided by the organization to the patron-hospital, provided such basis

is realistic in terms of the actual cost of the services to the organization.

(3) *Retention of net earnings.* Exemption will not be denied a cooperative hospital service organization solely because the organization, instead of paying all net earnings to its patron-hospitals, retains an amount for such purposes as retiring indebtedness, expanding the services of the organization, or for any other necessary purpose and allocates such amounts to its patrons. However, such funds may not be accumulated beyond the reasonable needs of the organization. Whether there is an improper accumulation of funds depends upon the particular circumstances of each case. Moreover, where an organization retains net earnings for necessary purposes, the organization's records must show each patron's rights and interests in the funds retained.

(4) *Nonpatronage income.* An organization described in section 501(e) may have income from nonpatronage sources such as investment of retained earnings. However, such an organization cannot be exempt if it engages in any business other than that of providing the specified services, described in paragraph (c), for the specified patron-hospitals, described in paragraph (d). Thus, it cannot have unrelated business taxable income as defined in section 512 other than debt-financed income which is treated as unrelated business taxable income solely because of the applicability of section 514. Such an organization may also have certain interest, annuities, royalties, and rents which are excluded from unrelated business taxable income because of the modifications contained in sections 512(b)(1), (2) or (3). The nonpatronage income permitted under this subparagraph must be allocated or paid as provided in subparagraph (1) or retained as provided in subparagraph (3).

(5) *Stock ownership.* An organization does not meet the requirements of section 501(e) unless all of the organization's outstanding capital stock, if there is such stock, is held solely by its patron-hospitals. However, no amount may be paid as dividends on the capital stock of the organization. For purposes of the preceding sentence, the term "capital stock" includes common stock (whether voting or nonvoting), preferred stock, or any other form evidencing a proprietary interest in the organization.

(c) *Scope of services.* An organization meets the requirements of section 501(e) only if the organization performs, on a centralized basis, one or more of the following services and only such services: data processing, purchasing (including the purchasing and dispensing of drugs and pharmaceuticals to patron-hospitals), warehousing, billing and collection, food, clinical, industrial engineering (including the installation, maintenance and repair of biomedical and similar equipment), laboratory, printing, communications, record center, and personnel (including recruitment, selection, testing, training, education and placement of personnel) services. An organization is not described in section 501(e) if, in addition to or instead of one or more of these specified services, the organization performs any other service.

Example. An organization performs industrial engineering services on a cooperative basis solely for patron-hospitals each of which is an organization described in section 501(c)(3) and exempt from taxation under section 501(a). However, in addition to this service, the organization operates laundry services for its patron-hospitals. This cooperative organization does not meet the requirements of this paragraph because it performs laundry services not specified in this paragraph.

(d) *Patron-hospitals*—(1) *Defined.* Section 501(e) only applies if the organization performs its services solely for two or more patron-hospitals each of which is—

(i) An organization described in section 501(c)(3) which is exempt from taxation under section 501(a),

(ii) A constituent part of an organization described in section 501(c)(3) which is exempt from taxation under section 501(a) and which, if organized and operated as a separate entity, would constitute an organization described in section 501(c)(3), or

(iii) Owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing.

(2) *Business with nonvoting patron-hospitals.* Exemption will not be denied a cooperative hospital service organization solely because the organization (whether organized on a stock or membership basis) transacts business with patron-hospitals which do not have voting rights in the organization and therefore do not participate in the decisions affecting the operation of the organization. Where the organization has both patron-hospitals with voting rights and patron-hospitals without such rights, the organization must provide at least 50 percent of its services to patron-hospitals with voting rights in the organization. Thus, the percentage of services provided to nonvoting patrons may not exceed the percentage of such services provided to voting patrons. Notwithstanding that an organization may have both voting and nonvoting patron-hospitals, patronage refunds must nevertheless be allocated or paid to all patron-hospitals solely on the basis specified in paragraph (b) of this section.

(3) *Services to other organizations.* An organization does not meet the requirements of section 501(e) if, in addition to performing services for patron-hospitals (entities described in subdivisions (i), (ii) or (iii) of subparagraph (1)), the organization performs any service for any other organization. For example, a cooperative hospital service organization is not exempt if it performs services for convalescent homes for children or the aged, vocational training facilities for the handicapped, educational institutions which do not provide hospital care in their facilities, and proprietary hospitals. However, the provision of the specified services between or among cooperative hospital service organizations meeting the requirements of section 501(e) is permissible.

(e) *Effective dates.* An organization, other than an organization performing clinical services, may meet the requirements of section 501(e) and be a tax exempt organization for taxable years ending after June 28, 1968. An organization performing

clinical services may meet the requirements of section 501(e) and be a tax exempt organization for taxable years ending after December 31, 1976.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 10, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 11, 1984, 49 F.R. 1384)

Notice of Proposed Rulemaking

Tax Treatment of Cafeteria Plans

EE-16-79

SUMMARY: This document contains proposed regulations relating to the tax treatment of cafeteria plans. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 17], by the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499] and by the Miscellaneous Revenue Act of 1980 [Pub. L. 96-605, 1980 C.B. 702]. The proposed regulations would provide the public with the guidance needed to comply with those Acts and would affect employees who participate in cafeteria plans.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 6, 1984. The regulations are generally proposed to be effective for plan years beginning after December 31, 1978, except with respect to certain provisions set forth in Q&A-21 which are effective as of September 4, 1984. In addition, transitional relief is provided with respect to employer contributions made before June 1, 1984, pursuant to certain "flexible spending arrangements" that satisfy specified conditions. Also, the provision relating to qualified cash or deferred arrangements is effective for plan years beginning after December 31, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-16-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Harry Beker of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:EE) (202-566-6212) (not a toll-free call).

SUPPLEMENTAL INFORMATION:

BACKGROUND

This document contains proposed Income Tax Regulations (26 CFR Part 1) under section 125 of the Internal Revenue Code of 1954. These proposed regulations are to be issued pursuant to section 134 of the Revenue Act of 1978 (92 Stat. 2763) [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 17], section 101 of the Technical Corrections Act of 1979 (92 Stat. 2227) [Pub. L. 96-222, 1980-1 C.B. 499], section 226 of the Miscellaneous Revenue Act of 1980 (94 Stat. 3529) [Pub. L. 96-605, 1980-2 C.B. 702] and under the authority contained in section 7805 of the Code (68A Stat. 917, 26 U.S.C. 7805).

FORMAT

These proposed regulations are presented in the form of questions and answers. The questions and answers do not address various issues regarding the application of the discrimination standards under section 125. Written comments are requested specifically with respect ot the application of these discrimination standards. In particular, comments are requested regarding tests that a plan may use to determine whether it is nondiscriminatory, methods by which to value benefits, appropriate safe harbors from discrimination, and tests to assure that the pricing of benefits under a cafeteria plan is not discriminatory.

The guidance provided by these questions and answers may be relied upon to comply with provisions of section 125 and will be applied by the Internal Revenue Service in resolving issues arising under cafeteria plans and related Code sections. However, pending the issuance of final regulations, advance determinations and rulings regarding whether a cafeteria plan is or is not discriminatory will not be issued; determinations regarding discrimination will be made only on audit.

If final regulations are more restrictive than the guidance in this Notice, the regulations will not be applied retroactively. No inference, however, should be drawn regarding issues not expressly raised that may be suggested by a particular question or answer or by the inclusion or exclusion of certain questions.

NONAPPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this Regulation is not subject to review under Executive Order 12291 or the Treasury or Office of Management and Budget implementation of the Order dated April 28, 1982.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submited (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held on a date announced in the notice of public hearing appearing elsewhere in this Federal Register.

DRAFTING INFORMATION

The principal author of these proposed regulations is Harry Beker of the Employee Plans and Exempt Or-

ganizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

LIST OF SUBJECTS
IN
26 CFR §§1.61-1—1.281-4

Income taxes, Taxable income.

Proposed amendments to the regulations

Accordingly, it is proposed to amend the Income Tax Regulations, 26 CFR Part 1, by adding the following new section:

§1.125-1 Questions and Answers Relating to Cafeteria Plans

Q-1: What does section 125 of the Internal Revenue Code provide?

A-1: Section 125 provides that a participant in a nondiscriminatory cafeteria plan will not be treated as having received the taxable benefits offered under the plan solely because the participant has the opportunity, before the benefits become currently available to the participant, to choose among the taxable and nontaxable benefits offered under the plan.

Q-2: What is a "cafeteria plan" under section 125?

A-2: A "cafeteria plan" is a separate written benefit plan maintained by an employer for the benefit of its employees, under which all participants are employees and each participant has the opportunity to select the particular benefits that he desires. A cafeteria plan may offer participants the opportunity to select among various taxable benefits and nontaxable benefits, but a plan must offer at least one taxable benefit and at least one nontaxable benefit. For example, if participants are given the opportunity to elect only among two or more nontaxable benefits, the plan is not a cafeteria plan.

Q-3: What must the written cafeteria plan document contain?

A-3: The written document embodying a cafeteria plan must contain at least the following information: (i) a specific description of each of the benefits available under the plan, including the periods during which the benefits are provided (i.e., the periods of coverage), (ii) the plan's eligibility rules governing participation, (iii) the procedures governing participants' elections under the plan, including the period during which elections may be made, the extent to which elections are irrevocable, and the periods with respect to which elections are effective, (iv) the manner in which employer contributions may be made under the plan, such as by salary reduction agreement between the participant and the employer or by nonelective employer contributions to the plan, (v) the maximum amount of employer contributions available to any participant under the plan, and (vi) the plan year on which the cafeteria plan operates.

In describing the benefits available under the cafeteria plan, the plan document need not be self-contained. For example, the plan document may include by reference benefits established under other "separate written plans," such as coverage under a qualified group legal services plan (section 120) or under a dependent care assistance program (section 129), without describing in full the benefits established under these other plans. But, for example, if the plan offers different maximum levels of coverage under a dependent care assistance program, the descriptions must specify the available maximums. In addition, an arrangement under which a participant is provided with coverage under a dependent care assistance program for dependent care expenses incurred during the period of coverage up to a specified amount (e.g., $500) and the right to receive, either directly or indirectly in the form of cash or any other benefit, any portion of the specified amount that is not reimbursed for such expenses will be considered a single benefit and must be fully described as such in the plan document. This also is the case with other benefits, such as coverage under an accident or health plan and coverage under a qualified group legal services plan. See Q&A-17 and Q&A-18 regarding the taxability of such benefit arrangements.

Q-4: What does the term "employees" mean under section 125?

A-4: The term "employees" includes present and former employees of the employer. All employees who are treated as employed by a single employer under subsections (b), (c), or (m) of section 414 are treated as employed by a single employer for purposes of section 125. The term "employees" does not, however, include self-employed individuals described in section 401(c) of the Code. Even though former employees generally are treated as employees, a cafeteria plan may not be established predominantly for the benefit of former employees of the employer.

In addition, even though the spouses and other beneficiaries of participants may not be participants in a cafeteria plan, a plan may provide benefits to spouses and beneficiaries of participants. For example, the spouse of a participant may not be permitted to participate actively in a cafeteria plan (i.e., the spouse may not be given the opportunity to select or purchase benefits offered by the plan), but the spouse of a participant may benefit from the participant's selection of family medical insurance coverage or of coverage under a dependent care assistance program. A participant's spouse will not be treated as actively participating in a cafeteria plan merely because the spouse has the right, upon the death of the participant, to select among various settlement options available with respect to a death benefit selected by the participant under the cafeteria plan or to elect among permissible distribution options with respect to the deceased participant's benefits under a cash or deferred arrangement that is part of the cafeteria plan.

Q-5: What benefits may be offered to participants under a cafeteria plan?

A-5: With the exception of benefits that defer the receipt of compensation (see Q&A-7), a cafeteria plan may offer participants the opportuni-

ty to select among certain taxable benefits and nontaxable benefits described in the plan document. The term "taxable benefit"means cash, property, or other benefits attributable to employer contributions that are currently taxable to the participant under the Internal Revenue Code upon receipt by the participant. The term "nontaxable benefit" means any benefit attributable to employer contributions to the extent that such benefit is not currently taxable to the participant under the Internal Revenue Code upon receipt of the benefit. Thus, a cafeteria plan may offer participants the following benefits, which will be nontaxable when provided in accordance with the applicable provisions of the Internal Revenue Code: group-term life insurance up to $50,000 (section 79), coverage under an accident or health plan (section 106), coverage under a qualified group legal services plan (section 120), and coverage under a dependent care assistance program (section 129). Also, amounts received by participants under one of these benefits may or may not be taxable depending upon whether such amounts qualify for an exclusion from gross income. See Q&A-17 and Q&A-18 regarding the inclusion of an accident or health plan, dependent care assistance program, or qualified group legal services plan in a cafeteria plan. Also, see Q&A-7 regarding the inclusion of deferred compensation benefits in a cafeteria plan.

In addition, a cafeteria plan may offer benefits that are nontaxable because they are attributable to after-tax employee contributions. For example, a cafeteria plan may offer participants the opportunity to purchase, with after-tax employee contributions, coverage under an accident or health plan providing for the payment of disability benefits. A participant's receipt of coverage under such an accident or health plan would not trigger taxable income because the coverage would be purchased with after-tax employee contributions. Similarly, any amounts paid to a participant under such an accident or health plan on account of disability incurred during the year of coverage may be nontaxable under section 104(a)(3).

Q-6: May employer contributions to a cafeteria plan be made pursuant to a salary reduction agreement between the participant and employer?

A-6: Yes. The term "employer contributions" means amounts that have not been actually or constructively received (after taking section 125 into account) by the participant and have been specified in the plan document as available to a participant for the purpose of selecting or "purchasing" benefits under the plan. A plan document may provide that the employer will make employer contributions, in whole or in part, pursuant to salary reduction agreements under which participants elect to reduce their compensation or to forgo increases in compensation and to have such amounts contributed, as employer contributions, by the employer on their behalf. A salary reduction agreement will have the effect of causing the amounts contributed thereunder to be treated as employer contributions under a cafeteria plan only to the extent the agreement relates to compensation that has not been actually or constructively received by the participant as of the date of the agreement (after taking section 125 into account) and, subsequently, does not become currently available to the participant. In addition, a plan document also may provide that the employer will make employer contributions on behalf of participants equal to specified amounts (or specified percentages of compensation) and that such nonelective contributions will be available to participants for the selection or purchase of benefits under the plan.

Q-7: May a cafeteria plan offer a benefit that defers the receipt of compensation?

A-7: No. A cafeteria plan does not include any plan that offers a benefit that defers the receipt of compensation, with the exception of the opportunity for participants to make elective contributions under a qualified cash or deferred arrangement defined in section 401(k). Thus, employer contributions made at a participant's election to a profit-sharing plan containing a qualified cash or deferred arrangement will be treated as nontaxable benefits under a cafeteria plan.

In addition, a cafeteria plan does not include a plan that operates in a manner that enables participants to defer the receipt of compensation. Generally, a plan that permits participants to carry over unused benefits or contributions from one plan year to a subsequent plan year operates to enable participants to defer the receipt of compensation. This is the case regardless of whether the plan permits participants to convert the unused contributions or benefits into another benefit in the subsequent plan year. For example, a plan that offers participants the opportunity to purchase vacation days (or to receive cash or other benefits under the plan in lieu of vacation days) will not be a cafeteria plan if participants who purchase the vacation days for a plan year are allowed to use any unused days in a subsequent plan year. This is the case even though the plan does not permit the participant to convert, in the subsequent plan year, the unused vacation days into any other benefit. In determining whether a plan permits participants to carry over unused vacation days, a participant will be deemed to have used his nonelective vacation days (i.e., the vacation days with respect to which the participant had no election under the plan) before his elective vacation days. For example, assume that an employer provides a participant with three weeks of vacation for a year and, under the plan, the participant is permitted to receive cash or other benefits in lieu of one of these three weeks. Assume that the participant elects not to exchange the one elective week of vacation for another benefit. If the participant uses two weeks of vacation during the year, he will be treated as having used the two nonelective weeks of vacation. Thus, if the participant is permitted to carry the one unused week over to the next year, the plan will be treated as operating to enable participants to defer the re-

ceipt of compensation. Thus, the plan will fail to be a cafeteria plan and the section 125 exception to the constructive receipt rules will not apply.

In addition, a plan that allows participants to use employer contributions for one plan year to purchase a benefit that will be provided in a subsequent plan year operates to enable participants to defer the receipt of compensation.

Q-8: What requirements apply to participants' elections under a cafeteria plan?

A-8: A plan is not a cafeteria plan unless the plan requires that participants make elections among the benefits offered under the plan. A plan may provide that elections may be made at any time. However, benefit elections under a cafeteria plan should be made in accordance with certain guidelines (see Q&A-15) in order for participants to qualify for the protections of the section 125 exception to the constructive receipt rules. An election will not be deemed to have been made if, after a participant has elected and begun to receive a benefit under the plan, the participant is permitted to revoke the election, even if the revocation relates only to that portion of the benefit that has not yet been provided to the participant. For example, a plan that permits a participant to revoke his election of coverage under a dependent care assistance program or of coverage under an accident or health plan after the period of coverage has commenced will not be a cafeteria plan. However, a cafeteria plan may permit a participant to revoke a benefit election after the period of coverage has commenced and to make a new election with respect to the remainder of the period of coverage if both the revocation and new election are on account of and consistent with a change in family status (e.g., marriage, divorce, death of spouse or child, birth or adoption of child, and termination of employment of spouse).

Q-9: What is the tax treatment of benefits offered under a nondiscriminatory cafeteria plan?

A-9: A participant in a nondiscriminatory cafeteria plan will not be treated as having received taxable benefits offered under the plan and thus will not be required to include the benefits in gross income solely because the plan offers the participant the opportunity, before the benefits become currently available to the participant, to elect to receive or not to receive the benefits. Section 125 thus provides an exception to the constructive receipt rules that apply with respect to employee elections among nontaxable and taxable benefits (including cash). These constructive receipt rules generally provide that an individual will be required to include in gross income the taxable benefits that he could have elected to receive if the individual had the opportunity to elect to receive or not to receive the benefits even though both the opportunity to make this election occurs and the actual election is made before the benefits become currently available to the individual. Section 125 does not, however, alter the application of the constructive receipt rules to a situation in which benefits become currently available to an individual even thought the individual elects not to receive and does not actually receive the benefits. Thus, if taxable benefits become currently available to a participant in a nondiscriminatory cafeteria plan, the participant will be taxable on the benefits, even though the participant has elected or subsequently elects not to receive the benefits and does not actually receive the benefits.

Q-10: What is the tax treatment of benefits offered under a discriminatory cafeteria plan?

A-10: The section 125 exception to the constructive receipt rules is not available to the highly compensated participants in a cafeteria plan that is discriminatory for a plan year. Thus, a highly compensated participant in a cafeteria plan that is discriminatory for a plan year will be taxable on the combination of the taxable benefits with the greatest aggregate value that he could have selected for the plan year. The section 125 exception to the constructive receipt rules remains available to participants who are not highly compensated without regard to whether the cafeteria plan is discriminatory.

Q-11: How are the amounts taxable to a highly compensated participant because a cafeteria plan is discriminatory for a plan year to be allocated among the benefits actually selected by the participant for the plan year?

A-11: A highly compensated participant in a discriminatory cafeteria plan is taxable on the maximum taxable benefits that he could have selected for the plan year. For example, assume that a cafeteria plan provides a highly compensated participant with the opportunity to select, for a plan year, benefits costing $1300 from among the following: up to $300 in cash, coverage under an accident or health plan providing medical expense reimbursement (cost of $600), coverage under an accident or health plan providing disability benefits (cost of $200), coverage under a qualified legal services plan (cost of $400), and coverage under a dependent care assistance program (cost of $400). For the plan year in question, the participant elects to receive $100 in cash, coverage under both of the accident or health plans ($600 and $200), and coverage under the dependent care assistance program ($400). If the cafeteria plan is discriminatory for the plan year, the participant will be taxable on the $100 cash benefit actually selected and on the $200 cash benefit that the participant could have selected. This $300 will be allocated, first, to the taxable benefits actually selected by the participant and, second, on a pro rata basis to the nontaxable benefits actually selected by the participant. Thus, $100 is allocated to the $100 cash benefit actually received and the $200 is allocated as employee contributions among the nontaxable benefits actually selected as follows: $100 to coverage under the accident or health plan for medical care, $33.33 to the coverage under the accident or health plan for disability benefits, and $66.67 to the coverage under the dependent care assistance program. This allocation would not affect the

nontaxable status of any of these benefits—the purchase of coverage under any of these plans with employee contributions would not trigger taxable income—but it may affect the taxability of amounts received under any of the plans. In addition, depending upon whether other conditions are satisfied, the participant may be able to deduct under section 213 some or all of the employee cost of the coverage under the accident or health plan for medical care. Thus, reimbursements received by the participant for medical care expenses incurred during the year of coverage may be nontaxable under either section 104(a)(3) or section 105(b), depending upon whether the reimbursements are attributable to after-tax employee or pre-tax employer contributions. Also, if the participant became disabled during the year of coverage, benefits provided under the accident or health plan would be nontaxable to the participant under section 104(a)(3) to the extent that the benefits were attributable to the portion of the coverage purchased with the after-tax employee contributions. Finally, any reimbursements received under the dependent care assistance program for the year of coverage will be nontaxable under section 129 if the requirements of that section are satisfied.

Q-12: When must a highly compensated participant in a discriminatory cafeteria plan include in gross income amounts attributable to the taxable benefits that the participant could have selected, but did not in fact select?

A-12: Amounts required to be included in gross income by a highly compensated participant because a cafeteria plan does not satisfy the applicable nondiscrimination standards for a plan year will be treated as received or accrued in the participant's taxable year within which ends the plan year with respect to which an election was or could have been made.

Q-13: Who are highly compensated participants under section 125?

A-13: The term "highly compensated participant" means a participant who is an officer, a shareholder owning more than 5 percent of the voting power or value of all classes of stock of the employer, or highly compensated. The classification of a participant as highly compensated for this purpose will be made on the basis of the facts and circumstances of each case. A spouse or a dependent (within the meaning of section 152) of any such "highly compensated participant" will be treated as highly compensated.

Q-14: When will a benefit be treated as currently available to a participant in a cafeteria plan?

A-14: A benefit is treated as currently available to a participant if the participant is free to receive the benefit currently at his discretion or the participant could receive the benefit currently if an election or notice of an intent to receive the benefit were given. A benefit will not be treated as not currently available merely because of a requirement that the participant must elect or give notice of intent to receive the benefit in advance of receipt of the benefit. However, a benefit is not currently available to a participant if there is a substantial limitation or restriction on the participant's receipt of the benefit. A benefit will not be treated as currently available if the participant may under no circumstances receive the benefit before a particular time in the future and there is a substantial risk that, if the participant does not fulfill specified conditions during the period preceding this time, the participant will not receive the benefit.

Q-15: What procedures with respect to benefit elections should a cafeteria plan adopt in order to assure that participants are not subject to tax, under the constructive receipt rules, on taxable benefits that the participants have elected not to receive?

A-15: Generally, in order for participants to avoid constructive receipt with respect to taxable benefits offered under a cafeteria plan, the taxable benefits must at no time become currently available to the participants. Thus, a cafeteria plan should require participants to elect the specific benefits that they will receive before the taxable benefits become currently available. A benefit will not be treated as currently available as of the time of the election if the election specifies the future period for which the benefit will be provided and the election is made before the beginning of this period.

In addition, after the beginning of the specified period for which the benefits are provided, the taxable benefits must not become currently available to the participants. After the commencement of this period, taxable benefits will be treated as currently available if participants have the right to revoke their elections of nontaxable benefits and instead to receive the taxable benefits for such period, without regard to whether the participants actually revoke their elections. For example, assume that a cafeteria plan offers each participant the opportunity to elect, for a plan year, between coverage under a dependent care assistance program for up to $2000 of the dependent care expenses incurred by the participant during the plan year or a cash benefit of $2000 for the year. If the plan requires participants to elect between these benefits before the beginning of the plan year and, after the year has commenced, the participants are prohibited from revoking their elections, participants who elected coverage under the dependent care assistance program will not be taxable on the cash benefit of $2000. But if, after the beginning of the plan year, participants have the right to revoke their elections of coverage under the dependent care assistance program and thereby to receive the cash benefit, the participants will be treated as having received the $2000 in cash even though they do not revoke their elections. The same result would obtain even though the cash benefit is not payable until the end of the plan year. See Q&A-8, however, regarding the revocation of elections on account of changes in family status.

Q-16: Do the rules of section 125 affect whether any particular benefit offered under a cafeteria plan is a taxable or nontaxable benefit?

A-16: Generally, no. A benefit that is nontaxable under the Internal Reve-

nue Code when offered separately is treated as a nontaxable benefit under a cafeteria plan only if the rules providing for the exclusion of the benefit from gross income continue to be satisfied when the benefit is offered under the cafeteria plan. For example, if $50,000 in group-term life insurance is offered under a cafeteria plan and the rules under section 79(a) governing the exclusion of the cost of this benefit from gross income are satisfied, the rules of section 79(d) still apply to determine the status of the benefit as taxable or nontaxable for key employees who participate in the plan. See Q&A-17 and Q&A-18, however, regarding the inclusion of coverage under an accident or health plan, dependent care assistance program, or qualified group legal services plan in a cafeteria plan.

Similarly, if a cafeteria plan offers benefits that are nontaxable under the Internal Revenue Code when offered outside of a cafeteria plan, but are prohibited from inclusion in a cafeteria plan, the benefits will be treated as taxable benefits under the cafeteria plan. Thus, coverage under a qualified transportation plan (section 124) and coverage under an educational assistance program (section 127) will be treated as taxable benefits if offered under a cafeteria plan. Also, any benefits (either reimbursement for expenses or in kind benefits) received by a participant under a qualified transportation plan or an educational assistance program will be taxable if the benefits are provided under a cafeteria plan.

Finally, if a benefit that is taxable under the Internal Revenue Code when offered separately is offered under a cafeteria plan, the benefit will continue to be a taxable benefit under the cafeteria plan. For example, if a cafeteria plan offers a participant the opportunity to direct the employer to make charitable contributions or contributions to an individual retirement account on behalf of the participant, such contributions must be included in the participant's gross income for income and employment tax purposes without regard to whether the plan satisfies section 125 and without regard to whether the contributions are deductible by the participant.

Q-17: How are the specific rules of section 105, providing an income exclusion for amounts received as reimbursement for medical care expenses under an accident or health plan, to be applied when coverage under an accident or health plan is offered as a benefit under a cafeteria plan?

A-17: Section 105(b) provides an exclusion from gross income for amounts that are paid to an employee under an employer-funded accident or health plan specifically to reimburse the employee for certain medical care expenses incurred by the employee during the period for which the benefit is provided to the employee, i.e., the period during which the employee is covered under the accident or health plan. Section 105(h) provides that the exclusion provided by section 105(b) is not available with respect to certain amounts received by a highly compensated individual (as defined in section 105(h)(5)) under a discriminatory self-insured medical reimbursement plan. Several rules are of particular importance when coverage under an accident or health plan is a benefit offered under a cafeteria plan.

First, in order for medical care reimbursements paid to a participant under a cafeteria plan to be treated as nontaxable under section 105(b), the reimbursements must be paid pursuant to a employer-funded "accident or health plan," as defined in section 105(e) and §1.105-5. This means that, although the reimbursements need not be provided under a commercial insurance contract, the reimbursements must be provided under a benefit that exhibits the risk-shifting and risk-distribution characteristics of insurance. A benefit will not exhibit the required risk-shifting and risk-distribution characteristics, even though the benefit is provided under a commercial insurance contract, if the ordinary actuarial risk of the insurer is negated either under the terms of the benefit or by any related benefit or arrangement (including arrangements formally outside of the cafeteria plan).

Second, a cafeteria plan benefit under which a participant will receive reimbursements of medical expenses is a benefit within sections 106 and 105(b) only if, under the benefit, reimbursements are paid specifically to reimburse the participant for medical expenses incurred during the period of coverage. Amounts paid to a participant as reimbursement are not treated as paid specifically to reimburse the participant for medical expenses if, under the benefit, the participant is entitled to the amounts, in the form of cash (e.g., routine payment of salary) or any other taxable or nontaxable benefit, irrespective of whether or not he incurs medical expenses during the period of coverage, even if the participant will not receive the amounts not used for expense reimbursement until the end of the period. A benefit under which participants will receive reimbursement for medical expenses up to a specified amount and, if they incur no expenses, will receive cash or any other benefit in lieu of the reimbursements is not a benefit that qualifies for the exclusions under sections 106 and 105(b). See §1.105.2. This is the case without regard to whether the benefit was purchased with contributions made at the employer's discretion, at the participant's discretion (such as pursuant to a salary reduction agreement), or pursuant to a collective bargaining agreement. For example, if a cafeteria plan offers participants coverage under an employer-funded plan that provides for the reimbursement of medical expenses incurred during the plan year up to a specified amount (e.g., $1,000) and the participants are entitled to receive, in the form of any other taxable or nontaxable benefits (including deferrals under a cash or deferred arrangement), any portion of the specified amount that is not paid as reimbursement for medical expenses, the employer contributions used to purchase the coverage will not qualify for the section 106 exclusion and any reimbursements paid to participants for expenses incurred during the year of coverage will not be eligible for the section 105(b) exception. Arrangements formally outside of the cafete-

ria plan that provide for the adjustment of a participant's compensation or a participant's receipt of any other benefits on the basis of the expenses incurred or reimbursements received by the partcipant will be considered in determining whether the reimbursements are provided under a benefit eligible for the exclusions under sections 106 and 105(b).

Third, the medical expenses that are reimbursed under an accident or health plan must have been incurred during the period for which the participant is actually covered by the accident or health plan in order for the reimbursements to be excluded from gross income under section 105(b). For purposes of this rule, expenses are treated as having been incurred when the participant is provided with the medical care that gives rise to the medical expenses, and not when the participant is formally billed, charged for, or pays for the medical care. Also, for purposes of this rule, medical expenses that are incurred before the later of the date the plan is in existence and the date the participant is enrolled in the plan will not be treated as having been incurred during the period for which the participant is covered by the plan. Thus, in order for reimbursements to be excluded from gross income under section 105(b), the accident or health plan must provide a participant the right to reimbursement for medical expenses incurred during a specified period of plan coverage. Reimbursements of expenses incurred prior to or after the specified period of coverage will not be excluded under section 105(b). However, the actual reimbursement of covered medical care expenses may be made after the applicable period of coverage.

Fourth, in order for reimbursements under an accident or health plan to qualify for the section 105(b) exclusion, the cafeteria plan may not operate in a manner that enables participants to purchase coverage under the accident or health plan only for periods during which the participants expect to incur medical care. For example, if a cafeteria plan permits participants to purchase coverage under an accident or health plan on a month-by-month or an expense-by-expense basis, reimbursements under the accident or health plan will not qualify for the section 105(b) exclusion. If, however, the period of coverage under an accident or health plan offered in a cafeteria plan is twelve months (or, in the case of a cafeteria plan's initial plan year, at least equal to the plan year) and the plan does not permit a participant to select specific amounts of coverage, reimbursement, or salary reduction for less than twelve months, the cafeteria plan will be deemed not to operate to enable participants to purchase coverage only for periods during which medical care will be incurred. See Q&A-8 regarding the revocation of elections during a period of coverage on account of changes in family status.

Fifth, in order for reimbursements to a highly compensated individual under a self-insured accident or health plan to be treated as nontaxable under a cafeteria plan, the discrimination rules of section 105(h) must be satisfied. For purposes of these rules, coverage under a self-insured accident or health plan offered by a cafeteria plan will be treated as an optional benefit (even if only one level and type of coverage is offered) and, for purposes of the optional benefit rule in §1.105-11(c)(3)(i), employer contributions will be treated as employee contributions to the extent that taxable benefits are offered by the plan. In addition, the accident or health plan offered by the cafeteria plan must provide for the nondiscriminatory reimbursement of expenses on a per capita basis, rather than as a proportion of compensation.

Q-18: How are the specific rules of section 129, providing an income exclusion for dependent care assistance provided under a dependent care assistance program, to be applied when coverage under a dependent care assistance program is offered as a benefit under a cafeteria plan?

A-18: Section 129(a) provides an employee with an exclusion from gross income both for employer-funded coverage under a dependent care assistance program and for amounts paid or incurred by the employer for dependent care assistance provided to the employee if the amounts are paid or incurred under a dependent care assistance program. A program under which participants receive reimbursements of dependent care expenses up to a specified amount and are entitled to receive, in the form of any other taxable or nontaxable benefits, any portion of the specified amount not used for reimbursement is to be treated as a single benefit that is not a dependent care assistance program within the scope of section 129. Thus, dependent care assistance provided under a cafeteria plan will be treated as provided under a dependent care assistance program only if, after the participant has elected coverage under the program and the period of coverage has commenced, the participant does not have the right to receive amounts under the program other than as reimbursements for dependent care expenses. This is the case without regard to whether coverage under the program was purchased with contributions made at the employer's discretion, at the participant's discretion, or pursuant to a collective bargaining agreement. For example, assume a cafeteria plan allows participants to elect to receive, for a particular plan year, either the right to reimbursements of dependent care expenses incurred during the year up to $2000 or a cash benefit of $2000. If the participant elects the right to receive reimbursements of dependent care expenses, the reimbursements will not be treated as made under a dependent care assistance program if, after the period of coverage has commenced, the participant has the right to revoke his election of this benefit and instead to receive the cash or if, under the terms of the program itself, the participant is entitled to receive, in the form of cash (e.g., routine payment of salary) or any other benefit, any amounts not reimbursed for dependent care provided during the period of coverage. Arrangements formally outside of the cafeteria plan that provide for the adjustment of a participant's compensation or a participant's receipt of any other benefits

on the basis of the assistance or reimbursements received by the participant will be considered a determining whether a dependent care benefit is a dependent care assistance program under section 129.

Moreover, in order for dependent care assistance to be treated as provided under a dependent care assistance program eligible for the section 129 exclusion, the care must be provided to or on behalf of the participant during the period for which the participant is covered by the program. For example, if a participant elects coverage for a plan year under a dependent care assistance program that provides for the reimbursement of dependent care expenses, only reimbursements for dependent care expenses incurred during that plan year will be treated as having been provided under a dependent care assistance program within the scope of the section 129. For purposes of this rule, dependent care expenses will be treated as having been incurred when the dependent care is provided, and not when the participant is formerly billed, charged for, or pays for the dependent care. Also, for purposes of this rule, expenses that are incurred before the later of the date the program is in existence and the date the participant is enrolled in the program will not be treated as having been incurred during the period for which the participant is covered by the program. Similarly, if the dependent care assistance program furnishes the dependent care in kind (e.g., under an employer-maintained child care facility), only dependent care provided during the plan year of coverage will be treated as having been provided under a dependent care assistance program within the scope of section 129.

In addition, in order for dependent care assistance under a cafeteria plan to be treated as provided under a dependent care assistance program eligible for the section 129 exclusion, the plan may not operate in a manner that enables participants to purchase coverage under the program only for periods during which the participants expect to receive dependent care assistance. If the period of coverage under a dependent care assistance program offered by a cafeteria plan is twelve months (or, in the case of a cafeteria plan's initial plan year, at least equal to the plan year) and the plan does not permit a participant to seelct specific amounts of coverage, reimbursement, or salary reduction for less than twelve months, the plan will be deemed not to operate to enable participants to purchase coverage only for periods during which dependent care assistance will be received. See Q&A-8 regarding the revocation of elections during the period of coverage on account of changes in family status.

Finally, if coverage under a dependent care assistance program is a benefit offered under a cafeteria plan, the rules of section 129 will determine the status of the benefit as a taxable or nontaxable benefit. As a result, coverage under a dependent care assistance program in a cafeteria plan will be nontaxable for a plan year only if, among other requirements, the principal shareholder and owner discrimination test contained in section 129(d)(4) is satisfied with respect to employer contributions actually used to provide participants with dependent care assistance during the plan year. In addition, amounts paid or incurred by the employer under a dependent care assistance program are excludable from gross income only to the extent that these amounts do not exceed the lesser of the participant's earned income or the participant's spouse's earned income.

Rules similar to the rules applicable to dependent care assistance programs apply with respect to coverage under a qualified group legal services plan (section 120) offered as a benefit under a cafeteria plan.

Q-19: What are the rules governing whether a cafeteria plan is discriminatory?

A-19: The applicable discrimination rules under section 125 provide that, in order to be treated as nondiscriminatory for a plan year, a cafeteria plan must not disciminate in favor of highly compensated participants as to benefits and contributions for that plan year. Generally, this discrimination determination will be made on the basis of the facts and circumstances of each case. Section 125(c) provides that a cafeteria plan does not discriminate where either (i) total nontaxable benefits and total benefits or (ii) employer contributions allocable to total nontaxable benefits and employer contributions allocable to total benefits do not discriminate in favor of highly compensated participants. A cafeteria plan must satisfy section 125(c) with respect to both benefit availability and benefit selection. Thus, a plan must give each participant an equal opportunity to select nontaxable benefits, and the actual selection of nontaxable benefits under the plan must not be discriminatory, i.e., highly compensated participants do not disproportionately select nontaxable benefits while other participants select taxable benefits.

In addition to not discriminating as to either benefit availability or benefit selection, a cafeteria plan must not discriminate in favor of highly compensated participants in actual operation. A plan may be discriminatory in actual operation if the duration of the plan (or of a particular nontaxable benefit offered under the plan) coincides with the period during which highly compensated participants utilize the plan (or the benefit).

Q-20: May nontaxable benefits provided under a cafeteria plan be counted as "compensation" under section 401(a)(5) for purposes of determining whether a qualified pension, profit-sharing, or stock bonus plan discriminates under section 401(a)(4), or under section 415 for purposes of the limitations contained in that section?

A-20: A qualified pension, profit-sharing, or stock bonus plan will not be treated as discriminatory within the meaning of section 401(a)(4) merely because, for purposes of allocating contributions to the participant or calculating the participant's benefit under the plan, the plan considers nontaxable benefits provided to a participant as compensation. For example, if a participant in a cafeteria plan elects coverage under an accident or health plan, the value of such coverage may be considered as com-

pensation under a qualified plan for purposes of calculating the participant's allocation or benefit under the qualified plan. Nontaxable reimbursements under the accident or health plan, however, generally may not be treated as compensation under a qualified plan. Similarly, the value of coverage under a dependent care assistance program may be counted as compensation under a qualified plan for allocation and benefit purposes, but nontaxable reimbursements of dependent care expenses under the program generally may not be treated as compensation for these purposes. On the other hand, a qualified plan will not be treated as discriminatory under section 401(a)(4) merely because the plan does not consider nontaxable benefits, such as coverage under an accident or health plan or coverage under a dependent care assistance program, as compensation for allocation or benefit purposes under the plan.

For purposes of section 415, "compensation" does not include amounts that are excluded from gross income, such as premiums for group-term life insurance under section 79 or employer contributions to an accident or health plan excluded under section 106.

Q-21: What are the effective dates of the rules contained in these questions and answers?

A-21: These rules contained in questions and answers relating to section 125 generally shall apply to plan years of cafeteria plans beginning after December 31, 1978. However, a cafeteria plan that failed to satisfy one or more of the following rules for plan years beginning before May 7, 1984 will not be deemed thereby to have failed to satisfy section 125 for such plan years if, by September 4, 1984, the plan is amended to operate in accordance with these rules: (i) the rules requiring certain information to be included in the cafeteria plan document (Q&A-3), (ii) the rules governing the active participation of a participant's spouse in a cafeteria plan (Q&A-4), (iii) only in the case of a plan under which participants were permitted neither to carry over unused benefits for more than one plan year nor to convert, into any other benefits, any unused benefits that had been carried over to a subsequent plan year, the rules prohibiting the carryover of any unused contribution or benefit from one plan year to a subsequent plan year (Q&A-7), and (iv) the rules limiting the revocability of benefit elections (Q&A-8). A cafeteria plan may treat the portion of its current plan year remaining after September 4, 1984 as a new period of coverage for purposes of satisfying the rules governing benefit elections (Q&A-8). Also, benefit offering participants the opportunity to make elective contributions under a qualified cash or deferred arrangement may be included in a cafeteria plan only in plan years beginning after December 31, 1980.

The rules contained in Q&A-17 governing the taxability of coverage and benefits under an accident or health plan relate specifically to sections 105 and 106 and thus generally are effective with respect to all taxable years beginning after December 31, 1953. The rules contained in Q&A-18 governing the taxability of coverage and benefits under a dependent care assistance program relate specifically to section 129 and thus generally are effective with respect to all taxable years beginning after December 31, 1981. The rules contained in Q&A-18 governing the taxability of coverage and benefits under a qualified group legal services plan relate specifically to section 120 and thus generally are effective with respect to all taxable years beginning after December 31, 1976. However, if coverage under an accident or health plan, dependent care assistance program, or qualified group legal services plan was offered as a benefit under a cafeteria plan and such benefit failed to satisfy, before May 7, 1984, the rule prohibiting a plan from operating to enable a participant to elect coverage under an accident or health plan, a dependent care assistance program, or a qualified group legal services plan only for periods during which the participant expects to receive medical care, dependent care, or legal services (Q&A-17 and Q&A-18), such benefit will not be deemed solely on account of such failure to have failed to satisfy the statutory rules providing for the income exclusion of such coverage or of any benefits provided thereunder, if, by September 4, 1984, the cafeteria plan is amended to operate in accordance with such election of coverage rule. A cafeteria plan may treat the portion of its current plan year remaining after September 4, 1984 as a new period of coverage and as an initial plan year for purposes of satisfying the rule prohibiting a plan from operating to enable participants to elect coverage under an accident or health plan, dependent care assistance program, or qualified group legal services plan only for periods during which they expect to receive medical care, dependent care, or legal services (Q&A-17 and Q&A-18).

In addition, if the conditions set forth below are satisfied, employer contributions (including elective and nonelective contributions) made before June 1, 1984, under an arrangement described in the next sentence which is part of a cafeteria plan, will not be treated as having been made to an accident or health plan, dependent care assistance program, or qualified group legal services plan that fails to satisfy the rules contained in the second and third paragraphs of Q&A-17 and the first paragraph of Q&A-18, merely because, for a plan year, a participant was entitled to receive, in the form of cash or any other taxable or nontaxable benefit, amounts available for reimbursement under the arrangement without regard to whether covered expenses are incurred. An arrangement is described in this sentence only if, under the arrangement,

(i) an account was actually established on behalf of the participant by the employer, by an entry on the employer's books or in similar fashion, prior to the beginning of the plan year (or prior to the date on which an individual first becomes eligible to participate under the arrangement in the case of an individual who first becomes eligible to participate, on account of years of employment, during the plan year);

(ii) the amount (or specific rate) of

contributions to the account under the arrangement was fixed prior to the beginning of the plan year;

(iii) neither the participant nor the employer possessed the right to increase or decrease contributions to the account during the plan year (but a plan may provide that contributions could be terminated during the year on account of the participant's (a) separation from service or (b) cessation of participation under the arrangement for the remainder of the plan year);

(iv) contributions were actually deposited in or credited to the account before being made available for reimbursement; and

(v) distributions were not available for reasons other than reimbursement of covered expenses until the end of the plan year (but a plan may provide that a single distribution of the unreimbursed balance may be made on account of the participant's (a) separation from service or (b) cessation of participation under the arrangement for the remainder of the plan year).

A cafeteria plan may operate on a plan year other than the calendar year for purposes of this transitional rule, so long as terms of the plan permit contributions to a plan to be fixed only once during, and a distribution of the unreimbursed amount to be received, only once for any plan year, provided that contributions may be fixed for a short plan year of the plan's first period of operation. This transitional rule does not affect or alter the requirement of Q&A-17 and-18 that expenses that are reimbursed under an arrangement must have been incurred during the period for which the participant actually is covered by the arrangement.

ROSCOE L. EGGER, JR.
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on May 2, 1984, 2:49 p.m., and published in the issue of the Federal Register for May 7, 1984, 49 F.R. 19321)

Notice of Proposed Rulemaking

Second Tier Excise Taxes

EE-16-81

SUMMARY: This document contains proposed regulations relating to second tier excise taxes. Changes to the applicable tax law were made by Pub. L. No. 96-596 [1980-2 C.B. 653]. The regulations will affect private foundations, black lung benefit trusts, pension plans, and disqualified persons with respect to the foregoing, who may become liable for second tier taxes within the meaning of section 4962(b) of the Internal Revenue Code of 1954.

DATES: Written comments and requests for a public hearing must be delivered or mailed by April 13, 1984. The amendments are proposed to be effective for second tier taxes assessed after December 24, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T:EE-16-81, Washington, D.C. 20224

FOR FURTHER INFORMATION CONTACT: George B. Baker of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T:EE-16-81, 202-566-3422 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Foundation and Similar Excise Taxes Regulations (26 CFR Part 53), to the Pension Excise Taxes Regulations (26 CFR Part 54), to the Temporary Excise Tax Regulations under the Employee Retirement Income Security Act of 1974, (26 CFR Part 141), and to the Procedure and Administration Regulations (26 CFR Part 301), under sections 4941, 4942, 4943, 4944, 4945, 4961, 4962, 4971, 4975, 6213, 6503, 6861, and 7422. These amendments are proposed to conform the regulations to section 2 of the Act of December 24, 1980 (Pub. L. No. 96-596, 94 Stat. 3469) and are to be issued under the authority of section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

PRIOR LAW

The Internal Revenue Code imposes excise taxes in two tiers to insure compliance with certain provisions of the Code by private foundations, black lung benefit trusts, pension trusts, and disqualified persons with respect to the foregoing entities. A first tier excise tax is imposed automatically if the foundation, trust, or disqualified person engages in a prohibited act (such as self-dealing between a disqualified person and a private foundation), or fails to perform a required act (such as private foundation's failure to distribute the amount described in section 4942). A much larger second tier excise tax is imposed for failing to correct the prohibited act or failure to act within a "correction period."

In *Adams v. Commissioner,* 72 T.C. 81 (1979), the Tax Court held that it lacked the authority to redetermine a deficiency of second tier tax with respect to an act of self dealing by a private foundation under Code section 4941(b). The court found that because the second tier tax was not "imposed" until after the court's decision was final, it did not have jurisdiction to redetermine a deficiency of that tax.

AMENDMENTS TO LAW

The Code was revised by section 2 of Pub. L. 96-596 to impose the second tier taxes at the end of a "taxable period," which begins with the event giving rise to the tax and ends on the earliest of (i) the date a notice of deficiency with respect to the first tier tax is mailed, or (ii) the date the first tier tax is assessed if no deficiency notice is mailed, or (iii) (in come cases) the date the taxable act is corrected.

Under new section 4961, if the taxpayer corrects the act (or failure to act) giving rise to the second tier tax within a "correction period," the tax is not to be assessed, and if assessed, it is to be abated, and if collected, it is to be credited or refunded as an overpayment. If the taxpayer files a petition with the Tax Court to redetermine the deficiency within the time limits of section 6213, the tax also is not to be assessed until the decision of the Tax Court becomes final (under

Code section 7481). The correction period begins on the day the taxable event occurs and ends 90 days after the date of mailing of a notice of deficiency with respect to the second tier tax, extended by any period during which section 6213 bars assessment (determined without regard to section 4961) including the period (where applicable) until the decision of the Tax Court becomes final. The correction period may also be extended for any period the Service determines is reasonable and necessary to bring about correction.

If no petition is filed with the Tax Court, the tax will be assessed. If the taxpayer pays the first tier tax in full, files a claim for refund of the amount paid, and files a refund suit if the claim is denied, all within the specified time limits, collection of an assessed second tier tax is suspended during administrative and judicial refund procedures.

Under section 4961, the court that determines that the second tier tax was properly imposed has jurisdiction to conduct supplemental proceedings to determine whether the taxable act was corrected within the correction period.

Finally, the amount involved for second tier tax under section 4941, 4951, or 4975, is the highest fair market value during the taxable period (rather than the correction period).

These revisions to the Code are effective for first tier taxes as if included in the Code when the tax was first imposed. The revisions are effective only for second tier taxes assessed after December 24, 1980, but do not operate to permit the assessment of a second tier tax in a case to which, on December 24, 1980, the doctrine of res judicata applied.

PROPOSED AMENDMENTS

These amendments are proposed to conform the regulations to the changes to the Code made by section 2 of Pub. L. 96-596.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The Internal Revenue Service invites comments on the proposal to delete from existing regulations the special rule for determining the end of the taxable period. *See, e.g.,* §53.4941(e)-1(a)(3). The Service may consider retaining the existing rule (and including it in the regulations under section 4975) when final regulations are published.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations was George B. Baker of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Proposed amendments to the regulations

Amendments to 26 CFR parts 53, 54, 141, and 301 are proposed as follows:

FOUNDATION AND SIMILAR EXCISE TAXES

[26 CFR Part 53]

Paragraph 1. Section 53.4941(b)-1(a) is amended by striking out the words "correction period (as defined in §53.4941(e)-1(d))." and insertng the words "taxable period (as defined in §53.4941(e)-1(a))." in lieu thereof.

Par. 2. Section 53.4941(e)-1 is amended: first, by removing subparagraph (3) of paragraph (a); second, by redesignating subparagraph (4) of paragraph (a) as subparagraph (3) of paragraph (a) and by revising Example (3) of the redesignated subparagraph; third, by striking out, in subparagraph (3) of paragraph (b) and in Example (2) of paragraph (e)(2)(ii), the words "correction period" and inserting the words "taxable period" in lieu thereof; fourth, by revising subparagraph (1) of paragraph (a); fifth, by revising Example (4) of paragraph (b)(4); and sixth, by revising paragraph (d), to read as follows:

§53.4941(e)-1 Definitions.

(a) *Taxable period*—(1) *In general.* For purposes of any act of self-dealing, the term "taxable period" means the period beginning with the date on which the act of self-dealing occurs and ending on the earliest of:

(i) The date of mailing of a notice

of deficiency under section 6212 with respect to the tax imposed by section 4941(a)(1),

(ii) The date on which correction of the act of self-dealing is completed, or

(iii) The date on which the tax imposed by section 4941(a)(1) is assessed.

* * * * *

(3) *Examples.****

Example (3). On July 16, 1980, F, a manager of private foundation X acting on behalf of the foundation, knowing his act to be one of self-dealing, willfully and without reasonable cause engaged in an act of self-dealing by selling certain real estate to A, a disqualified person. On March 25, 1981, A files a waiver of the restrictions on assessment and collection of the tax imposed on the sale under section 4941(a)(1) and the tax is assessed on April 1, 1981. The taxable period with respect to the act of self-dealing for both A and F is July 16, 1980, through April 1, 1981.

(b) *Amount involved.* ***

(4) *Examples.* ***

Example (4). D, a disqualified person with respect to private foundation T, purchases 100 shares of stock from T for $5,000 on June 15, 1982. The fair market value of the 100 shares of stock on that date is $4,800. D sells the 100 shares of stock on December 20, 1983, for $6,000. On December 27, 1983, a notice of deficiency with respect to the taxes imposed under subsections (a) and (b) of section 4941 is mailed to D and the taxable period ends. D fails to correct during the taxable period. Between June 15, 1982, and the end of the taxable period, the stock was quoted on the New York Stock Exchange at a high of $67 per share. The amount involved with respect to the tax imposed under subsection (a) is $5,000, and the amount involved with respect to the tax imposed under subsection (b) for failure to correct is $6,700 (100 shares at $67 per share), the highest fair market value during the taxable period.

* * * * *

(d) *Cross reference.* For rules relating to taxable events that are corrected within the correction period, defined in section 4962(e), see section 4961(a), and the regulations thereunder.

* * * * *

Par. 3. Section 53.4942(a)-1 is amended: (1) by striking out, in subparagraph (2) of paragraph (a), the words "correction period" and "paragraph (c)(3)" and inserting the words "taxable period" and "paragraph (c)(1)" respectively in lieu thereof; (2) by removing Example (3) from subparagraph (4) of paragraph (c); and (3) by revising subparagraph (4) of paragraph (a) and subparagraphs (1) and (3) of paragraph (c) to read as follows:

§53.4942(a)-1 Taxes for failure to distribute income.

(a) *Imposition of tax.* ***

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). *M*, a private foundation which uses the calendar year as its taxable year, has at the end of 1981, $50,000 of undistributed income (as defined in paragraph (a) of §53.4942(a)-2) for 1981. As of January 1, 1983, $40,000 is still undistributed. On August 15, 1983, a notice of deficiency with respect to the excise taxes imposed by section 4942(a) and (b) is mailed to *M* under section 6212(a) and the taxable period ends. Thus, under these facts, an initial excise tax of $6,000 (15 percent of $40,000) is imposed upon *M*. An additional excise tax of $40,000 (100 percent of $40,000) is imposed by section 4942(b). Under section 4961(a), however, if the undistributed income is reduced to zero during the correction period, this latter tax will not be assessed, and if assessed, it will be abated, and if collected, it will be credited or refunded as an overpayment.

Example (2). Assume the facts as stated in example (1), except that the notice of deficiency is mailed to *M* on Sepember 7, 1984, and as of January 1, 1984, only $10,000 of the $50,000 of undistributed income with respect to 1981 is undistributed. Therefore, initial excise taxes of $6,000 (15 percent of $40,000, M's undistributed income from 1981, as of January 1, 1983) and $1,500 (15 percent of $10,000, *M*'s undistributed income from 1981 as of January 1, 1984) are imposed by section 4942(a). If the $10,000 remains undistributed as of September 7, 1984, the end of the taxable period, an additional excise tax of $10,000 (100 percent of $10,000, *M*'s undistributed income from 1981, as of September 7, 1984) is imposed by section 4942(b).

* * * * *

(c) *Certain periods.* For purposes of this section—

(1) *Taxable period.* The term "taxable period" means, with respect to the undistributed income of a private foundation for any taxable year, the period beginning with the first day of the taxable year and ending on the earlier of:

(i) The date of mailing of a notice of deficiency under section 6212(a) with respect to the initial excise tax imposed under section 4942(a), or

(ii) The date on which the initial excise tax imposed under section 4942(a) is assessed.

For example, assume *M*, a private foundation which uses the calendar year as the taxable year, has $15,000 of undistributed income for 1981. A notice of deficiency is mailed to *M* under section 6212(a) on June 1, 1983. With respect to the undistributed income of *M* for 1981, the taxable period began on January 1, 1981, and ended on June 1, 1983.

* * * * *

(3) *Cross reference.* For rules relating to taxable events that are corrected within the correction period, defined in section 4962(e), see section 4961(a) and the regulations thereunder.

* * * * *

Par. 4. Section 53.4942(a)-3 is amended by revising Example (2) in paragraph (d)(3) to read as follows:

§53.4942(a)-3 Qualifying distributions defined.

* * * * *

(d) *Treatment of qualifying distributions.* ***

(3) *Examples.* ***

Example (2). *M*, a private foundation which uses the calendar year as the taxable year, has undistributed income of $300 for 1981, $200 for 1982, and $400 for 1983. On January 14, 1983, *M* makes its first qualifying distribution in 1983 when it sets aside (within the meaning of paragraph (b) of this section) $700 for construction of a hospital. On February 24, 1983 a notice of deficiency with respect to the excise taxes imposed by section 4942(a) and (b) in regard to *M*'s undistributed income for 1981 is mailed to *M* under section 6212(a). *M* notifies the Commissioner in writing on March 24, 1983, that it is making an election under subparagaph (2) of this paragraph to have its distribution of January 14th applied first against its undistributed income for 1982, next against its undistributed income for 1981, and last against its undistributed income for 1983. Thus, $200 of the $700 qualifying distribution is treated as made out of the undistributed income for 1982; $300, out of undistributed income for 1981; and $200 ($700 less the sum of $200 and $300), out of the undistributed income for 1983. Thus, an initial excise tax of $45 (15 percent of $300) is imposed under section 4942 (a). Since *M* made the election described above, the $300 (treated as distributed out of undistributed income for 1981) corrects (within the meaning of section 4962(d)(2)) the taxable act because the undistributed income for 1981 is reduced to zero. Furthermore, correction is effected within the correction period (as defined in section 4962(e)(1) and §53.4962-1(e)). Therefore, under the provisions of section 4961(a), the additional tax imposed by section 4942(b) will not be assessed.

* * * * *

Par. 5. Section 53.4943-2 is amended by revising paragraph (b) to read as follows:

§53.4943-2 Imposition of tax on excess business holdings of private foundations.

* * * * *

(b) *Additional tax.* In any case in which the initial tax is imposed under

section 4943(a) with respect to the holdings of a private foundation in any business enterprise, if, at the close of the taxable period (as defined in section 4943(d)(2) and §53.4943-9) with respect to such holdings the foundation still has excess business holdings in such enterprise, there is imposed a tax under section 4943(b) equal to 200 percent of the value of such excess holdings as of the last day of the taxable period.

Par. 6. Section 53.4943-9 is amended by revising subparagraphs (1) and (2) of paragraph (a), and by revising paragraph (b) to read as follows:

§53.4943-9 Business holdings; certain periods.

(a) *Taxable period*—(1) *In general.* For purposes of section 4943, the term "taxable period" means, with respect to any excess business holdings of a private foundation in a business enterprise, the period beginning with the first day on which there are such excess business holdings and ending on the earliest of:

(i) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed on the holdings by section 4943(a);

(ii) The date on which the excess is eliminated; or

(iii) The date on which the tax imposed by section 4943(a) is assessed.

(2) *Example.* *M*, a private foundation, first has excess business holdings in *X*, a corporation, on February 5, 1972. A notice of deficiency is mailed under section 6212 to *M* on June 1, 1974. With respect to *M*'s excess business holdings in *X*, the taxable period begins on February 5, 1972, and ends on June 1, 1974.

* * * * *

(b) *Cross reference.* For rules relating to taxable events that are corrected within the correction period, defined in section 4962(e), see section 4961(a) and the regulations thereunder.

* * * * *

Par. 7. Section 53.4944-2 is amended by striking out the words "correction period" throughout the section and inserting the words "taxable period" in lieu thereof and by striking out, in paragraph (a), the words "4944(e)(3)" and inserting the words "4944(e)(1)" in lieu thereof.

Par. 8. Section 53.4944-5 is amended by revising paragraphs (a) and (d) to read as follows:

§53.4944-5 Definitions.

(a) *Taxable period.* For purposes of section 4944, the term "taxable period" means, with respect to any investment which jeopardizes the carrying out of a private foundation's exempt purposes, the period beginning with the date on which the amount is invested and ending on the earliest of:

(1) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed on the making of the investment by section 4944(a)(1);

(2) The date on which the amount invested is removed from jeopardy; or

(3) The date on which the tax imposed by section 4944(a)(1) is assessed.

* * * * *

(d) *Cross reference.* For rules relating to taxable events that are corrected within the correction period, defined in section 4962(e), see section 4961(a) and the regulations thereunder.

Par. 9. Section 53.4945-1 is amended: (1) by striking out, in subparagraph (1) of paragraph (b), the words "correction period" and inserting the words "taxable period" in lieu thereof; and (2) by revising Example (2) in paragraph (c)(3) and by revising paragraph (e) to read as follows:

§53.4945-1 Taxes on taxable expenditures.

* * * * *

(c) *Special rules.* ***

(3) *Examples.* ***

Example (2). Assume the same facts as in example (1). Further assume that within the taxable period A makes a motion to correct the taxable expenditure at a meeting of the board of directors. The motion is defeated by a two-to-one vote, A voting for the motion and B and C voting against it. In these circumstances an additional tax is imposed on the private foundation in the amount of $100,000 (100 percent of $100,000). The additional tax imposed on B and C is $10,000 (50 percent of $100,000 subject to a maximum of $10,000). B and C are jointly and severally liable for the $10,000, and this sum may be collected by the Service from either of them.

* * * * *

(e) *Certain periods*—(1) *Taxable period.* For purposes of section 4945, the term "taxable period" means, with respect to any taxable expenditure, the period beginning with the date on which the taxable expenditure occurs and ending on the earlier of:

(i) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed on taxable expenditures by section 4945(a)(1); or

(ii) The date on which the tax imposed by section 4945(a)(1) is assessed.

(2) *Cross reference.* For rules relating to taxable events that are corrected within the correction period, defined in section 4962(e), see section 4961(a) and the regulations thereunder.

Par. 10. Subpart K of Part 53 is redesignated subpart L, and a new subpart K is added to read as follows:

SUBPART K—SECOND TIER EXCISE TAXES

§53.4961-1 Abatement of second tier taxes for correction within correction period.

If any taxable event is corrected during the correction period for the event, then any second tier tax imposed with respect to the event shall not be assessed. If the tax has been assessed, it shall be abated. If the tax has been collected, it shall be credited or refunded as an overpayment. For purposes of this section, the tax imposed includes interest, additions to the tax and additional amounts. For definitions of the terms "second tier tax," "taxable event," "correct," and "correction period," see §53.4962-1.

53.4961-2 Court proceedings to determine liability for second tier tax.

(a) *Introduction.* Under section 4961(b) and (c), the period of limitations on collection may be suspended and assessment or collection of first or second tier tax may be prohibited during the pendency of administrative and judicial proceedings conducted to determine a taxpayer's liability for second tier tax. This section provides rules relating to the suspension of the limitations period and the prohibitions on assessment and collec-

tion. In addition, this section describes the administrative and judicial proceedings to which these rules apply.

(b) *Initial proceeding*—(1) *Defined.* For purposes of subpart K, an initial proceeding means a proceeding described in subparagraph (2) or (3).

(2) *Tax Court proceeding before assessment.* A proceeding is described in this subparagraph (2) if it is a proceeding with respect to the taxpayer's liability for second tier tax and is commenced in accordance with section 6213(a).

(3) *Refund proceeding commenced before correction period ends.* A proceeding is described in this subparagraph (3) if it is a proceeding commenced under section 7422, in accordance with the provisions of §53.4962-1(e)(4) and (5) (relating to prerequisites to extension of the correction period during certain refund proceedings), and with respect to the taxpayer's liability for second tier tax.

(c) *Supplemental proceeding*—(1) *Jurisdiction.* If a determination in an initial proceeding that a taxpayer is liable for a second tier tax has become final, the court in which the initial proceeding was commenced shall have jurisdiction to conduct any necessary supplemental proceeding to determine whether the taxable event was corrected during the correction period.

(2) *Time for beginning proceeding.* The time for beginning a supplemental proceeding begins on the day after a determination in an initial proceeding becomes final and ends on the 90th day after the end of the correction period.

(d) *Restriction on assessment during Tax Court proceeding.* If a supplemental proceeding described in section 4961(b) and §53.4961-2(c) is commenced in the Tax Court, the provisions of the second and third sentences of section 6213(a) and the first and third sentences of §301.6213-1(a)(2) apply with respect to a deficiency in second tier tax until the decision of the Tax Court in the supplemental proceeding is final.

(e) *Suspension of period of collection for second tier tax*—(1) *Scope.* Except as provided in subparagraph (6), this paragraph (e) applies to the second tier tax assessed with respect to a taxable event if a claim described in subparagraph (2) is filed.

(2) *Claim for refund.* A claim for refund is described in this subparagraph (2) if, no later than 90 days after the day on which the second tier tax is assessed with respect to a taxable event, the taxpayer—

(i) Pays the full amount of first tier tax for the taxable period, and

(ii) Files a claim for refund of the amount paid.

(3) *Collection prohibited.* No levy or proceeding in court for the collection of the second tier tax shall be made, begun, or prosecuted until the end of the collection prohibition period described in subparagraph (5). Notwithstanding section 7421(a), the collection by levy or proceeding may be enjoined during the collection prohibition period by a proceeding in the proper court.

(4) *Suspension of running of period of limitations on collection.* With respect to a second tier tax to which this paragraph (e) applies, the running of the period of limitations provided in section 6502 (relating to collection of tax by levy or by a proceeding in court) shall be suspended for the collection prohibition period described in subparagraph (5).

(5) *Collection prohibition period.* The collection prohibition period begins on the day the second tier tax is assessed and ends on the latest of:

(i) The day a decision in a refund proceeding commenced before the 91st day after denial of the claim described in subparagraph (2) of this paragraph (including any supplemental proceeding under §53.4961-2(c)) becomes final;

(ii) The 90th day after the claim referred to in subparagraph (2) is denied; or

(iii) The 90th day after the second tier tax is assessed.

(6) *Jeopardy collection.* If the Secretary makes a finding that the collection of the second tier tax is in jeopardy, nothing in this paragraph (e) shall prevent the immediate collection of such tax.

(f) *Finality*—(1) *Tax Court proceeding.* For purposes of this subpart K, section 7481 applies in determining when a decision in a Tax Court proceeding becomes final.

(2) *Refund proceeding.* For purposes of this subpart K, §301.7422-1 applies in determining when a decision in a refund proceeding becomes final.

§53.4962-1 Definitions.

(a) *First tier tax.* For purposes of this subpart K, the term "first tier tax" means any tax imposed by subsection (a) of section 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4971, or 4975. A first tier tax may also be referred to as an "initial tax" in parts 53 and 54.

(b) *Second tier tax.* For purposes of this subpart K, the term "second tier tax" means any tax imposed by subsection (b) of section 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4971, or 4975. A second tier tax may also be referred to as an "additional tax" in parts 53 and 54.

(c) *Taxable event.* For purposes of this subpart K, the term "taxable event" means any act, or failure to act, giving rise to liability for tax under section 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4971, or 4975.

(d) *Correct*—(1) *In general.* Except as provided in subparagraph (2), the term "correct" has the same meaning for purposes of this subpart K as in the section which imposes the second tier tax or the regulations thereunder.

(2) *Special rules.* The term "correct" means—

(i) For a second tier tax imposed by section 4942(b), reducing the amount of the undistributed income to zero,

(ii) For a second tier tax imposed by section 4943(b), reducing the amount of the excess business holdings to zero, and

(iii) For a second tier tax imposed by section 4944(b), removing the investment from jeopardy.

(e) *Correction period*—(1) *In general.* The correction period with respect to any taxable event shall begin with the date on which the taxable event occurs and shall end 90 days after the date of mailing of a notice of deficiency under section 6212 with re-

spect to the second tier tax imposed with respect to the taxable event.

(2) *Extensions of correction period.* The correction period referred to in subparagraph (1) of this paragraph shall be extended by any period in which a deficiency cannot be assessed under section 6213(a). In addition, the correction period referred to in subparagraph (1) of this paragraph (e) shall be extended in accordance with subparagraphs (3), (4), and (5) of this paragraph except that subparagraph (4) or (5) shall not operate to extend a correction period with respect to which a taxpayer has filed a petition with the United States Tax Court for redetermination of a deficiency within the time prescribed by section 6213(a).

(3) *Extensions by Commissioner.* The correction period referred to in subparagraph (1) of this paragraph may be extended by any period which the Commissioner determines is reasonable and necessary to bring about correction (including, for taxes imposed by section 4975, equitable relief sought by the Secretary of Labor) of the taxable event. The Commissioner ordinarily will not extend the correction period unless the following factors are present:

(i) The taxpayer on whom the second tier tax is imposed, the Secretary of Labor (for taxes imposed by section 4975), or an appropriate State officer (as defined in section 6104(c)(2)) is actively seeking in good faith to correct the taxable event;

(ii) Adequate corrective action cannot reasonably be expected to result during the unextended correction period;

(iii) For taxes imposed by section 4975, the Secretary of Labor requests the extension because subdivision (ii) applies; and

(iv) For taxes imposed by chapter 42 (other than taxes imposed by section 4940), the taxable event appears to have been an isolated occurrence so that it appears unlikely that similar taxable events will occur in the future.

(4) *Extension for payment of first tier tax.* If, within the unextended correction period, the taxpayer pays the full amount of the first tier tax imposed with respect to the taxable event the Commissioner shall extend the correction period to the later of—

(i) Ninety days after the payment of the first tier tax, or

(ii) The last day of the correction period determined without regard to this paragraph.

(5) *Extensions for filing claim for refund or refund suit.* If prior to the expiration of the correction period (including extensions) a claim for refund is filed with respect to payment of the full amount of the first tier tax imposed with respect to the taxable event, the Commissioner shall extend the correction period during the pendency of the claim plus an additional 90 days. If within that time a suit or proceeding referred to in section 7422(g) with respect to the claim is filed, the Commissioner shall extend the correction period until the determination in the suit for refund (determined without regard to a supplemental proceeding under section 4961(b)) is final, determined under §301.7422-2(a).

(6) *End of correction period if waiver accepted.* If the notice of deficiency referred to in paragraph (1) is not mailed because there is a waiver of the restrictions on assessment and collection of the deficiency or because the deficiency is paid, the correction period will end with the end of the collection prohibition period described in §53.4961-2(e)(5).

(7) *Date on which taxable event occurs.* For purposes of subparagraph (1), the taxable event shall be treated as occurring—

(i) Under section 4942, on the first day of the taxable year for which there is undistributed income,

(ii) Under section 4943, on the first day on which there are excess business holdings,

(iii) Under section 4971, on the last day of the plan year in which there is an accumulated funding deficiency, and

(iv) In all other cases, the date on which the event occurred.

(f) *Effective date.* The provisions of this subpart K are effective with respect to second tier taxes assessed after December 24, 1980. The preceding sentence shall not be construed to permit the assessment of a tax in a case to which, on December 24, 1980, the doctrine of res judicata applied.

PENSION EXCISE TAX REGULATIONS

[26 CFR Part 54]

Par. 11. Section 54.4971-1 is amended by adding paragraphs (c) and (e) to read as follows:

§54.4971-1 General rules relating to excise tax on failure to meet minimum funding standards.

* * * * *

(c) *Additional tax.* Section 4971(b) imposes an excise tax in any case in which an initial tax is imposed under section 4971(a) on an accumulated funding deficiency and the accumulated funding deficiency is not corrected within the taxable period (as defined in section 4971(c)(3)). The additional tax is 100 percent of the accumulated funding deficiency to the extent not corrected.

* * * * *

(e) *Definition of taxable period.* For purposes of any accumulated funding deficiency, the term "taxable period" means the period beginning with the end of the plan year in which there is an accumulated funding deficiency and ending on the earlier of:

(1) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed by section 4971(a), or

(2) The date on which the tax imposed by section 4971(a) is assessed.

Par. 12. The following section is inserted in the appropriate place:

§54.4975-1 General rules relating to excise tax on prohibited transactions.

(a) *Scope.* This section provides general rules for the imposition of the excise taxes on prohibited transactions.

(b) *Initial tax.* Section 4975(a) imposes an initial tax on each prohibited transaction. The initial tax is 5 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period.

(c) *Additional tax.* Section 4975(b) imposes an excise tax in any case in

which an initial tax is imposed under section 4975(a) on a prohibited transaction and the prohibited transaction is not corrected within the taxable period (as defined in paragraph (d) of this section). The additional tax is 100 percent of the amount involved with respect to the prohibited transaction.

(d) *Taxable period.* For purposes of any prohibited transaction, the term "taxable period" means the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of:

(1) The date of mailing of a notice of deficiency under section 6212 with respect to the tax imposed by section 4975(a);

(2) The date on which correction of the prohibited transaction is completed; or

(3) The date on which the tax imposed by section 4975(a) is assessed.

TEMPORARY EXCISE TAX REGULATIONS UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

[26 CFR Part 141]

Par. 13. Section 141.4975-13 is amended: (1) by striking out the words "4975(f)(2), (4), (5) and (6)," and inserting the words "4975(f)(4) and (5)," in lieu thereof; and (2) by revising the title to read as follows:

§141.4975-13 Definition of "amount involved" and "correction".

* * * * *

PROCEDURE AND ADMINISTRATION

[26 CFR Part 301]

Par. 14. Section 301.6212-1 is amended by adding the following two sentences at the end of paragraph (c):

§301.6212-1 Notice of deficiency.

* * * * *

(c) *Further deficiency letters restricted.* *** Solely for purposes of applying the restriction of section 6212(c), a notice of deficiency with respect to second tier tax under chapter 43 shall be deemed to be a notice of deficiency for the taxable year in which the taxable event occurs. See §53.4962-1(e)(7)(iii) or (iv) for the date on which the taxable event occurs.

Par. 15. Section 301.6213-1 is amended by revising the first sentence of paragraph (e) to read as follows:

§301.6213-1 Restrictions applicable to deficiencies; petition to Tax Court.

* * * * *

(e) *Suspension of filing period for certain chapter 42 and chapter 43 taxes.* The period prescribed by section 6213(a) for filing a petition in the Tax Court with respect to the taxes imposed by section 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4971, or 4975, shall be suspended for any other period which the Commissioner has allowed for making correction under §53.4962-1(e)(3).***

Par. 16. Paragraph (a) of §301.6503(a)-1 is revised by adding a new subparagraph (3) to read as follows:

§301.6503(a)-1 Suspension of running of period of limitation; issuance of statutory notice of deficiency.

(a) *General rule.****

(3) For provisions relating to suspension of the running of the period of limitation with respect to collection of "second tier" excise taxes (as defined in section 4962) until final resolution of a refund proceeding described in sections 4961 and 7422 for the determination of the taxpayer's liability for the second tier taxes, see §53.4961-2(e)(4).

* * * * *

Par. 17. Section 301.6503(g)-1 is amended by striking out everything following the word "correction" and inserting "under section 4962 (e)(1)(B)." in lieu thereof.

Par. 18. Paragraph (g) of section 301.6861-1 is amended by removing the last sentence.

Par. 19. Section 301.7422-1 is revised to read as follows:

§301.7422-1 Special rules for certain excise taxes imposed by chapter 42 or 43.

(a) *Finality of refund proceeding.* For purposes of sections 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4961, 4962, 4971, and 4975, and the regulations thereunder, a decision in a suit for refund instituted under the provisions of this section shall be final—

(1) Upon the expiration of the time allowed for filing a notice of appeal from a decision of the United States Claims Court or of the United States District Court, if no timely notice of appeal is filed; or

(2) Upon the expiration of the time allowed for filing a petition for certiorari from a decision of the United States Claims Court, or from a decision of the United States District Court, which has been affirmed or the appeal dismissed by the United States Court of Appeals, if no timely petition for certiorari is filed; or

(3) If a petition for certiorari has been filed, thirty days from the denial of such petition; or

(4) Thirty days from the date of a decision of the United States Supreme Court if no timely petition for rehearing is filed; however, if a timely petition for rehearing from such a decision is filed, and is denied, thirty days from the denial thereof; or

(5) If a decision is entered upon a rehearing or if a decision is modified or reversed as the result of a decision of a higher court, upon the expiration, with respect to the decision on rehearing or the modified or reversed decision, of periods similar to those provided in subparagraphs (1) through (4).

(b) *Right to bring action.* With respect to any taxable event, payment of the full amount of first tier tax for the taxable period shall constitute sufficient payment in order to maintain an action under this section with respect to the second tier tax.

(c) *Limitation on suit for refund.* No suit may be maintained under this section for the credit or refund of any tax imposed under section 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4971, or 4975 with respect to any taxable event unless—

(1) No other suit has been maintained for credit or refund of any tax imposed by such sections with respect to such taxable event; and

(2) No petition has been filed in the Tax Court with respect to a deficiency in any tax imposed by such sec-

tions with respect to such taxable event.

(d) *Final determination of issues.* For purposes of this section, any suit for the credit or refund of any tax imposed under section 4941, 4942, 4943, 4944, 4945, 4951, 4952, 4971, or 4975, together with a supplemental proceeding (if any) under section 4961(b), with respect to any taxable event, shall constitute a suit to determine all questions with respect to any other tax imposed with respect to such taxable event under such sections. Consequently, failure by the parties to the suit to bring before the court any question described in the preceding sentence shall constitute a bar to the question.

(e) *Definitions.* For definitions of the terms "taxable event," "first tier tax," and "second tier tax," see §53.4962-1.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 10, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 13, 1984, 49 F.R. 5350)

Notice of Proposed Rulemaking

Computation of "Income" of an electric cooperative under section 501(c)(12)

EE-17-81

SUMMARY: This document contains proposed amendments to the Income Tax Registrations relating to electric cooperatives under section 501(c)(12) of the Internal Revenue Code of 1954. These proposed regulations will provide necessary guidance to those electric cooperatives making a determination of their exempt status under section 501(c)(12) and will affect such cooperatives and their members.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 12, 1984. The amendments are proposed to be effective for taxable years beginning after [THE DATE OF PUBLICATION OF THESE REGULATIONS IN THE FEDERAL REGISTER AS A TREASURY DECISION].

ADDRESS: Send comments and requests for a public hearing to Commissioner of Internal Revenue, Attention: CC:LR:T (EE-17-81), Washington, D.C. 20224).

FOR FURTHER INFORMATION CONTACT: Patricia K. Keesler of the Employee Plans and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Construction Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3430, not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations under section 501(c)(12) of the Internal Revenue Code of 1954. Section 501(c)(12) provides that local benevolent life insurance companies, mutual irrigation and telephone companies and like organizations are exempt from federal income tax if certain requirements are met. Rev. Rul. 67-265, 1967-2 C.B. 205, provides that a cooperative organization furnishing light and water to its members is a "like organization" within the meaning of section 501(c)(12). The proposed regulations amend the existing regulations to conform them to the current position of the Internal Revenue Service that cooperatives that furnish light, water, heat, gas, or electricity to their members are like organizations under 501(c)(12).

COMPUTATION OF INCOME

Under section 501(c)(12) an organization must receive 85 percent or more of its income from members in order to be exempt from federal taxation. The existing regulations do not provide a method for electric cooperatives to compute income for purposes of the 85 percent member-income test. This lack of clarity has caused administrative difficulties for the Service as well as the public. The proposed amendments to the regulations provide that income is determined by subtracting cost of goods sold from gross sales and cost of goods sold is determined in accordance with the full absorption method of inventory costing under §1.471-11 of the Income Tax Regulations. Comments are requested on alternative methods of computing cost cost of goods sold, in lieu of or in addition to the full absorption method.

EFFECTIVE DATE

The requirement that an electric cooperative's income be determined by subtracting the cost of goods sold from gross sales would be effective for taxable years beginning after the date on which final regulations are issued. For taxable years beginning before final regulations are issued, an electric cooperative may continue to determine its income for purposes of the 85 percent member-income test pursuant to the method consistently applied by the organization prior to January 10, 1984.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner has determined that this proposed regulation is not a major regulation for purposes of Executive Order 12291. Accordingly, a regulatory impact analysis is not required.

Although this document is a notice of proposed rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A

public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Patricia K. Keesler of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

It is proposed to amend 26 CFR Part 1 by adding the following new §1.501(c)(12)-2 immediately after §1.501(c)(12)-1:

§1.501(c)(12)-2 Like Organizations.

(a) *In general.* For purposes of section 501(c)(12) and §1.501(c)(12)-1, the term "like organization" includes an organization that furnishes light, water, heat, gas or electricity to its members on a cooperative basis. Thus, for example, a cooperative that provides electricity to its members may qualify for exemption from federal income taxes as a "like organization" under section 501(c)(12) provided 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(b) *Electric cooperatives.* For taxable years of an electric cooperative beginning after [THE DATE ON WHICH THIS REGULATION IS PUBLISHED AS A TREASURY DECISION], income from the sale of electricity shall be determined for purposes of applying the 85 percent member-income test by subtracting the cost of producing or purchasing electricity (whichever is applicable) from the gross receipts derived from sales of electricity. The cost of producing or purchasing electricity shall be determined in the manner described in §1.471-11, relating to the full absorption method of inventory. Section 1.471-11 shall apply as if the sale of electricity were an income producing factor, with inventories required at the beginning and end of each taxable year. However, notwithstanding any contrary provision in §1.471-11, for purposes of this section, the cost of producing electricity shall not include patronage dividends (as defined in section 1388(a)), whether paid by way of cash or qualified or nonqualified written notice of allocation.

(c) *Example.* The following example illustrates the provisions of this section.

Example. For its most recently completed taxable year, an electric power cooperative had gross receipts of $185*x*: $170*x* from sales of electricity to its members, $10*x* from sales of electricity to nonmembers, and $5*x* from capital gains, dividends and interest. The cost of goods sold, determined in accordance with the provisions of §1.471-11, was $102*x* for the sales to members and $6*x* for the sales to nonmembers. For purposes of the 85 percent member-income requirement of section 501(c)(12), the electric power cooperative's "income" from sales of electricity to its members is its gross income of $68*x* ($170*x* from sales to members minus $102*x*, cost of goods sold to members). Its "income" from sales of electricity to nonmembers is its gross income of $4*x* ($10*x* from sales to nonmembers minus $6*x*, cost of goods sold to nonmembers). Therefore, of the total gross income of $77*x* ($68*x* from sales to members plus $4*x* from sales to nonmembers plus $5*x* from capital gains, dividends and interest), the amount collected from members for the sole purpose of meeting losses and expenses is 88 percent ($68*x* gross income from members dividend by total gross income of $77*x*). Thus, the cooperative meets the 85 percent test of section 501(c)(12).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January, 1984, and published in the issue of the Federal Register for January 10, 1984, 49 F.R. 1244)

Notice of Proposed Rulemaking

Individual Retirement Plans, Simplified Employee Pensions, and Qualified Voluntary Employee Contributions

EE-148-81

SUMMARY: This document contains proposed regulations relating to individual retirement plans, simplified employee pensions, and qualified voluntary employee contributions. Changes to the applicable law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations would provide the public with the guidance needed to comply with the Act. The regulations would affect: institutions which sponsor individual retirement plans and simplified employee pensions, employers and individuals who use individual retirement plans and simplified employee pensions for retirement income, employers who maintain plans which accept qualified voluntary employee contributions and employees who make qualified voluntary employee contributions.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 23, 1984. The regulations are generally effective for taxable years beginning after December 31, 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-148-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: William D. Gibbs of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1), the Estate Tax Regulations (26 CFR Part 20), the Gift Tax Regulations (26 CFR Part 25), and the Procedure and Administration Regulations (26 CFR Part 301) under sections 219, 408, 409, 415, 2039, 2517, and 6652 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to sections 311 (except subsection (b)) and 314(b) of the Economic Recovery Tax Act of 1981 (95 Stat. 274, 286) [Pub. L. 97-

34, 1981-2 C.B. 256, 310, 317]. These regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

INDIVIDUAL RETIREMENT PLANS

Section 219, as amended by the Economic Recovery Tax Act of 1981, allows an individual a deduction of up to the lesser of $2,000 or compensation includible in gross income for contributions to an individual retirement plan. Unlike old section 219, an individual is allowed this deduction whether or not he is an "active participant" in an employer's plan. The deduction for individual retirement plan contributions is reduced, however, by amounts which the employee contributes to an employer's plan and treats as qualified voluntary employee contributions. The remainder of the individual retirement plan rules are similar to those under prior law.

SPOUSAL INDIVIDUAL RETIREMENT ACCOUNTS

Code section 220 was deleted by the Economic Recovery Tax Act of 1981. In its place is new section 219(c), which allows an individual and his nonworking spouse to contribute up to the lesser of compensation includible in the working spouse's gross income or $2,250 to individual retirement accounts. The spouses must file a joint return to obtain this additional $250 deduction. No deduction is allowed if the spouse for whose benefit the individual retirement plan is maintained has attained age 70½ before the close of the taxable year.

There is no requirement, as under old law, that equal amounts be contributed to the individual retirement accounts of both spouses. However, no more than $2,000 may be contributed to the individual retirement account of either spouse.

SIMPLIFIED EMPLOYEE PENSIONS

The Economic Recovery Tax Act of 1981 increased the maximum deduction for contributions to simplified employee pensions to the lesser of 15% of compensation from the employer maintaining the simplified employee pension arrangement or the amount contributed by the employer to the simplified employee pension and included in gross income (but not in excess of $15,000). An employee may also contribute and deduct the lesser of $2,000 or compensation includible in gross income regardless of the employer's contribution to the simplified employee pension.

QUALIFIED VOLUNTARY EMPLOYEE CONTRIBUTIONS

Section 219, as amended by the Economic Recovery Tax Act of 1981, allows an individual a deduction for qualified voluntary employee contributions (QVEC's). QVEC's are voluntary contributions made by an individual as an employee under an employer's plan. The employer's plan must allow employees to make contributions which may be treated as QVEC's.

The maximum amount which can be deducted as a QVEC is the lesser of $2,000 or the compensation includible in gross income from the employer which maintains the plan which accepts the QVEC's.

Proposed §1.219(a)-5(a) sets forth in type of plans which can accept qualified voluntary employee contributions.

Proposed §1.219(a)-5(c) sets forth the rules a plan must follow to receive qualified voluntary employee contributions.

Additional rules for QVEC's are set forth in proposed §1.219(a)-5(d), (e), and (f).

The reporting rules for qualified voluntary employee contributions are in proposed §1.219(a)-5(g). This provision gives the Commissioner discretionary authority to modify the reporting requirements for these contributions. Any such modification of the reporting requirements would be subject to review by the Office of Management and Budget under the Paperwork Reduction Act of 1980.

OTHER AMENDMENTS

Conforming and technical amendments made by the Economic Recovery Tax Act of 1981 have been made to the regulations under Code sections 408, 409, 415, 2039, 2517, and 6652.

Although the Treasury Department stopped selling retirement bonds in early 1982, the regulations contain references to Code sections 405 and 409. These references apply to retirement bonds sold through early 1982 and to retirement bonds that may be sold subsequently.

These proposed regulations do not reflect amendments made to the Code by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. These proposed regulations reflect changes in the applicable statutory provisions made by the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451].

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner has determined that this proposed regulation is not a major regulation for persons of Executive Order 12291. Accordingly, a regulatory impact analysis is not required.

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act of 1980. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Office for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is William D. Gibbs of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Parts 1, 20, 25, and 301 are as follows:

INCOME TAX REGULATIONS

[26 CFR Part 1]

Paragraph 1. There are added after proposed §1.219-3, 46 Fed. Reg. 36202 (1981) [EE-7-78, 1981-2 C.B. 735, 740] the following new sections 1.219(a)-1 through 1.219(a)-6:

§1.219(a)-1 Deduction for contributions to individual retirement plans and employer plans under the Economic Recovery Tax Act of 1981.

(a) *In general.* Under section 219, as amended by the Economic Recovery Tax Act of 1981, an individual is allowed a deduction from gross income for amounts paid on his behalf to an individual retirement plan or to certain employer retirement plans. The following is a table of contents for the rules for deductions on behalf of individuals to individual retirement plans or employer plans.

§1.219(a)-2: Individual retirement plans.

§1.219(a)-3: Spousal individual retirement accounts.

§1.219(a)-4: Simplified employee pensions.

§1.219(a)-5: Employer plans.

§1.219(a)-6: Divorced individuals.

(b) *Definitions.* The following is a list of terms and their definitions to be used for purposes of this section and §§1.219(a)-2 through 1.219(a)-6:

(1) *Individual retirement plan.* The term "individual retirement plan" means an individual retirement account described in section 408(a), an individual retirement annuity described in section 408(b), and a retirement bond described in section 409.

(2) *Simplified employee pension.* The term "simplified employee pension" has the meaning set forth in §1.408-7(a).

(3) *Compensation.* The term "compensation" means wages, salaries, professional fees, or other amounts derived from or received for personal service actually rendered (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, and bonuses), but does not include amounts derived from or received as earnings or profits from property (including, but not limited to, interest and dividends) or amounts not includible in gross income such as amounts excluded under section 911. Compensation includes earned income, as defined in section 401(c)(2), reduced by amounts deductible under sections 404 and 405. Compensation does not include amounts received as deferred compensation, including any pension or annuity payment. Compensation does not include unemployment compensation within the meaning of section 85(c).

(4) *Qualified voluntary employee contribution.* The term "qualified voluntary employee contribution" means any employee contribution which is not a mandatory contribution within the meaning of section 411(c)(2)(C) made by an individual as an employee under a qualified employer plan or government plan, which plan allows an employee to make such contributions, and which the individual has not designated as a contribution other than a qualified voluntary employee contribution. Thus, if employee contributions are required as a condition of plan participation, they are mandatory contributions within the meaning of section 411(c)(2)(C) and cannot be treated as qualified voluntary employee contributions.

(5) *Qualified retirement contribution.* The term "qualified retirement contribution" means any amount paid in cash for the taxable year by or on behalf of an individual for his benefit to an individual retirement plan and any qualified voluntary employee contribution paid in cash by the individual for the taxable year.

(6) *Deductible employee contribution.* The term "deductible employee contribution" means any qualified voluntary employee contribution made after December 31, 1981, in a taxable year beginning after such date and allowable as a deduction under section 219(a) for such taxable year.

(7) *Qualified employer plan.* The term "qualified employer plan" means—

(i) A plan described in section 401(a) which includes a trust exempt from tax under section 501(a).

(ii) An annuity plan described in section 403(a).

(iii) A qualified bond purchase plan described in section 405(a), and

(iv) A plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

(8) *Government plan.* The term "government plan" means any retirement plan, whether or not qualified, established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

(c) *Effective date.* This section and §§1.219(a)-2 through 1.219(a)-6 are effective for taxable years of individ-

uals beginning after December 31, 1981.

§1.219(a)-2 Deduction for contributions to individual retirement plans under the Economic Recovery Tax Act of 1981.

(a) *In general.* Subject to the limitations and restrictions of paragraph (b) and the special rules of paragraph (c)(3) of this section, there shall be allowed a deduction under section 62 from gross income of amounts paid for the taxable year of an individual by or on behalf of such individual to an individual retirement plan. The deduction described in the preceding sentence shall be allowed only to the individual on whose behalf such individual retirement plan is maintained and only in the case of a contribution of cash. No deduction is allowable under this section for a contribution of property other than cash. In the case of a retirement bond, no deduction is allowed if the bond is redeemed within 12 months of its issue date.

(b) *Limitations and restrictions*—(1) *Maximum deduction.* The amount allowable as a deduction for contributions to an individual retirement plan to an individual for any taxable year cannot exceed the lesser of—

(i) $2,000, or

(ii) An amount equal to the compensation includible in the individual's gross income for the taxable year.

reduced by the amount of the individual's qualified voluntary employee contributions for the taxable year.

(2) *Contributions after age 70½.* No deduction is allowable for contributions to an individual retirement plan to an individual for the taxable year of the individual if he has attained the age of 70½ before the close of such taxable year.

(3) *Rollover contributions.* No deduction is allowable under §1.219(a)-2(a) for any taxable year of an individual with respect to a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 405(d)(3), 408(d)(3), or 409(b)(3)(C).

(4) *Amounts contributed under endowment contracts.* (i) For any taxable year, no deduction is allowable under §1.219(a)-2(a) for amounts paid under an endowment contract described in §1.408-3(e) which is allocable under subdivision (ii) of this subparagraph to the cost of life insurance.

(ii) For any taxable year, the cost of current life insurance protection under an endowment contract described in paragraph (b)(4)(i) of this section is the product of the net premium cost, as determined by the Commissioner, and the excess, if any, of the death benefit payable under the contract during the policy year beginning in the taxable year over the cash value of the contract at the end of such policy year.

(c) *Special rules*—(1) *Separate deduction for each individual.* The maximum deduction allowable for contributions to an individual retirement plan is computed separately for each individual. Thus, if a husband and wife each has compensation of $15,000 for the taxable year, the maximum amount allowable as a deduction on their joint return is $4,000. See §1.219(a)-3 for the maximum deduction for a spousal individual retirement plan when one spouse has no compensation.

(2) *Community property.* Section 219 is to be applied without regard to any community property laws. Thus, if, for example, a husband and wife, live in a community property jurisdiction, the husband has compensation of $30,000 for the taxable year, and the wife has no compensation for the taxable year, then the maximum amount allowable as a deduction for contributions to an individual retirement plan, other than a spousal individual retirement plan, is $2,000.

(3) *Employer contributions.* For purposes of this chapter, any amount paid by an employer to an individual retirement plan of an employee (other than a self-employed individual who is an employee within the meaning of section 401(c)(1)) constitutes the payment of compensation to the employee. The payment is includible in the employee's gross income, whether or not a deduction for such payment is allowable under section 219 to this employee. An employer will be entitled to a deduction for compensation paid to an employee for amounts the employer contributes on the employee's behalf to an individual retirement plan if such deduction is otherwise allowable under section 162. See §1.404(h)-1 for certain limitations on this deduction in the case of employer contributions to a simplified employee pension.

(4) *Year of inclusion in income.* Any amount paid by an employer to an individual retirement plan (including retirement account or individual retirement annuity maintained as part of a simplified employee pension arrangement) shall be included in the gross income of the employee for the taxable year for which the contribution was made.

(5) *Time when contributions deemed made.* A taxpayer shall be deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of the taxable year which includes such last day and is made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). A contibution made not later than the time prescribed by law for filing the return for a taxable year (including extensions thereof) shall be treated as made on account of such taxable year if it is irrevocably specified in writing to the trustee, insurance company, or custodian that the amounts contributed are for such taxable year.

(d) *Excess contributions treated as contribution made during subsequent year for which there is an unused limitation*—(1) *In general.* This paragraph sets forth rules for the possible deduction of excess contributions made to an individual retirement plan for the taxable years following the taxable year of the excess contribution. If for a taxable year subsequent to the taxable year for which the excess contribution was made, the maximum amount allowable as a deduction for contributions to an individual retirement plan exceeds the amount contributed, then the taxpayer, whether or not a deduction is actually claimed, shall be treated as having made an additional contribution for the taxable year in an amount

equal to the lesser of—

(i) The amount of such excess, or

(ii) The amount of the excess contributions for such taxable year (determined under section 4973(b)(2) without regard to subparagraph (C) thereof).

(2) *Amount contributed.* For purposes of this paragraph, the amount contributed—

(i) Shall be determined without regard to this paragraph, and

(ii) Shall not include any rollover contribution.

(3) *Special rule where excess deduction was allowed for closed year.* Proper reduction shall be made in the amount allowable as a deduction by reason of this paragraph for any amount allowed as a deduction for contributions to an individual retirement plan for a prior taxable year for which the period for assessing a deficiency has expired if the amount so allowed exceeds the amount which should have been allowed for such prior taxable year.

(4) *Excise tax consequences.* See section 4973 and the regulations thereunder for the excise tax applicable to excess contributions made to individual retirement plans.

(5) *Examples.* The provisions of this paragraph may be illustrated by the following examples. (Assume in each example, unless otherwise stated, that T is less than age 70½ and is not married.)

Example (1). (i) T, a calendar-year taxpayer, earns $1,500 in compensation includible in gross income for 1982. On December 1, 1982, T establishes an individual retirement account (IRA) and contributes $2,000 to the account. T does not withdraw any money from the IRA after the initial contribution. Under section 219(b)(1), the maximum amount that T can deduct for 1982 is $1,500. T has an excess contribution for 1982 of $500.

(ii) For 1983, T has compensation includible in gross income of $12,000. T makes a $1,000 contribution to his IRA for 1983.

(iii) Although T made only a $1,000 contribution to his tax for 1983, under the rules contained in this paragraph, T is treated as having made an additional contribution of $500 for 1983 and will be allowed to deduct $1,500 as his 1983 IRA contribution.

Example (2). (i) For 1982, the facts are the same as in *Example (1).*

(ii) For 1983, T has compensation includible in gross income of $12,000. T makes a $2,000 contribution to his IRA for 1983.

(iii) T will be allowed a $2,000 deduction for 1983 (the amount of his contribution). T will not be allowed a deduction for the $500 excess contribution made in 1982 because the maximum amount allowable for 1983 does not exceed the amount contributed.

Example (3). (i) For 1982, the facts are the same as in *Example (1).*

(ii) For 1983, T has compensation includible in gross income of $12,000. T makes a $1,800 contribution to his IRA for 1983.

(iii) For 1983, T will be allowed to deduct his contribution of $1,800 and $200 of the excess contribution made for 1982. He will not be allowed to deduct the remaining $300 of the excess contribution made for 1982 because his deduction for 1983 would then exceed $2,000, his allowable deduction for 1983.

(iv) For 1984, T has compensation includible in gross income of $15,000. T makes a $1,300 contribution to his IRA for 1984.

(v) T will be allowed to deduct both his $1,300 contribution for 1984 and the remaining $300 contribution made for 1982.

Example (4). (i) For 1982, the facts are the same as in *Example (1).*

(ii) For 1983, T has compensation includible in gross income of $12,000. T makes a $1,000 contribution to his IRA for 1983. T is allowed to deduct the $500 excess contribution for 1983 but fails to do so on his return. Consequently, T deducts only $1,000 for 1983.

(iii) Under no circumstances will T be allowed to deduct the $500 excess contribution made for 1982 for any taxable year after 1983 because T is treated as having made the contribution for 1983.

Example (5). For 1982, T has no compensation includible in gross income.

(iii) T will not be allowed to deduct for 1983 the $500 excess contribution for 1982 because the maximum amount allowable as a deduction under section 219(b)(1) is $0.

§1.219(a)-3 Deduction for retirement savings for certain married individuals.

(a) *In general.* Subject to the limitations and restrictions of paragraphs (c) and (d) and the special rules of paragraph (e) of this section, there shall be allowed a deduction under section 62 from gross income of amounts paid for the taxable year of an individual by or on behalf of such individual for the benefit of his spouse to an individual retirement plan. The amounts contributed to an individual retirement plan by or on behalf of an individual for the benefit of his spouse shall be deductible only by such individual and only in the case of a contribution of cash. No deduction is allowable under this section for a contribution of property other than cash. In the case of an individual retirement bond, no deduction is allowed if the bond is redeemed within 12 months of its issue date.

(b) *Definition of compensation.* For purposes of this section, the term "compensation" has the meaning set forth in §1.219(a)-1(b)(3).

(c) *Maximum deduction.* The amount allowable as a deduction under this section to an individual for any taxable year may not exceed the smallest of—

(1) $2,000,

(2) An amount equal to the compensation includible in the individual's gross income for the taxable year less the amount allowed as a deduction under section 219(a) (determined without regard to contributions to a simplified employee pension allowed under section 219(b)(2)), §1.219(a)-2 and §1.219(a)-5 for the taxable year, or

(3) $2,250 less the amount allowed as a deduction under section 219(a) (determined without regard to contributions to a simplified employee pension allowed under section 219(b)(2)), §1.219(a)-2 and §1.219(a)-5 for the taxable year.

(d) *Limitations and restrictions—*(1) *Requirement to file joint return.* No deduction is allowable under this section for a taxable year unless the individual and his spouse file a joint return under section 6013 for the taxable year.

(2) *Employed spouses.* No deduction is allowable under this section if the spouse of the individual has any compensation for the taxable year of such spouse ending with or within the taxable year of the individual. For purposes of this subparagraph, compensation has the meaning set forth in §1.219(a)-1(b)(3), except that compensation shall include amounts excluded under section 911.

(3) *Contributions after age 70½.* No deduction is allowable under this section with respect to any payment which is made for a taxable year of an individual if the individual for whose benefit the individual retirement plan is maintained has attained age 70½ before the close of such taxable year.

(4) *Recontributed amounts.* No deduction is allowable under this section for any taxable year of an individual with respect to a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 405(d)(3), 408(d)(3), or 409(b)(3)(C).

(5) *Amounts contributed under endowment contracts.* The rules for en-

dowment contracts under this section are the same as the provisions for such contracts under §1.219(a)-2(b)(4).

(e) *Special rules*—(1) *Community property.* This section is to be applied without regard to any community property laws.

(2) *Time when contributions deemed made.* The time when contributions are deemed made is determined under section 219(f)(3). See §1.219(a)-2(c)(5).

§1.219(a)-4 Deduction for contributions to simplified employee pensions.

(a) *General rule*—(1) *In general.* Under section 219(b)(2), if an employer contribution is made on behalf of an employee to a simplified employee pension described in section 408(k), the limitations of this section, and not section 219(b)(1) and §1.219(a)-2, shall apply for purposes of computing the maximum allowable deduction with respect to that contribution for that individual employee.

(2) *Employer limitation.* The maximum deduction under section 219(b)(2) for an employee with respect to an employer contribution to the employee's simplified employee pension under that employer's arrangement cannot exceed an amount equal to the lesser of—

(i) 15 percent of the employee's compensation from that employer (determined without regard to the employer contribution to the simplified employee pension) includible in the employee's gross income for the taxable year, or

(ii) The amount contributed by that employer to the employee's simplified employee pension and included in gross income (but not in excess of $15,000).

(3) *Special rules*—(i) *Compensation.* Compensation referred to in paragraph (a)(2)(i) has the same meaning as under §1.219)a)-1(b)(3) except that it includes only the compensation from the employer making the contribution to the simplified employee pension. Thus, if an individual earns $50,000 from employer A and $20,000 from employer B and employer B contributes $4,000 to a simplified employee pension on behalf of the individual, the maximum amount the individual will be able to deduct under section 219(b)(2) is 15 percent of $20,000, or $3,000.

(ii) *Special rule for officers, shareholders, and owner-employees.* In the case of an employee who is an officer, shareholder, or owner-employee described in section 408(k)(3) with respect to a particular employer, the $15,000 amount referred to in paragraph (a)(2)(ii) shall be reduced by the amount of tax taken into account with respect to such individual under section 408(d)(3)(D).

(iii) *More than one employer arrangement.* Except as provided in paragraph (c), below, the maximum deduction under paragraph (a)(2) for an individual who receives simplified employee pension contributions under two or more employers' simplified employee pension arrangements cannot exceed the sum of the maximum deduction limitations computed separately for that individual under each such employer's arrangement.

(iv) *Section 408 rules.* Under section 408(j), the limitations under section 408(a)(1) and (b)(2)(B) (§1.408-2(b)(1) and §1.408-3(b)(2)), shall be applied separately with respect to each employer's contributions to an individual's simplified employee pension.

(4) *Additional deduction for individual retirement plan and qualified voluntary employee contribution.* The deduction under this paragraph is in addition to any deduction allowed under section 219(a) to the individual for qualified retirement contributions.

(b) *Contributions to simplified employee pensions after age 70½.* The denial of deductions for contributions after age 70½ contained in section 219(d)(1) and §1.219(a)-2(b)(2) shall not apply with respect to employer contributions to a simplified employee pension.

(c) *Multiple employer, etc. limitations*—(1) *Section 414(b), (c) and (m) employers.* In the case of a controlled group of employers within the meaning of section 414(b) or (c) or employers aggregated under section 414(m), the maximum deduction limitation for an employee under paragraph (a)(2) shall be computed by treating such employers as one employer maintaining a single simplified employee pension arrangement and by treating the compensation of that employee from such employers as if from one employer. Thus, for example, for a particular employee the 15 percent limitation on compensation would be determined with regard to the compensation from all employers within such group. Further, the maximum deduction with respect to contributions made by employers included within such group could not exceed $15,000.

(2) *Self-employed individuals.* In the case of an employee who is a self-employed individual within the meaning of section 401(c)(1) with respect to more than one trade or business, the maximum deduction limitation for such an employee under paragraph (a)(2) shall not exceed the lesser of the sum of such limitation applied separately with respect to the simplified employee pension arrangement of each trade or business or such limitation determined by treating such trades or businesses as if they constituted a single employer.

(d) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Corporation X is a calendar-year, cash basis taxpayer. It adopts a simplified employee pension agreement in 1982 and wishes to contribute the maximum amount on behalf of each employee for 1982. Individual E is a calendar-year taxpayer who is employed solely by Corporation X in 1982. Beginning in June, 1982, Corporation X pays $100 each month into a simplified employee pension maintained on behalf of E. X makes a total payment to E's simplified employee pension during the year of $700. E's other compensation from X for the year totals $15,000. The maximum amount which E will be allowed to deduct as a simplified employee pension contribution is 15% of $15,000, or $2,250. Therefore, X may make an additional contribution for 1982 to E's simplified employee pension of $1,550. X makes this additional contribution to E's simplified employee pension in February of 1983. E's total compensation includible in gross income for 1982 is $15,000 + $2,250 or $17,250.

Example (2). (i) Corporation G is a calendar-year taxpayer which adopts a simplified employee pension agreement for 1982. It does not maintain an integrated plan as defined in section 408(k)(3)(E). It wishes to contribute 15% of compensation on behalf of each employee reduced by its tax under section 3111(a). The corporation has 4 employees, A, B, C, and

D. D is a shareholder. The compensation for these employees for 1982 is as follows:
A = $10,000
B = 20,000
C = 30,000
D = 120,000

(ii) The amount of money which the corporation will be allowed to contribute on behalf of each employee under this allocation formula and the amount of the employer contribution each employee will be allowed to deduct is set forth in the following table:

Employee	Compensation	Lesser of $15,000 or 15% of Comp.	3111(a) [1] Tax	SEP [2] Contribution	Sec. 219 (b)(2) deduction
A	$10,000	$1,500	$ 540.00	$ 960.00	$ 960.00
B	20,000	3,000	1,080.00	1,920.00	1,920.00
C	30,000	4,500	1,620.00	2,880.00	2,880.00
D	120,000	15,000	1,749.60	13,250.40	13,250.40

[1] The section 3111 (a) tax is computed by multiplying compensation up to the taxable wage base (32,400 for 1982) by the tax rate (5.40% for 1982).
[2] Simplified Employee Pension

Example (3). Corporations A and B are calendar year taxpayers. Corporations A and B are not aggregated employers under section 414(b), (c) or (m). Individual M is employed full-time by Corporation A and part-time by Corporation B. Corporation A adopts a simplified employee pension agreement for calendar year 1982 and agrees to contribute 15% of compensation for each participant. M is a participant under Corporation A's simplified employee pension agreement and earns $15,000 for 1982 from Corporation A before A's contribution to his simplified employee pension. M also earns $5,000 as a part-time employee of Corporation B for 1982. Corporation A contributes $2,500 to M's simplified employee pension. The maximum amount that M will be allowed to deduct under section 219(b)(2) for 1982 is 15% of $15,000 or $2,250. In addition, M would be allowed to deduct the remaining $250 under section 219(a) for qualified retirement contributions.

Example (4). Individual P is employed by Corporation H and Corporation O. Corporations H and O are not aggregated employers under section 414(b), (c) or (m). Both Corporation H and Corporation O maintain a simplified employee pension arrangement and contribute 15 percent of compensation on behalf of each employee, up to a maximum of $15,000. P earns $100,000 from Corporation H and $120,000 from Corporation O. Corporation H and O each contribute $15,000 under its simplified employee pension arrangement to an individual retirement account maintained on behalf of P. P will be allowed to deduct $30,000 for employer contributions to simplified employee pensions because each employer has a simplified employee pension arrangement and the SEP contributions by Corporation H and O do not exceed the applicable $15,000-15 percent limitation with respect to compensation received from each employer. In addition, P would be allowed to deduct $2,000 under section 219(a) for qualified retirement contributions.

§1.219(a)-5 Deduction for employee contributions to employer plans.

(a) *Deduction allowed.* In the case of an individual, there is allowed as a deduction amounts contributed in cash to a qualified employer plan or government plan (as defined, respectively, in paragraphs (b)(7) and (b)(8) of §1.219(a)-1) and designated as qualified voluntary employee contributions. If an employee transfers an amount of cash from one account in a plan to the qualified voluntary employee contribution account, such transfer is a distribution for purposes of sections 72, 402 and 403, and the amounts are considered recontributed as qualified voluntary employee contributions. No deduction will be allowed for a contribution of property other than cash.

(b) *Limitations*—(1) *Maximum amount of deduction.* The amount allowable as a deduction under paragraph (a) to any individual for any taxable year shall not exceed the lesser of $2,000 or an amount equal to the compensation (from the employer who maintains the plan) includible in the individual's gross income for such taxable year.

(2) *Contributions after age 70½.* No deduction is allowable for contributions under paragraph (a) to an individual for the taxable year of the individual if he has attained the age of 70½ before the close of such taxable year.

(3) *Rollover contributions.* No deduction is allowable under paragraph (a) for any taxable year of an individual with respect to a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 405 (d)(3), 408(d)(3), or 409(b)(3)(C).

(c) *Rules for plans accepting qualified voluntary employee contributions*—(1) *Plan provision, etc.* (i) No plan may receive qualified voluntary employee contributions unless the plan document provides for acceptance of voluntary contributions. No plan may receive qualified voluntary employee contributions unless either the plan document provides for acceptance of qualified voluntary employee contributions or the employer or the plan administrator manifests an intent to accept such contributions. Such intention must be communicated to the employees. Any manner of communication that satisfies §1.7476-2(c)(1) shall satisfy the requirements of this subparagraph.

(ii) If the plan document provides for the acceptance of voluntary contributions, but does not specifically provide for acceptance of qualified voluntary employee contributions, the plan qualification limitation on voluntary contributions (the limit of 10 percent of the employee's cumulative compensation less prior voluntary contributions) would apply to both qualified voluntary employee contributions and other voluntary contributions. On the other hand, if the plan document provides for acceptance of both qualified voluntary employee contributions and other voluntary contributions, the plan qualification limitation on voluntary contributions would apply only to the contributions other than the qualified voluntary employee contributions.

(2) *Plans accepting only qualified voluntary employee contributions.* A qualified pension plan or stock bonus plan may be established that provides only for qualified voluntary employee contributions. Similarly, a government plan may be established that provides only for qualified voluntary employee contributions. A plan that provides only for qualified voluntary employee contributions would not satisfy the qualification requirements for a profit-sharing plan.

(3) *Recordkeeping provisions.* Separate accounting for qualified voluntary employee contributions that are deductible under this section is not required as a condition for receiving qualified voluntary employee contributions. However, failure to properly account for such contributions may result in adverse tax consequences to employees upon subsequent plan distributions and reporting and recordkeeping penalties for employers. See section 72(o) for rules for accounting for such contributions.

(4) *Status as employee.* An account will not be considered as a qualified voluntary employee contribution on behalf of an individual unless the individual is an employee of the employer at some time during the calendar year for which the voluntary contribution is made. See section 415(c) concerning the effect of a nondeductible voluntary employee contribution on plan qualification.

(5) *Contribution before receipt of compensation.* A plan may allow an individual to make a qualified voluntary employee contribution greater than the amount he has received in compensation from the employer at the time the contribution is made. However, see paragraph (f) of this section.

(d) *Designations, procedures, etc.*—(1) *Plan procedures.* (i) A plan which accepts qualified voluntary employee contributions may adopt procedures by which an employee can designate the character of the employee's voluntary contributions as either qualified voluntary employee contributions or other employee contributions. Such procedures may, but need not, be in the plan document.

(ii) In the absence of such plan procedures, all voluntary employee contributions shall be deemed to be qualified voluntary employee contributions unless the employee notifies the employer that the contributions are not qualified voluntary employee contributions. Such notification must be received by April 15 following the calendar year for which such contributions were made. If such notification is not received, contributions are deemed to be qualified voluntary employee contributions for the prior year.

(2) *Characterization procedures, etc.* (i) The plan procedures may allow an employee to elect whether or not an employee contribution is to be treated as a qualified voluntary employee contribution or as other voluntary contributions. This election can be required either prior to or after the contribution is made. If a contribution may be treated under such procedures as a qualified voluntary employee contribution or other voluntary contribution for a calendar year and the employee has not by April 15 of the subsequent calendar year designated the character of the contribution, the contribution must be treated as a qualified voluntary employee contribution for the calendar year. An employer may allow the election to be irrevocable or revocable. A procedure allowing revocable elections may limit the time within which an election may be revoked. The revocation of an election after April 15 following the calendar year for which the contribution was made is deemed to be ineffective in changing the character of employee contributions.

(ii) For purposes of this section, if the plan procedures allow employees to make contributions on account of the immediately preceding calendar year, a taxpayer shall be deemed to have made a qualified voluntary employee contribution to such plan on the last day of the preceding calendar year if the contribution is on account of such year and is made by April 15 of the calendar year or such earlier time as provided by the plan procedure.

(e) *Nondiscrimination requirements*—(1) *General rule.* Plans subject to the nondiscrimination requirements of section 401(a)(4) which accept qualified voluntary employee contributions must permit such contributions in a nondiscriminatory manner in order to satisfy section 401(a)(4). If a plan permits participants to make qualified voluntary employee contributions, the opportunity to make such contributions must be reasonably available to a nondiscriminatory group of employees. The availability standard will be satisfied if a nondiscriminatory group of employees is eligible to make qualified voluntary employee contributions under the terms of the plan and if a nondiscriminatory group of employees actually has the opportunity to make qualified voluntary employee contributions when plan restrictions are taken into account.

(2) *Eligible employees.* A nondiscriminatory group of employees is eligible to make qualified voluntary employee contribution under the terms of the plan if the group either meets the percentage requirements of section 410(b)(1)(A) or comprises a classification of employees that does not discriminate in favor of employees who are officers, shareholders, or highly compensated, as provided in section 410(b)(1)(B).

(3) *Plan restrictions.* In some cases, an employee may not be permitted to make qualified voluntary employee contributions until a plan restriction (such as making a certain level of mandatory employee contributions) is satisfied. In this case, it is necessary to determine whether a nondiscriminatory group of employees actually has the opportunity to make qualified voluntary employee contributions. For this purpose, only employees who have satisfied the plan restriction will be considered to have the opportunity to make deductible contributions. Thus, for example, if a plan requires an employee to make mandatory contributions of 6 percent of compensation in order to make qualified voluntary employee contributions and if only a small percentage of employees make the 6 percent mandatory contributions, then the group of employees who have the opportunity to make qualified voluntary employee contributions may not satisfy either test under section 410(b). A similar rule is applicable to integrated plans: employees who are not permitted to make qualified voluntary employee contributions to such a plan because they earn less than the integration level amount will be considered as employees who do not have the opportunity to make qualified voluntary employee contributions.

(4) *Permissible contributions.* If the availability standards are met, and if the qualified voluntary employee contributions permitted are not higher, as a percentage of compensation, for officers, shareholders or highly compensated employees than for other participants, the qualified voluntary employee contribution feature will meet the requirement that contributions or benefits not discriminate in favor of employees who are officers, shareholders, or highly compensated. This is so because the contributions are made by the employee, not the employer.

(5) *Acceptable contributions.* A

plan may accept qualified voluntary employee contributions in an amount less than the maximum deduction allowable to an individual.

(f) *Excess qualified voluntary employee contributions.* Voluntary employee contributions which exceed the amount allowable as a deduction under paragraph (b) of this section will be treated as nondeductible voluntary employee contributions to the plan. See §1.415-6(b)(8).

(g) *Reports*—(1) *Requirements.* Each employer who maintains a plan which accepts qualified voluntary employee contributions must furnish to each employee—

(i) A report showing the amount of qualified voluntary employee contributions the employee made for the calendar year, and

(ii) A report showing the amount of withdrawals made by the employee of qualified voluntary employee contributions during the calendar year.

(2) *Times.* (i) The report required by paragraph (g)(1)(i) of this section must be furnished by the later of January 31 following the year for which the contribution was made or the time the contribution is made.

(ii) The report required by paragraph (g)(1)(ii) of this section must be furnished by January 31 following the year of withdrawal.

(3) *Authority for additional reports.* The Commissioner may require additional reports to be given to individuals or to be filed with the Service. Such reports shall be furnished at the time and in the manner that the Commissioner specifies.

(4) *Authority to modify reporting requirements.* The Commissioner may, in his discretion, modify the reporting requirements of this paragraph. Such modification may include: the matters to be reported, the forms to be used for the reports, the time when the reports must be filed or furnished, who must receive the reports, the substitution of the plan administrator for the employer as the person required to file or furnish the reports, and the deletion of some or all of the reporting requirements. The Commissioner may, in his discretion, relieve employers from making the reports required by section 219(f)(4) and this paragraph (g). This discretion includes the ability to relieve categories of employers (but not individual employers) from furnishing or filing any report required by section 219(f)(4) and this paragraph (g).

(5) *Effective date.* This paragraph shall apply to reports for calendar years after 1982.

§1.219(a)-6 Alternative deduction for divorced individuals.

(a) *In general.* A divorced individual may use the provisions of this section rather than §1.219(a)-2 in computing the maximum amount he may deduct as a contribution to an individual retirement plan. A divorced individual is not required to use the provisions of this section; he may use the provisions of §1.219(a)-2 in computing the maximum amount he may deduct as a contribution to an individual retirement plan.

(b) *Individuals who may use this section.* An individual may compute the deduction for a contribution to an individual retirement plan under this section if—

(1) An individual retirement plan was established for the benefit of the individual at least five years before the beginning of the calendar year in which the decree of divorce or separate maintenance was issued, and

(2) For at least three of the former spouse's most recent taxable years ending before the taxable year in which the decree was issued, such former spouse was allowed a deduction under section 219(c) (or the corresponding provisions of prior law) for contributions to such individual retirement plan.

(c) *Limitations*—(1) *Amount of deduction.* An individual who computes his deduction for contributions to an individual retirement plan under this section may deduct the smallest of—

(i) The amount contributed to the individual retirement plan for the taxable year,

(ii) $1,125, or

(iii) The sum of the amount of compensation includible in the individual's gross income for the taxable year and any qualifying alimony received by the individual during the taxable year.

(2) *Contributions after age 70½.* No deduction is allowable for contributions to an individual retirement plan to an individual for the taxable year of the individual if he has attained the age of 70½ before the close of such taxable year.

(3) *Rollover contributions.* No deduction is allowable under this section for any taxable year of an individual with respect to a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 405(d)(3), 408(d)(3), or 409(b)(3)(C).

(d) *Qualifying alimony.* For purposes of this section, the term "qualifying alimony" means amounts includible in the individual's gross income under section 71(a)(1) (relating to a decree of divorce of separate maintenance).

Par. 2. Section 1.408-2 is amended by revising paragraph (b)(1) to read as follows:

§1.408-2 Individual retirement accounts.

* * * * *

(b) ***

(1) *Amount of acceptable contributions.* Except in the case of a contribution to a simplified employee pension described in section 408(k) and a rollover contribution described in section 408(d)(3), 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 405(d)(3), or 409(b)(3)(C), the trust instrument must provide that contributions may not be acceptable by the trustee for the taxable year in excess of $2,000 on behalf of any individual for whom the trust is maintained. An individual retirement account maintained as a simplified employee pension may provide for the receipt of up to the limits specified in section 408(j) for a calendar year.

* * * * *

Par. 3. Section 1.408-3 is amended by revising paragraph (b)(2) to read as follows:

§1.408-3 Individual retirement annuities.

* * * * *

(b) ***

(2) *Annual premium.* Except in the case of a contribution to a simplified employee pension described in section 408(k), the annual premium on behalf of any individual for the annuity cannot exceed $2,000. Any refund of premiums must be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits. An individual retirement annuity maintained as a simplified employee pension may provide for an annual premium of up to the limits specified in section 408(j).

* * * * *

Par. 4. There is added after proposed §1.408-9, 46 Fed. Reg. 36209 (1981) [EE-7-78, 1981-2 C.B. 735, 747], the following new section 1.407.10:

§1.408-10 Investment in collectibles.

(a) *In general.* The acquisition by an individual retirement account or by an individually-directed account under a plan described in section 401(a) of any collectible shall be treated (for purposes of section 402 and 408) as a distribution from such account in an amount equal to the cost to such account of such collectible.

(b) *Collectible defined.* For purposes of this section, the term "collectible" means—

(1) Any work or art,

(2) Any rug or antique,

(3) Any metal or gem,

(4) Any stamp or coin,

(5) Any alcoholic beverage,

(6) Any musical instrument,

(7) Any historical objects (documents, clothes, etc.), or

(8) Any other tangible personal property which the Commissioner determines is a "collectible" for purposes of this section.

(c) *Individually-directed account.* For purposes of this section, the term "individually-directed account" means an account under a plan that provides for individual accounts and that has the effect of permitting a plan participant to invest or control the manner in which the account will be invested.

(d) *Acquisition.* For purposes of this section, the term acquisition includes purchase, exchange, contribution, or any method by which an individual retirement account or individually-directed account may directly or indirectly acquire a collectible.

(e) *Cost.* For purposes of this section, cost means fair market value.

(f) *Premature withdrawal penalty.* The ten percent penalty described in sections 72(m)(5) and 408(f)(1) shall apply in the case of a deemed distribution from an individual retirement account described in paragraph (a) of this section.

(g) *Amounts subsequently distributed.* When a collectible is actually distributed from an individual retirement account or an individually-directed account, any amounts included in gross income because of this section shall not be included in gross income at the time when the collectible is actually distributed.

(h) *Effective date.* This section applies to property acquired after December 31, 1981, in taxable years ending after such date.

Par. 5. Proposed section 1.409-1, 46 Fed. Reg. 36210 (1981) [EE-7-78, 1981-2 C.B. 735, 748], is amended by revising paragraph (b)(2)(i) to read as follows:

§1.409-1 Retirement bonds.

* * * * *

(b) ***

(2) *Exceptions.* (i) If a retirement bond is redeemed within 12 months after the issue date, the proceeds are excluded from gross income if no deduction is allowed under section 219 on account of the purchase of such bond. For definition of issue date, see 31 CFR §346.1(c). The rule in this subdivision (i) shall not apply to the extent that the bond was purchased with a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 405(d)(3), 408(d)(3) or 409(b)(3)(C).

* * * * *

Par. 6. Section 1.415-1 is amended by removing paragraph (c) and paragraph (f)(3).

Par. 6A. Section 1.415-2 is amended by removing paragraph (b)(8).

Par. 7. Section 1.415-6 is amended by: (1) revising paragraph (b)(3) as set forth below, (2) removing subdivision (iv) of paragraph (b)(7), and (3) adding a new paragraph (b)(8) as set forth below.

§1.415-6 Limitation for defined contribution plans.

* * * * *

(b) *Annual additions.* ***

(3) *Employee contributions.* For purposes of subparagraph (1)(ii) of this paragraph, the term "annual additions" includes, to the extent employee contributions would otherwise be taken into account under this section as an annual addition, mandatory employee contributions (as defined in section 411(c)(2)(C) and the regulations thereunder) as well as voluntary employee contributions. The term "annual additions" does not include—

(i) Rollover contributions (as defined in section 402(a)(5), 403(a)(4), 403(b)(8), 405(d)(3), 408(d)(3) and 409(b)(3)(C)),

(ii) Repayments of loans made to a participant from the plan,

(iii) Repayments of amounts described in section 411(a)(7)(B) (in accordance with section 411(a)(7)(C)) and section 411(a)(3)(D) (see §1.411(a)-7(d)(6)(iii)(B)),

(iv) The direct transfer of employee contributions from one qualified plan to another,

(v) Employee contributions to a simplified employee pension allowable as a deduction under section 219(a), or

(vi) Deductible employee contributions within the meaning of section 72(o)(5).

However, the Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employee or certain allocations to participants' accounts as giving rise to annual additions.

* * * * *

(8) *Qualified voluntary employee contributions.* This subparagraph provides rules for qualified voluntary employee contributions that are eligible for the deduction under section 219(a). This subparagraph is applicable only if the total of such contributions for the year is not in excess of

$2,000. If such contributions are not deductible under section 219, and result in an annual addition that causes the section 415 limits to be exceeded, they will not be treated as annual additions to the extent that the portion of the contribution exceeding the limitation (and earnings thereon) is returned to the employee as soon as administratively feasible after the employer knows or has reason to know that such contributions are not deductible employee contributions within the meaning of section 72(o)(5).

* * * * *

Par. 8. Section 1.415-7 is amended by: (1) deleting subdivision (iii) of paragraph (c)(2), (2) renumbering subdivision (iv) of paragraph (c)(2) as subdivision (iii), and deleting paragraph (i).

ESTATE TAX REGULATIONS

[26 CFR Part 20]

Par. 9. Section 20.2C39-2 is revised by adding a new subdivision (ix) to paragraph (c)(1) to read as follows:

§20.2039-2 Annuities under "qualified plans" and section 403(b) annuity contracts.

* * * * *

(c) *Amounts excludable from the gross estate.*

(1) ***

(ix) Any deductible employee contributions (within the meaning of section 72(o)(5)) are considered amounts contributed by the employer.

* * * * *

Par. 9a. Section 20.2039-4 is revised by adding a new paragraph (h) to read as follows:

§20.2039-4 Lump sum distributions from "qualified plans;" decedents dying after December 31, 1978.

* * * * *

(h) *Accumulated deductible employee contributions.* For purposes of this section, a lump sum distribution includes an amount attributable to accumulated deductible employee contributions (as defined in section 72(o)(5)(B)) in any qualified plan taken into account for purposes of determining whether any distribution from that qualified plan is a lump sum distribution as determined under paragraph (b) of this section. Thus, amounts attributable to accumulated deductible employee contributions in a qualified plan under which amounts are payable in a lump sum distribution are not excludible from the decedent's gross estate under §20.2039-2, unless the recipient makes the section 402(a)/403(c) taxation election with respect to a lump sum distributable payable from that qualified plan.

GIFT TAX REGULATIONS

[26 CFR Part 25]

Par. 10. Section 25.2517-1 is revised by adding a new subdivision (viii) to paragraph (c)(1) to read as follows:

§25.2517-1 Employees' annuities.

* * * * *

(c) *Limitation on amount excludable from gift.*

(1) ***

(viii) Any deductible employee contributions (within the meaning of section 72(o)(5)) are considered amounts contributed by the employer.

* * * * *

PROCEDURE AND ADMINISTRATION REGULATIONS

[26 CFR Part 301]

Par. 11. There is added after §301.6652-3 the following new section:

§301.6652-4 Failure to file information with respect to qualified voluntary employee contributions.

(a) *Failure to make annual reports to employees.* In the case of a failure to make an annual report required by §1.219(a)-5(g) which contains the information required by such section on the date prescribed therefor, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such annual report an amount equal to $25 for each participant with respect to when there was a failure to make such report, multiplied by the number of years during which such failure continues.

(b) *Limitation.* The total amount imposed under this section on any person shall not exceed $10,000 with respect to any calendar year.

ROSCOE L. EGGER, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 18, 1984, 1:28 p.m., and published in the issue of the Federal Register for January 23, 1984, 49 F.R. 2794)

Notice of Proposed Rulemaking

Excise Tax on Tires

I-99-82

SUMMARY: This document contains proposed amendments which revise the regulations concerning the excise tax on tires. This revision would change the definition of manufacturing for excise tax purposes to exclude a particular method of recapping or retreading tires. The regulations provide necessary guidance to the public for compliance with the law and affect all persons required to pay excise taxes on recapped or retreaded tires.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 9, 1984. The amendments are proposed to be effective for articles sold on or after January 1, 1984. ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (I-99-82).

FOR FURTHER INFORMATION CONTACT: Jane E. Wilson of the Interpretative Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-4069 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48) under section 4071 of the Internal Revenue Code of 1954

(Code) with respect to the excise tax on recapped or retreated tires.

Prior to its amendment by section 514 of the Highway Revenue Act of 1982 (P.L. 97-424) [1983-1 C.B. 405, 411], effective on January 1, 1984, referred to as the 1982 Act, section 4071(a) generally imposed excise taxes on manufacturers, producers, and importers of tires and tread rubber. The excise tax on tires exceed the tax on tread rubber.

Section 48.4071-1(d) of the regulations draws a distinction between tires that have been retreaded from "shoulder to shoulder," a retreading process that involves the application of tread rubber to the road surface of the worn tire, and tires that have been retreaded from "bead to bead," a retreading process that involves not only the application of tread rubber to the road surface of the worn tire, but also the application of a veneer of rubber on the outside of each tire over the sidewall.

Under the existing regulations, retreading a tire from shoulder to shoulder is not classified as manufacturing of a taxable tire. No excise tax is payable on a tire retreaded shoulder to shoulder so long as there had been a prior taxable sale of the tire in the United States. Retreading a tire from bead to bead, however, does constitute manufacturing of a taxable tire under the current regulations, with the result that the excise tax imposed on the sale of tires under section 4071 of the Code applies to a tire that has been retreaded from bead to bead. The distinction between shoulder to shoulder and bead to bead retreaded tires was adopted in section 4071(f) which subjects an imported, shoulder to shoulder retreaded tire to the manufacturers excise tax on the sale of tread rubber. Section 4071(f) does not apply to bead to bead retreaded tires, since imported, bead to bead retreaded tires are subject to the manufacturers excise tax on the sale of tires.

As amended by the 1982 Act, section 4071(a) no longer imposes an excise tax on tread rubber. The amendment is generally effective for articles sold on or after January 1, 1984. Section 4071(f), therefore, ceases applicability on or after that date.

This document proposes to remove the distinction drawn in section 48.4071-1(d) between shoulder to shoulder and bead to bead retreaded tires. The difference between the two types of retreaded tires is cosmetic rather than structural. The bead to bead process is used where the tire carcass has small defects in the sidewall, which, if not recapped, would detract from the attractiveness of the tire. A bead to bead retreaded tire does not compete with a new tire in the original equipment market and would only compete, if ever, with the lowest quality of new tire in the replacement market. A retreaded tire must be sold for less than a new tire, if it is to be marketed. A bead to bead retreaded tire competes with a shoulder to shoulder retreaded tire in the replacement market. Thus, the proposed regulations would treat bead to bead retreaded tires in the same manner as shoulder to shoulder retreaded tires are treated under section 48.4071-1(d).

The proposed amendment to the regulations would be effective for articles sold on or after January 1, 1984.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

Although this document is a Notice of Proposed Rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6). The Commissioner of the Internal Revenue Service has also determined that the proposed regulation is not a major regulation as defined in Executive Order 12291 and therefore a regulatory impact analysis is not required.

DRAFTING INFORMATION

The principal author of these proposed regulations is Jane E. Wilson of the Interpretative Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR Part 48 are as follows:

Section 48.4071-1(d) is revised to read as set forth below:

§48.4071-1 Imposition and rates of tax.

* * * * *

(d) *Recapped or retreaded tires.*— The recapping or retreading of a tire, whether from shoulder to shoulder or bead to bead, does not constitute manufacture of a taxable tire. The tax on tires imposed by section 4071 does not apply to the sale of a recapped or retreaded tire, except that a used tire or tire carcass not previously sold in the United States that is recapped or retreaded from shoulder to shoulder or bead to bead in a foreign country and imported into the United States is subject to the tax imposed by section 4071 when such tire is sold or used by the importer. This paragraph (d) is effective for recapped and retreaded tires sold on or after January 1, 1984.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on February 7, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 8, 1984, 49 F.R. 4790)

Withdrawal of Notice of Proposed Rulemaking

Personal Holding Companies

LR-680

SUMMARY: This document withdraws the notice of proposed rulemaking relating to personal holding companies that was published in the FEDERAL REGISTER for September 5, 1968 (33 FR 12553).

FOR FURTHER INFORMATION CONTACT: Susan Thompson Baker of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document withdraws the notice of proposed rulemaking that was published in the FEDERAL REGISTER for September 5, 1968 (33 FR 12553). That notice proposed regulations under sections 541 through 544, 551 through 554, 856, 1016, 1022, 1023, 1244, and 1361 of the Internal Revenue Code of 1954 to conform the Income Tax Regulations to section 225 of the Revenue Act of 1964 (78 Stat. 79) [Pub. L. 88-272, 1964-1 (Part 2) C.B. 6, 54] and to section 3 of the Act of August 22, 1964 (Pub. L. 88-484, 78 Stat. 598) [1964-2 C.B. 605, 606]. Because of the extreme age of these proposed amendments to the regulations and because of the passage of legislation affecting these sections of the Code in the years intervening since the publication of these proposed amendments to the regulations, it was determined that these proposed amendments should be withdrawn.

DRAFTING INFORMATION

The principal author of this document is Susan Thompson Baker of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service participated in developing this document, both in matters of substance and style.

Withdrawal of proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 relating to personal holding companies published in the FEDERAL REGISTER for September 5, 1968 (33 FR 12553), are hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on November 28, 1983; 8:45 a.m., and published in the issue of the Federal Register for November 29, 1983, 48 F.R. 53719)

Withdrawal of Notice of Proposed Rulemaking

Interest on Obligations of a State, Territory, Etc.

LR-8-73

SUMMARY: This document withdraws the notice of proposed rulemaking relating to obligations issued on behalf of governmental units which was published in the FEDERAL REGISTER for February 2, 1976 (41 FR 4829). It was determined that this notice be withdrawn in light of the public comments received thereon and in light of the additional guidance provided in the recently-published Revenue Procedure 82-26 [1982-1 C.B. 476].

ADDRESS ENQUIRIES TO: John A. Tolleris of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document withdraws a notice of propose rulemaking that would amend §1.103-1 to provide rules under which authorities which are not governmental units may (issue governmental obligations on behalf of such units. The notice was published in the FEDERAL REGISTER for February 2, 1976 (41 FR 4829). A large number of comments were received, and a public hearing was held on April 26, 1976. After consideration of the comments it has been determined that this notice be withdrawn. Accordingly, prior revenue rulings relating to entities issuing obligations on behalf of a State or local governmental unit, such as Rev. Rul. 57-187, 1957-1 C.B. 65, Rev. Rul. 60-248, 1960-2 C.B. 35 (as modified by Rev. Rul. 82-56, 1982-1 C.B. 17), and Rev. Rul. 63-20, 1963-1 C.B. 24, are not superseded and continue to form the primary source of guidance on this question. See also Rev. Proc. 82-26, 1982-1 C.B. 476.

The effective date of the proposed regulations provided issuers the option of applying the proposed rules to issues on or after February 2, 1976. Accordingly, the Internal Revenue Service will continue to permit the application of the proposed regulations, hereby withdrawn, to issues issued on or after February 2, 1976, and before February 14, 1984, at the option of the issuer. In general, it is expected that issuers meeting the standards described in the notice of the proposed rulemaking will also meet the standards of the revenue rulings. To ensure this result in all cases, however, the option provided in the notice of proposed rulemaking is preserved. Issuers that may have relied on the notice standards are thereby provided a 60-day period to consider whether they qualify as "on behalf of" entities under the standards in effect without regard to the option provided by the notice.

DRAFTING INFORMATION

The principal author of this document is John P. MacMaster of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other officers of the Internal Revenue Service and Treasury Department participated in preparing this document.

The proposed amendments to 26 CFR Part 1, relating to obligations of a State, Territory, etc., published in the FEDERAL REGISTER for February 2, 1976 (41 FR 4829), are hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 15, 1983; 8:45 a.m., and published in the issue of the Federal Register for December 16, 1983, 48 F.R. 55878)

Withdrawal of Notice of Proposed Rulemaking

Certain Payments for Oil or Gas Which are Not to be Considered as Taxes.

LR-65-75

SUMMARY: This document withdraws the notice of proposed rulemaking relating to certain payments for oil or gas which are not to be considered as taxes that appeared in the FEDERAL REGISTER on November 17, 1980 (45 FR 75692). The notice is being withdrawn because the wording of the statute is sufficiently clear for the rare situations that arise under section 901(f) of the Internal Revenue Code of 1954.

FOR FURTHER INFORMATION CONTACT: Mary Frances Pearson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-65-75), 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document withdraws the notice of proposed rulemaking that appeared in the FEDERAL REGISTER on November 17, 1980 (45 FR 75692). The notice proposed amendments to the regulations under section 901(f) of the Internal Revenue Code of 1954. The principal purpose of the proposed amendments was to provide the public with the guidance needed to comply with section 901(f). The regulations proposed on November 17, 1980, are no longer necessary because the situations within the scope of section 901(f) are rare and the wording of the statute is sufficiently clear.

DRAFTING INFORMATION

The principal author of this document is Mary Frances Pearson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this document, both in matters of substance and style.

Withdrawal of proposed amendments

The proposed amendments to 26 CFR Part 1, relating to certain payments for oil or gas which are not to be considered as taxes and published in the FEDERAL REGISTER on November 17, 1980 (45 FR 75692), are hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 1, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 2, 1984, 49 F.R. 4105)

Notice of Proposed Rulemaking

Farming Syndicate Expenditures

LR-144-76

SUMMARY: This document contains proposed regulations relating to farming syndicate expenditures. Changes to the applicable tax law were made by the Tax Reform Act of 1976, the Revenue Act of 1978, and the Subchapter S Revision Act of 1982. These regulations would provide necessary guidance to the public for compliance with those Acts and would affect passive investors in certain farming enterprises.

DATES: Written comments and requests for a public hearing must be delivered or mailed by January 16, 1984. The regulations are proposed to be effective for taxable years beginning after December 31, 1975, except as otherwise provided.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-144-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Howard A. Balikov of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3288) not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 278 and 464 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to sections 207(a) and (b) of the Tax Reform Act of 1976 (90 Stat. 1536 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 12]), section 701(l)(3) of the Revenue Act of 1978 (92 Stat. 2907 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 141]), and section 5(a)(30) of the Subchapter S Revision Act of 1982 (96 Stat. 1695 [Pub. L. 97-354, 1982-2 C.B. 702, 715]), and are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

PURPOSE OF STATUTORY CHANGES

Prior to these statutory changes, the tax laws allowed all persons with interests in farming enterprises to take a current deduction for a number of expenses that might not generate income until later years. If the enterprise did not earn income until later years, as was often the case, the result of these rules was that a person with high income from non-farm sources could shelter such income with currently deductible expenses of the farming enterprise. Thus, the person could defer taxes on the non-farm income until the later years. Sometimes the income generated by the farming enterprise was in the nature of a capital gain, and thus was taxed at a rate lower than the ordinary in-

come rate that would have applied to the non-farm income but for the farming enterprise deductions. Congress enacted the changes in the tax law to prevent the generation of such deductions by farming enterprises that typically attract investors seeking deferral tax shelters.

THE NEW RULES

The new rules place limitations on deductions allowed to farming syndicates. Under the new rules, farming syndicates may not deduct costs of feed, seed, fertilizer and other similar farm supplies before the supplies are actually used or consumed. In addition, farming syndicates must capitalize or inventory certain costs of poultry. Farming syndicates also must capitalize costs of planting, cultivating, maintaining and developing certain groves, orchards and vineyards, if the costs are incurred before the grove, orchard or vineyard bears a commercial crop or yield. Code sections 278(b) and (c), Code sections 464(a) and (b), and proposed regulation §§1.278-2 and 1.464-1 contain details regarding the operation of the new rules.

Farming syndicates subject to the new rules are, in general, enterprises sold by means of registered securities offerings and enterprises with a significant proportion of passive investors. Code section 464(c)(1)(B) defines the term "farming syndicate" to include certain enterprises where "more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs." Proposed regulation §1.464-2(a)(2) provides rules for applying section 464(c)(1)(B). The Internal Revenue Service invites comments on proposed regulation §1.464-2(a)(2).

EFFECTIVE DATES

Generally, the statutory changes and these proposed regulations are effective for expenditures made in taxable years beginning after December 31, 1975. However, proposed regulation §§1.278-2(d) and 1.464-1(c) provide transitional rules that make the new rules inapplicable to certain investments already in existence on that date.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is to be held, notice of the time and place will be published in the FEDERAL REGISTER.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. The Internal Revenue Service has concluded that although this document is a notice of proposed rulemaking that solicits public comment, the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal author of these proposed regulations is Howard A. Balikov of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. A new section 1.278-2 is inserted in the appropriate place to read as follows:

§1.278-2 Certain capital expenditures of farming syndicates.

(a) *General rule.* (1) Except as provided in paragraph (c) of this section, farming syndicates (as defined in section 464(c) and the regulations thereunder) engaged in planting, cultivating, maintaining or developing a grove, orchard or vineyard in which fruit or nuts are grown must capitalize any amount which—

(i) Would be allowable as a deduction but for the provisions of section 278(b) and this section,

(ii) Is attributable to the planting, cultivation, maintenance or development of such grove, orchard or vineyard, and

(iii) Is incurred in a taxable year before the first taxable year in which such grove, orchard or vineyard bears a crop or yield in commercial quantities.

For purposes of determining whether amounts are described in subparagraph (a)(1)(ii) of this section, the rules of §1.278-1(a)(2)(iii) shall apply as if such section applied to such grove, orchard or vineyard. Subparagraph (a)(1)(iii) of this section is applied without regard to whether an amount is incurred before or after the plants are permanently planted. For purposes of section 278(b) and this section, an amount shall be considered as "incurred" in accordance with the taxpayer's regular tax accounting method used in reporting income and expenses connected with planting, cultivating, maintaining or developing the grove, orchard or vineyard. For purposes of this paragraph (a)(1), any portion of a grove, orchard or vineyard planted in one taxable year shall be treated separately from any other portion of such grove, orchard or vineyard planted in another taxable year, and plants that are more than one year older than other plants shall be treated separately.

(2) For purposes of section 278(b) and this section a grove, orchard, or vineyard in which fruit or nuts are grown includes any group of trees, bushes, shrubs, or vines which produce a crop or yield of fruits or nuts. For purposes of this section, a "fruit" is defined as a fertilized and developed ovary of a plant, including the seeds, or, in the case of a plant that does not bear seeds, the fertile

structure of the plant, and a "nut" is defined as a hard-shelled fruit. For example, fruits or nuts include apples, avocados, coffee beans, grapes, jojoba beans or seeds, pecans, pistachios and walnuts.

(3) For purposes of section 278(b) and this section a tree or vine shall be considered to be "planted" on the date on which the tree or vine is placed in the permanent grove, orchard or vineyard from which production is expected.

(4) The period during which expenditures described in section 278(b) and paragraph (a)(1) of this section are required to be capitalized shall, once determined, be unaffected by a sale or other disposition of the grove, orchard or vineyard to any other farming syndicate. Such period shall be computed by reference to the taxable years of the owner of the grove, orchard or vineyard at the time the trees or vines were planted. Therefore, if a grove, orchard or vineyard subject to the provisions of section 278(b) and paragraph (a)(1) of this section is sold or otherwise transferred by the original owner of the grove, orchard or vineyard to a purchaser or other transferee that is a farming syndicate before the first taxable year in which such grove, orchard or vineyard bears a crop or yield in commercial quantities, expenditures described in section 278(b) and paragraph (a)(1) of this section made by the purchaser or other transferee before the beginning of the original holder's first taxable year in which such grove, orchard or vineyard bears a crop or yield in commercial quantities are required to be capitalized. For an illustration of a similar rule, see §1.278-1(a)(3)(ii).

(b) *Relationship of section 278(b) to section 278(a)—*

(1) *In general.* In the case of a farming syndicate engaged in the planting, cultivation, maintenance or development of a citrus or almond grove, the capitalization rules of section 278(a) and §1.278-1 apply prior to the capitalization rules of section 278(b) and this section.

(2) *Examples.* The provisions of paragraph (b)(1) of this section may be illustrated by the following examples.

Example (1). X, a farming syndicate on the calendar year basis, plants almond saplings in an almond grove in 1983. Throughout 1983 and later years, X incurs expenditures for cultivating and maintaining the almond grove. During 1985, X's almond grove produces almonds in commercial quantities. Pursuant to section 278(a), X must capitalize any cultivation or maintenance costs of the almond grove that are incurred before the close of 1986.

Example (2). Z, a farming syndicate on the calendar year basis, plants an orange grove in 1983. Z's orange grove does not produce commercial quantities of oranges until 1988. Section 278(a) requires Z to capitalize all amounts attributable to planting, cultivating, maintaining, or developing the orange grove that are incurred before the close of 1986. Section 278(b), however, requires the capitalization of all amounts attributable to such activities that are incurred before the close of 1987. Accordingly, Z must capitalize all such amounts incurred before the close of 1987.

(c) *Exceptions.* Paragraph (a)(1) of this section shall not apply to amounts allowable as deductions (without regard to section 278(b) or this section) and attributable to a grove, orchard or vineyard (or part thereof) that is replanted by the taxpayer after having been lost or damaged (while in the hands of the taxpayer) by reason of freeze, disease, drought, pests or casualty.

(d) *Effective date*—(1) *In general.* Section 278(b) and this section apply to amounts paid or incurred in taxable years beginning after December 31, 1975.

(2) *Transitional rule.* Section 278(b) and this section do not apply to amounts paid or incurred with respect to a grove, orchard or vineyard which was planted or replanted before January 1, 1976. For this purpose, a tree or vine that was planted before January 1, 1976 at a place other than the grove, orchard or vineyard of the taxpayer, but which was owned by the taxpayer (or with respect to which the taxpayer had a binding contract to purchase) before January 1, 1976, is considered to have been planted on December 31, 1975, in the grove, orchard or vineyard of the taxpayer.

Par. 2. Sections 1.464-1 and 1.464-2 are inserted in the appropriate place to read as follows:

§1.464-1 Limitations on deductions in case of farming syndicates.

(a) *General rule*—(1) *In general.* Except as provided in paragraph (a)(2) of this section, amounts paid by a farming syndicate (as defined in section 464(c) and §1.464-2(a)) for feed, seed, fertilizer or other similar farm supplies (as defined in §1.464-2(c)) shall be deducted only for the taxable year in which actually used or consumed or, if later, for the taxable year for which a deduction for such amounts would be allowed under the taxpayer's method of accounting. In addition, the cost of poultry purchased by a farming syndicate for resale shall not be deducted until the taxable year in which the poultry is sold or otherwise disposed of. The cost of poultry (including egg-laying hens and baby chicks) purchased by a farming syndicate for use in a trade or business (or purchased by a farming syndicate both for use in a trade or business and subsequent resale) is to be capitalized and (taking into account salvage value) deducted ratably on a monthly basis over the lesser of 12 months or their useful life in that trade or business.

(2) *Exceptions.* The provisions of section 464(a) and the first sentence of paragraph (a)(1) of this section, relating to amounts paid by a farming syndicate for feed, seed, fertilizer or other similar farm supplies, shall not apply to either of the following:

(i) Amounts paid for feed, seed, fertilizer, or other farm supplies which are on hand at the close of the taxable year solely because the consumption of such items during the year was prevented by fire, storm, flood or other casualty or because of disease or drought.

(ii) Amounts required to be capitalized under section 278 and the regulations thereunder. For example, in the case of fertilizer expenditures subject to the rules of section 278, no deduction is allowed upon consumption of the fertilizer. Instead, the amount must be charged to capital account.

(b) *Override of accounting methods.* To the extent use of any accounting method (such as the farmprice method of inventory valuation) conflicts with the requirements of section 464 and this section, the requirements

of section 464 and this section shall prevail.

(c) *Effective date*—(1) *In general.* Except as provided in paragraph (c)(2) of this section, section 464 and this section apply to amounts paid or incurred in taxable years beginning after December 31, 1975.

(2) *Transitional rule.* In the case of a farming syndicate in existence on December 31, 1975, and for which there was no change of membership throughout its taxable year beginning in 1976, section 464 and this section apply only to amounts paid or incurred in taxable years beginning after December 31, 1976. A change in membership which disqualifies a farming syndicate from this transitional rule includes the addition of a new member and the sale of an existing member's interest, but does not include a substitution occurring by operation of law, by gift, or by the death or withdrawal of an existing member.

§1.464-2 Farming syndicates—definitions and special rules.

(a) *Farming syndicate*—(1) *General rule.* The term "farming syndicate" means—

(i) A partnership or any other enterprise (other than a corporation which is not an S corporation (as defined in section 1361(a)(1)) engaged in the trade or business of farming (as defined in section 464(e)(1) and paragraph (b) of this section), if at any time any interest in the partnership or enterprise has been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale, or

(ii) A partnership or any other enterprise (other than a corporation which is not an S corporation) engaged in the trade or business of farming, if more than 35 percent of the losses for any taxable year are allocable to limited partners or limited entrepreneurs.

The form of organization that a farming syndicate may take includes, but is not limited to, a general or limited partnership, a sole proprietorship involving an agency relationship created by a management contract, a trust, a common trust fund (as defined in section 584(a)), and an S corporation (as defined in section 1361(a)(1)). See paragraphs (a)(3), (4), and (5) of this section for rules concerning the definition of the term "limited entrepreneur." See paragraph (a)(7) of this section for rules concerning the registration of offerings with Federal or State agencies.

(2) *Special rules*—(i) An enterprise described in paragraph (a)(1)(ii) of this section is a farming syndicate for the first taxable year in which more than 35 percent of the losses are allocable to limited partners or limited entrepreneurs, and for all subsequent taxable years.

(ii) For purposes of paragraph (a)(1)(ii) of this section, the term "losses" means the excess of the deductions from the trade or business of farming allowable under the Internal Revenue Code to the enterprise for the taxable year (determined without regard to sections 278(b) and 464 and the regulations thereunder) over the amount of income received or accrued by the enterprise during the taxable year from the trade or business of farming. For purposes of this definition, the following amounts are not included in determining losses: gain and losses from the sale of capital assets or section 1231 assets; charitable contributions; and investment income or expenses.

(iii) A farming syndicate that is a partnership is considered terminated only if it would be considered terminated under section 708(b). The same principles apply to determine whether a farming syndicate that is not a partnership is considered terminated.

(iv) The provisions of paragraph (a)(2) of this section may be illustrated by the following examples.

Example (1). In 1983, D and E formed the DE limited partnership, a calendar year cash basis taxpayer. The principal business of the partnership is operating a peanut farm. In addition, the partnership has a business which prepares and sells "DE peanut butter." D, who is the general partner, owns a 75 percent interest in the partnership, and E, who is the limited partner, owns a 25 percent interest. The partnership agreement provides that 75 percent of the partnership's operating income and losses from the peanut farm, exclusive of specially allocated deductions, will be allocated to D, and 25 percent will be allocated to E. The partnership agreement also provides that 40 percent of the partnership's fertilizer expenditures will be specially allocated to D, and 60 percent will be specially allocated to E. The partnership agreement further provides that 50 percent of DE's income and losses from the sale of DE peanut butter will be specially allocated to D, and 50 percent will be specially allocated to E. During 1983, DE incurred taxable losses described in section 702(a)(8) attributable to the peanut farm operations of $100, fertilizer expenditures of $200, and income from the sale of DE peanut butter of $230. The calculation necessary to determine whether DE is a farming syndicate for 1983, under section 464(c)(1)(B) and §1.464-2(a)(1)(ii), is as follows:

Taxable loss described in section 702(a)(8) attributable to the peanut farm operations, for 1983	$100
Specially allocated deduction attributable to the peanut farm operations for 1983	200
Total	$300

Taxable loss described in section 702(a)(8) attributable to the peanut farm operations, for 1983, allocated to E	$ 25
Deduction for 1983 attributable to the peanut farm operations specially allocated to E	120
Total	$145

Total losses attributable to the peanut farm operations allocated to E $145 / Total losses attributable to the peanut farm operations of partnership $300 = 48%

The business of preparing and selling DE peanut butter is not a trade or business of farming. Therefore, neither the income nor the deductions attributable to the preparation or sale of DE peanut butter is included in the section 464(c)(1)(B) calculation. For purposes of paragraph (a)(1)(ii) of this section, 48 percent of the DE partnership's loss from the trade or business of farming for 1983 is considered allocated to E, the limited partner. Therefore, the DE partnership is a farming syndicate for 1983 and all subsequent years.

Example (2). Assume the same facts as in example (1) except that during 1983, DE had operating income from the peanut farm, exclusive of specially allocated deductions, of $160. The calculation necessary to determine whether DE is a farming syndicate for 1983, under section 464(c)(1)(B) and §1.464-2(a)(1)(ii), is as follows:

Taxable income described in section 702(a)(8) attributable to the peanut farm operations, for 1983	$ 160
Specially allocated deduction attributable to the peanut farm operations for 1983	(200)
Total	$(40)

Taxable income described in section 702(a)(8) attributable to the peanut farm operations for 1983, allocated to E	$ 40
Deduction for 1983 attributable to the peanut farm operations allocated to E	(120)
Total	$(80)

Total losses attributable to the peanut farm operations allocated to E $(80)

Total losses attributable to the peanut farm operations allocated to E $(40) = 200%

For purposes of paragraph (a)(1)(ii) of this section, 200 percent of the DE partnership's loss from the trade or business of farming for 1983 is considered allocated to E, the limited partner. Therefore, the DE partnership is a farming syndicate for 1983 and all subsequent years.

(3) *Limited entrepreneur.* For purposes of this section, the term "limited entrepreneur" means a person who has an interest in an enterprise other than as a limited partner and who does not actively participate in the management of such enterprise. The determination of whether a person actively participates in the management or operation of a farming enterprise depends on the facts and circumstances of each case. Factors which tend to indicate active participation include participating in the decisions involving the operation or management of the farm, actually working on the farm, living on the farm, or hiring and discharging employees (as compared to only the farm manager). Factors which tend to indicate a lack of active participation include lack of control of the management and operation of the farm, having authority only to discharge the farm manager, having a farm manager who is an independent contractor rather than an employee, and having limited liability for farm losses. For purposes of this paragraph, lack of fee ownership of the farm land shall not be a factor indicating a lack of active participation.

(4) *Limited liability.* (i) For purposes of paragraph (a)(3) of this section in determining whether a person has limited liability for farm losses, all the facts and circumstances are to be taken into account.

(ii) A person generally will be considered to have limited liability for farm losses if that person is protected against losses to any significant degree by nonrecourse financing, stop-loss orders, guarantees, fixed price purchase or repurchase agreements, insurance, or other similar arrangements. Examples of persons with limited liability for farm losses include, in appropriate circumstances:

(A) A general partner who has obtained a guaranty or other protection against loss from another general partner or an agent, or

(B) A principal who has given actual authority to another party to conduct the farm operations, such as an investor in feeder cattle who employs a feedlot manager to manage the cattle, and who utilizes nonrecourse financing, stop-loss orders, insurance, or other similar arrangements to limit the risk of loss.

(5) *Active partners and entrepreneurs.* For purposes of paragraph (a)(1)(ii) of this section, the following shall be treated as an interest which is not held by a limited partner or a limited entrepreneur:

(i) In the case of any individual who has actively participated (for a period of not less than 5 years) in the management of any trade or business of farming, any interest in a partnership or other enterprise which is attributable to such active participation;

(ii) In the case of any individual whose principal residence is on a farm, any interest in a partnership or other enterprise engaged in the trade or business of farming such farm;

(iii) In the case of any individual who is actively participating in the management of any trade or business of farming or who is an individual who is described in paragraph (a)(5)(i) or (ii) of this section, any participation in the further processing of livestock which was raised in such trade or business (or in the trade or business referred to in paragraph (a)(5)(i) or (ii));

(iv) In the case of an individual whose principal business activity involves active participation in the management of a trade or business of farming, any interest in any other trade or business of farming; and

(v) Any interest held by a member of the family as defined in section 267(c)(4) (or a spouse of any such member) of a grandparent of an individual described in paragraph (a)(5)(i), (ii), (iii), or (iv) of this section if the interest in the partnership or the enterprise is attributable to the active participation of the individual described in paragraph (a)(5)(i), (ii), (iii), or (iv).

For purposes of paragraph (a)(5)(i) of this section, an interest in a partnership or other enterprise unrelated to the trade or business in the management of which the limited partner or limited entrepreneur participated will not be considered attributable to such participation; however, where the farming enterprise substitutes one farm for another or adds a farm to its trade or business, both farms shall be treated as one.

(6) *Examples.* The provisions of paragraphs (a)(5)(i), (iv) and (v) of this section may be illustrated by the following examples:

Example (1). A, an individual who has owned and operated a farm for more than 5 years, retires and forms the AB partnership with B, an unrelated individual who actively manages the farm. More than 35 percent of the losses are allocated to A, the limited partner. The AB partnership will not be treated as a farming syndicate because, pursuant to section 464(c)(2)(A) and paragraph (a)(5)(i) of this section, A's interest is not treated as a limited partnership interest for purposes of determining whether losses are allocated to limited partners. If A's interest is transferred to C, A's child, the BC partnership will not be a farming syndicate, whether the transfer occurs before or after A's retirement or death. See paragraph (a)(5)(v) of this section.

Example (2). H is the owner and full-time manager of the LR apple orchard. H has operated the LR apple orchard for 10 years. H also holds a limited partnership interest in the JHU partnership, which owns and operates another apple orchard. The JHU partnership will not be treated as a farming syndicate solely because of the limited partnership interest held by H Since H's principal business activity is the active management of the LR apple grove, H's limited partnership interest in the JHU partnership shall be treated under section 464(c)(2)(D) and paragraph (a)(5)(iv) of this section as an interest which is not held by a limited partner.

(7) *Registration with a Federal or State agency.* (i) For purposes of section 464(c)(1)(A) and paragraph (a)(1)(i) of this section, the question of whether an offering is required to be registered with a state agency having authority to regulate the offering of securities for sale is a question of state law. Thus, it may happen that an enterprise in one state is a farming syndicate under paragraph (a)(1)(i) of this section while a similar enterprise in another state is not. In addition, if interests in a particular enterprise are offered for sale in more than one state, any one of which requires registration of the offering, all the interests in the enterprise will be treated as subject to the registration requirement for purposes of section

464(c)(1)(A) and paragraph (a)(1)(i) of this section.

(ii) Offerings made through a dealer who is a member of the National Association of Securities Dealers, or through a real estate company, as well as interests in private enterprises which are not sold by a broker-dealer or similar party, are not offerings within the scope of section 464(c)(1)(A) and paragraph (a)(1)(i) of this section if they are not required to be registered with any Federal or state agency having the authority to regulate the offering of securities for sale. However, such an offering may fall within the scope of paragraph (a)(1)(ii) of this section if it meets the 35 percent test of that paragraph.

(b) *Farming.* For purposes of section 464 and the regulations thereunder, the term "farming" means the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training and management of animals. For example, farming includes the raising of fish, poultry, bees, dogs, flowers or vegetables. Farming does not, however, include the raising or harvesting of trees (other than fruit or nut bearing trees). For purposes of this paragraph (b), the raising or harvesting of trees includes forestry (*i.e.*, the care and conservation of forests), the timber and logging industries, and the raising of trees for lumber or pulp, but does not include the raising or harvesting of plants grown for home decoration, aesthetic, or landscaping purposes, including ornamental trees, Christmas trees, house plants that are called trees, and house plants with tree-like qualities (such as scheffleras, Norfolk Island pines, ficus decova, weeping figs, areca palms, and parlor palms).

(c) *Other similar farm supplies.* The term "other similar farm supplies" in section 464(a) and §1.464-1(a)(1) means those supplies used in raising or producing farm assets the cost of which are allowed (without regard to section 464) as deductions against income in the taxable year in which the supplies are purchased by the taxpayer.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on November 14, 1983, 8:45 a.m., and published in the issue of the Federal Register for November 15, 1983, 48 F.R. 51936)

Notice of Proposed Rulemaking

Change in Limitations on the Gift and Estate Tax Marital Deductions

LR-211-76

SUMMARY: This document contains proposed amendments to the regulations relating to the estate tax and gift tax marital deductions. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] and the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. These amendments, if adopted, will provide the public with the guidance needed to comply with those Acts.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 20, 1984. The amendments necessitated by the Tax Reform Act of 1976 and the Revenue Act of 1978 are generally proposed to be effective with respect to transfers by gift occurring after December 31, 1976, and to estates of decedents dying after December 31, 1976. The amendments necessitated by the Economic Recovery Tax Act of 1981 are proposed to be effective with respect to transfers by gift occurring after December 31, 1981, and to estates of decedents dying after December 31, 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224; Attention: CC:LR:T, LR-211-76.

FOR FURTHER INFORMATION CONTACT: Robert B. Coplan of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224; Attention: CC:LR:T, LR-211-76. Telephone 202-566-3287 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Estate Tax Regulations (26 CFR Part 20) and the Gift Tax Regulations (26 CFR Part 25). The affected regulations are primarily under sections 2044, 2056, 2207A, 2519, 2523, and 6019 of the Internal Revenue Code of 1954 (Code); conforming changes are proposed for regulations under other sections of the Code. These amendments are proposed to conform the estate and gift tax regulations to the amendments of the Code made by sections 2002(a), (b), and (d) and section 2006(a) of the Tax Reform Act of 1976 (Pub. L. 94-455; 90 Stat. 1854-56, 1880) [1976-3 C.B. (Vol. 1) 1, 330, 355]; section 702(g) of the Revenue Act of 1978 (Pub. L. 95-600, 92 Stat. 2930) [1978-3 C.B. (Vol. 1) 1, 164]; sections 403(a), (b), (c)(3)(B), (d) and (e) of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34; 95 Stat. 301-05) [1981-2 C.B. 256, 324]; and section 104(a) of the Technical Corrections Act of 1982 (Pub. L. 97-448; 96 Stat. 2379-81) [1983-1 C.B. 451, 458]. The proposed amendments, if adopted, will be issued under the authority contained in section 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805).

GIFT TAX FOR GIFTS PRIOR TO 1982

For interspousal gifts occurring after December 31, 1976, and before January 1, 1982, the Tax Reform Act of 1976 (the 1976 Act) provides for an unlimited gift tax marital deduction until the aggregate marital deduction equals $100,000. Thereafter, no deduction is allowed for the next $100,000 of post-1976 interspousal gifts and a 50 percent deduction is allowed for any additional interspousal gifts.

The 1976 Act did not change the effect of section 2524. Thus, although a marital deduction may be allowed under section 2523, section 2524 provides that a marital deduction may be taken only to the extent interspousal gifts exceed the exclusion for gifts under section 2503(b). For example, if a taxpayer's first post-1976 interspousal gift is a gift of $10,000 cash made during 1977, the marital deduction allowable under section 2523 is $10,000 (100% of $10,000); however, because the section 2503(b) exclusion is $3,000, section 2524 further limits the marital deduction which may be taken to $7,000.

ESTATE TAX FOR ESTATES OF DECEDENTS DYING AFTER 1976 AND BEFORE 1982

For estates of decedents dying after December 31, 1976, and before January 1, 1982, and the 1976 Act increases the maximum allowable estate tax marital deduction to the greater of $250,000 or one-half the decedent's adjusted gross estate. It also provides for two adjustments to the deduction. First, the maximum allowable estate tax marital deduction is reduced by the amount by which the aggregate gift tax marital deductions for post-1976 interspousal gifts exceed 50 percent of the value of those gifts. Second, the $250,000 limitation is adjusted downward where the decedent owned community property at death. This adjustment is like the preexisting adjustments to the 50 percent limitation in the sense that it maintains the parity between common law property states and community property states.

Many wills in existence before the 1976 Act provided for bequests to a surviving spouse in an amount determined by reference to the maximum marital deduction allowed by Federal law. Because Congress was concerned that many testators using such formula clauses may not have wanted their spouses to receive more than one-half of the adjusted gross estate (the maximum allowable deduction under prior law), the 1976 Act provides for a 2-year transitional rule applicable to property passing under certain formula provisions. The marital deduction for property passing under a maximum martial deduction formula provision in a will executed or trust created before December 31, 1976, cannot exceed 50 percent of the adjusted gross estate unless (1) the formula provision of the will is amended after December 31, 1976, (2) the decedent dies after December 31, 1978, or (3) a State statute is enacted that construes the formula provision as referring to the maximum marital deduction available after the amendments made by the Tax Reform Act of 1976.

The 1976 Act imposed a tax on certain generation-skipping transfers. When a decedent is the "deemed transferor" of a generation-skipping transfer occurring at or after the decedent's death, that decedent's marginal estate tax rate is used to determine the generation-skipping transfer tax; however, the tax is imposed on the generation-skipping transfer rather than on the decedent's estate. Congress intended the tax on generation-skipping transfers to be substantially equivalent to the estate tax which would have been imposed if the property were actually transferred outright to successive generations. To accomplish this result, Congress provided for an adjustment to the maximum allowable marital deduction. When a decedent is the "deemed transferor" of a generation-skipping transfer occurring at the same time as or within 9 months after the decedent's death, the marital deduction is calculated by including in the decedent's gross estate the amount of the generation-skipping transfer. Thus, the alternative limitation on the marital deduction of 50 percent of the decedent's adjusted gross estate may be increased.

The Revenue Act of 1978 provides two clarifications regarding the adjustment for post-1976 interspousal gifts. First, because any benefit derived from a gift tax marital deduction is negated if the property is required to be included in the gross estate, the 1978 Act provides that no reduction of the maximum allowable marital deduction is required with respect to property included in the decedent's estate solely by reason of section 2035 of the Code (gifts within 3 years of death). Second, in order to relieve executors of the administrative difficulty of determining the amount of small gifts, the 1978 Act provides that gifts not required to be included in a gift tax return will have no effect on the adjustment to the maximum allowable estate tax marital deduction.

GIFT TAX AND ESTATE TAX AFTER 1981

For transfers by gift occurring after December 31, 1981, and for estates of decedents dying after December 31, 1981, the Economic Recovery Tax Act of 1981 (the 1981 Act) generally provides a 100 percent marital deduction for the value of interspousal transfers, including transfers of community property. Under prior law, gifts or bequests of community property did not qualify for the marital deduction.

Many wills which were in existence prior to the 1981 Act provides for bequests to a surviving spouse in an amount determined by reference to the maximum deduction allowed by Federal law. Because Congress was concerned that many testators may not have wanted their spouse to receive an unlimited amount, the 1981 Act provides that the pre-1982 quantitative limitations on the deduction (the greater of $250,000 or 50 percent of the adjusted gross estate) shall apply for property passing under a maximum marital deduction formula provision in a will executed or trust created before September 12, 1981, unless either (1) the formula provision of the will (or trust) is amended after September 11, 1981, or (2) a State statute is enacted that construes the formula provision as referring to the maximum marital deduction available after the amendments made by the 1981 Act.

Under prior law, the marital deduction was available only with respect to property passing outright to the spouse or in specified forms which gave the spouse control over the transferred property. These limitations are referred to as the qualitative limitations. Because the surviving

spouse had to be given control over the property, the decedent could not insure that the property would pass to the decedent's children or other persons after the spouse's death. For gifts made after 1981 and estates of decedents dying after 1981, Congress made several changes to the qualitative limitations on the marital deduction. These changes allow the decedent to control the disposition of the property after the spouse's death.

For transfers to a charitable remainder annuity trust or a charitable remainder unitrust of which the donee spouse is the only noncharitable beneficiary (other than a donor), sections 2056(b)(8) and 2523(g) provide that the terminable interest rules (in sections 2056(b)(1) and 2523(b)) do not apply to the donee spouse's interest. The donor will receive a charitable deduction for the value of the remainder interest passing to the charity and a marital deduction for the value of the annuity or unitrust interest passing to the spouse. Consequently, no transfer tax is imposed on such transfers.

In addition, the 1981 Act adopts the qualified terminable interest exception to the terminable interest rules. This new exception provides that if certain conditions are met, a life interest granted to one's spouse, either by gift or bequest, will be treated as a transfer to the spouse of the entire value of the property (not just the value of the life interest) and no interest will be treated as passing to any person other than the spouse. Accordingly, the entire value of such property will qualify for the marital deduction. The conditions which must be met are (1) the donor (or decedent's executor) must elect qualified terminable interest treatment, (2) the spouse must be entitled to all the income from the property for life, payable annually or at more frequent intervals, and (3) no person may have the power to appoint any part of the qualifying property to any person other than the spouse during the spouse's lifetime.

Income interests granted for a term of years or life estates subject to termination upon the occurrence of a specified event during the spouse's lifetime are not interests for life, and thus do not qualify for the qualified terminable interest exception. The spouse's interest need not be in trust to qualify. However, for purposes of determining whether the spouse's income interest meets the income entitlement requirement of section 2056(b)(7)(B)(ii)(I), the regulations adopt the principles contained in §20.2056(b)-5(f). These principles apply to property in trust and property not in trust, thus clarifying that the type of rights to income which qualify, in the case of property not in trust, are equivalent to the rights to income which would qualify if the property were in trust. Accordingly, the spouse's interest must be substantially that degree of beneficial enjoyment of the property during the spouse's life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. Under the proposed regulations, the spouse's exclusive and unrestricted right to the use of a residence for life satisfies the income entitlement requirement.

In determining the application of the rules relating to qualified terminable interest property, any "specific portion" (as defined in §20.2056(b)-5(c)) of property is treated as separate property. Thus, for example, if the spouse is given an interest in only 50 percent of the trust income, 50 percent of the entire interest in the property may be treated as qualified terminable interest property. Amendments are proposed to the definition of the term "specific portion" to conform that definition to the rule set forth by the Supreme Court in *Northeastern Pennsylvania National Bank and Trust Co. v. United States*, 387 U.S. 213 (1967).

The proposed regulation also makes it clear that the election to treat property as qualified terminable interest property may be made with respect to a fraction or percentage of property. However, a partial election is permitted only if it relates to a fractional or percentile share of property. The fraction or percentage may be determined by means of a formula.

Qualified terminable interest treatment delays the imposition of transfer taxes only so long as the property remains in a marital unit. Qualified terminable interest property is subject to transfer taxes at the earlier of (1) the date on which the spouse disposes (either by gift, sale or otherwise) of all or part of the qualifying income interest or (2) the spouse's death.

If the qualified terminable interest property is ultimately subject to tax as a result of the spouse's lifetime transfer of the qualifying income interest, the full value of the entire property subject to the spouse's income interest, less amounts received or retained by the spouse upon the disposition and less amounts which the spouse is entitled to recover under section 2207A (relating to the recovery of taxes paid), will be treated as a taxable gift under Code sections 2511 and 2519. (Any subsequent failure by the donor spouse to recover amounts to which the donor spouse is entitled under section 2207A will be treated as a separate taxable gift, as discussed below.) When the spouse makes a gift of the qualifying income interest, the value of the income interest will be eligible for the annual exclusion under section 2503(b). However, no section 2503(b) annual gift tax exclusion will be permitted for the imputed transfer of the remainder interest unless the transfer of the income interest is to a remainderman who holds full title to the property immediately after the transfer.

If the donee spouse is not treated as having made a complete transfer of the property subject to the qualifying income interest prior to the donee spouse's death, the fair market value of the property subject to the qualifying income interest determined as of the date of the donee spouse's death (or the alternate valuation date, if elected) will be included in the donee spouse's gross estate pursuant to Code section 2044.

Pursuant to Code section 2207A, the spouse is granted a right to recover any gift tax paid on the value of the remainder interests in qualified terminable interest property. The spouse's estate is also granted a right to recover any estate tax paid as a result of including property in the spouse's estate. For purposes of this

recovery provision, use of all or part of the spouse's unified credit is not treated as the payment of tax. Proposed regulation §25.2207A-1 clarifies that under section 2511, the spouse's failure to exercise the right under section 2207A(b) to recover gift taxes paid upon the lifetime disposition of qualified terminable interest property is treated as a taxable transfer of the amount of the unrecovered taxes to the persons from whom such recovery could have been obtained.

If property is includible in a spouse's estate under section 2044, section 2207A gives the spouse's estate the right to recover the estate tax attributable to such property. The full value of the qualified terminable interest property is includible in the spouse's gross estate under section 2044 without reduction for the amount recoverable by the spouse's estate under section 2207A. Thus, proposed regulation §20.2207A-1 clarifies that the amount of estate tax recoverable by the spouse's estate under section 2207A is not an amount includible in the spouse's gross estate under section 2041 (relating to property subject to a general power of appointment).

Consistent with certain provisions of the Technical Corrections Act of 1982, these proposed regulations provide that property deemed to be transferred by a spouse under section 2044 shall be deemed to have passed from that spouse for purposes of section 1014 and chapters 11 and 13 of the Code. Thus, the provisions contained in section 1014 (regarding step-up in basis), section 2055 (regarding charitable deductions) and section 2032A (regarding special use valuation) are applicable to qualified terminable interest property included in a spouse's gross estate under section 2044.

Because an unlimited marital deduction is permitted for interspousal transfers after 1981, the 1981 Act generally exempts from the gift tax filing requirements all such transfers eligible for the marital deduction other than transfers of qualified terminable interest property. Property transferred by gift may be treated as qualified terminable interest property only if an election is made with respect to the property on the transferor's gift tax return on or before the first April 15th after the calendar year in which the property was transferred.

EXECUTIVE ORDER 12291 AND REGULATORY FLEXIBILITY ACT

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. The Internal Revenue Service has concluded that although this document is a notice of proposed rulemaking that solicits public comment, the regulations proposed herein are interpretative and the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis is required for this rule.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal authors of these proposed regulations are John R. Harman and Robert B. Coplan of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Parts 20 and 25 are as follows:

Paragraph 1. The last sentence of §20.0-1(b)(1) is amended by substituting "20.2056(d)-1" for "20.2056(e)-3".

Par. 2. Section 20.2012-1 is amended as follows:

(a) The first sentence of paragraph (a) is revised to read as set forth below.

(b) The fourth and fifth sentences of paragraph (d)(2)(ii) are removed.

(c) Paragraph (d)(3) is removed.

§20.2012-1 Credit for gift tax.

(a) *In general.* With respect to gifts made before 1977, a credit is allowed under section 2012 against the Federal estate tax for gift tax paid under chapter 12 of the Internal Revenue Code, or corresponding provisions of prior law, on a gift by the decedent of property subsequently included in the decedent's gross estate.***

* * * * *

Par. 3. Paragraph (b)(3)(ii) of §20.2013-4 is amended by substituting "20.2056(c)-2A" for "20.2056(c)-2".

Par. 4. Section 20.2014-3 is amended as follows:

(a) The flush material immediately following pragraph (b)(2) is revised to read as set forth below.

(b) The second sentence of subdivision (ii) of example (3) in paragraph (c) is revised to read as set forth below.

§20.2014-3 "Second limitation".

* * * * *

(b) ***

Any reduction described in subparagraph (1) or (2) of this paragraph (b) on account of the marital deduction must proportionately take into account, if applicable, the limitation on the aggregate amount of the marital deduction contained in §§20.2056(c)-1A and (c)-2A. See example (3) of paragraph (c) of this section.

(c) ***

Example (3). ***

(ii) *** Assume that the limitation imposed by section 2056(c), as it existed before 1982, is applicable so that the aggregate marital deduction allowed to the estate is limited to one-half the adjusted gross estate, or $400,000 (which is 50% of $800,000). ***

Par. 5. Section 20.2044-1 is redesig-

nated as §20.2045-1 and a new §20.2044-1 is added immediately following §20.2043-1, to read as set forth below.

§20.2044-1 Certain property for which marital deduction was previously allowed.

(a) *In general.* The value of the gross estate shall include under section 2044 the value of property in which the decedent had a "qualifying income interest for life" (as defined in §20.2056(b)-7(c) or §25.2523(f)-1(c)) if—

(1) A deduction was taken under section 2056(b)(7) or under section 2523(f) upon the transfer that created the decedent's qualifying income interest for life in that property, and

(2) That property was not treated as transferred under section 2519 (relating to dispositions of certain life estates).

The value of the property included in the gross estate under section 2044 shall not be reduced by any section 2503(b) exclusion that may have been taken for the transfer creating the interest. If any income from such property for the period between the date of the transfer that created the decedent's qualifying income interest for life and the date of the decedent's death has not been distributed before the decedent's death, then the gross estate also shall include such undistributed income. See section 2207A in regard to the estate's right to recover the estate tax attributable to such property from persons receiving the property.

(b) *Passed from.* For purposes of section 1014 and chapters 11 and 13 of Subtitle B of the Code, property included in a decedent's gross estate under section 2044 shall be considered to have been acquired from or to have passed from the decedent to the person receiving the property upon the decedent's death. Thus, the property will be treated as passing from the decedent for purposes of determining the availability of current use valuation under section 2032A, the availability of the charitable deduction under section 2055, and the availability of the marital deduction under section 2056. In order to qualify for special use valuation under section 2032A, the property must pass to a person who is a "qualified heir" (described in section 2032A (e)(1)) of the decedent.

(c) *Presumption.* If the decedent has a qualifying income interest for life in any property, it shall be presumed that a deduction was taken under section 2056(b)(7) or section 2523(f) upon the transfer which created the decedent's interest. In order to avoid the inclusion of property in the decedent's gross estate under this section, the executor must establish that a deduction was not taken for the transfer of property which created the qualifying income interest.

(d) *Amount included.* If the executor establishes that upon the transfer of property that created the decedent's qualifying income interest for life, a deduction was taken under section 2056(b)(7) or section 2523(f) for a fractional or percentile share of the entire interest in the property, then the amount includible in the decedent's gross estate under this section (assuming section 2519 has not applied) is equal to the fair market value of the entire interest in the property on the date of the decedent's death (or the alternate valuation date, if applicable) multiplied by such fractional or percentile share. However, such share shall be appropriately reduced if—

(1) The decedent's interest is in a trust and appointments of principal have been made to the decedent, and

(2) The trust provides that the appointments are to be made from the qualified terminable interest share of the trust, and

(3) The executor can establish to the satisfaction of the district director the reduction in that share based on the fair market value of the trust assets at the time of each appointment.

See example (4) of paragraph (e) of this section. If the decedent's interest is in a trust consisting of only qualified terminable interest property, and such trust has been severed (in compliance with §20.2056(b)-7(b) or §25.2523(f)-1(b), whichever is applicable) from a trust which also contained property which was not qualified terminable interest property, then only the value of the property in the severed portion of the trust is includible in the decedent's gross estate. If an executor establishes that upon the transfer of property (including an annuity contract) that created the decedent's lifetime annuity or other income interest, a deduction was taken under section 2056(b)(7) or section 2523(f) for an amount less than the fair market value of the entire property at the time of such transfer, then only a portion of the value of the property is includible in the decedent's gross estate under this section. The includible amount (assuming section 2519 has not applied) is equal to the fair market value of the entire property on the date of the decedent's death (or the alternate valuation date, if applicable) multiplied by a fraction, the numerator of which is the amount of the deductible interest determined under §20.2056(b)-(7)(c)(2) or §25.2523(f)-1(c)(2), and the denominator of which is the fair market value of the entire property at the time of the transfer creating the decedent's annuity or other income interest. See example (7) of paragraph (e) of this section.

(e) *Examples.* The following examples illustrate the application of principles in paragraphs (a) through (d) of this section.

Example (1). D died during 1982 passing property under a will providing that certain income producing assets valued at $800,000 in D's gross estate (net of debts, expenses, and other charges, including death taxes, payable from the property) were to be put in trust with all the income payable to D's surviving spouse, S, for life. The will provides that the corpus of the trust shall be distributed to D's children upon S's death. D's estate deducted $800,000 under section 2056(b)(7). Assume that S dies during 1984, at which time the value of the trust is $740,000; that S's executor does not elect the alternate valuation date; and that S has made no disposition of "all or part of the property" within the meaning of section 2519. The amount included in S's gross estate pursuant to section 2044 is $740,000.

Example (2). Assume that the facts are the same as in example (1) except that the executor of D's estate elected to deduct, pursuant to section 2056(b)(7), only 50 percent of the value of the trust ($400,000). Consequently, only an equivalent portion of the trust is included in S's gross estate, that is, $370,000 (50 percent of $740,000).

Example (3). Assume that the facts are the same as in example (1) except that S received a lifetime interest in only 20 percent of the income of the trust and that D's executor elected to deduct, pursuant to section 2056(b)(7), only

50 percent of the amount allowable, that is, $80,000 (50 percent of 20 percent of $800,000). Consequently, only an equivalent portion of the trust is included in S's gross estate, that is, $74,000 (50 percent of 20 percent of $740,000).

Example (4). Assume that the facts are the same as in example (1) except that the executor of D's estate elected to deduct, pursuant to section 2056(b)(7), only 50 percent of the value of the trust ($400,000), and that the trustee has the discretion to appoint principal to the surviving spouse. Assume that the trust instrument provides that appointments of principal will be made from the qualified terminable interest share first and that the trustee makes only one appointment of principal, to the spouse of $100,000, during 1983 when the value of the trust was $1,100,000. Immediately prior to the appointment, the qualified terminable interest portion of the trust was 50 percent ($550,000 of the $1,100,000). Immediately after the appointment, the qualified terminable interest portion of the trust was 45 percent ($450,000 divided by $1,000,000). Thus, the amount included in S's gross estate will be $333,000 (45 percent of $740,000) rather than $370,000, provided S's executor can establish to the satisfaction of the district director the facts in this example.

Example (5). Assume that the facts are the same as in example (1) except that, during 1983, S transfers to X the right to 40 percent of the income from the trust, for the life of S. Because S's entire interest (other than the right to the remaining 60 percent of the trust income and the amount of gift tax, if any, recoverable by S under section 2207A) is treated as transferred under section 2519, no part of the trust is included in S's gross estate under section 2044. However, since S retains an income interest in 60 percent of the property (the remainder interest in which is treated pursuant to section 2519 as having been transferred by S for both gift and estate tax purposes), 60 percent of the property is included in S's gross estate under section 2036(a)(1).

Example (6). During 1982 A created a trust for A's spouse, B, with the income payable annually to B for the lfe of B. The value of the trust on the day of creation was $800,000. The trust provides that upon B's death, $100,000 of corpus shall be paid to X charity and the remainder distributed to A's children. Assume that at the time of B's death the fair market value of the trust is $1,000,000, and that B's executor does not elect the alternate valuation date. If A had taken a deduction under section 2523(f) for the entire transfer, the amount included in B's estate would be the fair market value at B's death of the property in which B had a qualifying income interest for life, that is, $1,000,000. The amount passing to X charity is treated as a transfer by B to X charity for purposes of section 2055. Therefore, B's estate will be allowed a charitable deduction for the $100,000 transferred from the trust to the charity to the same extent that such a deduction would be allowed by section 2055 for a bequest by B to X charity.

Example (7). D died during 1983 passing property under a will providing that income producing assets valued at $500,000 in D's gross estate (net of debts, expenses, and other charges, including death taxes, payable from the property) were to be put in trust, with the trustee required to pay an annuity to D's surviving spouse, S, of $20,000 a year for life. All of the trust income other than amounts paid to S as an annuity are to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. D's estate deducted $200,000 under section 2056(b)(7) and §20.2056(b)-7(c)(2). Assume that S dies in 1988, at which time the value of the trust property is $800,000. Also assume that S's executor does not elect the alternate valuation date and that S has made no disposition of "all or part of the property" within the meaning of section 2519. The amount included in S's gross estate pursuant to section 2044 is $320,000 [($200,000/$500,000) x $800,000].

Par. 6. A new §20.2055-6 is added immediately following §20.2055-5, to read as set forth below.

§20.2055-6 Disallowance of double deduction in the case of terminable interest property.

No deduction shall be allowed from the decedent's estate under section 2055 for property transferred, if a deduction is taken from the decedent's estate with respect to that property by reason of section 2056(b)(7). See section 2056(b)(9).

Par. 7. Section 20.2056(a)-1 is revised to read as set forth below.

§20.2056(a)-1 Marital deduction; in general.

(a) A deduction is allowed under section 2056 from the gross estate of a decedent who was a citizen or resident of the United States at the time of the decedent's death for the value of any property interest which passed from the decedent to the decedent's surviving spouse, if the interest is a "deductible interest" as defined in §20.2056(a)-2. However, with respect to decedents dying in certain years, a deduction is allowed under section 2056 only to the extent that the total of the deductible interests does not exceed the applicable limitations set forth in §§20.2056(c)-1A and 20.2056(c)-2A. The deduction allowed under section 2056 is referred to as the "marital deduction." Except as otherwise provided by a death tax convention with a foreign country, the marital deduction is not allowed in the case of an estate of a nonresident who was not a citizen of the United States at the time of death. However, if the decedent was a citizen or resident, the estate is not deprived of its right to the marital deduction by reason of the fact that the decedent's surviving spouse was neither a resident nor a citizen. For convenience, the surviving spouse is generally referred to in the feminine gender, but if the decedent was a woman the reference is to her surviving husband. Sections 20.2056(b)-1 through 20.2056(b)-8 contain miscellaneous rules for determining the amount of "deductible interests"; §§20.2056(c)-1A and 20.2056(c)-2A provide limitations on the allowable amount of the marital deduction for decedents dying in certain years; §§20.2056(c)-1 through 20.2056(c)-3 define various terms used in the aforementioned sections; and §20.2056(d)-1 provides special rules concerning disclaimers of interests in property.

(b) In order to obtain the marital deduction with respect to any property interest, the executor must establish the following facts:

(1) That the decedent was survived by a spouse (see §20.2056(c)-2(e));

(2) That the property interest passed from the decedent to the spouse (see §§20.2056(b)-5 through 20.2056(b)-7 and 20.2056(c)-1 through 20.2056(c)-3);

(3) That the property interest is a "deductible interest" (see §20.2056 (a)-2); and

(4) The value of the property interest (see §20.2056(b)-4).

If a limitation on the allowable amount of the marital deduction applies to the estate (see §§20.2056(c)-1A and 20.2056(c)-2A), the executor must establish the facts relating to the application of such limitation. The executor must submit such proof as is necessary to establish any fact required by this paragraph (b), including any evidence requested by the district director.

Par. 8. The last sentence of paragraph (a) of §20.2056(a)-2 is revised to read as set forth below.

§20.2056(a)-2 Marital deduction; "deductible interests" and "nondeductible interests."

(a) *** Subject to the limitations set forth in §§20.2056(c)-1A and 20.2056(c)-2A (relating to quantitative limitations on the marital deduction in certain cases), if applicable, the marital deduction is equal in amount to the aggregate value of the "deductible interests."

* * * * *

Par. 9. Section 20.2056(b)-1 is

amended as follows:

(a) Paragraphs (d)(2) and (d)(3) are revised, and new paragraphs (d)(4) and (d)(5) are added immediately following paragraph (d)(3), to read as set forth below.

(b) Paragraph (e)(4) is revised to read as st forth below.

(c) The first sentence of paragraph (g) is replaced by the two sentences set forth below.

§20.2056(b)-1 Marital deductions; limitation in case of life estate or other "terminable interest."

* * * * *

(d) *Exceptions.* ***

* * * * *

(2) It is a right to income for life with a general power of appointment, meeting the requirements set forth in §20.2056(b)-5;

(3) It consists of life insurance or annuity payments held by the insurer with a general power of appointment in the spouse, meeting the requirements set forth in §20.2056(b)-6;

(4) It is qualified terminable interest property, meeting the requirements set forth in §20.2056(b)-7; or

(5) It is an interest in a qualified charitable remainder trust of which the spouse is the only noncharitable beneficiary, as provided under §20.2056(b)-8.

(e) *Miscellaneous principles.****

(4) The terms "passed from the decedent," "passed from the decedent to his surviving spouse" and "passed from the decedent to a person other than his surviving spouse" are defined in §§20.2056(c)-1 through 20.2056(c)-3.

* * * * *

(g) *Examples.* The application of this section may be illustrated by the following examples. In each example it is assumed that the executor made no election under section 2056(b)(7), that the property interest which passed from the decedent to a person other than his surviving spouse did not pass for an adequate and full consideration in money or money's worth, and that section 2056(b)(8) is inapplicable.

* * * * *

Par. 10. Paragraph (b) of §20.2056(b)-4 is amended by revising the reference to "§20.2056(c)-2" to read "§20.2056(c)-2A".

Par. 11. Section 20.2056(b)-5 is amended as follows:

(a) Paragraph (c) is revised to read as set forth below.

(b) The heading and first sentence of paragraph (d) are revised to read as set forth below.

§20.2056(b)-5 Marital deduction; life estate with power of appointment in surviving spouse.

* * * * *

(c) *Meaning of "specific portion"* —(1) Except as provided in paragraphs (c)(2) and (c)(3) of this section, a partial interest in property is not treated as a specific portion of the entire interest. In addition, any specific portion of an entire interest in property is nondeductible to the extent such specific portion is subject to invasion for the benefit of any person other than the surviving spouse, except in the case of deduction allowable under section 2056(b)(5), relating to invasions by the surviving spouse in the exercise of a general power of appointment.

(2) A partial interest in property is treated as a specific portion of the entire interest if the rights of the surviving spouse in income and the required rights as to the power (described in §20.2056(b)-5(a)) constitute a fractional or percentile share of a property interest so that such interest or share in the surviving spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to a specified fraction or percentage of the property, or the equivalent, the interest is considered as a specific portion.

(3) A specific sum payable annually or at more frequent intervals out of the property and its income that is not limited by the income of the property will be treated as a right to the income of a specific portion of the property. However, no deduction will be allowable under section 2056(b)(5) except to the extent the surviving spouse has the required power of appointment over a fractional or a percentile share of the property. The deductible interest, for purposes of §20.2056(a)-1(a), is the specific portion of the property that, assuming the interest rate generally applicable for the valuation of annuities at the time of the decedent's death, would produce income equal to such specific annual payment. However, such specific sum payable to a surviving spouse will not be treated as a right to the income of a specific portion of the property for purposes of this paragraph (c)(3), if any person other than the surviving spouse may receive, during the surviving spouse's lifetime, any distribution of the property or its income out of which the surviving spouse's payments are made. To determine the applicable interest rate, see section 2031 and the regulations under that section.

(4) A partial interest in property is treated as a specific portion of the entire interest if it is shown that the surviving spouse has rights under local law which are identical to those he or she would have acquired had the size of the share been expressed in terms satisfying the requirements of either paragraph (c)(2) or paragraph (c)(3) of this section.

(5) The following examples illustrate the application of paragraphs (a) through (c)(4) of this section.

Example (1). The decedent, D, transferred to a trustee 500 identical shares of X company stock. D provided that during the lifetime of D's surviving spouse, S, the trustee should pay S annually one-half of the trust income of $6,000, whichever is the larger. All of the trust income other than amounts paid to S are to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. S was also given a general power of appointment exercisable by S's last will over all the trust corpus. For purposes of paragraphs (a) and (b) of this section, S shall be considered as receiving the greater of (i) all the income from one-half of the entire interest in the stock or (ii) the specific portion of the stock which under §20.2056(b)-5(c)(3) is determined to be the portion required to produce annual income equal to $6,000.

Example (2). Assume that the facts are the same as in example (1) except that S's testamentary general power of appointment is exercisable over only one-fourth of the trust corpus and D's executor does not elect to treat the trust property as qualified terminable interest property under §20.2056(b)-7. Consequently, the marital deduction is only allowed for one-fourth of the trust (the lesser of the portion determined in example (1) or one-fourth of the trust).

Example (3). Assume that the facts are the same as in example (1) except that S's testamentary general power of appointment is exercisable over the sum of $160,000 and D's executor does not elect to treat the trust property as qualified terminable interest property under §20.2056(b)-7. Inasmuch as there is no certainty as to what portion of the stock will be valued at $160,000 on S's death, the power of appointment over $160,000 is not considered a power of appointment over a specific portion of the entire interest. Thus, no marital deduction is allowed.

Example (4). The decedent, D, bequeathed to a trustee an office building and 250 identical shares of Y Company stock. D provided that during the lifetime of D's surviving spouse, S, the trustee should pay S annually three-fourths of the trust income. S was given a general power of appointment exercisable by will over the office building and 100 shares of stock. By the terms of D's will, S is given all the income from a definite fraction of the entire interest in the office building and in the stock. However, since the amount of property represented by a single share of stock would be altered if the corporation split its stock, issued stock dividends, made a distribution of capital, etc., a power to appoint 100 shares at the time of S's death is not the same necessarily as a power to appoint 100/250 of the entire interest which the 250 shares represented on the date of D's death. If it is shown in this case that under local law S has a general power to appoint not only the 100 shares designated by D, but also 100/250 of any shares or amounts that are distributed by the corporation and included in the corpus, the requirements of paragraph (c)(2) of this section will be satisfied and S will be considered as having a general power to appoint 100/250 of the entire interest in the 250 shares.

(d) *Meaning of "entire interest."* Since a marital deduction is allowed for each qualifying separate interest in property passing from the decedent to the decedent's surviving spouse (subject to any applicable limitation on the aggregate amount of deductions contained in §§20.2056(c)-1A and 20.2056(c)-2A), for purposes of paragraphs (a) and (b) of this section, each property interest with resepct to which the surviving spouse received some rights is considered separately in determining whether the surviving spouse's rights extend to the entire interest or to a specific portion of the entire interest.***

* * * * *

Par. 12. There are added immediately following §20.2056(b)-6 the following new sections.

§20.2056(b)-7 Election with respect to life estate for surviving spouse.

(a) *In general.* A marital deduction is allowed under section 2056(b)(7) with respect to estates of decedents dying after December 31, 1981, for "qualified terminable interest property." All of the property for which a deduction is allowed under this paragraph (a) shall be treated as passing to the surviving spouse (for purposes of §20.2056(a)-1) and no part of such property shall be treated as passing to any person other than the surviving spouse (for purposes of §20.2056(b)-1).

(b) *Qualified terminable interest property defined.* For purposes of this section, the term "qualified terminable interest property" means property—

(1) Which passes from the decedent,

(2) In which the surviving spouse has a "qualifying income interest for life" as defined in paragraph (c) of this section, and

(3) Which the executor elected to treat as qualified terminable interest property.

For purposes of this section, the term "property" generally means an "entire interest in property" (within the meaning of §20.2056(b)-5(d)) or a "specific portion of the entire interest" (within the meaning of §20.2056(b)-5(c)). The election may relate to all or any part of property that meets the requirements of paragraphs (b)(1) and (2) of this section, provided that any partial election shall relate to a fractional or percentile share of the property so that the elective part will reflect its proportionate share of the increment or decline in the whole of the property for purposes of applying sections 2044 or 2519. Thus, if the interest of the surviving spouse in a trust meets the requirements of paragraphs (b)(1) and (2) of this section, the executor may make an election under paragraph (b)(3) with respect to a part of the trust only if the election relates to a defined fraction or percentage of the entire trust or specific portion thereof (within the meaning of §20.2056(b)-5(c)). The fraction or percentage may be defined by means of a formula. If the interest of the surviving spouse in a trust meets the requirements of paragraphs (b)(1) and (2) of this section, the trust may be divided into separate trusts to reflect a partial election that has been made or is to be made. If a trust is severed, it must be clear, by virtue of the duties imposed on the fiduciary either by applicable state law or by the express or implied provisions of the instrument governing the trust, that the fiduciary must divide the trust according to the fair market value of the assets of the trust at the time of the division. To have a valid election under paragraph (b)(3) of this section, the election shall be made by the executor (defined in section 2203 and the regulations under that section) who is in possession of the qualified terminable interest property and shall be made by such executor on the return of tax imposed by section 2001. For purposes of this paragraph, the term "return of tax imposed by section 2001" means the last estate tax return filed by such executor on or before the due date of the return, or if a timely return is not filed by such executor, the first estate tax return filed by the executor after the due date. The election, once made, is irrevocable. If an executor appointed under state law has made an election with respect to one or more properties, then no subsequent election may be made with respect to other properties in the executor's possession.

(c) *Qualifying income interest for life defined.* (1) *In general.* For purposes of this section, the term "qualifying income interest for life" means—

(i) The surviving spouse is entitled for life to all the income from the property, payable annually or at more frequent intervals, and

(ii) No person (including the surviving spouse) has a power, other than a power the exercise of which takes effect only at or after the surviving spouse's death, to appoint any part of the property to any person other than the surviving spouse.

In general, the principles outlined in §20.2056(b)-5(f), relating to whether the spouse is entitled for life to all of the income from the entire interest or a specific portion of the entire interest, are applicable in determining whether the surviving spouse is entitled for life to all the income from the property, regardless of whether the interest passing to the spouse is in trust. An income interest granted for

a term of years, or a life estate subject to termination upon the occurrence of a specified event (*e.g.*, remarriage), is not a qualifying income interest for life. In addition, an income interest (or life estate) that is contingent upon the executor's election under paragraph (b)(3) of this section is not a qualifying income interest for life, regardless of whether the election is actually made. On the other hand, an income interest will not fail to constitute a qualifying income interest for life solely because income between the last distribution date and the date of the surviving spouse's death is not required to be distributed to the surviving spouse or the surviving spouse's estate. See §20.2044-1 relating to the inclusion of such undistributed income in the surviving spouse's estate. An income interest in a trust will not fail to constitute a qualifying income interest for life solely because the trustee has a power to distribute corpus to or for the benefit of the surviving spouse. Also, the fact that property (*i.e.*, income or corpus) distributed to a surviving spouse may be transferred by the spouse to another person does not result in a failure to satisfy the requirement of paragraph (c)(1)(ii) of this section. However, if the governing instrument requires the surviving spouse to transfer the distributed property to another person without full and adequate consideration in money or money's worth, the requirement of paragraph (c)(1)(ii) of this section is not satisfied.

(2) *Annuities.* In general, a surviving spouse's lifetime annuity interest shall be treated as a qualifying income interest for life for purposes of section 2056(b)(7)(B)(ii). The deductible interest, for purposes of §20.2056(a)-1(a), is the specific portion of the property (including an annuity contract) that, assuming the interest rate generally applicable for the valuation of annuities at the time of the decedent's death, would produce income equal to the minimum amount payable annually to the surviving spouse for life. In no case may the value of the deductible interest exceed the value of the property out of which the annuity is paid. If the annual payment may increase, the annuity interest will not be disqualified, but the increased amount shall not be taken into account in valuing the deductible interest. However, an annuity interest will not be treated as a qualifying income interest for life for purposes of section 2056(b)(7)(B)(ii), if any person other than the surviving spouse may receive, during the surviving spouse's lifetime, any distribution of the property or its income (including any distribution under an annuity contract) out of which the annuity is payable. To determine the applicable interest rate for valuing annuities, see section 2031 and regulations under that section. If, assuming such interest rate, the entire property from which the annuity may be satisfied is insufficient to produce income equal to the minimum annual payment, the value of the deductible interest is the entire value of such property.

(d) *Application of local law.* The provisions of local law shall be taken into account in determining whether or not the conditions of paragraphs (b) and (c) of this section are satisfied. For example, silence of a trust instrument as to the frequency of payment will not be regarded as a failure to satisfy the condition in paragraph (c) of this section that the income must be payable to the surviving spouse annually or more frequently, unless the applicable law permits payment to be made less frequently than annually.

(e) *Examples.* The following examples illustrate the application of paragraphs (a) through (c) of this section. In each example it is assumed that the decedent dies after 1981.

Example (1). A decedent at the time of death owns a personal residence valued at $250,000 for estate tax purposes. Under the decedent's will, which was executed after September 11, 1981, the exclusive and unrestricted right to use such property (including the right to continue to occupy the property as a personal residence or to rent such property and receive the income) passes to the decedent's surviving spouse, S, for life. After S's death the property passes to the decedent's children. If the executor elects to treat all of such property as qualified terminable interest property, the deductible interest is the value of such property for estate tax purposes, *i.e.*, $250,000.

Example (2). Assume that the facts are the same as in example (1) except that the property is a recently planted tree farm which is not expected to be income producing for 20 years after the decedent's death. In addition, assume that S is 70 years old at the time of the decedent's death, and that applicable local law does not require or permit S to require the conversion of the property into a productive asset within a reasonable time after the decedent's death. S does not have a qualifying income interest for life because the bequest does not give S that degree of beneficial enjoyment during S's life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. See §20.2056(b)-5(f). Therefore, no deduction for the bequest is allowable under section 2056(b)(7).

Example (3). Pursuant to a will executed after September 11, 1981, the decedent establishes a trust that is funded with property valued at $500,000 for estate tax purposes. The assets used to fund the trust include both income producing assets and non-productive assets. The surviving spouse, S, is given the right exercisable annually to require distribution of all the trust income to himself or herself. There is no power to distribute trust property during S's lifetime to any person other than S. Applicable State law permits S to require that the trustee either make the trust property productive or sell the property and reinvest in productive property within a reasonable time. If the executor elects to treat all of the trust as qualified terminable interest property, the deductible interest is $500,000. If the executor elects to treat only 20 percent of the trust as qualified terminable interest property, the deductible interest is only $100,000, that is, $500,000 multiplied by 20 percent.

Example (4). Assume that the facts are the same as in example (3) except that S is given the right exercisable annually to require distribution to herself or himself of only 50 percent of the trust income for life. The other 50 percent of the trust income is to be distributed among S and the decedent's children in the trustee's discretion or accumulated. If the executor elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the deductible interest is $250,000, which is the value of the trust for estate tax purposes ($500,000) multiplied by the spouse's percentile share of the trust income (50 percent). If the executor elects to treat only 20 percent of the portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the deductible interest is only $50,000, that is, $250,000 multiplied by 20 percent.

Example (5). Assume that the facts are the same as in example (3) except that the trustee is given the power to use annually $5,000 from the trust for the maintenance and support of X. S does not have a qualifying income interest for life in any portion of the trust because the bequest fails to satisfy the condition set forth in §20.2056(b)-7(c)(2), which is the condition that no person have a power, other than a power the exercise of which takes effect only at or after S's death, to appoint any part of the property to any person other than S. The trust would also be nondeductible under section 2056(b)(7) if S were given the power, rather than the trustee, to appoint a portion of the corpus to X.

Example (6). Assume that the facts are the same as in example (3) except that, upon S's remarriage, S's interest in the trust will pass to X. The trust is not deductible under section 2056(b)(7). S's income interest is not a "qualifying income interest for life" because it is not for life, but rather is terminable upon S's remarriage.

Example (7). Assume that the facts are the

same as in example (3) except that S is given the right to require distribution to S of only that percentage of the trust income which the executor elects to treat as qualified terminable interest property. S does not have a qualifying income interest for life in any portion of the trust because the income interest is contingent upon the executor's election. Accordingly, the executor cannot elect qualified terminable interest treatment for any portion of the trust. If the decedent's will gives the the surviving spouse a qualifying income interest for life in a specific portion of the trust (such as the minimum portion of the trust that is necessary to reduce Federal estate tax to zero) and such interest is not contingent on the executor's election of qualified terminable interest treatment, the executor can elect qualified terminable interest treatment for the specified portion of the trust.

Example (8). Pursuant to a will executed after September 11, 1981, the decedent, D, establishes a trust funded with the residue of D's estate. Income of the trust is to be paid annually to D's surviving spouse, S, for S's life, and the principal is to be distributed to D's children upon S's death. S has the power to require that all the trust property be made productive. There is no power to distribute trust property during S's lifetime to any person other than S. D's executor elects to deduct under section 2056(b)(7) a fractional share of the residuary estate. The executor provides that the numerator of the fraction is the amount of deduction necessary to reduce the Federal estate taxes to zero (taking into account final estate tax values) and the denominator of the fraction is the final estate tax value of the residuary trust (after taking into account any specific bequests or liabilities of the estate paid out of the residuary estate). The formula election is of a fractional share. The value of such share qualifies for the marital deduction even though the executor's determinations to claim administration expenses as estate or income tax deductions and the final estate tax value will affect the amount of the fractional share.

Example (9). Assume that the facts are the same as in example (8) except that, rather than defining a fraction, the executor's formula states: "I elect that portion of the residuary trust, up to 100 percent, necessary to reduce the Federal estate taxes to zero, after taking into account the available unified credit, final estate tax values and any liabilities paid out of and specific bequests funded out of the residuary estate." The formula election is of a fractional share. The share is equivalent to the fractional share determined in example (8).

Example (10). Assume that the facts are the same as in example (8) except that S is also the life beneficiary of the sixteen remaining annual installments of D's individual retirement account for which the 19 original annual installments began being paid when D reached age 70 ½. Also assume that each installment is equal to all the income earned on the remaining principal in the account plus a share of the remaining principal equal to $\frac{1}{19}$ in the first year, $\frac{1}{18}$ in the second year, $\frac{1}{17}$ in the third year, etc. Any remaining payment after S's death passes to D's children. S's interest in the account is a qualifying income interest for life. If D's executor makes two separate elections, one as to 100 percent of the retirement account and a second as to the residuary trust in the same manner as example (8), each election qualifies the property subject to the election for the marital deduction.

Example (11). Assume that the facts are the same as in example (8) except that D's will directs the executor to elect qualified terminable interest treatment for the minimum amount of property necessary to reduce estate taxes on D's estate to zero, directs the executor to divide the residuary estate into two separate trusts to reflect the election and directs that any payments of principal to S shall be charged first to the marital deduction trust. S remains the sole life beneficiary of both trusts. The authorization and direction have no effect on the allowance of a marital deduction, and only the property remaining in the marital deduction trust, after payments of principal to S, will be subject to inclusion in S's gross estate (by section 2044) or subject to gift tax (by section 2519). If rather than authorizing the executor to form two separate trusts, D's will directs the executor to form a single trust and reduce the marital deduction share of that trust by any invasions of principal for S, the executor's formula election will be valid. See §§20.2044-1(d) and 25.2519-1(d) for the effect of appointments of principal.

Example (12). Pursuant to a will executed after September 11, 1981, the decedent, D, establishes a trust funded with income producing property valued at $500,000 for estate tax purposes. The trustee is required by the trust instrument to pay $20,000 a year to D's surviving spouse, S, for life. The rest of the income from the trust is to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. S's lifetime annuity interest is treated as a qualifying income interest for life. If the executor elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the value of the deductible interest is $200,000, since such amount would yield an income to S of $20,000 a year (assuming D died in March 1984 and a 10 percent interest rate applies in valuing annuities).

Example (13). Assume the same facts as in example (12) except that the trustee is required to pay S $70,000 a year for life. If the executor elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the value of the deductible interest is $500,000, which is the lesser of the entire value of the property ($500,000), or the amount of property that (assuming a 10 percent interest rate) would yield an income to S of $70,000 a year ($700,000).

Example (14). Pursuant to a will executed after September 11, 1981, the decedent, D, provides that upon his death, the executor shall purchase a commercial annuity for his surviving spouse, S, that will pay S $100,000 a year for life. Based on S's life expectancy at the time of D's death, the cost of the annuity is $700,000. S's annuity interest is treated as a qualifying income interest for life. If the executor elects to treat the entire property in which S has a qualifying income interest for life as qualified terminable interest property, the deductible interest is the cost of the annuity, or $700,000.

Example (15). Pursuant to a will executed after September 11, 1981, the decedent transfers $200,000 to a pooled income fund, within the meaning of section 642(c)(5), designating his wife as the income beneficiary for her life. If the executor elects to treat the entire $200,000 as qualified terminable interest property, the deductible interest is $200,000. The deduction will not be denied under this section if the decedent's transfer to his wife is conditioned on the payment by the wife of state death taxes attributable to the pooled income fund.

§20.2056(b)-8 Special rule for charitable remainder trusts.

With respect to estates of decedents dying after December 31, 1981, section 2056(b)(8) provides that if the surviving spouse of the decedent is the only noncharitable beneficiary of a charitable remainder annuity trust or a charitable remainder unitrust described in section 664 (qualified charitable remainder trust), section 2056(b)(1) shall not apply to any interest in such trust which is transferred to the surviving spouse. Thus, the estate will receive a charitable deduction under section 2055 for the value of the remainder interest and a marital deduction under section 2056(b)(8) for the value of the annuity or unitrust interest. A marital deduction for the value of the surviving spouse's annuity or unitrust interest in a qualified charitable remainder trust is allowable only under section 2056(b)(8). No marital deduction is allowable for any portion of a qualified charitable remainder trust under section 2056(b)(7). The surviving spouse's interest need not be an interest for life. For purposes of this section, the term "non-charitable beneficiary" means any beneficiary of the qualified charitable remainder trust other than an organization described in section 170(c). A deduction will not be denied under this section by reason of the transfer to the surviving spouse being conditioned on the payment of state death taxes attributable to the qualified charitable remainder trust. See §20.2056(b)-4(c) for the effect of such a condition on the amount of deduction allowable.

Par.13. Section 20.2056(c)-1 is redesignated §20.2056(c)-1A and is amended as follows:

(a) Paragraph (a) is revised to read as set forth below.

(b) Paragraph (b) is redesignated as paragraph (d) and a new paragraph (b) is inserted in its place to read as set forth below.

(c) A new paragraph (c) is added to read as set forth below.

(d) Paragraph (d) as redesignated by this document is amended by inserting a new sentence immediately after the second sentence, by revising

the reference to "§20.2056(c)-2" to read "§20.2056(c)-2A", and by removing the last sentence of the example and inserting a new sentence in its place, to read as set forth below.

§20.2056(c)-1A Marital deduction; limitation on aggregate of deductions for decedants dying in certain years.

(a) *Estates of decedants dying either prior to January 1, 1977, or, in certain cases, after December 31, 1976, and before January 1, 1979.* In general, the allowable marital deduction for estates of decedents dying before January 1, 1977, and the allowable marital deduction for certain decedents dying after December 31, 1976, and before January 1, 1979 (as provided in paragraph (c)(1) of this section relating to maximum marital deduction formula provisions), is limited to the smaller of the following amounts:

(1) The aggregate value of the "deductible interests" which passed from the decedent to the surviving spouse (see §20.2056(a)-2(a)); or

(2) Fifty percent of the value of the decedent's "adjusted gross estate."

(b) *Estates of decedents dying either after December 31, 1976, and prior to January 1, 1982, or, in certain cases, after December 31, 1981*— (1) *In general.* Except as provided by paragraphs (b)(2) and (c)(1) of this section, the allowable marital deduction for estates of decedents dying after December 31, 1976, and prior to January 1, 1982, and the allowable marital deduction for certain decedents dying after December 31, 1981 (as provided in paragraph (c)(2) of this section relating to maximum marital deduction formula provisions), is limited to the smaller of the following amounts:

(i) the aggregate value of the "deductible interests" which passed from the decedent to the surviving spouse (see §20.2056(a)-2(a)); or

(ii) The greater of—

(A) Two hundred fifty thousand dollars (reduced for community property as provided in §20.2056(c)-2A), or

(B) Fifty percent of the value of the decedent's "adjusted gross estate."

(2) *Adjustment for certain gifts to a spouse*—(i) *In general.* The limitation provided by paragraph (b)(1)(ii) of this section shall be reduced (but not below zero) by the excess, if any, of—

(A) The aggregate deductions allowed under section 2523 for post-1976 interspousal gifts made by the decedent and not included in the gross estate under section 2035 (gifts within 3 years of death); over

(B) The aggregate deductions which would have been allowable under section 2523 for those gifts if the amount deductible were 50 percent of the aggregate value of the deductible interests in the gifts.

In the case of remarriage, the adjustment required by this paragraph (b)(2)(i) shall be determined on the basis of gifts to all spouses. For purposes of this paragraph (b)(2)(i), a gift shall be treated as included in the gross estate by section 2035 only if it is included in the gross estate solely by reason of section 2035.

(ii) *Determination of post-1976 interspousal gifts.* In general, the term "post-1976 interspousal gifts" shall include all transfers by gift occurring after December 31, 1976, from the decedent to the decedent's spouse. However, the term shall not include gifts that were not required to be included in a gift tax return. See §25.6019-1(a)(1). Therefore, so long as a particular year's interspousal gifts do not exceed the annual per donee exclusion and do not include a future interest, that year's interspousal gifts are not included in the adjustment set out in paragraph (b)(2)(i) of this section. In years where interspousal gifts are in excess of the annual per donee exclusion or include a future interest, all interspousal gifts transferred during the year are included in the computation.

(iii) *Examples.* The following examples illustrate the reduction required by paragraph (b)(2)(i) of this section. The reduction for post-1976 transfers is equal to the lesser of:

A; or

B − C − 50% (D − E)

where the letters correspond to the following amounts:

A = the limitation on the marital deduction before adjustment for interspousal gifts and after the reduction required for community property (paragraph (b) of §20.2056(c)-2A);

B = the aggregate deductions under section 2523 for post-1976 gifts;

C = the aggregate deductions under section 2523 for post-1976 gifts included in the gross estate solely by reason of section 2035;

D = the sum of deductible interests (within the meaning of §25.2523(a)-1(b)(2)) in post-1976 interspousal gifts required to be included in a gift tax return; and

E = the sum of deductible interests (within the meaning of §25.2523(a)-1(b)(2)) in post-1976 interspousal gifts required to be included in the gross estate by reason of section 2035.

Example (1). W died during 1979 having made two gifts to W's spouse after 1976. The first gift was for $103,000 and was made during 1977. With respect to the first gift, W deducted $100,000 under 2523 and excluded $3,000 from taxable gifts under section 2503(b). The second gift was made during 1978 and was in the amount of $4,000, of which $3,000 was excluded from taxable gifts under section 2503(b) and $1,000 was reported as a taxable gift. W never held property as community property and died with an adjusted gross estate of $300,000 (including $107,000 of previous gifts included in the gross estate by reason of section 2035). The reduction in the marital deduction limitation required as a result of post-1976 gifts is zero, computed as follows:

Lesser of:

$250,000; or

$0,

i.e., $100,000 − $100,000 − 50% ($107,000 − $107,000).

Example (2). The facts are the same as in example (1) except W dies on January 1, 1981, with an adjusted gross estate of $300,000. Pursuant to section 2035, the adjusted gross estate includes the $4,000 gift made during 1978. W made no gifts to W's spouse other than those in example (1). The reduction in the marital deduction limitation as a result of post-1976 gifts is $48,500, computed as follows:

Lesser of:

$250,000; or

$48,500, *i..e.*, $100,000 − $0 − 50% ($107,000 − $4,000).

Example (3). The facts are the same as in example (2) except W made a second transfer by gift to W's spouse during 1977. The second gift during 1977 was a gift of a nondeductible terminable interest in property. Therefore, the second gift during 1977 has no effect on the limitation on the marital deduction. The reduction in the marital deduction limitation as a result of post-1976 gifts remains $48,500.

Example (4). The facts are the same as in example (2) except the gift made during 1978 was for $3,000 and therefore was not required to be included in a gift tax return. The reduction in the marital deduction limitation as a result of post-1976 gifts is $48,500, computed as follows:

Lesser of:
$250,000; or
$48,500, *i.e.*, $100,000 − 0 − 50% ($103,000 − $0).

Example (5). The facts are the same as in example (4) except a portion of W's gross estate includes an interest in community property. Assume for purposes of this example that the maximum allowable marital deduction, after adjustments for community property and prior to adjustments for gifts to the spouse, is $12,500 (see §20.2056(c)-2A). The reduction in the marital deduction limitation as a result of post-1976 gifts is $12,500, computed as follows:
Lesser of:
$12,500; or
$48,500, *i.e.*, $100,000 − $0 − 50% ($103,000 − $0).

(c) *Special rules for property passing under a maximum marital deduction formula provision*—(1) *Decedents dying before January 1, 1979.* The allowable marital deduction for property passing to a surviving spouse from a decedent dying after December 31, 1976, but before January 1, 1979, under a maximum marital deduction formula provision (defined in paragraph (c)(3) of this section) in a will executed or trust created before January 1, 1977, is limited to the amount determined under paragraph (a) of this section (*i.e.*, the limitation applicable to estates of decedents dying before January 1, 1977) unless—

(i) The maximum marital deduction formula provision of the will or trust (or another provision of the will or trust that refers to the maximum marital deduction formula provision) is amended after December 31, 1976, and before the decedent's death; or

(ii) A state statute applicable to the estate is enacted which construes the type of formula used as referring to the allowable marital deduction limitation under section 2056 as amended by the Tax Reform Act of 1976.

The marital deduction allowable to an estate to which the rule in this paragraph (c)(1) applies may exceed the paragraph (a) limitation, but only to the extent that the value of property passing outside of the formula provision is in excess of the paragraph (a) limitation.

(2) *Decedents dying after December 31, 1981.* The allowable marital deduction for property passing from a decedent dying after December 31, 1981, to a surviving spouse under a maximum marital deduction formula provision (defined in paragraph (c)(3) of this section) in a will executed or trust created before September 12, 1981, is limited to the amount determined in paragraph (b)(1) of this section (*i.e.*, the limitation applicable to estates of decedents dying after December 31, 1976, and prior to January 1, 1982) unless—

(i) The maximum marital deduction formula provision of the will or trust (or another provision of the will or trust that relates to the maximum marital deduction formula provision) is amended after September 11, 1981, and before the decedent's death to refer specifically to an unlimited marital deduction; or

(ii) A state statute applicable to the estate is enacted which construes the type of formula used as referring to the allowable marital deduction under section 2056 as amended by the Economic Recovery Tax Act of 1981.

The marital deduction allowable to an estate to which the rule in this paragraph (c)(2) applies may exceed the paragraph (b) limitation, but only to the extent that the value of property passing outside of the formula provision is in excess of the paragraph (b) limitation. For purposes of this paragraph (c)(2), the paragraph (b) limitation shall be increased by the value of any interest in property that is deducted from the decedent's gross estate by reason of section 2056(b)(7) or (b)(8).

(3) *Maximum marital deduction formula provision.* For purposes of this section, the term "maximum marital deduction formula provision" means a will or trust provision expressly providing that the decedent's surviving spouse is to receive an amount or share which is determined with reference to the maximum allowable marital deduction, even though the amount passing under the formula provision may be reduced to insure full usage of the decedent's unified credit or to take into account transfers outside of the formula provision that qualify for the marital deduction. However, the term shall not include any provision in a will or trust where the instrument specifically indicates that the decedent intended to give the surviving spouse additional property if Federal law were changed to increase the allowable marital deduction.

(4) *Examples.* The following examples illustrate the effect of paragraphs (c)(1) through (c)(3) of this section. Unless otherwise specified, in each example it is assumed that sections 2056(b)(7) and (b)(8) are not applicable to the decedent's estate.

Example (1). The decedent died during 1978 with an adjusted gross estate valued at $400,000. All of the decedent's property was disposed of in accordance with a will executed prior to January 1, 1977. It is assumed for purposes of this example that the decedent and the spouse never held any property as community property; that the decedent made no gifts to a spouse after December 31, 1976; that the will was never amended; and that the State did not enact a statute construing the use of maximum marital deduction formula clauses. Although the decedent's will contained a maximum marital deduction formula provision, an aggregate amount of $225,000 passed to the surviving spouse by operation of a specific bequest. The allowable marital deduction is $225,000, because the estate is entitled to the marital deduction allowed for estates of decedents dying after 1976 to the extent property passes outside the maximum marital deduction formula provision (*e.g.*, joint tenancy property, insurance proceeds passing directly to the spouse outside the will, and property passing under provisions of the will other than the marital deduction formula provision).

Example (2). The decedent died after December 31, 1981, passing property under a will executed prior to September 12, 1981, and not amended thereafter. The will contains a formula provision that established a marital deduction trust equal to the maximum amount qualifying for the marital deduction allowable under Federal estate tax law, reduced by transfers outside of the formula provision which qualify for the marital deduction, and further reduced to the extent (if any) necessary to increase the decedent's taxable estate to the largest amount which will result in no Federal estate tax being payable after taking the available unified credit into account. No State statute is enacted to construe the formula provision as referring to the unlimited marital deduction. Pursuant to paragraph (c)(2) of this section, the marital deduction allowable for property passing under the formula provision in this case may not exceed the amount determined in paragraph (b)(1) of this section, reduced by the value of qualifying property interests passing to the spouse outside the formula provision, and further reduced by the available unified credit. Paragraph (c)(2) of this section does not limit the marital deduction allowable for property passing outside the will (*e.g.*, joint tenancy property or insurance proceeds) or property passing under provisions of the will other than the maximum marital deduction formula provision. Thus, if the decedent's adjusted gross estate is $1,500,000, the will makes a specific bequest to the spouse of tangible personal property worth $500,000, and the spouse receives joint bank accounts in the amount of $50,000 outside the will, then the maximum marital deduction allowable for property passing under the formula provision is $650,000, less any amount by which the formula bequest is reduced to insure full usage of the available

unified credit. The total marital deduction allowable to the estate in this case is $750,000 (*i.e.*, the $650,000 deductible amount that may pass under the formula provision plus the $50,000 specific bequest and the $50,000 of joint bank accounts). If the facts are as just stated except that the surviving spouse also receives life insurance proceeds of $750,000 that are includable in the decedent's gross estate but pass to the surviving spouse outside the will, no marital deduction is allowable to the estate for property passing under the formula provision and the total marital deduction allowable to the estate is $850,000 (*i.e.*, the $750,000 of life insurance proceeds plus the $50,000 specific bequest and the $50,000 of joint bank accounts).

Example (3). The decedent died after December 31, 1981, passing property under a trust instrument executed prior to September 12, 1981, and not amended thereafter. The trust instrument establishes a separate marital deduction trust for the decedent's spouse at the decedent's death pursuant to a formula provision similar to the one described in example (2), except that the amount passing to the marital deduction trust is determined with reference to the maximum amount qualifying for the marital deduction allowable "under the Federal estate tax law in effect at [the decedent's] death." In this case the trust instrument specifically indicates that the decedent intended to give the surviving spouse additional property if the Federal estate tax law were changed to increase the allowable marital deduction. Accordingly, paragraph (c)(2) of this section does not apply and the marital deduction allowable to the estate is not subject to any quantitative limitation imposed by this section.

Example (4). The decedent died after December 31, 1981, passing property under a will executed prior to September 12, 1981, and not amended thereafter. The will contains a formula provision that establishes a marital deduction trust equal to the maximum amount qualifying for the marital deduction allowable under Federal estate tax law reduced by other property qualifying for the marital deduction and passing to the surviving spouse outside of the formula provision. No State statute is enacted to construe the formula provision as referring to the unlimited marital deduction. The surviving spouse receives no property outside the will. The only other property the surviving spouse receives under the will is (i) an interest in a trust (funded with the residuary of the decedent's estate) that qualifies for qualified terminable interest treatment under section 2056(b)(7) and (ii) an interest in a qualified charitable remainder trust that qualifies for deduction under section 2056(b)(8). The decedent's adjusted gross estate is $1,500,000 and applicable State law provides that the marital deduction trust is funded with one-half the adjusted gross estate. Accordingly, the marital deduction allowable to the estate in this case is $750,000 (one-half the adjusted gross estate of $1,500,000) for the marital deduction trust plus the portion of the residuary trust that the executor elects to treat as qualified terminable interest property plus the value of the spouse's interest in the qualified charitable remainder trust.

(d) *Adjusted gross estate.* *** However, solely for purposes of determining the allowable marital deduction, the decedent's gross estate is deemed to include the amount of any generation-skipping transfer taxable under section 2601 if—

(1) The decedent is the deemed transferor within the meaning of section 2612, and

(2) The generation-skipping transfer occurs at the same time as, or within 9 months after, the decedent's death.

Example. *** Assuming the decedent died prior to January 1, 1977, the allowable marital deduction is limited to $85,000 (50 percent of the value of the adjusted gross estate).

Par. 14. Section 20.2056(c)-2 is redesignated §20.2056(c)-2A, retitled to read as set forth below, and amended as follows:

(a) Paragraph (a) is revised to read as set forth below.

(b) Paragraph (j) is revised by removing the first nine words of example (1) and inserting new language in their place, and by adding a new example (3) immediately after example (2), to read as set forth below.

§20.2056(c)-2A Additional limitation on marital deduction applicable in certain cases involving community property.

(a) This section only affects the marital deduction for estates of decedents for which the limitation imposed by either paragraph (a) or (b) of section 20.2056(c)-1A is applicable.

(1) If the decedent and the decedent's surviving spouse at any time held property as "community property," as defined in this section, the "adjusted gross estate" referred to in §20.2056(c)-1A is the entire value of the gross estate less the sum of the following values and amounts:

(i) The value of any property included in the gross estate that was at the time of the decedent's death held by the decedent and the decedent's surviving spouse as "community property," as defined in this section.

(ii) The value of property (to the extent included in the gross estate) transferred by the decedent during the decedent's life, if at the time of such transfer the property was held by the decedent and the decendent's surviving spouse as "community property," as defined in this section.

(iii) The amount (to the extent included in the gross estate) receivable as insurance under policies upon the life of the decedent, to the extent purchased with premiums or other consideration paid out of property then held by the decedent and the decedent's surviving spouse as "community property," as defined in this section.

(iv) An amount that bears the same ratio to the aggregate amount of the deductions for expenses, indebtedness, taxes and losses allowed by sections 2053 and 2054 as the value of the gross estate, reduced by the aggregate amount subtracted under paragraphs (a)(1)(i), (1)(ii) and (1)(iii) of this section, bears to the entire value of the gross estate. The amount to be subtracted under this paragraph (a)(1)(iv) is:

$$\frac{\text{community property}}{\text{entire gross estate}} \times \text{gross estate, less deductions for expenses, indebtedness, taxes, and losses.}$$

(2) If the decedent and the decedent's surviving spouse at any time held property as "community property," as defined in this section, the limitation on the marital deduction set forth in paragraph (b)(1)(ii)(A) of §20.2056(c)-1A (the $250,000 limitation) shall be reduced by the sum of the values and amounts in paragraphs (a)(1)(i) through (1)(iv) of this section and increased by the aggregate amount of the deductions for expenses, indebtedness, taxes and losses allowed by sections 2053 and 2054. The amount to be subtracted (from the $250,000 limitation) under this paragraph (a)(2) is:

$$\frac{\text{community property}}{\text{entire gross estate}} \times \text{community property, less deductions for expenses, indebtedness, taxes, and losses.}$$

* * * * *

(j) ***

Example (1). The decedent, A, died prior to January 1, 1977, with a gross estate having a value of $300,000, ***

* * * * *

Example (3). The facts are the same as in example (1) except that the decedent dies after December 31, 1976, and before January 1, 1982. It is assumed for the purpose of this example that no property passed to the surviving spouse by operation of a maximum marital deduction formula provision in a will executed or

trust created before January 1, 1977, and that the decedent made no gifts to a spouse after December 31, 1976. The alternative limitation on the marital deduction set forth in §20.2056(c)-1A(b)(1)(ii)(A) is computed as follows:

Maximum limitation on the marital deduction.....	$250,000
Reduction under paragraph (a) of this section ($100,000, less ((($100,000 X $45,000)) (($300,000)))....	$85,000
Limitation adjusted for community property	$165,000

The marital deduction will be $165,000 (the greater of one-half the adjusted gross estate ($85,000, see computation in example (1) above) or the limitation set forth in §20.2056(c)-1A(b)(1)(ii)(A)) if the aggregate value of the deductible interests passing from the decedent to the decedent's surviving spouse equals or exceeds that amount.

Par. 15. Section 20.2056(e)-1 is redesignated 20.2056(c)-1, inserted in the appropriate place, and amended by revising the reference to "§20.2056(c)-2" in paragraph (b) to read "§20.2056(c)-2A".

Par. 16. Section 20.2056(e)-2 is redesignated 20.2056(c)-2, inserted in the appropriate place, and amended as follows:

(a) The first sentence of paragraph (a) is amended by revising the reference to "§20.2056(e)-1" to read "§20.2056(c)-1".

(b) Paragraphs (a)(2) through (a)(5) are redesignated as paragraphs (a)(3) through (a)(6), respectively, and a new paragraph (a)(2) is inserted in the appropriate place to read as set forth below.

(c) The first sentence in the flush material following redesignated paragraph (a)(5) is revised to read as set forth below.

(d) Paragraphs (b)(1)(iv), (b)(2)(iii) and (b)(3)(v) are amended by revising the references to "§20.2056(b)-5" to read "§§20.2056(b)-5 or 20.2056(b)-7".

§20.2056(c)-2 Marital deduction; definition of "passed from the decedent to his surviving spouse".

(a) *In general.* ***

(2) In the case of certain interests with income for life to the surviving spouse which the executor elects to treat as qualified terminable interest property (see §20.2056(b)-7);

* * * * *

(5) ***

A property interest is considered as passing to the surviving spouse only if it passed to her as beneficial owner, except to the extent otherwise provided in §§20.2056(b)-5 through 20.2056(b)-7.

* * * * *

Par. 17. Section 20.2056(e)-3 is redesignated 20.2056(c)-3, inserted in the appropriate place, and amended by revising the references therein to "§20.2056(e)-1" and "§20.2056(e)-2" to read "§20.2056(c)-1" and "§20.2056(c)-2", respectively.

Par. 18. A new section is added immediately following §20.2207-1, to read as set forth below.

§20.2207A-1 Right of recovery of estate taxes in the case of certain marital deduction property.

(a) *In general.* If the gross estate includes property the value of which is includable in the gross estate by reason of section 2044 (relating to property received by the decedent as qualified terminable interest property under sections 2056(b)(7) or 2523(f)), such estate shall be entitled to recover from the "person receiving the property" (as defined in paragraph (d) of this section) the amount of estate tax attributable to that property. There shall be no right of recovery from any person for the portion of property received by that person for which a deduction was allowed from the gross estate, because no tax is attributable to such portion. Failure of an estate to exercise a right of recovery provided by section 2207A upon a transfer subject to section 2044 is treated as a transfer for Federal gift tax purposes of the unrecovered amounts from the persons who would benefit from such transfer to the persons from whom such recovery could have been obtained. See §25.2511-1. Such transfer is considered as made when such right to recovery is no longer enforceable and is treated as a gift even if recovery is impossible. This paragraph (a) shall not apply to the extent that the decedent's will provides that a recovery shall not be made.

(b) *Amount of estate tax attributable to all such properties.* The amount of estate tax that is attributable to all such properties includable in the gross estate is the amount by which—

(1) The total estate tax (including penalties and interest attributable to the tax) under chapter 11 of the Code which has been paid exceeds

(2) The total estate tax (including penalties and interest attributable to the tax) under chapter 11 of the Code which would have been payable if the value of the properties includable in the gross estate by reason of section 2044 had not been included.

(c) *Amount of estate tax attributable to a particular property.* An estate's right of recovery with respect to a particular property is an amount equal to the amount determined in paragraph (b) of this section multiplied by a fraction. The numerator of the fraction is the value of the particular property included in the gross estate by reason of section 2044 less any deduction allowed for such property. The denominator of the fraction is the total value of all properties included in the gross estate by reason of section 2044 less any deductions allowed with respect to those properties.

(d) *Definition of "person receiving the property."* If the property is in a trust at the time of the decedent's death, the "person receiving the property" is—

(1) The trustee, and

(2) Any person who has received a distribution of the property if the property does not remain in trust.

This paragraph (d) shall not affect the right, if any, under local law, of any person with an interest in property to reimbursement or contribution from another person with an interest in such property.

(e) *Example.* The following example illustrates the application of paragraphs (a) through (d) of this section.

Example. H died in 1982. H's will created a trust funded with certain income producing assets valued in H's estate at $1,000,000. The trust provides that all the income is payable to H's wife, W, for life, remainder to be divided equally among their four children, 25 percent to each. In computing H's gross estate, H's executor deducted, pursuant to section 2056(b)(7), $1,000,000. Assume that W received no other property from H, that W made no section 2519 disposition of the property, that the property was included in W's gross estate during 1983 at a value of $1,080,000, and that W's will contained no provision regarding section

2207A(a). The tax attributable to the property is equal to the amount by which the total estate tax (including penalties and interest) paid for W's estate exceeds the estate tax (including penalties and interest) which would have been paid if W's gross estate had been reduced by $1,080,000. That amount of tax may be recovered by W's estate from the trust. If at the time W's estate seeks reimbursement the trust has been distributed to the four children, W's estate is also entitled to recover the tax from the children.

Par. 19. Paragraph (a) of §20.6018-3 is amended by substituting "20.2056(d)-1" for "20.2056(e)-3" in the second sentence.

Par. 20. A new §25.2207A-1 is added immediately before §25.2501-1, to read as set forth below.

§25.2207A-1 Right of recovery of gift taxes in the case of certain marital deduction property.

(a) *In general.* If a person is treated as transferring an interest in property by reason of section 2519, such person or such person's estate shall be entitled to recover from the "person receiving the property" (as defined in paragraph (d) of this section) the amount of gift tax attributable to that property. The value of property to which this paragraph (a) applies is the value of all interests in such property other than the qualifying income interest. There shall be no right to recovery from any person for the portion of property received by that person for which a deduction was allowed from the total amount of gifts, because no tax is attributable to such portion. Failure of a person to exercise a right of recovery provided by section 2207A upon a lifetime transfer subject to section 2519 is treated as a transfer for Federal gift tax purposes of the unrecovered amounts to the persons from whom such recovery could have been obtained. See §25.2511-1. Such a transfer is considered as made when such right to recovery is no longer enforceable and is treated as a gift even if recovery is impossible. Any delay in the exercise of such right of recovery shall be treated as an interest-free loan with the appropriate gift tax consequences.

(b) *Amount of gift tax attributable to all such properties.* The amount of gift tax that is attributable to all such properties includable in the total amount of gifts made during the calendar year is the amount by which—

(1) The total gift tax for the calendar year (including penalties and interest attributable to the tax) under chapter 12 of the Code which has been paid exceeds

(2) The total gift tax for the calendar year (including penalties and interest attributable to the tax) under chapter 12 of the Code which would have been payable if the value of the properties includable in the total amount of gifts by reason of section 2519 had not been included.

(c) *Amount of gift tax attributable to a particular property.* A person's right of recovery with respect to a particular property is an amount equal to the amount determined in paragraph (b) of this section multiplied by a fraction. The numerator of the fraction is the value of the particular property included in the total amount of gifts made during the calendar year by reason of section 2519 less any deduction allowed for such property. The denominator of the fraction is the total value of all properties included in the total amount of gifts made during the calendar year by reason of section 2519 less any deductions allowed with respect to those properties.

(d) *Definition of "person receiving the property."* If the property is in a trust at the time of the transfer, the "person receiving the property" is—

(1) The trustee, and

(2) Any person who has received a distribution of the property if the property does not remain in trust.

This paragraph (d) shall not affect the right, if any, under local law, of any person with an interest in property to reimbursement or contribution from another person with an interest in such property.

(e) *Example.* The following example illustrates the application of paragraphs (a) through (d) of this section.

Example. Assume that H created an inter vivos trust during 1982 with certain income producing assets valued at $1,000,000. The trust provides that all the income is payable to H's wife, W, for life, with the remainder at W's death to be divided equally among their four children, 25 percent to each. In computing taxable gifts during calendar year 1982, H deducted, pursuant to section 2523(f), $1,000,000 from the total amount of gifts made. In addition, assume that W received no other transfers from H and that W made a gift during 1983 of the entire life interest to one of the children, at which time the value of trust assets was $1,080,000 and the value of W's life interest was $200,000. Although the entire value of the trust assets ($1,080,000) is, pursuant to sections 2511 and 2519, included in the total amount of W's gifts for calendar year 1983, W is only entitled to reimbursement for the tax attributable to the value of the remainder interest, that is, the tax attributable to $880,000 ($1,080,000 less $200,000). The tax attributable to $880,000 is equal to the amount by which the total gift tax (including penalties and interest) paid for the calendar year exceeds the gift tax (including penalties and interest) which would have been paid if the total amount of gifts during 1983 had been reduced by $880,000. That amount of tax may be recovered by W from the trust.

Par. 21. Section 25.2515-1 is amended by inserting a new paragraph (a)(1) immediately before paragraph (a), to read as set forth below, and redesignating paragraph (a) as paragraph (a)(2).

§25.2515-1 Tenancies by the entirety; in general.

(a)(1) *Scope.* This section and §§25.2515-2 through 25.2515-4 shall have no effect on the creation of a tenancy by the entirety occurring after December 31, 1981, and do not reflect changes made to the Code by sections 702(k)(1)(A) of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1), 1,166] or section 2002(c)(2) of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1), 1,331].

(a)(2) *Nature of.* ***

* * * * *

Par. 22. A new §25.2519-1 is added immediately before §25.2521-1, to read as set forth below.

§25.2519-1 Dispositions of certain life estates.

(a) *In general.* If a person ("the donee spouse") makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under section 2056(b)(7) or section 2523(f) for the transfer creating the qualifying income interest, the donee spouse shall be treated for purposes of chapters 11 and 12 of Subtitle B of the Code as transferring all interests in such property other than the qualifying income interest. For example, if the donee spouse makes a disposition of part of a qualifying income interest for life, such spouse will be treated for purposes of section 2036 as hav-

ing transferred the portion of the property to which the retained income interest is attributable. The amount treated as a transfer under this section upon a disposition of all or part of a qualifying income interest for life in qualified terminable interest property is equal to the full value of the property subject to the qualifying income interest on the date of the disposition (including any accumulated income and unreduced by any section 2503(b) exclusion that may have been taken for the transfer creating the interest), less the value of the qualifying income interest in such property on the date of the disposition and less the amounts that the spouse is entitled to recover under section 2207A (relating to the right to recover taxes attributable to the remainder interest). If the spouse is entitled to recover taxes under section 2207A, the determination of the amount of taxes recoverable and thus also the determination of the value of the remainder interest treated as transferred under section 2519 are made by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability (commonly referred to as "net gifts"). The gift tax consequences of the disposition of the qualifying income interest are determined separately under §§25.2511-2 and 25.2514-1(b)(2).

(b) *Presumption.* If a donee spouse has a qualifying income interest for life in any property, it shall be presumed that a deduction was taken under section 2056(b)(7) or section 2523(f) upon the transfer which created the donee spouse's interest. To avoid the application of section 2519 upon a transfer of the donee spouse's income interest, the donee spouse must establish that a deduction was not taken for the transfer of property which created the qualifying income interest.

(c) *Amount treated as a transfer.* If the donee spouse establishes that, upon the transfer of property that created such spouse's qualifying income interest for life, a deduction was taken under section 2056(b)(7) or section 2523(f) for a fractional or percentile share of the entire interest in the property, the amount treated as a transfer by the donee spouse under this section is equal to the fair market value of the entire interest in the property on the date of the disposition multiplied by such fractional or percentile share. However, such share shall be appropriately reduced if—

(1) The donee spouse's interest is in a trust and appointments of principal have been made to the donee spouse, and

(2) The trust provides that the appointments are made from the qualified terminable interest share of the trust, and

(3) The donee spouse can establish to the satisfaction of the district director the reduction in that share based on the fair market value of the trust assets at the time of each appointment.

See example (5) of paragraph (h) of this section. If the donee spouse's interest is in a trust consisting of only qualified terminable interest property, and such trust had been severed (in compliance with §20.2056(b)-7(b) or §25.2523(f)-1(b), whichever is applicable) from a trust which also contained property which was not qualified terminable interest property, then only the value of the property in the severed portion of the trust at the time of the disposition shall be treated as transferred under this section. If the donee spouse establishes that upon the transfer of property (including an annuity contract) that created such spouse's lifetime annuity or other income interest, a deduction was taken under section 2056(b)(7) or section 2523(f) for an amount less than the fair market value of the entire property at the time of such transfer, then the amount treated as a transfer by the donee spouse under this section is equal to the fair market value of the entire property (other than the qualifying income interest) on the date of the disposition multiplied by a fraction, the numerator of which is the amount of the deductible interest determined under §20.2056(b)-7(c)(2) or §25.2523(f)-1(c)(2), and the denominator of which is the fair market value of the entire property at the time of the transfer creating the donee spouse's annuity or other income interest. See example (6) of paragraph (h) of this section.

(d) *Identification of property transferred.* If only part of the property in which a donee spouse has a qualifying income interest for life is qualified terminable interest property, then the donee spouse shall, in the case of a disposition of the income interest within the meaning of section 2519, be deemed to have transferred a pro rata portion of the property that is qualified terminable interest property. If consideration is received in exchange for the income interest, see section 2512(b) for the determination of the amount of the gift.

(e) *Exercise of power of appointment.* A reduction in the value of the qualified terminable interest property by reason of an exercise by any person of a power to appoint property to a donee spouse is not treated as a disposition under section 2519, even though the donee spouse subsequently disposes of the appointed property.

(f) *Conversion of qualified terminable interest property.* The conversion of property that is qualified terminable interest property into other property in which the donee spouse has a qualifying income interest for life shall not, for purposes of this §25.2519-1, be treated as a disposition of the qualifying income interest. Thus, the sale and reinvestment of assets of a trust which meets the requirements of qualified terminable interest property will not be considered a disposition of the qualifying income interest, provided that the donee spouse continues to have a qualifying income interest for life in the trust after the sale and reinvestment. Similarly, the sale of real property which meets the requirements of qualified terminable interest property, followed by the transfer of the proceeds into a trust which also meets the requirements of qualified terminable interest property, or by the reinvestment of the proceeds in income producing property in which the donee spouse has a qualifying income interest for life, will not be considered a disposition of the qualifying income interest. On the other hand, the sale of such real property, followed by the

payment to the donee spouse of a portion of the proceeds equal to the value of the donee spouse's income interest, will be considered a disposition of the qualifying income interest.

(g) *Right to recover certain taxes paid.* See section 2207A and the regulations under that section for the right of the donee spouse to recover the gift taxes (attributable to a disposition subject to this section) from persons receiving the qualified terminable interest property.

(h) *Examples.* The following examples illustrate the application of principles contained in paragraphs (a) through (g) of this section. Except as provided otherwise, it is assumed in each example that the full amount of the section 2503(b) exclusion has already been utilized for each year with respect to the donee in question; that section 2503(e) is not applicable to the amount deemed transferred; and that the gift taxes for the amount treated as transferred under section 2519 are offset by the donee spouse's unified credit.

Example (1). Assume that a decedent, D, owned at the time of death a personal residence valued at $250,000 for estate tax purposes; that such property passed under D's will to D's surviving spouse, S, for life and after S's death to D's children; and that D's executor elected to treat that property as qualified terminable interest property on the estate tax return for D's estate. During 1988, S makes a gift of all of S's interest in the property to D's children, at which time the fair market value of the property is $300,000 and the value of S's life interest in the property is $100,000. Pursuant to section 2519, S is treated as making a gift in the amount of $200,000 (which is the fair market value of the qualified terminable interest property less the fair market value of the life interest in such property). In addition, S is treated pursuant to section 2511 as making a gift of $100,000 (which is the fair market value of S's income interest in the property). See §§25.2511-2 and 25.2514-1(b)(2).

Example (2). Assume that the facts are the same as in example (1) except that, during 1988, S sells S's interest in the property to D's children for $100,000. Pursuant to section 2519, S is treated as making a gift in the amount of $200,000. S is not treated as making a gift under section 2511, since the consideration received for S's income interest is equal to the value of the income interest.

Example (3). Assume that the will of a decedent, D, established a trust valued for estate tax purposes at $500,000, all of the income of which is payable annually to D's surviving spouse, S, for life. After S's death, the corpus of the trust is to be distributed to D's children. Assume that only 50 percent of the trust was treated as qualified terminable interest property. During 1984, S makes a gift of all of S's interest in the trust to D's children, at which time the fair market value of the trust is $400,000 and the fair market value of S's life income interest in the trust is $100,000. Pursuant to section 2519, S is treated as making a gift of $150,000 (which is the fair market value of the qualified terminable interest property, 50 percent of $400,000, less the $50,000 income interest in the qualified terminable interest property). S is also treated pursuant to section 2511 as making a gift of $100,000 (which is the fair market value of S's life income interest).

Example (4). Assume that the facts are the same as in example (3) except that S makes a gift of only 40 percent of S's interest in the trust. S is treated pursuant to section 2519 as making a gift of $150,000 (which is the fair market value of the qualified terminable interest property, 50 percent of $400,000, less the $50,000 value of the income interest in the qualified terminable interest property). S is also treated pursuant to section 2511 as making a gift of $40,000 (which is the fair market value of 40 percent of S's life income interest). In addition, under §25.2519-1(d), S's disposition of 40 percent of the income interest is deemed to have been a transfer of a pro rata portion of the property that is qualified terminable interest property. Thus, 30 percent (60 percent of 50 percent) of the trust property will be included in S's gross estate under section 2036.

Example (5). Assume that the facts are the same as in example (4) except that D's will gives the trustee the authority to appoint principal to the surviving spouse and provides that the appointments of principal will be made from the qualified terminable interest share first. Assume that the trustee makes only one appointment of principal to the spouse in the amount of $50,000 during 1983 when the value of the trust was $550,000. Immediately prior to the appointment, the qualified terminable interest portion of the trust was 50 percent ($275,000 of the $550,000). As in example (4), assume that the value of the trust at the time of S's 1984 disposition is $400,000 and the fair market value of S's income interest is $100,000. Provided S can establish to the satisfaction of the district director the above facts, the qualified terminable interest portion of the trust immediately after the appointment became 45 percent ($225,000 divided by $500,000). Thus, when S makes the disposition during 1984, S would be treated pursuant to section 2519 as making a gift of $135,000 (which is the fair market value of the qualified terminable interest property, 45 percent of $400,000, less the value of the income interest in the qualified terminable interest property, $45,000). S is also treated pursuant to section 2511 as making a gift of $40,000 (which is the fair market value of 40 percent of S's income interest). In addition, under §25.2519-1(d), S's disposition of 40 percent of the income interest is deemed to have been a transfer of a pro rata portion of the property that is qualified terminable interest property. Thus, 27 percent (60 percent of 45 percent) of the trust property will be included in S's gross estate under section 2036.

Example (6). D died in 1983. D's will established a trust valued for estate tax purposes at $500,000. The trust instrument required the trustee to pay an annuity to D's surviving spouse, S, of $20,000 a year for life. All of the trust income other than the amounts paid to S as an annuity are to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. After S's death, the corpus of the trust is to be distributed to D's children. Under §20.2056(b)-7(c)(2), 40 percent of the property, or $200,000 was treated as the deductible interest. During 1988, S makes a gift of the annuity interest to D's children at which time the fair market value of the trust is $800,000, and the fair market value of S's annuity interest in the trust is $100,000. Pursuant to section 2519, S is treated as making a gift of $220,000 (which is the fair market value of the qualified terminable interest property, 40 percent of $800,000, less the $100,000 annuity interest in the qualified terminable interest property). S is also treated pursuant to section 2511 as making a gift of $100,000 (which is the fair market value of S's annuity interest).

Par. 23. A new §25.2522(c)-4 is added immediately following §25.2522(c)-3, to read as set forth below.

§25.2522(c)-4 Disallowance of double deduction in the case of terminable interest property.

No deduction shall be allowed for property under section 2522 if a deduction is taken from the "total amount of gifts" with respect to that property by reason of section 2523(f). See section 2523(h).

Par. 24. Section 25.2523(a)-1 is amended as follows:

(a) The first sentence of paragraph (a) is revised to read as set forth below.

(b) The first sentence of paragraph (b)(3)(ii) is revised to read as set forth below.

(c) Paragraphs (c) and (d) are redesignated as paragraphs (d) and (e), respectively, and a new paragraph (c) is added to read as set forth below.

(d) Paragraph (d) as redesignated by this document is amended by removing the heading thereof and inserting in its place the heading "*Examples.*", by removing the first three sentences and inserting a new sentence in their place to read as set forth below, and by adding a new example (8), immediately after example (7), to read as set forth below.

(e) Paragraph (e) as redesignated by this document is amended by revising the first sentence to read as set forth below.

§25.2523(a)-1 Gift to spouse; in general.

(a) *In general.* In determining the amount of taxable gifts for the calendar quarter (with respect to gifts made after December 31, 1970, and before January 1, 1982), or calendar year (with respect to gifts made before January 1, 1971, or after December 31, 1981), a donor who was a citi-

zen or resident of the United States at the time the gift was made, may deduct the value of any property interest transferred by gift to a donee who at the time of the gift was the donor's spouse, except as limited by paragraphs (b) and (c) of this section. ***

(b) *"Deductible interests" and "nondeductible interests"* ***

(3) *"Nondeductible interests".* ***

(ii) Any property interest transferred by a donor to the donor's spouse is a "nondeductible interest" to the extent it is not required to be included in a gift tax return for a calendar quarter (for gifts made after December 31, 1970, and before January 1, 1982) or calendar year (for gifts made before January 1, 1971, or after December 31, 1981. ***

(c) *Computation*—(1) *In general.* The amount of the marital deduction will depend upon when the interspousal gifts are made, whether the gifts are terminable interests, whether the limitations of §25.2523(f)-1A (relating to gifts of community property) are applicable, and whether §25.2523(f)-1 (relating to the election with respect to life estates) is applicable.

(2) *Gifts prior to January 1, 1977.* Generally, with respect to gifts made during a calendar quarter prior to January 1, 1977, the marital deduction allowable under section 2523 is 50 percent of the aggregate value of the deductible interests. But see section 2524 for an additional limitation on the amount of the deduction which may be taken.

(3) *Gifts after December 31, 1976, and before January 1, 1982.* Generally, with respect to gifts transferred during a calendar quarter beginning after December 31, 1976, and ending prior to January 1, 1982, the marital deduction allowable under section 2523 is computed as a percentage of the deductible interest in those gifts. If the aggregate amount of deductions for such gifts is $100,000 or less, the deduction is 100 percent. The deduction is zero percent of the next $100,000 of deductible interests in such gifts and 50 percent thereafter. If a donor remarries, the computations in this paragraph (c)(3) shall be made on the basis of aggregate gifts to all persons who at the time of such gifts were the donor's spouse. See section 2524 for an additional limitation on the amount of deduction which may be taken.

(4) *Gifts after December 31, 1981.* Generally, with respect to gifts transferred during a calendar year beginning after December 31, 1981, the marital deduction allowable under section 2523 shall be 100 percent of the aggregate value of the deductible interests. See section 2524 for an additional limitation on the amount of deductions which may be taken.

(d) *Examples.* The following examples (in which it is assumed that the donors have previously utilized any specific exemptions provided by section 2521 for gifts prior to January 1, 1977) illustrate the application of paragraph (c) of this section and the interrelationship of sections 2523 and 2503.

* * * * *

Example (8). A donor made a transfer by gift to the donor's spouse of $200,000 cash on January 1, 1982. The donor made no other transfers during 1982. For calendar year 1982, the amount excluded under section 2503(b) is $10,000; the marital deduction is $190,000; and the amount of taxable gifts is zero ($200,000 − $10,000 (annual exclusion) − $190,000 (marital deduction)).

(e) *Valuation.* If the income from property is made payable to the donor or another individual for life, or for a term of years, with remainder absolutely to the donor's spouse or to the estate of the donor's spouse, the marital deduction shall be computed (pursuant to §25.2523(a)-1(c)) with respect to the present value of the remainder. ***

Par. 25. Section 25.2523(b)-1 is amended as follows:

(a) Paragraph (a)(1) is revised to read as set forth below.

(b) Paragraph (b)(3) is amended by substituting "§25.2523(e)-1 or 25.2523(f)-1" for "§25.2523(e)-1" in the first sentence thereof, and by revising the fifth sentence (the sentence immediately before the examples) to read as set forth below.

(c) The second sentence of paragraph (b)(6), which is the sentence immediately prior to the examples, is revised to read as set forth below.

(d) The second sentence of paragraph (c)(2), which is the sentence immediately prior to the example, is revised to read as set forth below.

§25.2523(b)-1 Life estate or other terminable interest.

(a) *In general.*—(1) The provisions of section 2523(b) generally prevent the allowance of the marital deduction with respect to certain property interests (referred to generally as "terminable interests" and defined in paragraph (a)(3) of this section) transferred to the donee spouse under the circumstances described in paragraph (a)(2) of this section, unless the transfer comes within one of the exceptions set forth in §25.2523(d)-1, relating to certain joint interests; §25.2523(e)-1, relating to certain life estates with powers of appointment; §25.2523(f)-1, relating to certain qualified terminable interest property; or §25.2523(g)-1, relating to certain qualified charitable remainder trusts.

* * * * *

(b) *Interest in property which another donee may possess or enjoy.* ***

(3) *** The following examples, in which it is assumed that the donor did not make an election under sections 2523(f)(2)(C) and (f)(4), illustrate the application of the provisions of this paragraph (b)(3).

* * * * *

(6) *** In each example it is assumed that the donor made no election under sections 2523(f)(2)(c) and (f)(4) and that the property interest which the donor transferred to a person other than the donee spouse was not transferred for an adequate and full consideration in money or money's worth:

* * * * *

(c) *Interest in property which the donor may possess or enjoy.* ***

(2) *** The application of this paragraph may be further illustrated by the following example, in which it is assumed that the donor made no election under sections 2523(f)(2)(C) and (f)(4).

* * * * *

Par. 26. The first sentence of paragraph (c) of §25.2523(c)-1 is removed and three new sentences are inserted

in its place, to read as set forth below.

§25.2523(c)-1 Interest in unidentified assets.

* * * * *

(c) If both the circumstances in paragraph (b) of this section exist, only a portion of the property interest passing to the spouse is a deductible interest. The portion qualifying as a deductible interest is an amount equal to the excess, if any, of the value of the property interest passing to the spouse over the aggregate value of the asset (or assets) which if transferred to the spouse would not qualify for the marital deduction. See paragraph (c) of §25.2523(a)-1 to determine the percentage of the deductible interest allowable as a marital deduction. ***

Par. 27. The third sentence of §25.2523(d)-1 is revised to read as set forth below.

§25.2523(d)-1 Joint interests.

*** Thus, if the donor purchased real property in the name of the donor and the donor's spouse as tenants by the entirety, or as joint tenants with rights of survivorship and, pursuant to the provisions of section 2515(c), elected to treat such transaction as a completed gift, a marital deduction is allowable with respect to the value of the interest of the donee spouse in such property (subject to the limitations set forth in §25.2523(a)-1). ***

Par. 28. Paragraph (c) of §25.2523(e)-1 is revised to read as set forth below.

§25.2523(e)-1 Marital deduction; life estate with power of appointment in donee spouse.

* * * * *

(c) *Meaning of "specific portion"*—(1) Except as provided in paragraphs (c)(2) and (c)(3) of this section, a partial interest in property is not treated as a specific portion of the entire interest. In addition, any specific portion of an entire interest in property is nondeductible to the extent such specific portion is subject to invasion for the benefit of any person other than the donee spouse, except in the case of a deduction allowable under section 2523(e), relating to invasions by the donee spouse in the exercise of a general power of appointment.

(2) A partial interest in property is treated as a specific portion of the entire interest if the rights of the donee spouse in income and the required rights as to the power described in §25.2523(e)-1(a) constitute a fractional or percentile share of a property interest so that such interest or share in the donee spouse reflects its proportionate share of the increment or decline in the whole of the property interest to which the income rights and the power relate. Thus, if the right of the spouse to income and the power extend to a specified fraction or percentage of the property, or the equivalent, the interest is considered as a specific portion.

(3) A specific sum payable annually or at more frequent intervals out of the property and its income that is not limited by the income of the property will be treated as a right to the income of a specific portion of the property. However, no deduction will be allowable under section 2523(e) except to the extent the donee spouse has the required power of appointment over a fractional or percentile share of the property. The deductible interest, for purposes of §25.2523(a)-1(b)(2), is the specific portion of property that, assuming the interest rate generally applicable for the valuation of annuities at the time of the transfer to the donee spouse, would produce income equal to such specific annual payment. However, such specific sum payable to a donee spouse will not be treated as a right to the income of a specific portion of the property for purposes of this paragraph (c)(3), if any person other than the donee spouse may receive, during the donee spouse's lifetime, any distribution of the property or its income out of which the donee spouse's payments are made. To determine the applicable interest rate, see section 2031 and the regulations under that section.

(4) A partial interest in property is treated as a specific portion of the entire interest if it is shown that the donee spouse has rights under local law which are identical to those he or she would have acquired had the size of the share been expressed in terms satisfying the requirements of either paragraph (c)(2) or paragraph (c)(3) of this section.

(5) The following examples illustrate the application of paragraphs (a) through (c)(4) of this section.

Example (1). The donor, D, transferred to a trustee 500 identical shares of X company stock. D provided that during the lifetime of D's spouse, S, the trustee should pay S annually one-half of the trust income or $6,000, whichever is the larger. All of the trust income other than amounts paid to S are to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. S was also given a general power of appointment exercisable by S's last will over all the trust corpus. For purposes of paragraphs (a) and (b) of this section, S shall be considered as receiving the greater of (i) all the income from one-half of the entire interest in the stock or (ii) the specific portion of the stock which under §25.2523(e)-1(c)(3) is determined to be the portion required to produce annual income equal to $6,000.

Example (2). Assume that the facts are the same as in example (1) except that S's testamentary general power of appointment is exercisable over only one-fourth of the trust corpus and D does not elect to treat the trust property as qualified terminable interest property under §25.2523(f)-1(b). Consequently, the marital deduction is only allowed for one-fourth of the trust (the lesser of the portion determined in example (1) or one-fourth of the trust).

Example (3). Assume that the facts are the same as in example (1) except that S's testamentary general power of appointment is exercisable over the sum of $160,000 and D does not elect to treat the trust property as qualified terminable interest property under §25.2523(f)-1(b). Inasmuch as there is no certainty as to what portion of the stock will be valued at $160,000 on S's death, the power of appointment over $160,000 is not considered a power of appointment over a specific portion of the entire interest. Thus, no marital deduction is allowed.

Example (4). The donor, D, transferred by gift to a trustee an office building and 250 identical shares of Y company stock. D provided that during the lifetime of D's spouse, S, the trustee should pay S annually three-fourths of the trust income. S was given a general power of appointment exercisable by will over the office building and 100 shares of stock. By the terms of D's gift, S is given all the income from a definite fraction of the entire interest in the office building and in the stock. However, since the amount of property represented by a single share of stock would be altered if the corporation split its stock, issued stock dividends, made a distribution of capital, etc., a power to appoint 100 shares at the time of S's death is not the same necessarily as a power to appoint 100/250 of the entire interest which the 250 shares represented on the date of D's gift. If it is shown in this case that under local law S has a general power to appoint not only the 100 shares designated by D, but also 100/250 of any shares or amounts that are distributed by the corporation and included in the corpus, the requirements of paragraph (c)(2) of this section will be satisfied and S will be considered as having a general power to appoint 100/250 of the entire interest in the 250 shares.

* * * * *

Par. 29. Section 25.2523(f)-1 is redesignated as §25.2523(f)-1A and amended as follows:

(a) The heading of the redesignated section is revised to read as set forth below.

(b) The first sentence of paragraph (a) is revised to read as set forth below.

§25.2523(f)-1A Special rule applicable to community property transferred prior to January 1, 1982.

(a) *In general.* With respect to gifts made prior to January 1, 1982, the marital deduction is allowable with respect to any transfer by a donor to the donor's spouse only to the extent that the transfer can be shown to represent a gift of property which was not, at the time of the gift, held as "community property," as defined in paragraph (b) of this section. ***

* * * * *

Par. 30. New §§25.2523(f)-1 and 25.2523(g)-1 are added immediately following redesignated §25.2523(f)-1A, to read as follows:

§25.2523(f)-1 Election with respect to life estate for donee spouse.

(a) *In general.* With respect to gifts made after December 31, 1981, section 2523(f) provides that a marital deduction is allowed under section 2523(a) for "qualified terminable interest property," subject to the condition set forth in section 2523(b)(2). That is, if the donor retains a power described in section 2523(b)(2) to appoint an interest in qualified terminable interest property, a deduction shall not be allowed under section 2523(a) for such qualified terminable interest property. All of the property for which a deduction is allowed under this paragraph (a) shall be treated as passing to the donee spouse (for purposes of §25.2523(a)-1) and no part of such property shall be treated as passing to any person other than the donee spouse (for purposes of §25.2523(b)-1(b)).

(b) *Qualified terminable interest property defined.* For purposes of this section, the term "qualified terminable interest property" means property—

(1) Which is transferred by the donor spouse,

(2) In which the donee spouse has a "qualifying income interest for life" as defined in paragraph (c) of this section, and

(3) Which the donor spouse elects to treat as qualified terminable interest property.

For purposes of this section, the term "property" generally means an "entire interest in property" (within the meaning of §25.2523(e)-1(d)) or a "specific portion of the entire interest" (within the meaning of §25.2523(e)-1(c)). To have a valid election under paragraph (b)(3) of this section, the election shall be made on the return of tax imposed by section 2501 for the calendar year in which the interest was transferred and shall be made no later than the first April 15th following the calendar year during which the interest was transferred. For purposes of this paragraph (b), the term "return of tax imposed by section 2501" means the last gift tax return filed on or before the due date of the return. The election, once made, is irrevocable. The election may relate to all or any part of property that meets the requirements of paragraphs (b)(1) and (2) of this section, provided that any partial election shall relate to a fractional or percentage share of the property so that the elective part will reflect its proportionate share of the increment or decline in the whole of the property for purposes of applying sections 2044 or 2519. Thus, if the interest of the donee spouse in a trust (or other property in which the spouse has a life estate) meets the requirements of paragraphs (b)(1) and (2) of this section, the election may be made under paragraph (b)(3) with respect to a part of the trust (or other property) only if the election relates to a defined fraction or percentage of the entire trust (or other property) or specific portion thereof within the meaning of §20.2056(b)-5(c). The fraction or percentage may be defined by means of a formula. If the interest of the donee spouse in a trust meets the requirements of paragraphs (b)(1) and (2) of this section, the trust may be divided into separate trusts to reflect a partial election that has been made or is to be made. If a trust is severed, it must be clear, by virtue of the duties imposed on the fiduciary either by applicable state law or by the express or implied provisions of the instrument governing the trust, that the fiduciary must divide the trust according to the fair market value of the assets of the trust at the time of the division.

(c) *Qualifying income interest for life defined.*—(1) *In general.* For purposes of this section, the term "qualifying income interest for life" means—

(i) The donee spouse is entitled for life to all the income from the property, payable annually or at more frequent intervals, and

(ii) No person (including the donee spouse) has a power, other than a power the exercise of which takes effect only at or after the donee spouse's death, to appoint any part of the property to any person other than the donee spouse.

In general, the principles outlined in §25.2523(e)-1(f), relating to whether the spouse is entitled for life to all of the income from the entire interest or a specific portion of the entire interest, are applicable in determining whether the donee spouse is entitled for life to all the income from the property, regardless of whether the interest passing to the donee spouse is in trust. An income interest granted for a term of years, or a life estate subject to termination upon the occurrence of a specified event (*e.g.*, divorce), is not a qualifying income interest for life. On the other hand, an income interest will not fail to constitute a qualifying income interest for life solely because income for the period between the last distribution date and the date of the donee spouse's death is not required to be distributed to the donee spouse's estate. See §20.2044-1 relating to the inclusion of such undistributed income in the donee spouse's gross estate. The fact that property (income or corpus) distributed to a spouse may be transferred by such spouse to another person does not result in a failure to satisfy the requirement of paragraph (c)(1)(ii) of this section.

However, if the governing instrument requires the donee spouse to transfer the distributed property to another person without full and adequate consideration in money or money's worth, the requirement of paragraph (c)(1)(ii) of this section is not satisfied.

(2) *Annuities.* In general, a donee spouse's lifetime annuity interest shall be treated as a qualifying income interest for life for purposes of section 2523(f)(3). The deductible interest, for purposes of §25.2523(a)-1(c)(4), is the specific portion of the property (including an annuity contract) that, assuming the interest rate generally applicable for the valuation of annuities at the time of the transfer creating the annuity interest, would produce income equal to the minimum amount payable annually to the donee spouse for life. In no case may the value of the deductible interest exceed the value of the property out of which the annuity is paid. If the annual payment may increase, the annuity interest will not be disqualified, but the increased amount shall not be taken into account in valuing the deductible interest. However, an annuity interest will not be treated as a qualifying income interest for life for purposes of section 2523(f)(3), if any person other than the donee spouse may receive, during the donee spouse's lifetime, any distribution of the property or its income (including any distribution under an annuity contract) out of which the annuity is payable. To determine the applicable interest rate for valuing annuities, see section 2031 and regulations under that section. If, assuming such interest rate, the entire property from which the annuity may be satisfied is insufficient to produce income equal to the minimum annual payment, the value of the deductible interest is the entire value of such property.

(d) *Treatment of interest retained by the donor spouse*—(1) *In general.* In the case of any retained interest in qualified terminable interest property, such property shall not be includable in the gross estate of the donor spouse, and any subsequent transfer by the donor spouse of an interest in such property shall not be treated as a transfer for gift tax purposes.

(2) *Exception.* Paragraph (d)(1) of this section shall not apply with respect to any property after the donee spouse is treated as having transferred such property under section 2519, or after such property is includable in the donee spouse's gross estate under section 2044.

(e) *Application of local law.* The provisions of local law shall be taken into account in determining whether or not the conditions of paragraphs (b) and (c) of this section are satisfied. For example, silence of a trust instrument as to the frequency of payment will not be regarded as a failure to satisfy the condition in paragraph (c) of this section that the income must be payable to the donee spouse annually or more frequently, unless the applicable law permits payment to the made less frequently than annually.

(f) *Examples.* The following examples illustrate the application of paragraphs (a) through (c) of this section.

Example (1). A owns a personal residence valued at $250,000 for gift tax purposes. On January 1, 1982, A transfers the residence by gift to A's spouse, S, and A's children. The exclusive and unrestricted right to use such property (including the right to continue to occupy the property as a personal residence or rent such property and receive the income) is transferred to A's spouse, S, for life. After S's death the property is to pass to A's children. If A elects to treat all of such property as qualified terminable interest property, the deductible interest is the value of such property for gift tax purposes, $250,000.

Example (2). Assume that the facts are the same as in example (1) except that the property is a recently planted tree farm which is not expected to be income producing for 20 years. In addition, assume that S is 70 years old at the time of the transfer, and that applicable local law does not require or permit S to require the conversion of the property into a productive asset within a reasonable time after the transfer. S does not have a qualifying income interest for life because the gift does not give S that degree of beneficial enjoyment during S's life which the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust. See §25.2523(e)-1(f). Therefore, no deduction for the bequest is allowable under section 2523(f).

Example (3). Assume that A establishes a trust which is funded on January 1, 1982, with property valued at $500,000 for gift tax purposes. The assets used to fund the trust include both income producing assets and nonproductive assets. A's spouse, S, is given the right exercisable annually to require distribution of all the trust income to S. There is no power to distribute trust property during S's lifetime to any person other than S. Applicable State law permits S to require that the trustee either make the trust property productive or sell the property and reinvest in productive property within a reasonable time. If A elects to treat all of the trust as qualified terminable interest property, the deductible interest is $500,000. If A elects to treat only 20 percent of the trust as qualified terminable interest property, the deductible interest is only $100,000, that is, $500,000 multiplied by 20 percent.

Example (4). Assume that the facts are the same as in example (3) except that S is given the right exercisable annually to require distribution to herself or himself of only 50 percent of the trust income for life. The other 50 percent of the trust income is to be distributed among S and A's children in the trustee's discretion or accumulated. If A elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the deductible interest is $250,000, which is the value of the trust for gift tax purposes ($500,000) multiplied by the spouse's percentile share of the trust income (50 percent). If A elects to treat only 20 percent of the portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the deductible interest is only $50,000, that is, $250,000 multiplied by 20 percent.

Example (5). Assume that the facts are the same as in example (3) except that the trustee is given the power to use annually $5,000 from the trust for the maintenance and support of X. S does not have a qualifying income interest for life in any portion of the trust because the gift fails to satisfy the condition set forth in §25.2523(f)-1(c)(1)(ii), which is the condition that no person have a power, other than a power the exercise of which takes effect only at or after S's death, to appoint any part of the property to any person other than S. The trust would also be nondeductible under section 2523(f) if S, rather than the trustee, were given the power to appoint a portion of the corpus to X.

Example (6). Assume that the facts are the same as in example (3) except that, upon divorce, S's interest in the trust will pass to X. The trust is not deductible under section 2523(f). S's income interest is not a "qualifying income interest for life" because it is not for life, but rather is terminable upon S's divorce.

Example (7). Assume that B establishes a trust which is funded on January 1, 1984, with income producing property valued at $800,000 for gift tax purposes. The trustee is required by the trust instrument to pay $40,000 a year to B's wife, S, for life. The rest of the income from the trust is to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. S's lifetime annuity interest is treated as a qualifying income interest for life. If B elects to treat the entire portion of the trust in which S has a qualifying income interest as qualified terminable interest property, the value of the deductible interest is $400,000, since such amount would yield an income to S of $40,000 a year (assuming a 10 percent interest rate applies in valuing annuities).

Example (8). Assume the same facts as in example (7), except that the trustee is required to pay S $100,000 a year for life. If B elects to treat the entire portion of the trust in which S has a qualifying income interest for life as qualified terminable interest property, the value of the deductible interest is $800,000, which is the lesser of the entire value of the property ($800,000), or the amount of property

that (assuming a 10 percent interest rate) would yield an income to S of $100,000 a year ($1,000,000).

Example (9). Assume that A transfers $200,000 on January 1, 1982, to a pooled income fund, within the meaning of section 642(c)(5), designating his wife as the income beneficiary for her life. If A elects to treat the entire $200,000 as qualified terminable interest property, the deductible interest is $200,000.

§25.2523(g)-1 Special rule for charitable remainder trusts.

With respect to gifts made after December 31, 1981, section 2523(g) provides that if the spouse of the donor is the only noncharitable beneficiary (other than the donor) of a charitable remainder annuity trust or charitable remainder unitrust described in section 664 (qualified charitable remainder trust), section 2523(b) shall not apply to any interest in such trust which is transferred to the donee spouse. Thus, the donor will receive a charitable deduction under section 2522 for the value of the remainder interest and a marital deduction under section 2523(g) for the value of the annuity or unitrust interest. A marital deduction for the value of the donee spouse's annuity or unitrust interest in a qualified charitable remainder trust is allowable only under section 2523(g). No marital deduction is allowable for any portion of a qualified charitable remainder trust under section 2523(f). The donee spouse's interest need not be an interest for life. For purposes of this section, the term "noncharitable beneficiary" means any beneficiary of the qualified charitable remainder trust other than an organization described in section 170(c). A deduction will not be denied under this section by reason of the transfer to the donee spouse being conditioned on the payment of state taxes, if any, attributable to the qualified charitable remainder trust.

Par. 31. Section 25.6019-1 is amended as follows:

(a) The first 7 sentences of paragraph (a) are removed and four new sentences are added in their place, to read as set forth below.

(b) The last sentence of paragraph (a) is removed.

(c) Paragraphs (b)(1) through (b)(3) are removed.

(d) Paragraphs (c) and (d) are redesignated as paragraphs (b) and (c), respectively.

§25.6019-1 Persons required to file returns.

(a) *In general.* Any individual citizen or resident of the United States who in any calendar year beginning after December 31, 1981, makes any transfer by gift other than—

(1) A transfer which under section 2503(b) or (e) (relating, respectively, to certain gifts of $10,000 per donee and the exclusion for educational and medical expenses) is not to be included in the total amount of gifts for such year, or

(2) A transfer of an interest with respect to which a marital deduction is allowed for the value of the entire interest under section 2523 (other than a marital deduction allowed by reason of section 2523(f) regarding qualified terminable interest property),

shall file a gift tax return on Form 709 for such year. Any individual citizen or resident of the United States who makes a transfer by gift within any calendar year beginning after December 31, 1976, and before January 1, 1982, must file a gift tax return on Form 709 for any calendar quarter in which the sum of the taxable gifts made during such calendar quarter plus all other taxable gifts made during the year (for which a return has not yet been required to be filed) exceeds $25,000. For all transfers made in a calendar year after 1976, and before 1982, which are subject to the gift tax filing requirements but when aggregated do not exceed $25,000 in taxable gifts, a return need only be filed by the filing date for gifts made in the fourth quarter of such calendar year. Any individual citizen or resident of the United States who makes a transfer by gift within any calendar year beginning after December 31, 1970, and before January 1, 1977, must file a gift tax return on Form 709 for the calendar quarter in which any portion of the value of the gift or any portion of the sum of the values of the gifts to such donee during that calendar year is not excluded from the total amount of taxable gifts for such year, and for any subsequent quarter within the same taxable year in which any additional gift is made to the same donee. The rules contained in this section also apply to a nonresident not a citizen of the United States provided that under §25.2511-3 the transfer is subject to the gift tax. The return is required even though because of the deduction authorized by section 2522 (charitable, etc., deduction) no tax may be payable. ***

* * * * *

Par. 32. Section 25.6019-2 is revised to read as set forth below.

§25.6019-2 Returns required in case of consent under section 2513.

Except as otherwise provided in this section, the provisions of §25.6019-1 are applicable with respect to the filing of a gift tax return or returns in the case of a husband and wife who consent (see §25.2513-1) to the application of section 2513. In such a case, if both of the consenting spouses are (without regard to the provisions of section 2513) required under the provisions of §25.6019-1 to file returns, returns must be filed by both spouses. If only one of the consenting spouses is (without regard to the provisions of section 2513) required under §25.6019-1 to file a return, a return must be filed by that spouse. In the latter case, if after giving effect to the provisions of section 2513 the other spouse is considered to have made any gift not excluded from the total amount of such other spouse's gifts for the taxable year by section 2503(b) or (e)(relating, respectively, to certain gifts of $10,000 per donee and the exclusion for certain educational or medical expenses), then a return must also be filed by such other spouse. Thus, if during a calendar year beginning after December 31, 1981, the husband made a gift of $18,000 to a son (the gift not being either a future interest in property or an amount excluded under section 2503(e)) and the wife made no gifts, only the husband is required to file a return for such calendar year. However, if the wife had made a gift in excess of $2,000 to the same son during the same calendar year, or if the gift

made by the husband had amounted to $21,000, each spouse would be required to file a return if the consent is signified as provided in section 2513.

Par. 33. Section 25.6019-3 is amended as follows:

(a) The first sentence in paragraph (a) is revised to read as set forth below.

(b) The second sentence in paragraph (b) is revised to read as set forth below.

§25.6019-3 Contents of return.

(a) *In general.* The return shall set forth: (1) each gift made during the calendar year (or calendar quarter with respect to gifts made after December 31, 1970 and before January 1, 1982) which under sections 2511 through 2515 is to be included in computing taxable gifts; (2) the deductions claimed and allowable under sections 2521 through 2524; and (3) the taxable gifts made for each of the preceding calendar years (and calendar quarters with respect to gifts made after December 31, 1970, and before January 1, 1982). ***

(b) *Disclosure of transfers coming within provisions of sections 2516.* ***

In any case where a husband and wife enter into a written agreement of the type contemplated by section 2516, and the final decree of divorce is not granted on or before the due date for the filing of a gift tax return for the calendar year (or calendar quarter with respect to periods beginning after December 31, 1970, and ending before January 1, 1982) in which the agreement became effective (see §25.6075-1), then except to the extent §25.6019-1 provides otherwise, the transfer shall be disclosed by the transferor upon a gift tax return filed for the calendar year (or calendar quarter) in which the agreement became effect and a copy of the agreement shall be attached to the return. ***

Par. 34. The first sentence of §25.6019-4 is revised to read as set forth below.

§25.6019-4 Description of property listed in return.

The properties comprising the gifts made during the calendar year (or calendar quarter with respect to gifts made after December 31, 1970, and before January 1, 1982) shall be listed on the return and shall be described in such a manner that they may be readily identified. ***

May 11, 1984.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 16, 1984, 12:22 p.m., and published in the issue of the Federal Register for May 21, 1984, 49 F.R. 21350)

Notice of Proposed Rulemaking

Taxation of DISC Income to Shareholders

LR-246-76

SUMMARY: This document contains proposed regulations relating to the taxation of DISC income to shareholders. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. In addition, amendments would also be made under section 993, one relating to the treatment of accrued interest on a producer's loan as a qualified export asset and another defining the term "trade receivables." A further amendment would be made under section 994 allowing treatment of a prior DISC dividend as an additional payment of transfer price or repayment of a commission by the DISC. The regulations would provide the public with the guidance needed to comply with these Acts and would affect all corporations which have elected to be treated as a DISC and their shareholders.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 9, 1984. The regulations are proposed to apply for taxable years beginning after December 31, 1975, except that the regulations under the Tax Equity and Fiscal Responsibility Act apply for taxable years of DISCs beginning after February 31, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-246-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Jacob Feldman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., 20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 995 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 1101 of the Tax Reform Act of 1976 (90 Stat. 1655) [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 131] and a portion of section 204(a) of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 423) [Pub. L. 97-248, 1982-2 C.B. 462, 471], and are to be issued under the authority contained in sections 995(e)(7), (8) and (10), 995(g) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1655; 90 Stat. 1659; 68A Stat. 917, respectively). Amendments would also be made under section 993, one relating to the treatment of accrued interest on a producer's loan and another defining trade receivables. An amendment would also be made under section 994 allowing treatment of a prior DISC dividend as an additional payment of transfer price or repayment of a commission by the DISC. An amendment would also be made to the regulations under section 996 to conform to changes made by the Tax Equity and Fiscal Responsibility Act of 1982.

DISCUSSION

GENERAL EXPLANATION OF CHANGES

The tax law provides for a system of tax deferral for certain income earned by corporations known as domestic international sales corpora-

tions or "DISCs" and their shareholders. Under this system the profits of a DISC are not taxed to the DISC but are taxed to the shareholders of the DISC when distributed to them. However, each year a DISC is deemed to have distributed income representing at least 50 percent of its profits. The income deemed distributed is subject to current taxation to the shareholder of the DISC. Prior to the effective date of Tax Reform Act of 1976, there were, in addition to the deemed distribution of 50 percent of the DISC's profits, deemed distributions for the gross interest derived from producer's loans and certain gains from sales or exchanges. The Tax Reform Act added four additional deemed distributions. Two of these deemed distributions relate to participation in any international boycott and payment of foreign bribes or kickbacks and are the subject of other regulations projects. In addition, this regulations project covers a provision of the Tax Equity and Fiscal Responsibility Act which increased deemed distributions under section 995(b)(1)(F)(i) to corporate shareholders of DISCs from 50 percent to 57½ percent.

TAXABLE INCOME ATTRIBUTABLE TO MILITARY PROPERTY

New §1.995-6 provides rules with respect to taxable income attributable to military property described in section 995(b)(3). Under section 995(b)(1)(D) a DISC is deemed to distribute 50 percent of its taxable income for the taxable year attributable to military property. A DISC's taxable income from military sales is its gross income from the sales of military property reduced by the deductions properly allocable to that income. Military property is defined as arms, ammunition, or implements of war designated in the munitions list published pursuant to section 38 of the International Security Assistance and Arms Export Control Act of 1976 (22 U.S.C. 2778 which superseded 22 U.S.C. 1934) and the regulations thereunder (26 CFR 121.01). The deemed distribution of the DISC income from military sales is made prior to the deemed distribution of taxable income attributable to base period export gross receipts and the regular deemed distribution. In computing the taxable income attributable to base period export gross receipts, only half of the military sales are included in the ratio of the average export gross receipts for the base period to the export gross receipts for the taxable year.

TAXABLE INCOME ATTRIBUTABLE TO BASE PERIOD EXPORT GROSS RECEIPTS

Section 995(b)(1)(E) provides for a deemed distribution with respect to taxable income attributable to base period export gross receipts (hereinafter referred to as nonincremental distribution) computed under rules contained in section 995(e). Section 1.995-7 of the proposed regulations provides rules for determining the amount of the deemed distribution. The general rule, stated in paragraph (b)(1), is that the nonincremental distribution is computed by multiplying the adjusted taxable income of a DISC for the current year by a fraction. The numerator of the fraction is the adjusted base period export gross receipts. The denominator of the fraction is the export gross receipts of the DISC for the current taxable year. Adjusted taxable income, as defined in paragraph (b)(2), is taxable income of the DISC in the current year reduced by the deemed distributions under section 995(b)(1)(A), (B), (C), and (D) (*i.e.*, gross interest derived from producer's loans, gain on the sale of certain property and 50 percent of the taxable income of the DISC for the taxable year attributable to military property).

The term "adjusted base period export gross receipts", defined in paragraph (b)(4), means 67 percent of the average of the export gross receipts of the DISC for taxable years during the base period. Export gross receipts include those receipts which are received in the ordinary course of the export trade or business of the DISC. It is narrower than the term "qualified export receipts" (defined in section 993(a)) in that the term "export gross receipts" includes only income from the sale, exchange, lease or rental (including related subsidiary services) of export property for use outside the United States; engineering and architectural services for projects outside the United States; and managerial services for a DISC which relate to the sale, exchange, rental or other disposition of export property. The term "export gross receipts" does not include gross receipts from the sale of qualified export assets other than export property; dividends and deemed distributions from a related foreign export corporation; and interest on any obligation (such as Export-Import Bank obligations) which is a qualified export asset.

The base period for taxable years beginning in 1976, 1977, 1978, and 1979 is composed of the DISC's taxable years beginning in 1972, 1973, 1974, and 1975. For taxable years beginning in 1980 and later years, the base period becomes a 4-year moving base period which moves forward 1 year for each year beyond 1979. Thus, the base period years for any year after 1979 will be the taxable years beginning in the 4th, 5th, 6th, and 7th calendar years preceding such calendar year.

In general, the average export gross receipts for the base period is the sum of the export gross receipts for the 4 base period years divided by 4. If the taxpayer did not have a DISC in any year which would be included in the base period for the current year, the base period export gross receipts are computed by attributing a zero amount of export gross receipts to that base period year. However, base period export gross receipts do not include gross receipts from property which would not qualify during the taxable year as export property by reason of section 993(c)(2). Therefore, since coal is treated as excluded property under section 993(c)(2)(C), gross receipts from the sale of coal during base period years are not to be included in computing base period export gross receipts. Such export gross receipts from the sale of—excluded property would not be excluded from base period export gross receipts to the extent they are included in export

gross receipts from the current year under the binding contract exception to excluded property. In addition, for taxable years of the DISC ending before November 15, 1982, base period export gross receipts do not include receipts attributable to property sold or leased to a WHTC or receipts which arose in the absence of a written supplier's agreement unless the receipts were treated as qualified export receipts by the taxpayer.

Paragraphs (c)(1), (c)(2), and (c)(3) of §1.995-7 provide rules to compute average base period export gross receipts which take into account the different lengths of base periods. Under paragraph (b)(3) a special rule is also used with respect to computing current export gross receipts when the current year is a short taxable year.

Paragraph (d) provides rules where more than one member of a controlled group (as defined in section 993(a)(3)) qualifies as a DISC. In such cases, the adjusted base period export gross receipts and the current export gross receipts are aggregated to determine the fraction described in paragraph (b)(1). The adjusted taxable income of each member DISC is then multiplied by the fraction to determine its nonincremental distribution. A special rule is provided where member DISCs have different annual accounting periods including a provision enabling a DISC to change its annual accounting period without the approval of the Secretary.

Paragraph (e) provides rules for the separation of a DISC and the underlying trade or business which gives rise to the export gross receipts of the DISC. The effect of this provision is to provide a double attribution since the base period export gross receipts follow the trade or business and also remain with the DISC. Under paragraph (e)(3) a separation is deemed to occur if there is a lease of substantially all of the assets of a trade or business, or the licensing of a patent, trademark or copyright essential to the conduct of the trade or business. The disqualification of a DISC is treated under paragraph (e)(3) as a separation and the export gross receipts produced prior to disqualification are attributed to the separated trade or business. Therefore, a requalified DISC is treated as having additional gross receipts attributable to the separated trade or business.

Paragraph (f) provides rules with respect to DISC benefits attributed through 5 percent shareholders.

Paragraph (g) of §1.995-7 provides rules with respect to the small DISC exception to the incremental rules. DISCs with adjusted taxable income of $100,000 or less are exempted from the incremental rules. The exemption is phased out on a 2-for-1 basis so that DISCs with taxable income of $150,000 or more receive no exemption. In computing adjusted taxable income for purposes of the small DISC exception to the incremental rules, if more than one member of a controlled group qualifies as a DISC, the small DISC exemption is computed by aggregating the adjusted taxable income of each DISC which is a member of that group.

Paragraph (h) relates to situations where the DISC's export gross receipts are derived from one or more trades or businesses and the taxpayer wants to sell a part of or a complete trade or business along with its related DISC assets in order to avoid double attribution under the separation rules of section 995(e)(9). Paragraph (h) liberalizes the reorganization rules to permit the transfer of the related DISC assets in a non-taxable transaction.

AMENDMENTS UNDER SECTIONS 993, 994 and 996

Paragraph (f) of §1.993-2 would be amended to treat accrued interest on a producer's loan as a qualified export asset if the interest is paid within 60 days after the close of the taxable year of accrual. This amendment is necessitated by the present uncertainty as to the treatment of accrued interest on a producer's loan. Although accrued interest on a producer's loan is clearly a qualified export receipt under section 993(a)(1)(F), the statute and legislative history are both silent as to whether the accrued interest on a producer's loan is to be treated as a qualified export asset. If the accrued interest is not treated as a qualified export asset, then the taxpayer might fail the 95 percent test under section 992(a)(1)(B). It is, therefore, proposed to treat accrued interest on a producer's loan as a qualified export asset if it is paid within 60 days after the close of the taxable year of accrual. The 60-day period is proposed since this is the same period applying under §1.994-1(e)(3) with respect to the actual payment of the transfer price charged by a related supplier to a DISC and with respect to payment of sales commissions. In addition, a 60-day limitation would allow an accrual basis taxpayer to be paid the interest in the normal course of business. A limitation was considered necessary since permitting accrued interest between related parties to qualify as a qualified export asset without any limitation might result in abuse since the interest might be accrued and never paid.

An amendment would also be made to paragraph (d)(1) of §1.993-2 defining trade receivables. The amendment would add a definition of the term "trade receivables" to a section which had previously been reserved.

An additional amendment would be made to paragraph (e)(5) of §1.994-1 with respect to a redetermination of the transfer price or repayment of a commission. Where a redetermination results in an additional amount owed by the DISC to its related supplier, the related supplier and DISC may treat all or part of any distribution from previously taxed income which was received from the DISC with respect to the year to which the redetermination relates as an additional payment of transfer price or repayment of a commission and not as a distribution.

Section 1.996-3 of the regulations would also be amended to conform to changes in the Tax Equity and Fiscal Responsibility Act of 1982 which increased the deemed distribution for corporate shareholders of a DISC to 57½ percent while leaving the deemed distribution with respect to noncorporate shareholders at 50 percent. A new paragraph (g) would be added to deal with the computation of accumulated DISC income and previously taxed income for a DISC

owned by corporate and noncorporate taxpayers which is necessitated by the change under TEFRA.

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Regulatory Flexibility Act and Executive Order 12291

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The Commissioner of Internal Revenue has determined that this proposed rule is not subject to Executive Order 12291.

Drafting Information

The principal author of these proposed regulations is Jacob Feldman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other Offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed Amendments to the Regulations.

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.993-2 is amended by revising paragraphs (d)(1) and (f) as follows:

§1.993-2 Definition of qualified export assets.

* * * * *

(d) *Trade receivables*—(1) *In general.* For purposes of this section, trade receivables are accounts receivable and written evidences of indebtedness due the DISC (or, if it acts as an agent, due its principal) and held by the DISC.

* * * * *

(f) *Producer's loans.* For purposes of this section, a producer's loan is an evidence of indebtedness arising in connection with producer's loans which are made by a DISC and which meet the requirements of §1.993-4. If a producer's loan is a qualified export asset, interest accrued with respect to the producer's loan will also be treated as a qualified export asset provided that payment is made in cash or property (valued at its fair market value on the date of transfer) no later than 60 days following the close of the taxable year of accrual of the interest.

* * * * *

Par. 2. Section 1-994-1(e) is revised as follows:

1. The last sentence of paragraph (e)(4) is revised to read as set forth below.

2. The last sentence of subdivision (i)(*a*) of paragraph (e)(5) is revised by adding the phrase "due the DISC" after the term "account receivable" the first time such term appears.

3. Subdivision (v) of paragraph (e)(5) is renumbered as subdivision (vi) and a new subdivision (v) is added to read as set forth below.

§1.994-1 Inter-company pricing rules for DISCs.

* * * * *

(e) *Methods of applying paragraphs (c) and (d) of this section.* ***

(4) *Subsequent determination of transfer price or commission.* *** Such a redetermination would include a redetermination by reason of an adjustment under section 482 and the regulations thereunder or section 861 and §1.861-8 which affects the amounts which entered into the determination of the transfer price or commission.

(5) *Procedure for adjustments to transfer price or commission.*

* * * * *

(v)(*a*) In lieu of establishing an account receivable in accordance with subdivision (i) of this subparagraph for all or part of an amount due a related supplier, the related supplier and DISC are permitted to treat all or part of any distribution which was made by the DISC out of its previously taxed income with respect to the year to which the determination or redetermination relates as an additional payment of transfer price or repayment of commission (and not as a distribution) made as of the date the distribution was made.

Any additional amount arising on the determination or redetermination due the related supplier after this treatment shall be represented by an account receivable established under subdivision (i) of this subparagraph. To the extent that a distribution is so treated under this subdivision (v), it shall cease to qualify as a distribution for any Federal income tax purpose, and the DISC's account for previously taxed income shall be adjusted accordingly. If all or part of any distribution made to a shareholder other than the related supplier is recharacterized under this subdivision (v), the related supplier shall establish an account receivable from that shareholder for the amount so recharacterized. Such account receivable shall be paid in the time and manner set forth in this paragraph (e)(5). In order to obtain the relief provided by this subdivision (v), the conditions and procedures prescribed by Revenue Procedure 84-3 must be met.

(*b*) If, for example, during 1982, a DISC commission from a related supplier with respect to a transaction completed in 1980 was redetermined to be $1,000 less than the commission actually charged by, and paid to, the DISC, the amount of any distribution previously made by the DISC from its 1980 previously taxed income to the related supplier as a shareholder may, to the extent of $1,000, be treated not as a distribution but as a repayment of the commission.

* * * * *

Par. 3. Section 1.995-2 is amended

by adding new paragraphs (a)(4) and (a)(5) and revising paragraph (a)(6)(i) as follows:

§1.995-2 Deemed distributions in qualified years.

* * * * *

(a) *General rule.* ***

(4) For taxable years beginning after December 31, 1975, an amount equal to 50 percent of the taxable income of the DISC for the taxable year attributable to military property (as defined in §1.995-6).

(5) For taxable years beginning after December 31, 1975, the taxable income for the taxable year attributable to base period export gross receipts (as defined in §1.995-7).

(6) The sum of—

(i)(A) In the case of a corporate shareholder, an amount equal to 57.5 percent of the excess (if any) (one-half for DISCs' taxable years beginning before January 1, 1983) of the taxable income of the DISC for such year (computed as provided in §1.991-1(b)(1)) over the sum of the amounts deemed distributed for the taxable year in accordance with subparagraphs (1), (2), (3), (4) and (5) of this paragraph, or

(B) In the case of a non-corporate shareholder, an amount equal to one-half of the excess (if any) of the taxable income of the DISC for such year (computed as a provided in §1.991-1(b)(1)) over the sum of the amounts deemed distributed for the taxable year in accordance with subparagraphs (1), (2), (3), (4), and (5) of this paragraph.

* * * * *

Par. 4. The following sections are added immediately after §1.995-5:

§1.995-6 Taxable income attributable to military property.

(a) *Gross income attributable to military property.* For purposes of section 995(b)(3)(A)(i), the term "gross income which is attributable to military property" includes income from the sale, exchange, lease, or rental of military property (as described in paragraph (c) of this section). The term also includes gross income from the performance of services which are related and subsidiary (as defined in § 1.993-1(d)) to any qualified sale, exchange, lease, or rental of military property. Where gross income cannot be determined on an item by item basis, the total gross income shall be apportioned. The apportionment shall be according to the fair market value of the property sold or exchanged, the fair rental value of any leaseholds granted, and the fair market value of any related and subsidiary services performed in connection with such sale or lease.

(b) *Deductions.* For purposes of section 995(b)(3)(A)(ii), deductions shall be properly allocated and apportioned to gross income, described in paragraph (a) of this section, in accordance with the rules of § 1.861-8. These deductions include all applicable deductions from gross income provided under part VI of subchapter B of chapter 1 of the Code.

(c) *Military property.* For purposes of this section, the term "military property" means any property which is an arm, ammunition, or implement of war designated in the munitions list published pursuant to section 38 of the International Security Assistance and Arms Export Control Act of 1976 (22 U.S.C. 2778 which superseded 22 U.S.C. 1934) and the regulations thereunder (22 CFR 121.01).

(d) *Illustration.* The principles of this section may be illustrated by the following example:

Example. X Corporation elects to be a DISC for the first time in 1976. X has taxable income of $50,000, of which $30,000 is attributable to military property and $10,000 to interest on producer's loans. The total deemed distributions with respect to X are as follows:

(1)	Gross interest from producer's loans in 1976	$10,000
(2)	50 percent of the taxable income of the DISC attributable to military property in 1976	$15,000
(3)	One-half of the excess of taxable income for 1976 over the sum of lines (1) and (2) (1/2 of ($50,000 minus $25,000))	$12,500
(4)	Total deemed distribution (sum of total lines (1), (2), and (3))	$37,500

§ 1.995-7 Taxable income attributable to base period export gross receipts.

(a) *General rule.* This section provides rules for the computation of taxable income attributable to base period export gross receipts. Section 995 (b)(1)(E) treats taxable income attributable to base period export gross receipts as a deemed distribution to a shareholder of a DISC for taxable years of a DISC beginning after December 31, 1975. The amount attributable to base period export gross receipts that must be included in income of a shareholder will be referred to as the nonincremental distribution. The nonincremental distribution must be computed for each taxable year of a DISC. Such year will be referred to as the computation year.

(b) *Nonincremental distribution*—(1) *General rule.* The nonincremental distribution for a computation year of a DISC is computed by multiplying the adjusted taxable income of the DISC by a fraction. The numerator of the fraction is the amount of the adjusted base period export gross receipts and the denominator is the amount of the export gross receipts of the DISC for the computation year.

(2) *Adjusted taxable income.* The "adjusted taxable income" is the taxable income of a DISC for the computation year reduced by the amounts described under section 995(b)(1)(A) through (D) and the regulations thereunder.

(3) *Export gross receipts.* The "export gross receipts" is the qualified export gross receipts described in section 993(a)(1)(A), (B), (C), (G), and (H) of a DISC for a taxable year reduced by 50 percent of those receipts which are attributable to military property (as defined under §1.995-6). For purposes of determining the denominator described in this paragraph (b), if the computation year is a short taxable year, the amount of export gross receipts for that year is multiplied by a fraction. The numerator of the fraction is the number of days which would have been in the taxable year of the taxpayer if there had been a full taxable year and the denominator is the number of days in the short taxable year.

(4) *Adjusted base period export gross receipts.* The amount of adjusted base export gross receipts is 67 percent of the average of the base period export gross receipts.

(c) *Average base period export gross receipts*—(1) *Base period of 48*

months or less. If a DISC has a base period of 48 months or less, the amount of average base period export gross receipts is determined by dividing the base period export gross receipts by the number four (4).

(2) *Base period of more than 48 months.* If a DISC has a base period of more than 48 months, the amount of average base period export gross receipts is determined by multiplying the base period export gross receipts by a fraction. The numerator of the fraction is the number 365.25 and the denominator is the total number of days in the base period.

(3) *Change of accounting period.* Notwithstanding paragraph (c)(1) of this section, if a corporation that is a DISC changes its annual accounting period (other than during the first taxable year of its existence), and the effect of such a change creates a base period of less than 48 months, the average base period export gross receipts are determined under paragraph (c)(2) of this section. This paragraph (c)(3) applies with respect to changes of accounting period permitted under §1.995-7(d)(5).

(4) *Base period export gross receipts.* "Base period export gross receipts" means the aggregate export gross receipts of a DISC for all taxable years beginning during the base period reduced by the base period export gross receipts attributable to property that is excluded from export gross receipts during the computation year. Excluded property is property described in section 993(c)(2)(C) or (D) without regard to the fixed contract exception under §1.993-3(g)(6). When the fixed contract exception applies, the amount of excluded property is multiplied by a fraction. The numerator of the fraction is the amount of the gross receipts in the computation year attributable to excluded property less the amount of the export gross receipts by reason of the fixed contract exception under §1.993-3(g)(6). The denominator of the fraction is the total amount of gross receipts in the computation year attributable to excluded property. For taxable years of a DISC ending before November 15, 1982, base period export gross receipts do not include receipts attributable to property sold or leased to a WHTC or receipts which arose in the absence of a written supplier's agreement unless the receipts were treated as qualified export receipts by the taxpayers.

(5) *Illustration.* The following example illustrates the application of paragraph (c)(4) of this section:

Example. X Corporation, a DISC since 1972, derived $2000 from sales of coal and $3000 from sales of foodstuffs in 1976. In 1975 gross receipts from the sale of agricultural products were $1000 and from the sale of coal were $3000. One thousand dollars of the $3000 was derived from sales prior to March 19, 1975 and $2000 from sales made after March 18, 1975, of which $500 of the latter sales were pursuant to a fixed contract. Assume that all gross receipts are qualified export receipts (and, therefore, export gross receipts as provided in paragraph (b)(3) of §1.995-7) except to the extent that section 993(c)(2)(C) (which treats natural resources such as coal as excluded property) is applicable. Assume further that the gross receipts for 1972, 1973, and 1974 were each $500, all derived entirely from the sale of foodstuffs and all qualifying as export gross receipts. Under these facts the adjusted base period export gross receipts are determined as follows:

(1)	Export gross receipts for 1975		
(i)	Export gross receipts—agricultural products		$1000
(ii)	Export gross receipts—coal		$1500
	(*a*) Sales prior to March 19, 1975	$1000	
	(*b*) Sales subsequent to March 18, 1975	$500	
	(1) Fixed contract sales		
	(2) Non-fixed contract sales	$1500	$2000

Excluded property receipts ($2000) X (Excluded property receipts ($2000) — Fixed contract receipts ($500)) / Excluded property receipts ($2000)

Total export gross receipts ($1,000 + 1,500) $2500

(2)	Adjusted export gross receipts	
	1972 export gross receipts	$500
	1973 export gross receipts	500
	1974 export gross receipts	500
	1975 export gross receipts	2500
	Base period export gross receipts	4000
	Average base period export gross receipts 1972-75	1000
	Adjusted base period export gross receipts (.67 X average for base years	$670

(6) *Base years.* The base period is a 4-year period attributable to a computation year. For computation years of a DISC beginning before January 1, 1980, the base period calendar years are 1972, 1973, 1974, and 1975. For other computation years, the base period calendar years are the fourth, fifth, sixth, and seventh calendar years preceding the calendar year in which the computation year begins. If a DISC has taxable years beginning in every base period calendar year, the base period is the period which begins on the first day of the first taxable year beginning in the earliest base period calendar year and ends on the last day of the last taxable year beginning in the latest base period calendar year. A corporation that revoked its election to be treated as a DISC or failed to satisfy the condition of section 992(a)(1) for a taxable year to a DISC will, for purposes of computing its base period export gross receipts, be treated as a DISC newly established in such subsequent taxable year. However, see paragraph (e)(3) of this section, which treats a disqualification as a separation. This paragraph (c)(6) applies whether or not the DISC qualified (or was treated) as a DISC (within the meaning of section 992(a)(1) and §1.992-1) for all taxable years beginning in the base period calendar years. If a DISC does not have a taxable year beginning in every base period calendar year, the base period is the period which begins on the date during the earliest base period calendar year that corresponds to the date on which the first taxable year of the DISC begins, and ends on the last day of the last taxable year of the DISC beginning in the latest base period calendar year.

(7) *Illustrations.* The following examples illustrate the application of this paragraph (c):

Example (1). X Corporation, a DISC, was organized on March 1, 1972, and adopted a taxable year beginning on March 1. With re-

spect to the computation year beginning on March 1, 1976, X's base period calendar years are 1972, 1973, 1974, and 1975. The base period is the period which begins on March 1, 1972, and ends on February 29, 1976.

Example (2). Y Corporation, a DISC, was organized on Mrch 15, 1974, and adopted a taxable year beginning on October 1. With respect to the computation year beginning on October 1, 1977, Y's base period is the period which begins on March 15, 1972, and ends on September 30, 1976.

Example (3). Z Corporation, a DISC, was organized on December 10, 1974, and adopted a taxable year beginning on February 1. With respect to the computation year beginning on February 1, 1980. Z's base period calendar years are 1973, 1974, 1975, and 1976. The base period is the period which begins on December 10, 1973, and ends on January 31, 1977.

(d) *Controlled group*—(1) *General rule.* Where more than one member of a controlled group of corporations (as defined in section 993(a)(3) and §1.993-1(k)) qualifies or is treated as a DISC, special rules are used to calculate the nonincremental distribution. In such a case, the fraction described in paragraph (d)(2) of this section to compute the nonincremental distribution is the aggregate of the adjusted base period export gross receipts over the aggregate of the computation year export gross receipts for the computation year of every member DISC within the controlled group. This fraction is multiplied by the aggregate adjusted taxable income for each member DISC within the controlled group. The computation of the nonincremental distribution described in this paragraph applies to shareholders of DISC that is a member of a controlled group even though such shareholder is not a related person within the meaning §1.993-1(a)(6).

(2) *Aggregate adjusted base period export gross receipts.* If any DISC that is a member of the controlled group uses a taxable year that is different from another DISC that is a member of the same controlled group, the aggregate of the adjusted base period export gross receipts consists of the sum of the adjusted base period export gross receipts of each of the following DISCs:

(i) The DISC (primary DISC) with respect to which the nonincremental distribution is being determined; and

(ii) All other DISCs (secondary DISCs) that are members of the same controlled group (as defined in section 993(a)(3)) as the primary DISC and whose computation years end with or within the computation year of the primary DISC.

For purposes of this paragraph (d)(2), the base period calendar years of any secondary DISC is the base period calendar years of the primry DISC.

(3) *Aggregate current year export gross receipts.* If paragraph (d)(2) of this section applies, the aggregate of the export gross receipts for the computation year consists of the sum of the export gross receipts of the primary DISC and the export gross receipts of all secondary DISCs for thier computation years described in paragraph (d)(2)(ii) of this section.

(4) *Illustrations.* The following examples illustrate the application of this paragraph (d):

Example (1). P Corporation owns all of the stock of V and X Corporations. V owns all of the stock of Y Corporation, a DISC. X owns all of the stock of Z Corporation, a DISC. P, V, X, Y, and Z are members of the same controlled group for all periods involved. V uses a fiscal year ending June 30 as its taxable year. X uses the calendar year as its taxable year. Y and Z both use the calendar year as their taxable years. For the computation year ending in 1980, Y has adjusted taxable income (as defined under paragraph (b)(2) of this section) of $3,000, adjusted base period export gross receipts (as defined under paragraph (b)(4) of this section) of $2,000, and export gross receipts (as defined under paragraph (b)(3) of this section) of $5,000. For the same year, Z has adjusted taxable income of $4,000, adjusted base period export gross receipts of $6,000 and export gross receipts of $5,000. The numerator of the fraction to determine the nonincremental distribution is $8,000, the aggregate of the adjusted base period export gross receipts of Y and Z. The denominator of the fraction is $10,000, the aggregate of the export gross receipts of Y and Z. The nonincremental distribution under paragraph (b)(1) of this section with respect to Y is $2,400 ($3,000 × 4/5, and with respect to Z is $3200 ($4,000 × 4/5).

Example (2). The facts are the same as in example (1) except that Y uses a fiscal year ending January 31 as its taxable year and the computation year ends in 1980. In computing the nonincremental distribution with respect to Z, a calendar year DISC, Z is the primary DISC described in paragraph (d)(2)(i) of this section. In computing the adjusted base period export gross receipts of Y, Y's base period is the same as that of Z even though Y's computation year begins in the calendar year 1979. The adjusted taxable income and current year export gross receipts of Z are for the calendar year beginning January 1, 1980, and the current year export gross receipts of Y are for Y's fiscal year ending January 31, 1980.

(5) *Change of annual accounting period.* Where more than one member of a controlled group of corporations (as defined in section 993(a)(3) and §1.993-1(k)) qualifies or is treated as a DISC and where any two or more of the member DISCs have different annual accounting periods, the annual accounting periods of the member DISCs may be changed without the approval of the Secretary if, and only if

(i) All member DISCs have the same annual accounting period after the change; and

(ii) The period chosen is the annual accounting period of one of the member DISCs.

In the case of an existing controlled group with member DISCs having different annual accounting periods, the change may be made within one year after [the date of adoption of the regulations as a Treasury decision]; and in the case of a newly acquired DISC, the accounting period of such DISC may be changed by adopting the period of any existing DISC within one year after acquisition.

(e) *Separation of DISC and trade or business*—(1) *General rule.* If, at any time after the beginning of the base period of a DISC, there has been a separation of the ownership of the stock in that DISC from the ownership of a trade or business tht produced export gross receipts of the DISC, the persons who own the trade or business during the taxable year are treated as having in any DISC in which they have (or acquire) a direct or indirect interest additional export gross receipts attributable to the trade or business for purposes of computing base period export gross receipts. Notwithstanding the separation, the base period export gross receipts remain with the DISC after separation and are taken into account by shareholders of the DISC (whether or not there are new shareholders of the DISC as a result of the separation) in computing the adjusted base period export gross receipts of the DISC for taxable years beginning prior to the year in which the separation occurs.

(2) *Ownership.* A person will be treated as an owner of a trade or business which produced export gross receipts of a DISC if the person owns stock, directly or indirectly, in a corporation that conducts the trade or business. A person will also be treated as an owner of a trade or business if that person is, for example, a partner

in a partnership that either conducts the business or owns stock, directly or indirectly, in a corporation that conducts it, a lessee of substantially all the assets of a trade or business, or a licensee of a patent, copyright, trademark, or similar property essential to the conduct of a trade or business. For purposes of this paragraph (e)(2), a person who owns indirectly less than 5 percent of the entity conducting the trade or business shall not be treated as the owner of the trade or business. For purposes of this paragraph (e)(2), stock owned, directly, or indirectly, by or for a corporation, partnership, trust, or estate shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence may be treated as actually owned by such person.

(3) *Separation.* A separation occurs if the ratio of a person's percentage ownership interest in a DISC to his percentage ownership in the trade or business which produced export gross receipts of the DISC changes at any time during the year. Thus, if A Corporation owns all the stock of B, C, and D Corporations, and D is a DISC and B and C produced export gross receipts for D, the transfer of the stock of B or C will result in a separation. Similarly, the transfer of the stock of C and the stock of D will result in a separation as will the liquidation of D by A. The disqualification of a DISC by revocation of the election or by failing to satisfy the conditions of section 992(a)(1) for a taxable year shall be treated as a separation, and the export gross receipts produced prior to the disqualification will be attributed to the separated trade or business. A requalified DISC will be treated as having additional export gross receipts attributable to the separated trade or business. For purposes of this paragraph (e)(3), members of the same controlled group (as defined in section 993(a)(3)) will be treated as one person.

(4) *Amount of attribution.* If a separation described in paragraph (e)(3) of this section occurs, the additional amount referred to in paragraph (e)(1) of this section is the amount of the export gross receipts attributable to the separated trade or business.

(5) *Recapture of accumulated DISC income.* If a shareholder of a DISC recaptures accumulated DISC income (as defined in section 996(f)(1)) as a result of a disposition (as described in section 995(c)) of stock in a DISC or a disqualification which results in a separation, the base period export gross receipts of the DISC for base period years prior to the disposition are reduced on a pro rata basis to the extent of the recapture in the taxable year. This reduction does not apply for purposes of determining the amount described in paragraph (e)(1) and (4) of this section which is attributable to the owner or a trade or business after the separation.

(6) *Illustrations.* The principles of this paragraph (e) are illustrated by the following examples:

Example (1). A Corporation owns all the stock of B, C and D Corporations. D is a DISC and B and C each produced $5,000 of the export gross receipts of D. A sells the stock of B to Z, an unrelated party, which organizes P Corporation, a DISC, for which B produces export gross receipts. Under paragraph (e)(3) of §1.995-7, the sale of the stock of B constitutes a separation and under paragraph (e)(1) and (4), $5,000 of export gross receipts is attributable to P. Under paragraph (e)(1) the export gross receipts of D are $10,000 unchanged by the separation. If D is liquidated by A and F Corporation, a new DISC, is organized, F will have export gross receipts of $5,000. Under paragraph (e)(5), the export gross receipts of D are eliminated. However, paragraph (e)(5) does not apply to amounts attributable to the owner of the trade or business after the separation under paragraph (e)(4). Therefore, $5,000 is attributable to P (by B) and $5,000 is attributable to F (by C).

Example (2). G Corporation owns all the stock of H and I Corporations and H Corporation owns all the stock of J Corporation, a DISC. During the base period H produces all the export gross receipts of J, which amounts to $25,000. The sale of the stock of H to B does not constitute a separation within the meaning of paragraph (e)(3). If J is liquidated, there will be attributed to any future DISC organized with respect to H the export gross receipts attributable to the separate trade or business. Although the liquidation will result in a recapture of accumulated DISC income, paragraph (e)(5) does not apply for purposes of determining the amount attributable to the owner of the trade or business after the separation, and under paragraph (e)(1) such amount is attributed to any future DISC for which H produces exported gross receipts.

Example (3). P Corporation owns several corporations including R Corporation, a DISC, and M Corporation, which has produced export gross receipts for R. P also owns several other DISC's. The stock of M is sold to W Corporation. Assuming that M produced $100,000 of export gross receipts during the base period and that those receipts were the only receipts produced with respect to R, there is a separation under paragraph (e)(3), and under paragraph (e)(1) $100,000 in export gross receipts will be attributable to any DISC that W organizes with respect to M. In addition, under paragraph (e)(1) the export gross receipts of R are unreduced and taken into account in computing base period export gross receipts under the controlled group rules of paragraph (d). If R is liquidated, there will be a recapture of accumulated DISC income and under paragraph (e)(5) a reduction of the export gross receipts of R, but no reduction with respect to any DISC that W organizes with respect to M.

(f) *DISC base period attributed through shareholders*—(1) *In general.* If—

(i) Any person owns 5 percent or more of the stock of a DISC (referred to as the "first DISC"), and

(ii) that person at any time during the base period of the first DISC owned 5 percent or more of the stock of a second DISC, and

(iii) Both DISCs derived export gross receipts from the sale of the same or similar property, or from the performance of the same or similar services,

then the base period export gross receipts of the first DISC are increased by the shareholder's pro rata portion of the base period export gross receipts of the second DISC.

(2) *Exception.* Paragraph (f)(1) of this section does not apply to the extent paragraph (d) or (e) of this section apply.

(3) *Ownership of stock.* For purposes of this paragraph (f), the ownership of stock is determined under section 318.

(4) *Recapture of accumulated DISC income.* The rules with respect to recapture of accumulated DISC income described in paragraph (e)(5) of this section apply with respect to base period attribution under this paragraph.

(5) *Illustration.* The following example illustrates the application of this paragraph.

Example. A Corporation owns all the stock of B and C Corporations and B owns all the stock of D Corporation, a DISC. B produced $10,000 or export gross receipts of D for the base period 1972-1975. On January 1, 1976, A sells all the stock of C to X Corporation, an unrelated corporation. Subsequently A purchases 50 percent of the stock of F Corporation, another DISC, and B conducts all of its export business through F with B as the related sup-

plier. Neither the sale of C by A nor the purchase of F result in a separation with respect to A under paragraph (e) of this section. In addition, D and F are not members of the same controlled group within the meaning of section 993(a)(3), and paragraph (d) of this section does not apply. However, under paragraph (f)(1) of this section, the base period export gross receipts of F are increased by $10,000.

(g) *Small DISC exception*—(1) *Adjusted taxable income of $100,000 or less.* Except as provided in paragraph (g)(4) of this section, if a DISC has adjusted taxable income of $100,000 or less for the taxable year, section 995(b)(1)(E) and this section do not apply for that year.

(2) *Partial exception.* If, for a taxable year, a DISC has adjusted taxable income of more than $100,000 but less than $150,000, the nonincremental distribution under paragraph (b)(1) of this section is reduced (but not below zero) by an amount equal to twice the excess of $150,000 over the adjusted taxable income.

(3) *Short taxable year.* In computing a DISC's adjusted taxable income for purposes of this paragraph (g), when the current taxable year is a short taxable year, the adjusted taxable income for the year is multiplied by a fraction. The numerator of the fraction is the number of days in the full taxable year and the denominator is the number of days in the short taxable year.

(4) *Controlled groups.* If more than one member of a controlled group (as defined in section 993(a)(3)) qualifies, or is treated, as a DISC for the current taxable year, the adjusted taxable income of each member of the group is aggregated for purposes of determining the application of paragraph (g)(1) or (2) of this section. The adjusted taxable income of any DISC for purposes of this aggregation may not be less than zero. The aggregation is made in the same manner and with respect to those DISCs described in paragraph (d)(2) of this section. If the adjusted taxable income of the member DISCs is more than $100,000 but less than $150,000, the nonincremental distribution under paragraph (b)(1) of this section is determined in accordance with paragraph (d) of this section. The reduction determined under paragraph (g)(2) of this section is apportioned among the DISCs described in paragraph (d)(2) of this section in accordance with the ratio which the adjusted taxable income of each member DISC for the year bears to the total adjusted taxable income of all member DISCs for the year. This paragraph (g)(4) applies to a shareholder of a DISC even though the shareholder is not a related person as defined in §1.993-1(a)(6).

(h) *Certain transfer of DISC assets*—(1) *In general.* If—

(i) A corporation owns all the stock of a subsidiary and a DISC,

(ii) The corporation transfers (within the meaning of paragraph (h)(4) of this section) all the stock of the subsidiary,

(iii) The subsidiary has been engaged in the active conduct of a trade or business (within the meaning of section 355(b) and regulations thereunder) throughout the 5-year period ending on the date of the transfer, and continues to be so engaged thereafter,

(iv) During the taxable year of the subsidiary in which its stock is transferred, and its preceding taxable year, the trade or business produced qualified export receipts with respect to the subsidiary and the DISC,

(v) The DISC transfers all of its assets related to the conduct of the trade or business to a new DISC in exchange for all the stock of the new DISC, the DISC distributes the stock in the new DISC to the corporation and the corporation transfers the stock in the new DISC to the subsidiary, and

(vi) The transfers described in paragraph (h)(1)(v) of this section are undertaken for the sole purpose of avoiding the application of section 995(e)(9) and paragraph (e) of this section, and, therefore, preventing double attribution under paragraph (e)(1), then notwithstanding any other rule or regulation to the contrary the transfer described in paragraph (h)(1)(v) will be a reorganization within the meaning of section 368 (a)(1)(D) to which section 355 applies and an exchange of stock of the new DISC by the corporation for stock of the subsidiary to which section 351 applies.

(2) *Special rule.* If—

(i) A corporation owns, directly or indirectly, all the stock of a subsidiary and a DISC,

(ii) A transfer or transfers described in this paragraph (h)(2) of the stock or assets of the subsidiary and the DISC are for the purpose described in paragraph (h)(1)(vi) of this section, and

(iii) The transfer or transfers occur in a transaction other than one described in paragraph (h)(1)(v) of this section but which satisfies the requirements of paragraph (h)(1)(iii) and (iv) of this section,

then the transfer or transfers described in this paragraph (h)(2)(iii) will be a reorganization within the meaning of section 368, a transaction to which section 355 applies, an exchange of stock to which section 351 applies, or a combination of these, as the case may be, provided the transfer or transfers are consistent with the purpose and effect of those described in paragraph (h)(1)(v) of this section.

(3) *Ownership.* Stock owned, directly or indirectly, by a corporation shall be considered as owned proportionately by its shareholders.

(4) *Transfer.* The term "transfer" includes a sale, exchange, or other disposition of property.

(5) *Illustrations.* The following examples illustrate the application of this paragraph (h):

Example (1). P Corporation, which was organized on January 1, 1966, owns all the stock of X and Y Corporations, both also organized on January 1, 1966. X has been engaged in the manufacture of shoes. Y has been engaged in the manufacture of recreational equipment. On January 1, 1972, P organizes Z Corporation, a DISC. X and Y serve as the related suppliers of Z. On January 1, 1977, U Corporation offers to buy the stock of X. As part of an overall plan to avoid the application of section 995(e)(9) of this section, Z transfers all the export assets that relate to the trade or business conducted by X to V Corporation in exchange for all of the stock of V. Z then distributes all the stock of V to P, which transfers all the V stock to X. Immediately after this series of transactions, P sells all of the X stock to U Corporation. Under paragraph (h)(1) of this section, the transfer and distribution by Z constitute a reorganization under section 368 (a)(1)(D) to which section 355 applies, and the exchange by P constitutes an exchange to which section 351 applies. The result would be the same even if P sold less than all of the stock in X.

Example (2). The facts are the same as in ex-

ample (1), except that Y organizes and owns all the stock of Z. Accordingly, after the transfer by Z, Z distributes the stock of V to Y, which in turn distributes the stock of P. P transfers all the V stock to X. Under paragraph (h)(2) of this section, the transfers by Z to Y, and Y to P constitute a reorganization described in section 368(a)(1)(D) to which section 355 applies. The transfer by P to X constitutes an exchange to which section 351 applies.

* * * * *

Par. 5. Section 1.996-3 is amended by adding a new paragraph (g) as follows:

§1.996-3 Divisions of earnings and profits

* * * * *

(g) *DISCs having corporate and noncorporate shareholders.* In the case of a DISC having one or more corporate shareholders but less than all of its shareholders subject to the special rules of section 291(a)(4), relating to certain deferred DISC income as a corporate preference item, accumulated DISC income and previously taxed income of the DISC are divided between the corporate shareholders, as a class, and the other shareholders, as a class, in proportion to amounts of DISC income not deemed distributed and amounts deemed distributed to each class. Subsequent taxation of actual and qualifying distributions shall be based upon this division. Thus, if a DISC is owned 50 percent by corporate shareholders and 50 percent by individual shareholders and has undistributed taxable income of $2,000 for its year, the division is made as follows:

Corporate shareholders	
Previously taxed income	
(57.5% of $2,000 ÷ 2)	$575
Accumulated DISC income	
(42.5% of $2,000 ÷ 2)	425
Individual shareholders	
Previously taxed income	
(50% of $2,000 ÷ 2)	$500
Accumulated DISC income	
(50% of $2,000 ÷ 2)	$500

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 6, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 9, 1984, 49 F.R. 1075)

Notice of Proposed Rulemaking

Investment Credit for Cooperatives

LR-4-78

SUMMARY: This document contains proposed regulations relating to the investment credit for cooperative organizations. Changes to the applicable tax laws were made by the Revenue Act of 1978 [Pub L. 95-600, 1978-3 C.B. (Vol.1) 1]. The regulations would provide the public with the guidance needed to comply with that Act and would affect cooperatives that earn investment credit and the patrons of those cooperatives.

DATES: Written comments and requests for a public hearing must be delivered or mailed by February 27, 1984. In general, the amendments are proposed to be effective for taxable years of cooperatives ending after January 27, 1984. Cooperatives may elect to have these regulations apply to their taxable years ending after October 31, 1978, and before [31 DAYS AFTER PUBLICATION OF THESE PROPOSED AMENDMENTS AS A FINAL REGULATION]. However, the recapture provisions are generally effective for taxable years ending after October 31, 1978.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-4-78) Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Patricia K. Keesler of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3430), not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 46 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 316 of the Revenue Act of 1978 (92 Stat. 2829) and are to be issued under the authority contained in sections 38(b) (76 Stat. 963; 26 U.S.C. 38(b)), 46(h) (92 Stat. 2829; 26 U.S.C. 46(h)), and 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

Before the passage of the Revenue Act of 1978, section 46(e) limited the amount of investment credit allowable to a cooperative organization. In addition, unused credit was carried back and over at the cooperative level.

Section 316 of the Revenue Act of 1978 eliminated the special limitation on the investment credit of a cooperative and provided that unused credit must be passed through to the cooperative's patrons. These regulations reflect section 316 of the Act and provide the rules for allocating the credit to patrons of the cooperative.

The proposed regulations provide 2 methods for allocating the unused credit to a cooperative's patrons. Under the first method the cooperative allocates the credit to all its patrons on the basis of business done with the cooperative. As an alternative, the cooperative may elect to use the second method for all taxable years beginning with the year for which the election is first made. Under the second method, the unused credit is allocated first to the various allocation groups within the cooperative that reasonably expect to use the property. Allocation to each group is based on the ratio of credit earned on behalf of the group to credit earned on behalf of all of the groups within the cooperative. Within each group, alloca-

tion of credit to a patron is on the basis of business done with the group.

A cooperative may choose either of these methods for allocating the unused credit. The cooperative must use that method for allocating all unused credit earned for any one taxable year.

The proposed regulations provide a procedure for the cooperative to notify both the patrons and the Internal Revenue Service of an investment credit passthrough. This procedure will not substantially increase the reporting requirements for cooperatives. The regulations require the notification to appear on statements and forms (Forms 1096 and 1099-PATR) already required in the absence of special circumstances. An exception to the notification requirements applies for *de minimis* amounts of credit.

Under the proposed regulations, the recapture of the investment credit as well as other adjustments that affect the amount of tax are made only at the cooperative level.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

EXECUTIVE ORDER 12291

The Commissioner has determined that this proposed regulation is not a major regulation for purposes of Executive Order 12291. Accordingly, a regulatory impact analysis is not required.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal authors of these proposed regulation are Benedetta A. Kissel of the Legislation and Regulations Division and Patricia K. Keesler of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

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Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Paragraph (a)(3) of §1.46-3 is amended by inserting a new sentence to follow the first sentence to read as set forth below:

§1.46-3 Qualified investment.

(a) *In general.* ***

(3) ***However, in the case of a cooperative organization, the reduction is made only for property placed in service in taxable years ending before November 1, 1978.

* * * * *

Par. 2. Paragraph (c) of §1.46-4 is amended by—

(a) redesignating paragraphs (c)(1), (c)(2), and (c)(3) as (c)(2), (c)(3), and (c)(4), respectively,

(b) adding a new paragraph (c)(1), and

(c) removing "(1)(i) and the amount described in subparagraph (1)(11)" from the first sentence of paragraph (c)(3) (as redesignated) and adding instead "(2)(i) (c)(3) (as redesignated) and adding instead "(2)(i) and the amount described in subparagraph (2)(ii)".

The added provision reads as follows:

§1.46-4 Limitations with respect to certain persons.

* * * * *

(c) *Cooperatives.* (1) This paragraph (c) does not apply to property placed in service in taxable years of cooperatives ending after October 31, 1978. For rules that may be applicable to those taxable years see §1.46-10. For transitional rules see §1.46-10(g).

* * * * *

Paragraph 3. A new §1.46-10 is added immediately after §1.46-9 to read as follows:

§1.46-10 Cooperatives and their patrons.

(a) *In general—(1) Scope.* This section prescribes rules under section 46(h) of the Code, relating to the investment credit ("credit") of cooperatives and their patrons.

(2) *Definition of cooperative.* For purposes of this section, a cooperative is any cooperative organization described in section 1381(a).

(3) *Definition of patron.* For purposes of this section, the term "patron" has the same meaning as in §1.1388-1(e).

(4) *Effective date.* (i) This section is effective for property placed in service in a taxable year of a cooperative ending after [30 DAYS AFTER PUBLICATION OF THESE PRO-

POSED AMENDMENTS AS A FINAL REGULATION].

(ii) This section is also effective for recapture and corrective adjustments (as described in paragraph (f) of this section) that affect a taxable year ending after October 31, 1978. However, §1.46-10(f)(4) is effective for corrective adjustments made after [30 DAYS AFTER PUBLICATION OF THESE PROPOSED AMENDMENTS AS FINAL REGULATIONS].

For property placed in service in a taxable year of a cooperative ending before November 1, 1978, see §1.46-4(c). For property placed in service in a taxable year of a cooperative ending after October 31, 1978, and before [31 DAYS AFTER PUBLICATION OF THESE PROPOSED AMENDMENTS AS A FINAL REGULATION], see paragraph (g)(1) of this section.

(b) *Rules applicable at the cooperative level.* Except as otherwise provided in this section, the rules of sections 46, 47, and 48 apply at the cooperative level. Thus, under section 46(h), a cooperative determines the amount of credit earned and the limitation based on the amount of tax (such tax determined under sections 1381-1383 and section 11) in the same manner as other corporations. For example, to determine such items as qualified investment, useful lives, and the character of property, the rules apply at the cooperative level. In addition, pursuant to section 46(a)(7), if a cooperative has credit not attributable to energy percentage ("non-energy credit") and credit attributable to the energy percentage ("energy credit") it shall apply the credit earned against its tax liability in the same order as other corporations.

(c) *Allocation to patrons of unused credit*—(1) *Passthrough.* The amount of credit that cannot be used at the cooperative level for the credit year (as defined in §1.47-1(a)(1)(ii)(a)) due to the limitation contained in section 46(a)(3) must be passed through to the cooperative's patrons under the rules of this paragraph (c) and is referred to as a "passthrough" in this section. Thus, to the extent a cooperative cannot use an investment credit in the year property is placed in service, the credit may not be carried back or carried forward by the cooperative, but will be allocated to the patrons as set forth below. In determining the amount of the credit earned and the amount of the passthrough, the cooperative must separately determine for the taxable year the amount of each type of passthrough. The types are (A) passthrough not attributable to the energy percentage ("nonenergy credit passthrough") and (B) passthrough attributable to the energy percentage ("energy credit passthrough").

(2) *General rules for allocating a passthrough.* (i) Unless the election is made under paragraph (c)(3) of this section, the cooperative must allocate the amount of passthrough for a taxable year among its patrons on the basis of quantity or value of business done with or for those patrons. The amount of each type of passthrough (non-energy credit or energy credit) for a taxable year allocated to a particular patron is determined by multiplying the total amount of the passthough of that type by a fraction. The numerator of the fraction is the *quantity* or value of business done with or for that patron (or, if paragraph (c)(2)(ii) of this section applies, the amount distributed to that patron) and the denominator of the fraction is the aggregate of the quantity or value of business done with or for all patrons (or, if paragraph (c)(2)(ii) of this section applies, the amounts distributed to all the patrons for the same period).

(ii) If a cooperative makes distributions for the taxable year to patrons on the basis of the quantity or value of business done, the cooperative must allocate the passthrough to its patrons on the basis of those distributions. Thus, the cooperative must compute for its taxable year the amount distributed to each patron during the payment period (as defined in section 1382(d)) for that taxable year. The amount distributed is the sum of all of the distributions made to the patron, in any form (including per-unit retain allocations and qualified and nonqualified written notices of allocation as defined in section 1388), on the basis of quantity of value of business done with or for that patron for the taxable year. The amount of each type of passthrough (non-energy credit or energy credit) for a taxable year allocated to a particular patron is then determined by using the fraction set forth in paragraph (c)(2)(i) of this section.

(3) *Alternative group method of allocation.* (i) A cooperative that has more than one allocation group may elect the alternative group method of allocation as described in this paragraph. Under this method, the cooperative must allocate each type of passthrough first to the allocation group or groups that the cooperative reasonably expects will use the property, and then among the members of the group or groups to which the passthrough was allocated. For the manner of making the election, see paragraph (c)(3)(vi) of this section. For purposes of this section, an allocation group consists of those patrons treated by the cooperative as a group for purposes of computing patronage dividends under section 1388(a)(1).

(ii) The amount of a passthrough allocated to an allocation group is determined by first computing (A) the amount of nonenergy credit earned with respect to property placed in service during the taxable year for the use of the group and (B) the amount of energy credit so earned. To determine the amount of nonenergy credit passthrough allocated to an allocation group, the cooperative multiples the amount of the passthrough by a fraction. The numerator of the fraction is the amount of nonenergy credit earned by the group (determined under paragraphs (c)(3)(ii)(A) and (c)(3)(iii) of this section) and the denominator is the aggregate of the nonenergy credit earned *by* all the allocation groups of the cooperative. The same principles apply to determine the amount of energy credit passthrough allocated to an allocation group.

(iii) For purposes of the allocation under paragraph (c)(3)(ii) of this section, if property is placed in service for the use of 2 or more allocation

groups, the cooperative must apportion the credit earned with respect to the property among it allocation groups on the basis of the cooperative's reasonable expectations of the property's use by those groups for the period ending with the recapture period for that property. For example, if the cooperative reasonably expects 75 percent of a property's use to be by or for the egg group and 25 percent to be by or for the wheat group, the egg group is apportioned 75 percent of the credit earned for the property and the wheat group is apportioned 25 percent of the credit earned.

(iv) The amount of each type of passthrough allocated to a particular patron of an allocation group is determined by multiplying the total amount of the allocation group's passthrough of that type by a fraction. The numerator of the fraction is the quantity or value of business done by or for the patron with that allocation group (or, if paragraph (c)(2)(ii) of this section applies, the amounts distributed to the patron). The denominator of the fraction is the aggregate of the quantity or value of business done by or for (or, if paragraph (c)(2)(ii) of this section applies, the amounts distributed to) all patrons with that allocation group.

(v) If the patron is a member of more than one allocation group, that patron's passthrough of each type (energy or nonenergy credit) is the sum of the amounts of that type of passthrough allocated to the patron by the allocation groups in which the paron participates.

(vi) A cooperative elects the alternative group method of allocation by computing the amount of each patron's passthrough using that method for a taxable year and incluing on the notice to patrons under paragraph (c)(4) of this section, a statement that the alternative method was used. The election may not be changed after the due date for the statement required under paragraph (c)(4) of this section. The election applies for the taxable year made and for all succeeding taxable years. An election cannot be revoked for succeeding taxable years unless the cooperative obtains consent from appropriate Tax Rulings Division in the Office of Associate Chief Counsel (Technical). (See §601.201 (Statement of Procedural Rules)). A request for consent must state the reasons why the alternative group method is no longer an equitable method of allocating the passthrough to the patrons. The request must be made no later than 6 months prior to the due date of the first statement required by paragraph (c)(4) of this section that would reflect revocation of the election.

(4) *Time and manner of notifying patrons of passthrough.* (i) A cooperative must notify each patron and the Internal Revenue Service of the amount and type of passthrough allocated to the patron if the total amount of that patron's passthrough for the credit year is $10 or more. The amount and type of passthrough must be entered on the first statement that is required by section 6044 (Form 1099 PATR) or would be required by that section if (A) the amount of the payment subject to reporting were $10 or more or (B) the cooperative were not a consumer cooperative exempt from the requirements of section 6044. The statement must be furnished to the Internal Revenue Service and to the patron after the end of the payment period for the taxable year in which the credit was earned (or such earlier time as provided under the rules of section 6044 and the regulations thereuner.

(ii) If the total amount of passthrough allocated to a patron by the cooperative for the taxable year is less than $10, then the cooperative may, but is not required to, notify the particular patron of the passthrough. To the extent that notification is not made because the patron's passthrough is less than $10, the credit may not be used by any patron or the cooperative. Additionally, to the extent notification is not made, that amount of the passthrough is not subject to recapture under section 47 or §1.46-10(f).

(iii) The cooperative must enter on or attach to the notification, a statement that the passthrough must be reported on any of the patron's income tax returns described below.

(A) The first income tax return due (without regard to extensions) on or after receipt of the nofification by the patron, or

(B) If the patron has previously filed the income tax return described in paragraph (c)(4)(iii)(A) above, on a return amending such income tax return, or

(C) If the patron has filed the income tax return described in paragraph (c)(4)(iii)(A) above before receipt of the notification and does not file an amended return as permitted by paragraph (c)(4)(iii)(B) above, on the income tax return due for the patron's first taxable year ending on or after receipt of the notification by the patron.

The notice should also state that (1) the patron may not amend any return that was due (without regard to any extensions) prior to the receipt of the notification by the patron and (2) to the extent that any passthrough cannot be used by the patron due to the tax liability limitation of section 46(a)(3) of the Code, the patron may carry back and carry over the amount of unused credit in accordance with the rules of section 46(b) of the Code.

(iv) A cooperative that, without regard to this paragraph, is not required to furnish a statement to a patron, need not furnish the information described in §1.6044-5(b)(1).

(d) *Patrons' use of passthrough.* A patron notified of a passthrough shall report the passthrough on any one of the patron's income tax returns described in paragraph (c)(4)(iii) of this section. However, the patron may not amend any return that was due (without regard to any extensions) prior to the receipt of the notification by the patron.

To the extent any passthrough cannot be used by the patron due to the tax liability limitation of section 46(a)(3), that patron may carry back and carry over the amount of unused credit in accordance with the rules of section 46(b). The patron's nonenergy credit passthrough is added to, and used with, the patron's nonenergy credit earned in that first taxable year as if it were also nonenergy credit earned by the patron (rather than by the cooperative) during that year. The patron's energy credit passthrough is added to,

and used with, the patron's energy credit earned in that taxable year as if it were also energy credit earned by the patron during that year.

(e) Examples. The principles of paragraphs (b) through (d) of this section are illustrated by the following examples.

Example (1). Cooperative S, a calendar year taxpayer, operates both a sporting good purchasing activity and a cotton marketing activity. S places one asset, a cotton gin, in service during 1983 to be used in the cotton marketing activity. S earns investment tax credit on the cotton gin that it cannot use due to the limitation of section 46(a)(3). S treats the purchasing patrons and the marketing patrons as two separate allocation groups for purposes of computing patronage dividends. S elects to compute its patrons' passthrough under the alternative group method of allocation. S allocates the entire passthrough to the patrons of the purchasing group. Because it is reasonable to expect that the cotton gin will be used only by the cotton marketing group and never by the purchasing group, the cooperative will be required to reallocate the passthrough to the marketing group.

Example (2). (a) Cooperative Q, a calendar year taxpayer, markets wheat and eggs. Q places one asset, an egg sorter, in service during 1983 and earns credit that it cannot use due to the limitation of section 46(a)(3). Q treats its egg patrons and wheat patrons as two separate allocation groups for purposes of computing patronage dividends. Q elects to compute its patrons' passthrough under the alternative group method of allocation. Because the cooperative reasonably expects the property to be used only by the egg group, patrons of the egg group will receive 100 percent of the passthrough for 1983.

(b) For 1984, Q's credit earned is $60,000, consisting of $12,500 for a wheat grinder reasonably expected to be used only by the wheat group, $27,500 for an egg washer reasonably expected to be used only by the egg group, and $20,000 for energy property reasonably expected to be used 75 percent of the time for marketing wheat and 25 percent of the time for marketing eggs. Of the $60,000 credit earned $50,000 is nonenergy and $10,000 (of the $20,000 credit earned for energy property) is energy credit. Q has no unused credit from years prior to 1978. Q's tax liability for 1984 before application of investment credit is $20,000. Under section 46(a)(3), Q's tax liability limitation is $20,000. Thus, $20,000 of credit is used against Q's tax liability and $40,000 of the $60,000 credit is passed through. Since under §1.46-1(m) nonenergy credit is considered used first, $20,000 of the nonenergy credit is used by the cooperative. The nonenergy credit passthrough is $30,000 (*i.e.*, $50,000 minus $20,000) and the energy credit passthrough is $10,000. The credit earned on behalf of each group and passed through to each group is determined as follows:

Credit Earned	*Nonenergy*	*Energy*
Wheat	$20,000 (*i.e.*, $12,5000 + (.75 x $10,000))	$7,500 (*i.e.*, .75 x $10,000)
Egg	$30,000 (*i.e.*, $27,500 + (.25 x $10,000))	$2,500 (*i.e.*, .25 x $10,000)
Total	$50,000	$10,000
Allocation—wheat passthrough	$12,000 (*i.e.*, $30,000 x $20,000/$50,000)	$7,500 (*i.e.*, $10,000 x $7,500/$10,000)
egg passthrough	$18,000 (*i.e.*, $30,000 x $30,000/$50,000)	$2,500 (*i.e.*, $10,000 $2,500/$10,000)

(c) For 1984, Q allocates its passthrough to patrons on the basis of distributions. Q's distributions to patrons total $60,000 to the wheat group and $100,000 to the egg group. Q's distributions to patron A, a wheat producer, and patron B, an egg producer, are as follows:

	patron A	*patron B*
per unit retain allocation in cash	$4,000	$15,000
qualified per unit retain certificate	1,000	2,500
nonqualified per unit retain certificate	2,000	1,500
patronage dividend consisting of cash and qualified and nonqualified written notices of allocation	3,000	1,000
total	$10,000	$20,000

Q's passthrough to patrons A and B is determined as follows:

	NONENERGY	*ENERGY*
PATRON A	$2,000 (*i.e.*, $12,000 x $10,000/$60,000	$1,250 (*i.e.*, $7,500 x $10,000/$60,000
PATRON B	$3,600 (*i.e.*, $18,000 x $20,000/$100,000	$500 (*i.e.*, $2,500 x $20,000/$100,000)

Example (3). (a) In 1982, cooperative T, a calendar year taxpayer, places in service nonenergy property, and earns an investment credit of $10,000. All of it is unused credit due to the limitation of section 46(a)(3). Under the general rule of paragraph (c)(2) of this section, the cooperative allocates $1,000 of passthrough to A and $2,000 to B on the basis of business done with or for patrons.

(b) On January 15, 1984, T notifies patrons A and B of their share of the passthrough on their forms 1099-PATR for 1983. T reports the information contained in the patrons' notifications to the Internal Revenue Service on forms 1096 and 1099-PATR for 1983. Patrons A and B report the passthrough on the first tax return due after January 15, 1984.

(c) A is an individual and a calendar year taxpayer. In addition to the passed-through credit, A has $200 of nonenergy credit earned in 1983. In computing A's 1983 taxes, A finds that $500 of A's total $1,200 nonenergy credit cannot be used due to the limitation of section 46(a)(3). A carries the unused investment credit back and over in accordance with the rules of section 46(b).

(f) *Recapture or adjustments of investment credit*—(1) *Recapture.* If an event, such as a disposition of section 38 property by a cooperative, gives rise to a recapture determination, section 47 and the regulations thereunder apply as if the cooperative had claimed and used the credit against its tax liability in the credit year without regard to the amount of any passthrough. (See, however, §1.46-10(c)(4)(ii) for rules with regard to *de*

minimis amounts of passthrough credit that will not be recaptured.) Thus, the increase in tax under §1.47-1(a)(1)(i) for a cooperative's recapture year is not affected by the amount passed through in the credit year. Nor will such an increase in tax affect the ability of patrons to carry the passedthrough credit back or over. The terms "credit year", "recapture year" and "recapture determination" are defined in §1.47-1(a)(1)(ii).

(2) *Increase or decrease in amount of credit earned.*

(i) If the amount of credit earned by a cooperative for any credit year is increased or decreased as a result of any determination within the meaning of section 1313(a) of the Code, the rules of paragraphs (f)(2)(ii), (iii), (iv) and (v) of this section apply.

(ii) If the adjustment decreases the amount of the credit earned for the credit year, the adjustment generally will be treated like any other adjustment of the cooperative's tax liability for the credit year. In addition, if the amount of the decrease in credit exceeds the amount of the credit earned that was reported on the cooperative's income tax return as reducing its tax liability, the excess generally will be treated as an additional tax liability at the cooperative level in the credit year. Therefore, the excess will be treated as it the cooperative had claimed and used such excess against its tax liability in the credit year without regard to the amount of any passthrough. This adjustment will not affect the ability of the patrons to claim the credit or to carry the passthrough back or over.

(iii) In the event that (A) the amount of credit earned for any credit year is decreased as a result of a determination within the meaning of section 1313(a) of the Code and the decrease is due to an intentional overstatement by the cooperative, whether direct or indirect, of the amount of unused credit for any credit year, or (B) the cooperative is for any reason unable to satisfy the tax liability resulting from a determinaiton within the meaning of 1313(a) of the Code, that decreases the amount of credit earned for any credit year, the Internal Revenue Service shall have the authority to make an appropriate adjustment to the tax liability of each patron to whom the unused credit was passed by disallowing any passthrough claimed by a patron with respect to the credit that was decreased by the determination. If such an adjustment is made to the tax liability of a patron, the corresponding decrease in the amount of the credit earned for the year will not be treated like an adjustment of the cooperative's tax liability for the credit year.

(iv) The provisions of paragraph (f)(2)(iii) of this section are illustrated by the following example.

Example. Cooperative X earns $100 of credit in 1982, all of which is unused credit that is passed through in equal amounts under the rules of §1.46-10(c), to the cooperative's patrons A,B,C, and D. Assume that patrons A,B, and C each use their share of the passthrough to offset $25 of tax liability, but that patron D has no tax liability against which to offset the passthrough and that patron D does not carry the passthrough back or over under the rules of section 46(b). If, as a result of a determination under section 1313(a), the $100 credit earned by the cooperative is disallowed, but the cooperative is insolvent and unable to satisfy the resulting $100 tax liability, the Internal Revenue Service may disallow the $25 passthrough claimed by patrons A,B, and C. The Internal Revenue Service, however, may not make any adjustment in the case of patron D because patron D did not use the $25 passthrough to offset any tax liability. If an adjustment is in fact made to the tax liability of patrons A,B, and C, their $75 share of the decrease in the credit would not be treated as an adjustment to the tax liability of the cooperative. The $25 of unused credit passed through to patron D, however, could not be used by patron D in any taxable year.

(v) An increase in the amount of credit earned is used at the cooperative level to the extent that the limitation based on amount of tax (contained in section 46(a)(3)) for the credit year exceeds the credit previously used and not recaptured at the cooperative level. To the extent an increase in the amount of credit cannot be used at the cooperative level for the credit year; the increase must be passed through as an additional passthrough, as far as is practicable, to the patrons of that credit year. See paragraph (f)(4)(ii) of this section, relating to *de minimis* amounts of additional passthrough. See paragraph (f)(4) of this section for rules that apply when a cooperative makes an additional passthrough under this paragraph.

(3) *Change in tax liability limitation.* (i) If a cooperative's limitation based on amount of tax under section 46(a)(3) is increased or decreased for a credit year as a result of any determination within the meaning of section 1313(a) of the Code, the rules of paragraphs (f)(3)(ii) and (iii) of this section apply.

(ii) If a cooperative's limitation based on the amount of tax under section 46(a)(3) is increased for the credit year, and sufficient credit was earned for the credit year to offset that increase, the credit may be used at the cooperative level only if the cooperative has not yet notified its patrons of a passthrough of the credit or reported the passthrough to the Internal Revenue Service for the credit year. If the cooperative has notified its patrons of a passthrough of the credit or reported the passthrough to the Internal Revenue Service for the credit year, the cooperative's increase in tax liability may not be offset by that credit. However, an increase in the cooperative's limitation based on amount of tax does not affect the ability of patrons to use the full amount of the credit passed through for the credit year.

(iii) If the cooperative's limitation based on amount of tax is decreased for a credit year, the amount of credit that becomes unused credit because of the decrease must be passed through as an additional passthrough, as far as is practicable, to the patrons of the credit year. See paragraphs (f)(4)(ii) of this section, relating to *de minimis* amounts of additional passthrough. See paragraph (f)(4) of this section for rules that apply when a cooperative makes an additional passthrough under this subdivision (iii).

(4) *Additional passthrough.* If a cooperative must make an additional passthrough under paragraph (f)(2) or (3)(iii) of this section, the following rules apply:

(i) The cooperative must determine the amount to be passed through to each patron under the principles of paragraph (c)(2) of this section (or paragraph (c)(3) of this section if an election under that paragraph is in ef-

fect for the year the credit was earned),

(ii) If the additional amount to be passed through to a patron is less than $10, the cooperative may, but is not required to, notify the patron of the amount. To the extent notification is not made because the patron's passthrough is less than $10, the credit may not be used by any patron or the cooperative. Additionally, to the extent notification is not made, that amount of the passthrough is not subject to recapture under section 47 or paragraph (f)(1) of this section.

(iii) Except as provided in paragraph (f)(4)(ii) of this section, the cooperative must notify its patrons and the Internal Revenue Service of any additional passthrough on a statement that identifies the cooperative making the passthrough, the patron receiving the passthrough, and the amount of each type of passthrough. The notification must state that the passthrough must be reported on any one of the patron's income tax returns described in paragraph (c)(4)(iii) of this section, to the extent the passed through credit does not exceed the section 46(a)(3) tax liability limitation. To the extent any portion of the passed through credit cannot be used by the patron due to the tax liability limitation of section 46(a)(3), the patron may carry back or carry over the amount of the unused credit in accordance with the rules of section 46(b). The notification must be sent to the patrons within the time for sending the patrons the first Form 1099-PATR that is due after the adjustment is made. The cooperative must also send the passthrough information to the Internal Revenue Service within the time for filing the first forms 1096 and 1099-PATR that are due after the adjustment is made.

(iv) Any credit that cannot be allocated in this manner because, for example, a patron cannot be located after reasonable effort, shall increase amounts of additional passthrough of each type (as described in) paragraph (c)(1)(ii) of this section) available for passthrough to those patrons of the credit year who can be located.

(g) *Transitional rules*—(1) *Certain taxable years.* (i) Except as provided in (g)(1)(ii) of this section, for taxable years of a cooperative ending after October 31, 1978, and before [31 DAYS AFTER PUBLICATION OF THESE PROPOSED AMENDMENTS AS A FINAL REGULATION], any method of determining the passthrough and allocating the unused credit to patrons that is reasonable in light of the statutory language of section 316 of the Revenue Act of 1978, and the legislative history of that section, will be acceptable.

(ii) For taxable years of a cooperative ending after October 31, 1978, and before [31 DAYS AFTER PUBLICATION OF THESE PROPOSED AMENDMENTS AS A FINAL REGULATION], a cooperative may elect to recompute the allocation of unused credit in accordance with the rules of this section. Except as provided in section 6511, the effect of the election is to make all the rules contained in this section applicable to all taxable years of the cooperative ending after October 31, 1978. The cooperative makes an election under this paragraph by attaching to an amended return (or original return, as the case may be) for each of the years affected a statement that it elects to recompute the allocation of unused credit under §1.46-11(g)(1)(ii). The cooperative must notify the patrons of the adjustments, if any, due to the election under this subdivision (ii). The adjustments must be made under the principles of this section. In no event will the cooperative and its patrons be allowed an aggregate credit for taxable years ending after October 31, 1978 and before [31 DAYS AFTER PUBLICATION OF THESE PROPOSED AMENDMENTS AS A FINAL REGULATION] greater than would have been allowed if the regulations had been applied in the first instance for those taxable years.

(2) *Certain carryovers.* A cooperative that has credit carryovers deriving from taxable years ending before November 1, 1978, shall continue to carry the credit forward for the time prescribed in section 46(b). The amount of the credit is not recomputed under this section. Credit carried over under this paragraph (g)(2) shall be used by the cooperative prior to credits earned during the current taxable year. Thus, the carryovers may have the effect of increasing the amount of unused credit earned in taxable years ending after October 31, 1978 and available to be passed through to patrons. However, no amount of credit earned in taxable years ending before November 1, 1978, and carried over shall be passed through to patrons.

(3) *Patrons' carryback.* Patrons that are subject to the carryback provisions of section 46(b) shall carry back unused credit deriving from a cooperative's passthrough to those taxable years allowed by section 46 without regard to the effective date of this section.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 22, 1983; 11:39 a.m., and published in the issue of the Federal Register for December 27, 1983, 48 F.R. 56965)

Withdrawal of Notice of Proposed Rulemaking

Books and Records of Foreign Corporations and Operations

LR-133-78

SUMMARY: This document withdraws the notice of proposed rulemaking relating to books and records of foreign corporations and operations that appeared in the FEDERAL REGISTER on January 23, 1981 (46 FR 7401) [1981-1 C.B. 751]. The notice is being withdrawn because Congress, in the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462], has addressed the problems that were the focus of the proposed regulations.

FOR FURTHER INFORMATION CONTACT: Herman B. Bouma of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-133-78), 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document withdraws the notice of proposed rulemaking that appeared in the FEDERAL REGISTER on January 23, 1981 (46 FR 7401). The notice proposed amendments to the regulations under sections 482, 964, and 6001 of the Internal Revenue Code of 1954. The principal purpose of the proposed amendments was to aid the Internal Revenue Service in obtaining books and records of foreign corporations and operations. Aware of the problems the Service was experiencing in this area, Congress provided in Subtitle F of Title III of the Tax Equity and Fiscal Responsibility Act of 1982 a series of compliance provisions pertaining to transactions outside the United States or involving foreign persons. Because of these provisions, the regulations proposed on January 23, 1981, are no longer necessary.

DRAFTING INFORMATION

The principal author of this document is Herman B. Bouma of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this document, both in matters of substance and style.

Withdrawal of proposed amendments

The proposed amendments to 26 CFR Part 1 relating to books and records of foreign corporations and operations and published in the FEDERAL REGISTER on January 23, 1981 (46 FR 7401), are hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 7, 1983, 8:45 a.m., and published in the issue of the Federal Register for November 8, 1983, 48 F.R. 51330)

Withdrawal of Notice of Proposed Rulemaking

Work Incentive Program Credit

LR-200-78

SUMMARY: This document withdraws the notice of proposed rulemaking relating to the work incentive program (WIN) credit that was published in the FEDERAL REGISTER on April 30, 1980 (45 FR 28758). The WIN credit was terminated by section 261(b)(2)(B)(i) of the Economic Recovery Tax Act of 1981 for wages paid or incurred to an employee in any taxable year beginning after December 31, 1981. As a result of this termination, the Internal Revenue Service has decided to withdraw the notice of proposed rulemaking.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3516) (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document withdraws the notice of proposed rulemaking that appeared in the FEDERAL REGISTER on April 30, 1980 (45 FR 28758). That notice of proposed rulemaking contained proposed amendments to the regulations relating to the WIN credit. Several comments were received with respect to the proposed regulations, but no public hearing was requested or held.

Section 261(b)(2)(B)(i) of the Economic Recovery Tax Act of 1981 added section 50B(a)(5) to the Internal Revenue Code of 1954 which terminated the WIN credit for wages paid or incurred to employees in any taxable year beginning after December 31, 1981. However, section 261 of the Act also added "eligible work incentive employees" as a new targeted group for which a credit under section 44B is available for later taxable years. (See sections 44B and 51(d)(1)(H)).

Withdrawal of Notice of Proposed Rulemaking

The notice of proposed rulemaking containing proposed amendments to 26 C.F.R. Part 1 relating to the WIN credit that was published in the FEDERAL REGISTER (45 FR 28758) on April 30, 1980, is hereby withdrawn.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 7, 1983, 8:45 a.m., and published in the issue of the Federal Register for November 8, 1983, 48 F.R. 51331)

Notice of Proposed Rulemaking

Minimum Addition to Reserve for Losses on Loans of Mutual Savings Banks

LR-152-79

SUMMARY: This document contains proposed regulations imposing a requirement of a minimum addition of reserve for losses on loans of mutual savings banks and other organizations to which section 593 of the Internal Revenue Code of 1954 applies. Certain of the proposed regulations reflect changes to the applicable law under the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]; others are intended to clarify existing regulations provisions. The proposed regulations would provide affected financial institutions with the necessary guidance in complying with the tax laws.

DATES: Written comments and requests for a public hearing must be delivered or mailed by February 14, 1984. Generally, the amendments are proposed to apply to taxable years beginning more than sixty days after publication of this notice as a final Treasury decision. With respect to certain distributions in redemption, the amendments are proposed to apply to certain distributions made on or after January 1, 1981. The amendments treating certain stock associations as mutual savings banks are proposed to be effective for taxable years ending after August 13, 1983.

ADDRESS: Send comments and re-

quests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-152-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Susan Thompson Baker or George T. Magnatta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to clarify the Income Tax Regulations (26 CFR Part 1) under section 593 of the Internal Revenue Code of 1954. In addition, these amendments are proposed to conform the regulations to sections 243 and 245 of the Economic Recovery Tax Act of 1981 (95 Stat. 255) [Pub. L. 97-34, 1981-2 C.B. 256, 301]. These amendments are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

NEW RULES

This notice of proposed rulemaking contains new rules applicable to mutual savings banks, domestic building and loan associations, and cooperative banks without capital stock organized and operated for mutual pruposes and without profit (section 593 organizations). These new rules, which require that section 593 organizations make a minimum addition to their reserves for losses on qualifying real property loans and nonqualifying loans, are proposed in order to achieve consistency with the regulations under section 585, which contain a similar requirement with respect to other banking institutions.

CHANGES MADE BY THE ECONOMIC RECOVERY TAX ACT OF 1981

Section 243 of the Economic Recovery Tax Act of 1981 (ERTA) [Pub. L. 97-34, 1981-2 C.B. 256, 301] created an exception to the rule of section 593(e) that distributions from excess bad debt reserves of certain section 593 organizations are recaptured as ordinary income. Under the Act, this recapture rule does not apply to distributions to the Federal Savings and Loan Insurance Corporation in redemption of an interest in a section 593 organization originally received in exchange for financial assistance.

Additionally, ERTA provided that a bank (1) which has capital stock represented by shares, and (2) which is subject to, and operates under, Federal or State laws relating to mutual savings banks, is an organization that is eligible to compute its bad debt deduction under section 593. However, these organizations must compute their bad debt deduction under the percentage of taxable income method under the same rules applicable to building and loan associations (*i.e.*, 82 percent of their assets must be invested in qualified assets in order to receive the full 40-percent deduction and the reduction will be at three-fourths of one percent). ERTA also requires these stock organizations to recapture excess deductions to the extent required by section 593(e). Finally, ERTA provides that amounts paid to depositors of these organizations are deductible under section 591.

CLARIFYING AND CONFORMING CHANGES

These proposed amendments to the regulations also include clarifying changes to existing regulations. These changes include a renumbering of certain sections of the regulations under section 593 and the deletion of certain of those sections that pertained to taxable years beginning before January 1, 1963, or to taxable years beginning before July 12, 1969. These proposed amendments also clarify that section 593 organizations, like banking institutions subject to section 585, may adjust the amount of their addition to bad debt reserves, and thus change the amount of their bad debt decution, within the applicable period of limitations, subject only to the maximum and minimum requirements set forth in these regulations.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

NON-APPLICATION OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this proposed regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and no general notice of proposed rulemaking is required by 5 U.S.C. 553(b). Accordingly, no Regulatory Flexibility Analysis is required.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal authors of these proposed regulations are Susan Thompson Baker and George T. Magnatta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Paragraph (d)(3) of §1.166-4 is amended by removing "§§1.593-1 through 1.593-11" and inserting "§§1.593-1 through 1.593-8" in lieu thereof.

Par. 2. Section 1.581-2(b) is amended by removing the phrase "See section 593 and §1.593-1" and inserting in its place "See section 593 and §§1.593-1 through 1.593-8".

Par. 3. Section 1.591-1 is amended as follows:

1. Paragraph (a)(2) is amended by inserting "or a mutual savings bank described in section 591(b)" after "domestic building and loan association".

2. Paragraph (c)(2) is removed and paragraph (c)(1) is redesignated as paragraph (c)(2).

3. Paragraph (c)(2) as so redesignated is amended by inserting "and before the first day of the taxpayer's first taxable year ending after August 13, 1981," after "October 16, 1962," and by removing "; and" and inserting a period in lieu thereof.

4. A new paragraph (c)(1) is added which reads as follows:

§1.591-1 Deduction for dividends paid on deposits.

* * * * *

(c) *Effective date.* ***

(1) Dividends or interest paid or credited during a taxable year ending after August 13, 1981, by any taxpayer which (at the time of such payment or credit) qualifies as (i) a mutual savings bank (including a mutual savings bank which has capital stock represented by shares and which is subject to, and operates under, Federal or State laws relating to mutual savings banks), (ii) a domestic building and loan association (as defined in section 7701(a)(19)), (iii) a cooperative bank (as defined in section 7701(a)(32)), or (iv) any other savings institution chartered and supervised as a savings and loan or similar association under Federal or State law; and

* * * * *

Par. 4. Section 1.593-1 is removed.

Par. 5. Section 1.593-2 is removed.

Par. 6. Section 1.593-3 is removed.

Par. 7. Section 1.593-4 is redesignated as §1.593-1. Section 1.593-1 as so redesignated is amended to read as follows:

§1.593-1 Organizations to which section 593 applies.

The provisions of section 593 and §§1.593-2 through 1.593-8 (except 1.593-7), for taxable years ending after December 31, 1962, apply to (1) a mutual savings bank (including, for taxable years ending after August 13, 1981, a mutual savings bank described in section 591(b)), (2) a domestic building and loan association, or (3) a cooperative bank without capital stock organized and operated for mutual purposes and without profit. The term "thrift institution", as used in this section and §§1.593-2 through 1.593-8, refers to any such financial institution. For definition of the terms "domestic building and loan association" and "cooperative bank", see paragraphs (19) and (32), respectively, of section 7701(a).

Par. 8. Section 1.593-5 is redesignated as §1.593-2 and is amended to read as follows:

§1.593-2 Addition to reserves for bad debts.

(a) *In general.* As an alternative to a deduction from gross income under section 166(a) for specific debts which become worthless in whole or in part, a thrift institution is allowed a deduction under section 166(c) for a reasonable addition to a reserve for bad debts provided that the thrift institution adopts or has adopted the reserve method of treating bad debts in accordance with paragraph (b) of §1.166-1. The amount of the reasonable addition shall not exceed a maximum addition computed under §1.593-3(a) and, for taxable years beginning after sixty days after the publication of this notice as a final Treasury decision, shall be an amount at least equal to the amount computed under §1.593-3(b). For each taxable year the thrift institution shall include in its income tax return (or amended return) a computation of the amount of the addition determined under section 593 and the regulations thereunder showing the method used to determine that amount. The use of a particular method in the return for a taxable year is not a binding election by the taxpayer to apply that method either for that taxable year or for subsequent txable years. A thrift institution which adopts the reserve method is not entitled to charge off any bad debts under section 166(a) with respect to a loan (as defined in §1.593-8(a)).

(b) *Crediting to reserves.* The amount of the reasonable addition to a reserve for bad debts computed under §§1.593-3 and 1.593-4 shall be credited to a reserve for losses on qualifying real property loans or to a reserve for losses on nonqualifying loans, whichever is applicable. The reserves for bad debts of a thrift institution shall be established and maintained in accordance with the rules set forth in §1.593-5.

Par. 9. A new §1.593-3 is added to read as follows:

§1.593-3 Amount of addition to reserves.

(a) *Maximum addition.* The maximum reasonable addition to the reserve for losses on nonqualifying loans of a thrift institution is an amount computed, with respect to such nonqualifying loans, in the manner provided under section 585(b)(3) and §1.585-2(c). The maximum addition to the reserve for losses on qualifying real property loans is an amount equal to the larger of (i) the amount allowable under section 593(b)(2) and §1.593-4(b) (relating to the percentage of taxable income method); (ii) the amount allowable

under section 593(b)(3) and §1.593-4(c) (relating to percentage method); or (iii) the amount allowable under sections 593(b)(4), 585(b)(3) and §1.585-2(c)(1) (relating to the experience method), computed taking into account only qualifying real property loans.

(b) *Minimum addition.* For taxable years beginning after sixty days from the date of publication of this notice as a final Treasury decision, a thrift institution shall make a minimum addition to the reserve for losses on qualifying real property loans and a minimum addition to the reserve for losses on nonqualifying loans. The minimum addition to the reserve for losses on nonqualifying loans is an amount computed in the manner provided in section 585(b)(3)(A) and §1.585-2(c)(1)(ii). The minimum addition to the reserve for losses on qualifying real property loans is an amount equal to the lesser of (i) the amount allowable under section 593(b)(2) and §1.593-4(b) (relating to the percentage of taxable income method); (ii) the amount allowable under section 593(b)(3) and §1.593-4(c) (relating to the percentage method); or (iii) the amount allowable under section 585(b)(3)(A) and §1.585-2(c)(1)(ii) (relating to the experience method) computed taking into account only qualifying real property loans. In the event that the lesser of the amounts referred to in the preceding sentence is zero, the minimum addition to the reserve for losses on qualifying real property loans is zero.

Par. 10. Section 1.593-6 is removed.

Par. 11. Section 1.593-6A is redesignated as §1.593-4. Section 1.593-4 as so redesignated is amended as follows:

1. Its caption is amended to read "Addition to reserve for losses on qualifying real property loans".

2. Paragraph (b)(3) is amended by inserting "(which is not described in section 593(b))" after "mutual savings bank" in each of the two places where it appears, and by removing "paragraph (a)(1)(i) of §1.593-5" and inserting "§1.593-2(a)" in lieu thereof in each of the two places where it appears.

3. Paragraph (b)(5)(i) is amended by removing "§1.593-10" and inserting "§1.593-7" in lieu thereof.

4. Paragraph (b)(5)(iv) is amended by inserting "(eighteen forty-sixths, for taxable years ending after December 31,1978)" after "three-eighths" in each of the two places where it appears.

5. Paragraph (e) is amended by removing "paragraph (a)(1)(i) of §1.593-5" and inserting §1.593-2(a)" in lieu thereof and by removing the last sentence of paragraph (e).

6. Paragraphs (a) and (b)(2)(i) are amended as set forth below. Paragraph (b)(2)(ii) is amended be redesignating the example therein as "Example (1)", and by adding new examples (2) and (3) immediately following example (1) as so redesignated and by adding new paragraph (f) immediately following paragraph (e). The revised and added provisions read as follows:

§1.593-4 Addition to reserve for losses on qualifying real property loans.

(a) *In general*—(1) *Amount of addition determined for the taxable year.* For purposes of paragraph §1.593-2(a), the amount of the addition to the reserve for losses on qualifying real property loans for any taxable year beginning after July 11, 1969, is the amount which the taxpayer determines to constitute a reasonable addition to such reserve for such year. However, the amount so determined for such year shall be determined without regard to any amount charged for any taxable year against the reserve for losses on qualifying real property loans pursuant to §1.593-7 (relating to certain distributions to shareholders by a domestic building and loan association). The addition to the reserve shall be determined under section 593(b)(2), (3), or (4) (relating, respectively, to the percentage of taxable income method, the percentage method, and the experience method). See §1.593-3, for the maximum and minimum additions allowed. For each taxable year the taxpayer must include in its income tax return (or amended return) for such year a computation of the amount of the addition determined under this section. The use of a particular method in the return for a taxable year is not a binding election by the taxpayer to apply such method either for such taxable year or for subsequent taxable years. Thus, for example, in the case of a subsequent adjustment with respect to the income tax return (whether initiated by the taxpayer or by the Commissioner) which has the effect of increasing or decreasing taxable income, the amount of the addition to the reserve for losses on qualifying real property loans may be recomputed (subject to the rule of §1.593-3) under whichever method the taxpayer selects for the purpose of such recomputation, irrespective of the method initially applied for such taxable year.

* * * * *

(b) *Percentage of taxable income method.* ***

(2) *Reduction of applicable percentage in certain cases*—(i) *General rules.* If for the taxable year the percentage of the assets of a thrift institution, which are assets described in section 7701(a)(19)(C) (relating to assets of a domestic building and loan association) is less than—

(*a*) 82 percent of the total assets in the case of a thrift institution other than a mutual savings bank which is not described in section 591(b), the applicable percentage for such year provided by subparagraph (1) of this paragraph is reduced by three-fourth of 1 percentage point for each 1 percentage point of such difference; or

(*b*) 72 percent of the total assets in the case of a thrift institution which is a mutual savings bank which is not described in section 591(b), the applicable percentage for such year provided by subparagraph (1) of this paragraph is reduced by 1½ percentage points for each 1 percentage point of such difference.

If such percentage is less than 60 percent (50 percent for a taxable year beginning before 1973 in the case of a mutual savings bank not described in section 591(b)) of the total assets in the case of any thrift institution, section 593(b)(2) and this paragraph are not applicable. The percentage of to-

tal assets specified in this subparagraph is computed as of the close of the taxable year or, at the option of the taxpayer, may be computed on the basis of the average assets outstanding during the taxable year. Such average is determined by computing such percentage either as of the close of each month, as of the close of each quarter, or as of the close of each semiannual period during the taxable year and by using the yearly average of the monthly, quarterly, or semiannual percentages. A thrift institution which is a mutual savings bank (as defined in section 591) and which determines the amount of the reasonable addition for the taxable year to the reserve for losses on qualifying real property loans under this paragraph shall file for such taxable year a statement which shall show the amount of assets defined in paragraph (e) of §301.7701-13A as of the close of the taxable year and a brief description and the amount of all other assets, together with a description of the method used in determining such amounts. If the percentage specified in this subparagraph is computed by such thrift institution on the basis of the average assets outstanding during the taxable year, the statement shall also show such information as of the end of each month, each quarter, or each semiannual period and the manner of calculating the average.

(ii) *Examples.* The provisions of this subparagraph may be illustrated by the following examples: ***

Example (2). N is a mutual savings bank which has capital stock represented by shares (as defined in section 591(b)) to which section 593 applies. For its taxable year beginning in 1983, 80.5 percent of N's assets (computed as of the close of that year) constitute assets described in section 7701(a)(19)(C). N's assets which are assets described in section 7701(a)(19)(C) when computed on semiannual, quarterly, and monthly bases, constitute 79.8, 79.6 and 79.5 percent, respectively, of its total assets computed on the corresponding bases. N's applicable percentage for 1983 is 39.25 percent, determined as follows:

	Percent
Percentage of total assets specified in (*a*) of subdivision (i) of this subparagraph	82.0
Percentage of total assets constituting assets described in section 7701(a)(19)(C)	80.5
Difference	1.5
Applicable percentage determined under table in subparagraph (1) of this paragraph	40.0
Reduction of applicable percentage required by (*a*) of subdivision (i) of this subparagraph (¾ of 1 percentage point for each full percentage point of difference)	.75
Applicable percentage	39.25

Example (3). Assume the same facts as in example (2) except that N is a mutual savings bank other than a mutual savings bank described in section 593(b) and 70.5 percent of N's assets (computed as of the close of that year) constitute assets described in section 7701(a)(19)(C). N's assets which are assets described in section 7701(a)(19)(C), when computed on semiannual, quarterly, and monthly bases, constitute 69.8, 69.6 and 69.5 percent, respectively, of its total assets computed on the corresponding bases. N's applicable percentage for 1983 is 38.5 percent, determined as follows:

	Percent
Percentage of total assets specified in (*b*) of subdivision (i) of this subparagraph	72.0
Percentage of total assets constituting assets described in section 7701(a)(19)(C)	70.5
Difference	1.5
Applicable percentage determined under table in subparagraph (1) of this paragraph	40.0
Reduction of applicable percentage required by (*b*) of subdivision (i) of this subparagraph (1½ percentage points for each full percentage point of difference)	1.5
Applicable percentage	38.5

* * * * *

(f) *Definitions.* For purposes of this section—

(1) *Surplus, undivided profits, and reserves.* The term "surplus, undivided profits, and reserves" means the amount by which the total assets of the taxpayer exceed its total liabilities. The determination of such total assets and total liabilities shall conform to the method of accounting employed by the taxpayer in determining taxable income and to the rules applicable in determining its earnings and profits. Total deposits or withdrawable accounts (as defined in subparagraph (3) of this paragraph but determined as of the beginning of the taxable year) shall be considered a liability. In the case of a domestic building and loan association or a mutual savings bank described in section 591(b) having permanent nonwithdrawable capital stock represented by shares, the paid-in amount of such stock shall also be considered a liability. However, reserves for contingencies and other reserves which are mere appropriations of surplus are not liabilities for purposes of this section.

(2) *Total assets.* The term "total assets" means the sum of money (including time or demand deposits with, or withdrawable accounts in, any financial institution), plus the aggregate of the adjusted basis (determined under §1.1011-1) of the property other than money held by the taxpayer. For special rules with respect to adjustments to basis in the case of property acquired by the taxpayer in a transaction described in section 595(a), see section 595.

(3) *Total deposits or withdrawable accounts.* The term "total deposits or withdrawable accounts" means the total of the amounts placed with the taxpayer for deposit or investment. Such term also includes earnings outstanding on the books of account of the taxpayer at the close of the taxable year which have been credited as dividends or interest upon such deposits or withdrawable accounts prior to the close of such taxable year, and which are withdrawable on demand subject only to customary notice of intention to withdraw. In the case of a domestic building and loan association or a mutual savings bank described in section 591(b), however, such phrase does not include permanent notwithdrawable capital stock represented by shares, or earnings credited thereon.

Par. 12. Section 1.593-7 is redesignated as §1.593-5. Section 1.593-5 as so redesignated is amended as follows:

1. Paragraph (a)(1) is amended by removing "paragraph (b) of §1.593-5" and inserting in its place "§1.593-2".

2. Paragraph (a)(2)(ii) is amended by removing "subparagraph (1) or (2) of §1.593-5(a) (whichever applies) as the addition to such reserve for such year year" and inserting "§1.593-3" in lieu thereof.

3. Paragraph (b)(1)(ii) is amended by removing "(determined under §1.593-1 or §1.593-2)" and inserting "(determined under section 593)" in lieu thereof.

4. Example (1)(i) of paragraph (b)(5) is amended by removing "under §1.593-1 (relating to additions to reserve for bad debts) by reference to §1.593-9 (relating to taxable income for taxable years beginning in

1962 and ending in 1963)".

5. The references "§1.593-4", "§1.593-5", "§1.593-8", and "§1.593-10" are removed and "§1.593-1", "§1.593-2", "§1.593-6", and "§1.593-7", respectively, are inserted in lieu thereof in each place they appear as a reference in §1.593-5 as so redesignated.

Par. 13. Section 1.593-8 is redesignated as §1.593-6. Section 1.593-6 as so redesignated is amended as follows:

1. The references "§1.593-4" and "§1.593-7" are removed and "§1.593-1" and §1.593-5", respectively, are inserted in lieu thereof in each place that they appear as a reference in §1.593-6 as so redesignated.

2. Paragraph (b)(1)(i) is amended by removing the phrase "(under the principles of paragraph (d)(2) of §1.593-1)".

3. Paragraph (c)(1)(ii) is amended by removing the phrase "under the principles of paragraph (d)(2) of §1.593-1".

4. The first sentence of paragraph (d) is removed and the following new sentence is inserted in its place: "Any portion of the taxpayer's pre-1952 surplus which, under paragraph (a) of this section, is deemed to be included in the opening balance of the reserve for losses on qualifying real property loans shall not be treated as a reserve for bad debts for any purpose other than computing for any taxable year the amount determined under the method described in paragraph (b), (c), or (d) of §1.593-4 (relating, respectively, to the percentage of taxable income method, the percentage method, and the experience method)."

Par. 14. Section 1.593-9 is removed.

Par. 15. Section 1.593-10 is redesignated as §1.593-7. Section 1.593-7 as so redesignated is amended as follows:

1. Paragraph (b)(1) and (2) is amended by inserting "or institution" after "association" in both places that "association" appears.

2. Paragraph (b)(3)(i) is amended by removing "§1.593-6 or §1.593-6A (whichever is applicable)" and inserting "§1.593-4" in lieu thereof.

3. Paragraph (b)(3)(ii)(*b*) is amended by removing "paragraph (d) of §1.593-6 or paragraph (d) of §1.593-6A, whichever is applicable" and inserting "§1.593-4" in lieu thereof.

4. Examples (1)(i), (2)(i), and (3)(i) of paragraph (d) are amended by removing the phrase "described in paragraph (d) of §1.593-6".

5. The references "section 593(f)", "§1.593-7", and "§1.593-8", are removed and "section 593(e)", "§1.593-5", and "§1.593-6", respectively, are inserted in lieu thereof in each place that they appear as a reference or as part of a reference in §1.593-7 as so redesignated.

6. Paragraph (a) is revised to read as follows:

§1.593-7 Certain distributions to shareholders by a domestic building and loan association.

(a) *In general.* Section 593(e) provides that if a domestic building and loan association (as defined in section 7701(a)(19) and the regulations thereunder) distributes property after December 31, 1962, or an institution that is treated as a mutual savings bank under section 591(b) distributes property during a taxable year ending after August 13, 1981, to a shareholder with respect to its stock and if the amount of such distribution is not allowable to the association as a deduction under section 591 (relating to deduction for dividends paid on deposits), then, notwithstanding any other provision of the Code, the distribution shall be treated as provided in paragraphs (b) and (c) of this section. For purposes of the preceding sentence, the term "distribution" includes any distribution in redemption of stock to which section 302(a) or 303 applies, or in partial or complete liquidation of the association or institution, as well as any other distribution which the association or institution may make to a shareholder with respect to its stock. For definition of the term "property", see section 317(a). For determination of the amount of a distribution, see section 301(b). For taxable years beginning after July 11, 1969, this paragraph is not applicable to any transaction to which section 381 (relating to carryovers in certain corporate acquisitions) and the regulations thereunder apply. This paragraph also does not apply to any distribution made on or after January 1, 1981, to the Federal Savings and Loan Insurance Corporation in redemption of an interest in an association, if the interest was originally received by the Federal Savings and Loan Insurance Corporation in exchange for financial assistance under section 406(f) of the National Housing Act (12 U.S.C. §1729(f)).

* * * * *

Par. 16. Section 1.593-11 is redesignated as §1.593-8. In paragraph (b)(1) of §1.593-8 as so redesignated, the phrase "For purposes of §§1.593-4 through 1.593-10," is removed and the phrase "For purposes of §§1.593-1 through 1.593-7," is inserted in its place. In paragraph (c) of §1.593-8 as so redesignated, the phrase "For purposes of §§1.593-4 through 1.593-9," is removed and the phrase "For purposes of §§1.593-1 through 1.593-6," is inserted in its place.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 16, 1983, 8:45 a.m., and published in the issue of the Federal Register for December 19, 1983, 48 F.R. 56083)

Notice of Proposed Rulemaking

Property Transferred in Connection With the Performance of Services

LR-16-80

SUMMARY: This document contains proposed amendments to the existing regulations under section 83 of the Internal Revenue Code of 1954, relating to property transferred in connection with the performance of services. The proposed regulations reflect the changes made to the applicable law by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], and clarify certain provisions of the existing regulations. The regulation would provide the public with the guidance needed to comply

with section 83 and would affect certain taxpayers who participate in the transfer of property in connection with the performance of services.

DATES: Written comments and requests for a public hearing must be delivered or mailed by January 16, 1984. The amendments to §§1.83-3(e) and -6(a)(2) are proposed to be effective for property transferred after June 30, 1969. The additions of paragraphs (j) and (k) to §1.83-3 are proposed to be effective for property transferred after December 31, 1981.

ADDRESS: Send comments and a request for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR::T [LR-16-80], 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Bruce Jurist, of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3238, not a toll free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 83 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to section 252 of the Economic Recovery Tax Act of 1981 (95 Stat. 260, 26 U.S.C. 83(c)) and to make certain corrective and clarifying changes to the existing regulations under section 83. They are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A State. 917; 26 U.S.C. 7805).

EXPLANATION OF PROVISIONS

Section 83 deals with transactions in which property is transferred in connection with the performance of services. Section 1.83-3(e) defines "property" for purposes of section 83 and excludes from that term an "unfunded and unsecured promise to pay money in the future." These proposed regulations expand this exclusion so as to exclude from the definition of "property" an unfunded and unsecured promise to pay property other than money in the future.

Section 83(c)(3), as added by section 252(a) of the Economic Recovery Tax Act of 1981, provides that so long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in the property will be considered to be subject to a substantial risk of forfeiture and not transferable. The proposed addition of §1.83-3(j) to the regulations provides that for purposes of section 83 and the regulations thereunder, the section 16(b) restriction will be considered to have lapsed after its initial six-month period, notwithstanding any extension of such restriction under the rules of section 16(b) of the Securities Exchange Act of 1934.

Section 252(b) of the Economic Recovery Tax Act of 1981 provides that property is subject to a substantial risk of forfeiture and is not transferable so long as such property is subject to a restriction on transfer to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130((10/5/72) 37 FR 20937; 17 CFR 211.120) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; 17 CFR 211.135). The proposed addition of §1.83-3(k) to the regulations reflects the above-cited statute.

Section 1.83-6(a)(2) contains a special rule relating to the allowance of a deduction by an employer for property transferred to an employee in connection with the employee's performance of services. The regulation provides that the employer is entitled to a deduction for the taxable year in which the amount is includible in the employee's income, but only if the employer deducts and withholds upon such amount in accordance with section 3402 of the Code. The proposed amendment provides exceptions to the deduct and withhold requirement in cases where the employer either has no obligation to withhold under that section, or the employer is unable to withhold but includes the compensation on a Form W-2 or on an information return filed with the Service.

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the notice and public procedure requirements of 5 U.S.C. 553 do not apply because the rules proposed are interpretative. Accordingly, a Regulatory Flexibility Analysis is not required.

DRAFTING INFORMATION

The principal author of these proposed regulations is Philip R. Bosco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, other personnel in the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.83-3 is amended by revising paragraph (e) and adding new paragraphs (j) and (k). The amended section reads as follows:

§1.83-3 Meaning and use of certain terms.

* * * * *

(e) *Property.* For purposes of section 83 and the regulations thereunder, the term "property" includes real and personal property other than either money or an unfunded and unsecured promise to pay money or property in the future. The term also includes a beneficial interest in assets (including money) which are transferred or set aside from the claims of creditors of the transferor, for example, in a trust or escrow account. See, however, §1.83-8(a) with respect to employee trusts and annuity plans subject to section 402(b) and section 403(c). In the case of a transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, only the cash surrender value of the contract is considered to be property. Where rights in a contract providing life insurance protection are substantially nonvested, see §1.83-1(a)(2) for rules relating to taxation of the cost of life insurance protection.

* * * * *

(j) *Sales which may give rise to suit under section 16(b) of the Securities Exchange Act of 1934*—(1) *In general.* For purposes of section 83 and the regulations thereunder, if the sale of property at a profit within six months after the purchase of the property could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are treated as subject to a substantial risk of forfeiture and as not transferable until the expiration of such period.

(2) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). On January 1, 1983, X corporation sells to P, a principal officer of X, in connection with P's performance of services, 100 shares of X corporation stock at $10 per share. At the time of such sale the fair market value of the corporation stock is $100 per share. P, as a principal officer of X, is liable to suit under section 16(b) of the Securities Exchange Act of 1934 for recovery of any profit from any sale and purchase or purchase and sale of X corporation stock within a six-month period. Because the section 16(b) restriction is applicable to P, P's rights in the 100 shares of stock purchased on January 1, 1983, are treated as subject to a substantial risk of forfeiture and as not transferable through June 29, 1983. P does not include any amount with respect to the stock purchase in gross income as compensation on the date of purchase. On June 30, 1983, the fair market value of X corporation stock is $250 per share. P must include $24,000 (100 shares of X corporation stock x $240 ($250 fair market value per share less $10 price paid by P for each share)) in gross income as compensation on that date.

Example (2). Assume the same facts as in example (1) except that on June 1, 1983, X corporation sells to P an additional 100 shares of X corporation stock at $20 per share. At the time of such sale the fair market value of the X corporation stock is $150 per share. On June 30, 1983, P must include $24,000 in gross income as compensation with respect to the January 1, 1983 purchase. On November 30, 1983, the fair market value of X corporation stock is $200 per share. Accordingly, on that date P must include $18,000 (100 shares of X corporation stock x $180 ($200 fair market value per share less $20 price paid by P for each share)) in gross income as compensation with respect to the June 1, 1983 purchase.

(3) *Effective date.* Paragraph (j) of this section shall apply to property transferred after December 31, 1981.

(k) *Special rule for certain accounting rules.* (1) For purposes of section 83 and the regulations thereunder, property is subject to substantial risk of forfeiture and is not transferable so long as such property is subject to a restriction on transfer to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; 17 CFR 211.135).

(2) *Effective date.* Paragraph (k) of this section shall apply to property transferred after December 31, 1981.

Par. 2. Section 1.83-6 is amended by revising paragraph (a). The amended section reads as follows:

§1.83-6 Deduction by employer.

(a) *Allowance of deduction*—***

(2) *Special rule.* If the service provider is an employee of the person for whom services were performed, such deduction is allowed for the taxable year of the employer in which or with which ends the taxable year of the employee in which such amount is includible as compensation, but only if the employer deducts and withholds upon such amount in accordance with section 3402. A deduction will not be disallowed under the preceding sentence if the employer does not deduct and withhold because—

(i) A person other than the employer is required to deduct and withhold upon such compensation and such other person deducts and withholds on such amount but does not claim the deduction;

(ii) The employee's wages do not exceed the amount exempt from withholding;

(iii) The amount is excluded from the employee's gross income under a provision such as section 79, section 101(b) or subchapter N; or

(iv) The employer is unable to deduct and withhold and the employer includes the amount of such compensation on a Form W-2 or on an information return filed with the Internal Revenue Service in the case where the compensation is not "wages" as defined in section 3401(a).

The employer or other person will be considered to deduct and withhold if such person deducts and withholds by the day on which the last withholding payment for such person's taxable year is due. For taxable years of employees ending before July 21, 1978, such deduction is allowed for the taxable year of the employer in which or with which ends the taxable year of the employee in which such amount is includible as compensation, if either the employer deducts and withholds upon such amount in accordance with section 3402 or the employee includes such amount in gross income as compensation for such taxable year of the employee.

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ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 15, 1983; 8:45 a.m., and published in the issue of the Federal Register for November 16, 1983, 48 F.R. 52079)

Notice of Proposed Rulemaking

Allocation of the 1,000 barrel amount within a related group under the Crude Oil Windfall Profit Tax Act of 1980

LR-66-80

SUMMARY: This document contains proposed regulations relating to the allocation within a related group of the 1,000 barrel amount for independent producers subject to a reduced rate of windfall profit tax on domestic crude oil, imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1,2]. The regulations would provide the public with guidance needed to comply with the Act.

DATES: These proposed regulations would apply and be effective with respect to all crude oil removed (or deemed removed) from the premises after February 29, 1980. Written comments and requests for a public hearing must be delivered or mailed by March 12, 1984.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-66-80), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3297) (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the proposed Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980 (26 CFR Part 51) under section 4992(e) of the Internal Revenue Code of 1954. The proposed regulations are required to implement section 4992(e) as added by section 101(a)(1) of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1,2], and are to be issued under the authority contained in sections 4992(e), 4997(b), and 7805 of the Internal Revenue Code of 1954 (94 Stat. 236, 26 U.S.C. 4992(e); 94 Stat. 249, 26 U.S.C. 4997(b); 68A Stat. 917, 26 U.S.C. 7805).

IN GENERAL

The windfall profit tax is a temporary excise tax imposed upon the windfall profit from domestically produced taxable crude oil removed from the premises during each taxable period (generally a calendar quarter). Generally, the rate of tax on tier 1 and tier 2 oil is 70 percent and 60 percent, respectively. However, certain tier 1 and tier 2 oil produced by independent producers is subject to a 50 percent and 30 percent rate of tax, respectively. This oil subject to the reduced rate of tax is "independent producer oil."

"Independent producer oil" is that portion of an independent producer's qualified production for the quarter that does not exceed such person's independent producer amount for the quarter. A person's independent producer amount for any quarter is the product of 1,000 barrels multiplied by the number of days in the quarter. However, this 1,000 barrel amount must be allocated among independent producers who are members of the same related group at any time during the calendar quarter. If an independent producer is a member of the same related group for only a portion of the quarter, the 1,000 barrel amount is subject to allocation for those days on which the independent producer is a member of that related group. The Service considered a rule that would allocate on a quarterly basis among those who were group members at any time during a quarter. That is, a group member's independent producer amount for a quarter would be a share of one independent producer amount for the quarter (1,000 barrels times the number of days in the quarter), regardless of on how many days during the quarter the independent producer was a group member. The share would be proportionate to that independent producer's production for that quarter. This rule would have the effect of depriving an independent producer of the full 1,000 barrel per day amount even on those days when the independent producer was not a member of the related group. Such a rule is supportable under the language of section 4992(e)(1). Nevertheless, this rule was rejected in favor of the rule that only reduced the independent producer amount for those days on which the independent producer was a member of a related group.

MEMBERS OF A RELATED GROUP

An independent producer is treated as a member of a related group if the independent producer is a member of: (i) a family; (ii) a controlled group of corporations; (iii) a group of entities under common control; or (iv) if 50 percent or more of the beneficial interest in one or more of the corporations, trusts, or estates is owned by one or more members of the same family, all these entities and the family. A group of entities under common control means any group of entities that is either a parent-subsidiary group under common control, a brother-sister group under common control, or a combined group under common control. For purposes of determining whether 50 percent or more of the beneficial interest in one or more corporations, trusts, or estates is owned by one or more members of the same family, an interest owned by or for a corporation, partnership, trust or estate is considered as owned directly by the entity and proportionately by its stockholders, partners, or beneficiaries, as the case may be.

If, under these rules, an independent producer is a member of more than one related group for any concurrent period during the calendar quarter, the allocation of the 1,000 barrel amount to the independent producer is made by reference to that related group that results in the smallest allocation for that independent producer. Once an independent producer's allocation has been made by reference to that related group that results in the smallest allocation, the independent producer still is treated as a member of the other related group or groups for allocation purposes.

SPECIAL ANALYSES

The Commissioner of Internal Revenue had determined that the proposed rule is not subject to review under Executive Order 12291 or the

Treasury—OMB implementation of that Order, dated April 29, 1983. Accordingly, a Regulatory Impact Analyses is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably 7 copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Beverly A. Baughman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of style and substance.

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Proposed amendments to the regulations

Section 51.4992-1 is proposed to be amended by deleting paragraph (e) and a new §51.4992-2 is proposed to be added immediately thereafter. This proposed new section reads as follows:

§ 51.4992-2 Allocation within related group of 1,000 barrel amount.

(a) *General rule*—(1) *In general.* The 1,000 barrel amount described in section 4992(c)(1)(A) must be allocated among independent producers who are members of the same related group at any time during the calendar quarter. For the definition of the term "related group", see paragraph (b) of this section.

(2) *Method of allocation*—(i) *Members of the same related group for the entire quarter.* If an independent producer is a member of the same related group (one whose members do not vary) for the entire quarter, the independent producer's allocable share of the 1,000 barrel amount shall be equal to that amount which bears the same ratio to 1,000 barrels as that independent producer's qualified production of crude oil (as defined in section 4992(d)) for the quarter bears to the total qualified production of crude oil for the quarter of all the independent producers of that related group.

(ii) *Members of the same related group for part of the quarter*—(A) If an independent producer is a member of the same related group for less than the entire quarter, the 1,000 barrel amount prescribed in paragraph (a)(1) of this section shall be allocated for those days during the quarter on which the independent producer is a member of the related group. For each day that an independent producer is a member of the related group, the independent producer's allocable share of the 1,000 barrel amount shall be equal to that amount which bears the same ratio to 1,000 barrels as that independent producer's qualified production of crude oil (as defined on section 4992(d)) for that day bears to the total qualified production of crude oil for that day of all the independent producers of that related group. This calculation must be performed for each day that an independent producer is a member of a related group, unless the independent producer is a member of that related group for the entire quarter (see paragraph (a)(2)(i) of this section).

(B) On those days during the quarter that the independent producer described in paragraph (a)(2)(ii)(A) of the section is not a member of a related group, the independent producer is not required to allocate the 1,000 barrel amount pursuant to paragraph (a)(1) of this section.

(C) The independent producer amount for an independent producer described in paragraph (a)(2)(ii)(A) of this section for the quarter shall be equal to the sum of—

(*1*) The independent producer's daily amounts computed under paragraph (a)(2)(ii)(A) of this section, and

(*2*) The product of 1,000 barrels multiplied by the number of days in the quarter that the independent producer is not a member of any related group.

The 1,000 barrel amount prescribed in paragraph (a)(1) of this section is first allocated under this section before any further allocation is made under section 4992(c)(2) between tiers 1 and 2 and within any tier.

(3) *Examples.* The allocation described in paragraph (a)(1) of this section may be illustrated by the following examples:

Example (1). On April 1, 1980, A, B, and C, all independent producers, were members of the same related group. A and B continued to be members of the related group during the entire second quarter of 1980 (April through June), but C was a member of the related group only for the month of April. C did not become a member of any other related group during the quarter. C continued the production of oil. For the period from April 1, 1980 through April 30, 1980, A, B, and C each day had qualified production of 500 barrels, 400 barrels and 300 barrels, respectfully. For the period from May 1, 1980 through June 30, 1980, A, B, and C each day had qualified production of 1,000 barrels, 800 barrels, and 600 barrels, respectively, Because A, B, and C were all members of the same related group during part of the second quarter, the 1,000 barrel amount must be allocated among A, B, and C. However, only C's production during the time period that C was a member of the related group is counted for determining the allocation. Thus, for the period from April 1, 1980 through April 30, 1980, A's 1000 barrel amount is reduced to 417 barrels, B's 1,000 barrel amount is reduced to 333 barrels, and C's 1,000 barrel amount is reduced to 250 barrels, determined as follows:

Member A. $1{,}000 \times \frac{500}{1{,}200} = 417$ barrels

Member B. $1{,}000 \times \frac{400}{1{,}200} = 333$ barrels

Member C. $1{,}000 \times \frac{300}{1{,}200} = 250$ barrels

For the period from May 1, 1980 through June 30, 1980, A's 1,000 barrel amount is reduced to 556 barrels, and B's 1,000 barrel amount is reduced to 444 barrels determined as follows: (C's production is not counted because C was not a member of the related group during the period).

Member A. $1{,}000 \times \frac{1{,}000}{1{,}800} = 556$ barrels

Member B. $1{,}000 \times \frac{800}{1{,}800} = 444$ barrels

Member C. = 1,000 barrels (C is entitled to the entire 1,000 barrel amount for that part of the second quarter (May 1, 1980 through June 30, 1980) during which C is not a member of any related group).

Accordingly, for the second quarter of 1980, the independent producer amount for the members are as follows:

Member A	12,510 barrels	(417 × 30 days)
	33,916 barrels	(556 × 61 days)
	46,426	
Member B	10,000 barrels	(333.33 × 30 days)
	27,084 barrels	(444 × 61 days)
	37,084 barrels	
Member C	7,000 barrels	(250 × 30 days)
	61,000 barrels	(1,000 × 61 days)
	68,500 barrels	

Example (2). Assume the facts are the same as in example (1) except that B is not an independent producer and, therefore, does not have any qualified production. Thus, B is not entitled to any independent producer amount. The 1,000 barrel amount for A and C is not reduced by allocating a part of it to B.

(b) *Related group.* For purposes of this section, a related group is any one of the following groups:

(1) Members of the same family;

(2) A controlled group of corporations;

(3) A group of entities under common control; or

(4) If 50 percent or more of the beneficial interest in one or more corporations, trusts, or estates is owned by one or more members of the same family, all these entities and the family.

(5) The provisions of this paragraph (b)(4) may be illustrated by the following example:

Example. A, an independent producer, is unmarried and has no minor children. A owns 50 percent in value of the stock in each of nine corporations. These corporations are not members of a controlled group of corporations or members of a group of entities under common control. A and the nine corporations are treated as members of the same related group described in paragraph (b)(4) of this section because A owns 50 percent of the beneficial interest in each of these nine corporations.

(c) *Definitions.* For purposes of this section, the following terms have the following meanings:

(1) *Family.* The term "family" means an individual and the spouse and all minor children of the individual. For example, two minor children who are independent producers would be treated as members of the same family even though neither parent was an independent producer or neither parent had qualified production of oil during the calendar quarter. For this purpose, the status of a child as a minor shall be determined under state law.

(2) *Controlled group of corporations.* The term "controlled group of corporations" has the meaning given to this term by section 1563(a) (including other provisions of section 1563 and the regulations thereunder necessary in the application of section 1563(a)), except that section 1563(b)(2) shall not apply and except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a).

(3) *Group of entities under common control.* The term "group of entities under common control" means any group of entities that is either a "parent-subsidiary group under common control" as defined in paragraph (c)(3)(i) of this section, a "brother-sister group under common control" as defined in paragraph (c)(3)(ii) of this section, or a "combined group under common control" as defined in paragraph (c)(3)(iii) of this section. For purposes of this paragraph (c)(3), the term "organization" means a corporation, estate, or trust. If, for a calendar quarter, an organization is a member of more than one group of entities under common control, see paragraph (e) of this section for the rule that the organization's allocation is determined by reference to that group which results in the smallest allocation for that organization. For purposes of paragraph (c)(3) of this section, the following terms have the following meanings:

(i) *Parent-subsidiary group under common control.* The term "parent-subsidiary group under common control" means one or more chains of organizations that are connected through ownership of a controlling interest with a common parent organization if—

(A) A controlling interest in each of the organizations, except the common parent organization, is owned singly or in combination by one or more of the other organizations in the chain or chains; and

(B) The common parent organization owns a controlling interest in at least one of the other organizations, excluding, in computing this controlling interest, an interest owned directly in the organization by the other organizations.

(ii) *Brother-sister group under common control.* The term "brother-sister group under common control" means two or more organizations if the same five or fewer persons who are individuals, estates, or trusts own, singly or in combination, a controlling interest in each organization taking into account the ownership of each person only to the extent that the person's ownership is identical with respect to each organization.

(iii) *Combined group under common control.* The term "combined group under common control" means a group of three or more organizations if each organization is a member of either a parent-subsidiary group under common control, or a brother-sister group under common control, and at least one organization is the common parent organization of the parent-subsidiary group under common control and also is a member of the brother-sister group under common control.

(iv) *Controlling interest.* The term "controlling interest" means:

(A) In the case of an organization which is a corporation, ownership of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of the shares of all classes of stock of the corporation, and

(B) In the case of an organization which is an estate or trust, ownership of an actuarial interest (determined under (c)(3)(v) of this section) of more than 50 percent of the estate or trust.

The principles of the rules contained in §1.1563-2 shall apply for purposes of determining whether certain interests in an estate or trust or stock in a corporation are included in determining control, and the principles of the

rules contained in §1.1563-3 shall apply for purposes of determining the ownership of stock in a corporation or the ownership of an interest in an estate or trust.

(v) *Actuarial interest.* For purposes of this paragraph (c), the actuarial interest of each beneficiary of an estate or trust is determined by assuming the maximum exercise of discretion by the fiduciary in favor of the beneficiary. The factors and methods prescribed in §20.2031-10 for use in ascertaining the value of an interest in property for estate tax purposes shall be used to determine a beneficiary's actuarial interest.

(4) *Fifty percent or more of the beneficial interest.* The term "50 percent or more of the beneficial interest" means—

(i) With respect to any corporation, 50 percent or more in value of the outstanding stock (excluding Treasury stock) of such corporation, and

(ii) With respect to an estate or trust, an actuarial interest of 50 percent or more of the estate or trust (determined under paragraph (c)(3)(v) of this section).

The determination of the family's beneficial interest in an estate or trust shall be based on all of the property owned by the estate or trust and shall not be based on interests solely relating to oil production owned by the estate or trust.

(d) *Constructive ownership*—(1) *In general.* For purpose of determining, under paragraph (b)(4) of this section, whether 50 percent or more of the beneficial interest in one or more corporations, trusts, or estates is owned by one or more members of the same family, an interest owned by or for a corporation, partnership, trust, or estate is considered as owned directly by the entity and proportionately by its stockholders, partners, or beneficiaries in accordance with the attribution rules described in paragraph (d)(2) of this section.

(2) *Attribution rules*—(i) *Corporation.* An interest owned, directly or indirectly, by or for a corporation shall be considered as owned by each shareholder in that proportion which the value of the stock which such shareholder so owns bears to the value of all the stock in such corporation.

(ii) *Estates and trusts.* An interest owned, directly or indirectly, by or for an estate or trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in porportion to the actuarial interest of such beneficiaries in such estate or trust.

(iii) *Partnership.* An interest owned, directly or indirectly, by or for a partnership shall be considered as owned proportionately by its partners.

(iv) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. B and C are married and have two minor children, D and E. Each person is an independent producer. B is the sole beneficiary of Trust F, an independent producer that is a partner with an 80 percent capital and profits interest in the XYZ partnership. XYZ owns 75 percent in value of the stock of corporation M, an independent producer. F is treated as owning 80 percent of the property owned (or treated as owned) by XYZ. Thus, F is treated as owning 60 percent in value (80 percent of 75 percent) of the stock of M, and B is treated as owning the interest in M that is treated as owned by F. Accordingly, because B is treated as owning 50 percent of more of the beneficial interest in M, B, C, D, E, Trust F, and Corporation M are treated as members of the same related group described in paragraph (b)(4).

(e) *Members of more than one related group*—(1) *In general.* If, under this section, an independent producer is a member of more than one related group concurrently for the entire quarter (or for any concurrent period during the calendar quarter), the determination of the independent producer's allocation of the 1,000 barrel amount under paragraph (a)(1) of this section for that quarter (or concurrent period) shall be made by reference to the allocation of the related group that results in the smallest allocation for that person. However, for purposes of making the allocation under paragraph (a)(1) of this section with respect to any other related group, an independent producer whose allocation is made by reference to the allocation of the related group which results in the smallest allocation for the independent producer nevertheless shall be treated as a member of the other related group for purposes of determining the other members' allocable share of the 1,000 barrel amount.

(2) *Examples.* The rules of paragraph (e) may be illustrated by the following examples:

Example (1). Assume the facts are the same as in example (1) of paragraph (a)(3) of this section except that on May 1, 1980, C becomes a member of a related group with D and E, both independent producers, after ceasing to be a member of the related group with A and B. C remains a member with D and E through June 30, 1980. For the period from May 1, 1980 through June 30, 1980, C had qualified production of 600 barrels daily. For the period from May 1, 1980 through June 30, 1980, D and E each had qualified production of 1,200 barrels daily. Because C is not concurrently a member of more than one related group during the calendar quarter (April through June), C's allocation of the 1,000 barrel amount is not made by reference to the allocation of the related group that results in the smallest allocation to C. Instead C's allocation is determined separately for the period from April 1, 1980 through April 30, 1980, when C was a member of a related group with A and B and for the period from May 1, 1980 through June 30, 1980, when C was a member of a related group with D and E. Therefore, for the period from April 1, 1980 through April 30, 1980, C's allocation of the 1,000 barrel amount and C's independent producer amount are the same as in example (1) of paragraph (a)(3) of this section. For the period from May 1, 1980 through June 30, 1980, C's 1,000 barrel amount is reduced to 200 barrels, D's 1,000 barrel amount is reduced to 400 barrels and E's 1,000 barrel amount is reduced to 400 barrels determined as follows:

$$\text{Member C.}\quad 1{,}000 \times \frac{600}{3{,}000} = 200$$

$$\text{Member D.}\quad 1{,}000 \times \frac{1{,}200}{3{,}000} = 400$$

$$\text{Member E.}\quad 1{,}000 \times \frac{1{,}200}{3{,}000} = 400$$

Accordingly, for the period for May 1, 1980 through June 30, 1980, the independent producer amounts for C, D, and E are as follows:

Member C. 122,000 barrels (200 × 61 days)
Member D. 244,000 barrels (400 × 61 days)
Member E. 244,000 barrels (400 × 61 days)

Example (2). From January 1, 1982 through March 31, 1982, F and H, both independent producers, were members of related group FH. For the period from January 1, 1982 through January 30, 1982, H is also a member of a related group with I and J, both independent producers. For the period from January 31, 1982 through March 31, 1982, I and J are members of related group IJ. Each day of the quarter F, H, I, and J produce the following quantities of crude oil:

F = 1,200 barrels
H = 800 barrels
I = 1,600 barrels
J = 1,600 barrels

Because H is a member of more than one related group for a concurrent period (January 1, 1982 through January 30, 1982) during the calendar quarter (January through March), H's allocation for that concurrent period of the 1,000 barrel amount must be made by reference to the allocation of the related group that results in the smallest allocation to H. H's 1,000 barrel amount is reduced to 400 barrels for the period from January 1, 1982, through January 30, 1982, as a member of group FH and to 200 barrels as a member of group HIJ determined as follows:

$$1{,}000 \times \frac{800 \text{ (H's daily production)}}{2{,}000 \text{ (F\&H's daily production)}} = 400 \text{ barrels}$$

$$1{,}000 \times \frac{800 \text{ (H's daily production)}}{4{,}000 \text{ (H, I\&J's daily production)}} = 200 \text{ barrels}$$

Therefore, H's allocation as a member of a related group with I and J is smaller than H's allocation as a member of a related group with F. Thus, H is treated as a member of a related group with I and J for the period from January 1, 1982 through January 30, 1982. However, the amount of the reduction of F's 1,000 barrel amount for that period still will be determined with regard to H because H still is treated as a member of the related group with F for purposes of determining F's allocation.

Thus, for the period from January 1, 1982 through January 30, 1982, and for the period from January 31, 1982 through March 31, 1982, F's 1,000 barrel amount is reduced to 600 barrels determined as follow:

$$1{,}000 \times \frac{1{,}200 \text{ (F's daily production)}}{2{,}000 \text{ F\&H's daily production)}} = 600 \text{ barrels}$$

Accordingly, for the first quarter of 1982, the independent producer amount for F is 54,000 barrels determined as follows:

18,000 barrels (600 × 30 days)
36,000 barrels (600 × 60 days)
54,000 barrels

For the period from January 31, 1982 through March 31, 1982, H's 1,000 barrel amount is reduced to 400 barrels determined as follows:

$$1{,}000 \times \frac{800 \text{ H's daily production)}}{2{,}000 \text{ (F \& H's daily production)}} = 400 \text{ barrels}$$

Accordingly, for the first quarter of 1982, the independent producer amount for H is 30,000 barrels determined as follows:

6,000 barrels (30 days × 200 (H's allocation with reference to related group H, I&J)
24,000 barrels (60 days × 400)
30,000 barrels

For the period from January 1, 1982 through January 30, 1982, I's 1,000 barrel amount is reduced to 400 barrels determined as follows:

$$1{,}000 \times \frac{1{,}600 \text{ (I's daily production)}}{4{,}000 \text{ (H, I and J's daily production)}} = 400 \text{ barrels}$$

For the period from January 31, 1982 through March 30, 1982, I's 1,000 barrel amount is reduced to 500 barrels determined as follows:

$$1{,}000 \times \frac{1{,}600 \text{ (I's daily production)}}{3{,}200 \text{ (I and J's production}} = 500 \text{ barrels}$$

Accordingly, for the first quarter of 1982, the independent producer amount for I is 42,000 barrels determined as follows:

12,000 barrels (30 days × 400 barrels)
30,000 barrels (60 days × 500 barrels)
42,000 barrels

The reduction of the 1,000 barrel amount and the independent producer amount for the first quarter of 1982 for J is the same as for I.

Example (3). G and H are married and have a minor child J. G, H, and J are independent producers. For the entire second calendar quarter of 1982, G owns 50 percent in value of the stock in corporations N and O, and 45 percent in value of the stock in corporation P. N, O, and P are independent producers. K and L, independent producers, are unmarried and have no minor children. K and L are unrelated to G, H, and J, and unrelated to each other. For the entire second calendar quarter of 1982, K owns 30 percent in value of the stock in N, O, and P. For the entire second calendar quarter of 1982, L owns 20 percent in value of the stock in N and O, and 25 percent in value of the stock in P. Accordingly, corporations N, O, and P qualify as members of a brother-sister controlled group because G, K, and L in combination directly own more than 50 percent of the total value of the stock of each corporation, taking into account the stock ownership of each person only to the extent his stock ownership is identical with respect to each such corporation. However, N and O also qualify concurrently as members of a related group with G, H, and J because G owns 50 percent of the beneficial interest in N and O, and G, H, and J are a family. Assuming that each independent producer produces the same amount of oil per day, N and O, must be treated as members of the related group composed of G, H, J, N, and O since this group will result in the smallest allocations of the 1,000 barrel amounts to N and O. However, the amount of the reduction of P's 1,000 barrel amount shall be determined with regard to N and O because N and O still are treated as members of the related group with P for purposes of determining P's allocation. K and L are not treated as member of a related group.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on January 12, 1984, 8:45 a.m., and published in the issued of the Federal Register for January 13, 1984, 49 F.R. 1748)

Notice of Proposed Rulemaking

Installment Obligations Received From Liquidating Corporations

LR-184-80

SUMMARY: This document provides proposed regulations relating to reporting on the installment method gain attributable to the receipt of certain installment obligations by a shareholder from a liquidating corporation. Changes to the applicable tax law were made by the Installment Sales Revision Act of 1980 [Pub. L. 96-471, 1980-2 C.B. 489]. These regulations would affect all taxpayers who receive installment obligations as liquidating distributions and would provide them with the guidance to comply with the law.

DATES: Written comments or requests for a public hearing must be delivered or mailed by March 12, 1984. The regulations provided by this document are proposed to apply to installment obligations distributed by a liquidating corporation after March 31, 1980.

ADDRESS: Send comments and a request for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-184-80), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Lou Ann Craner or Cynthia Grigsby of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. (Attention: CC:LR:T) (202-566-3935).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed rules for reporting installment obligations received by a shareholder from

a liquidating corporation under section 453(h) of the Internal Revenue Code, as amended by the Installment Sales Revision Act of 1980, 94 Stat. 2247 [Pub. L. 96-471, 1980-2 C.B. 489]. This document does not contain regulations relating to the general rules for reporting installment sales and the rules relating to contingent payment installment sales. Temporary regulations relating to those rules were published in the Federal Register, February 4, 1981 [T.D. 7768, 1981-1 C.B. 296]. This document does not contain regulations relating to installment obligations received in certain exchanges in which gain or loss is generally not recognized, nor regulations relating to installment sales between related parties, nor regulations relating to private annuity transactions. Proposed regulations relating to those subjects will be contained in later documents, as will proposed regulations relating to installment sales under sections 453A, 453B, 691, 1038 and 1239. These regulations are issued under the authority contained in sections 453(j) and 7805 of the Code (94 Stat. 2247, 68A Stat. 917; 26 U.S.C. 453(j), 7805).

Under prior law, a shareholder who realized gain on receipt of installment obligations from a liquidating corporation was not permitted to report such gain on the installment method. Instead all the gain had to be recognized in the taxable year in which the obligations were received.

The Installment Sales Revision Act of 1980 provides that, unless a taxpayer elects otherwise, gain attributable to the receipt of an installment obligation in certain liquidations is to be reported on the installment method. To the greatest extent practicable, this regulation conforms the treatment of a shareholder receiving installment obligations from a liquidating corporation to the treatment of a shareholder selling the stock of the corporation in an installment sale.

The new rules under section 453(h) apply generally to obligations acquired by the distributing corporation in a sale of property during a complete liquidation to which section 337 applies and timely distributed to shareholders whose tax treatment is governed by section 331(a). However, obligations acquired in a sale or exchange of inventory property which was not sold or exchanged in bulk do not qualify. If a corporation has more than one trade or business, an installment obligation received in a bulk sale of the inventory of any one trade or business will qualify for installment method reporting whether or not the inventory of any other trade of business is sold in bulk.

Installment obligations received by shareholders of a corporation in a liquidation under sections other than section 331(a), *e.g.* in a partial liquidation that is not a step in a complete liquidation, do not qualify for installment method reporting under this provision.

The scope of the nonrecognition treatment provided under section 337(a) is limited. By statutory definition, nonrecognition treatment is denied to nonbulk sales of inventory, installment obligations received in respect of such sales of inventory, and installment obligations received in respect of sales and exchanges which took place before adoption of the plan of complete liquidation. Nonrecognition treatment is also denied to the extent of recapturable depreciation in the asset sold. In the liquidation of a collapsible corporation, nonrecognition treatment is not available for sales of depreciable property to a more than 20% (actual or constructive) shareholder, even when nonrecognition treatment is otherwise available under section 341(e)(4). In liquidations to which (prior to TEFRA) section 337(c)(2)(B) applied, nonrecognition treatment was limited to the appreciation in the value of the subsidiary's assets prior to the parent's acquisition of the stock of the subsidiary.

The regulations provide special rules for determining the method of reporting installment obligations distributed to shareholders in those liquidations in which the nonrecognition treatment provided in section 337(a) is limited. Installment obligations (or any portion thereof) received in respect of a nonbulk sale of inventory are not reported on the installment method, but any other installment obligations (or portions thereof) distributed in the liquidation are reported on the installment method. Thus, even though the liquidating corporation may recognize gain or loss on certain sales under exceptions to section 337(a) (*e.g.* sections 341(e)(4), 1245 or 1250) any installment obligation distributed to a qualifying shareholder is reportable on the installment method.

The regulations also provide a special rule for installment obligations received in liquidations to which section 337(c)(2) (formerly section 337(c)(2)(A)) applies. Section 337(a) does not apply to such liquidations but section 337(d) provides a special adjustment which provides minority shareholders with what amounts to a credit for the tax on the gain recognized by the liquidating corporation. Here, as in liquidations to which "old" section 337(c)(2)(B) applied, minority shareholders report on the installment method (unless the shareholder elects not so to report) installment obligations received as liquidation distributions without regard to any gain recognized by the corporation.

Generally, a shareholder who receives liquidating distributions in more than one taxable year recovers basis completely before recognizing any gain. This general rule is inconsistent with installment method reporting which requires that basis be ratably apportioned. Therefore, if a taxpayer receives distributions in more than one year, basis must be reallocated in the subsequent year among all the assets distributed in all years. If the reallocation in the later year indicates that the taxpayer did not recognize the appropriate amount of gain in the earlier year, the taxpayer must file an amended return for the first year. If the taxpayer has made a tax-free transfer to a corporation or partnership of an installment obligation which has an initial basis different from the basis it would have after all liquidating distributions are made, these regulations require that the person who has acquired the installment obligation appropriately readjust basis and file an amended return when necessary.

Section 1.453-2, which relates to special rules applicable to dealers in personal property, will be redesignated upon adoption of this document as a Treasury decision. Regulations relating to special rules applicable to dealers in personal property will be published in the future under section 453A. Until those regulations are issued, the material presently contained in §1.453-2 will remain in effect for dealers in personal property except to the extent that material conflicts with section 453A.

SPECIAL ANALYSIS

The Commissioner of Internal Revenue had determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. This document is a notice of proposed rulemaking that solicits public comment and the Internal Revenue Service has concluded that the notice and public procedure requirements of 5 U.S.C. 553 do apply because the rules proposed are legislative. Accordingly, a Regulatory Flexibility Analysis is required.

INITIAL REGULATORY FLEXIBILITY ANALYSIS

These proposed regulations are necessary to implement the provisions of section 453(h) of the Internal Revenue Code as amended by the Installment Sales Revision Act of 1980.

The objective of these regulations is to provide taxpayers with the guidance necessary to comply with the provisions of section 453(h) as amended by the Installment Sales Revision Act of 1980, relating to the treatment of installment obligations received by a shareholder from a liquidating corporation. These regulations are promulgated under sections 453(j) and 7805 of the Internal Revenue Code of 1954.

These proposed regulations, if adopted, will affect small businesses but not other small entities, such as local government or tax-exempt organizations, which do not pay taxes.

These proposed regulations, if adopted, will affect any corporation that is a small business if upon liquidation of the corporation a qualifying installment obligation is distributed to shareholders. It is anticipated that a significant number of small businesses will be affected. These regulations do not impose substantial reporting requirements beyond those already imposed by the tax laws generally nor record keeping requirements beyond those necessary to account for any complete liquidation. The professional competence necessary to comply with these regulations is no greater than that already necessary to arrange the complete liquidation of a corporation.

These regulations do not overlap with, conflict with or duplicate any existing federal regulations.

None of the significant alternatives considered in drafting these regulations would have significantly altered the economic impact of these regulations on small entities.

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably 7 copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of this regulation is Phoebe A. Mix of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

Accordingly, it is proposed to amend 26 CFR Part 1 by revising §1.453-2 to read as follows:

§1.453-2 Installment obligations received from a liquidating corporation.

(a) *In general.*—(1) *Generally.* Except as provided in proposed §1.453-3(i) (relating to installment sales of depreciable property to certain closely related persons), a qualifying shareholder who receives a qualifying installment obligation (as defined in paragraph (c) of this section) in connection with a liquidation to which section 337 applies (as defined in paragraph (d) of this section) will treat payments received in respect of the obligation, rather than the obligation, as payment for the shareholder's stock. The shareholder will report the payments received on the installment method unless the shareholder elects otherwise in accordance with the rules set forth in §1.453-1A(e) of these regulations.

(2) *Liquidating distributions treated as selling price.* All amounts distributed or treated as distributed to the qualifying shareholder incident to the liquidation, including, in addition to qualifying installment obligations, cash, other property, and obligations that are not qualifying installment obligations, will be considered as having been received by the shareholder as the selling price (as defined in §1.453-1A(b)(2)(ii)) for the shareholder's stock in the liquidating corporation. For the proper method of reporting liquidating distributions received in more than one taxable year of a shareholder, see paragraph (e) of this section. An election not to report on the installment method an installment obligation received as a liquidating distribution will apply to all distributions received in the liquidation.

(3) *Assumption of corporate liability by shareholders*—(i) *In general.* If in the course of the liquidation a shareholder assumes or takes subject to secured or unsecured indebtedness, the amount of the indebtedness is added to the shareholder's basis in the stock of the liquidating corporation. Such additions to basis will not affect the taxpayer's holding period in the stock. Liabilities assumed by or taken subject to by the shareholder do not reduce the amounts received in

computing the selling price.

(ii) *Example.* The following example illustrates the provision of paragraph (a)(3):

Example (i). A owns all of the stock of T corporation at a basis of $100,000. T, which is not a collapsible corporation, owns Blackacre, unimproved real property, at a basis of $700,000. Blackacre is subject to a mortgage ("underlying mortgage") of $1,100,000. A is not personally and primarily liable on the underlying mortgage and the T shares held by A are not encumbered by the underlying mortgage. The other assets of T consist of cash of $400,000 and accounts receivable having a total face amount (and value) of $600,000. The unsecured liabilities of T total $900,000. On February 1, 1983, T adopts a plan of complete liquidation comporting with section 337, and promptly sells Blackacre to unrelated B corporation for a mortgage note (bearing adequate stated interest) in the face amount of $4 million (the B note). Under the agreement between T and B corporations, T (or its successor) is to continue to service (make principal and interest payments on) the underlying mortgage. Immediately thereafter, T completes its liquidation by distributing to Mr. A its cash of $400,000, accounts receivable of $600,000, and the $4 million B note. A assumes T's $900,000 of unsecured liabilities and receives the distributed property subject to the obligation to continue to service the $1,100,000 underlying mortgage. In 1983 A receives no payments from B corporation on the B note.

(ii) Provided A does not elect out of installment treatment, the transaction will be reported by A on the installment method. Selling price is $5 million (cash of $400,000, accounts receivable of $600,000, and B note of $4 million). Total contract price also is $5 million. A's basis in the T shares, initially $100,000, is increased by the $900,000 of unsecured T liabilities assumed by Mr. A and by the obligation (to which A takes subject) to service the $1,100,000 underlying mortgage, to an aggregate basis of $2,100,000. Accordingly, gross profit is $2,900,000 (selling price $5 million less aggregate basis of $2,100,000). Gross profit ratio is 58% (gross profit $2,900,000 divided by total contract price of $5 million). 1983 payments to A are $1 million ($400,000 cash plus $600,000 receivables) and A will recognize gain in 1983 of $580,000 ($1 million times 58%).

(iii) In 1984 A receives payment from B corporation on the B note of $1 million (exclusive of interest). A's gain recognized in 1984 is $580,000 ($1 million times 58%).

(b) *Qualifying shareholder.* The term "qualifying shareholder" means a shareholder to which, with respect to the liquidating distribution, section 331 applies. Thus, a creditor who receives a distribution from a liquidating corporation in exchange for the creditor's claim is not a qualifying shareholder whether or not the liquidation is described in section 337(g).

(c) *Qualifying installment obligations*—(1) *In general.* Except as provided in paragraph (c)(4) of this section (relating to certain inventory sales), the term "qualifying installment obligation" means an installment obligation (as defined in §1.453.1A(c)(2)(i)) acquired in a sale or exchange of corporate assets by the liquidating corporation during the 12-month period set forth in section 337(a). In the case of a liquidation described in section 337(g), the period described in section 337(g)(2) shall be treated as the 12-month period set forth in section 337(a).

(2) *Corporate assets.* Except as provided in paragraph (c)(4) of this section (relating to certain sales of inventory), the nature of the assets sold by and the tax consequences to the selling corporation do not determine whether an installment obligation is a qualifying installment obligation. Thus, for example, the fact that the fair market value of an asset is less than the adjusted basis of that asset in the hands of the corporation, or that the sale of an asset will subject the corporation to depreciation recapture (*e.g.*, section 1245 and 1250), or that the assets of a trade or business sold by the corporation for an installment obligation include section 179 property, accounts receivable, installment obligations, or cash will not disqualify installment obligations received in exchange for those assets as qualifying installment obligations. However, a debt obligation received by the corporation in exchange for cash, as an investment functionally unrelated to a sale or exchange of noncash assets by the corporation, will not be treated as a qualifying installment obligation.

(3) *Installment obligations distributed in liquidations to which section 337(c)(3) applies*—(i) *In general.* In the case of a liquidation to which section 337(c)(3) (relating to certain liquidating subsidiary corporations) applies, a qualifying installment obligation acquired in respect of a sale or exchange by the liquidating subsidiary corporation will be treated as a qualifying installment obligation if distributed to a qualifying shareholder of a distributee corporation (as defined in section 337(c)(3)(B)).

(ii) *Examples.* The provisions of paragraph (c)(3) of this section are illustrated by the following examples:

Example (1). A, an individual, owns all of the stock of T corporation. T has an operating division and three wholly-owned subsidiaries, X, Y, and Z. Neither T nor any of its subsidiaries is a collapsible corporation (as defined in section 341(b)). On February 1, 1981, T, Y, and Z all adopt plans of complete liquidation. The following sales promptly are made to unrelated purchasers: T sells its operating division to B for cash and an installment obligation. T sells the stock of X to C for an installment obligation. Y sells all of its assets to D for an installment obligation. Z sells all of its assets to E for cash. In June 1981, Y and Z completely liquidate, distributing their respective assets (installment obligations and cash) to T. In July 1981, T completely liquidates, distributing to A cash and the installment obligations respectively issued by B, C, and D. The liquidation of T is a liquidation to which section 337 applies and the liquidations of Y and Z are liquidations to which section 337(c)(3) applies. A is a qualifying shareholder and the installment obligations issued by B, C, and D are qualifying installment obligations. Unless A elects otherwise, A reports the transaction on the installment method as if the cash and installment obligations had been received in an installment sale of the stock of T corporation.

Example (2). A, a cash method individual taxpayer, owns all of the stock of P corporation. P owns 20% of the stock of S corporation. The balance of the S stock is owned by unrelated individuals. On February 1, 1981, P adopts a plan of complete liquidation and sells all of its property, other than its S stock, to B, an unrelated purchaser for cash and an installment obligation. On March 1, 1981, S adopts a plan of complete liquidation, then sells all of its property to unrelated C for cash and installment obligations, and immediately distributes the cash and installment obligations to its shareholders in completion of the liquidation. Promptly thereafter, P liquidates, distributing to A cash, the B installment obligation, and a C installment obligation that P received in the liquidation of S. In the hands of A, the B installment obligation is a qualifying installment obligation. In the hands of P, the C installment obligation was a qualifying installment obligation. However, in the hands of A, the C installment obligation will not be treated as a qualifying installment obligation because P only owns a 20% stock interest in S. Because P does not own at least 80% of the stock of S, the liquidation of S is not a case to which section 337(c)(3) applies. Thus, in the hands of A, the C obligation is considered to be a third party note (not a purchaser's evidence of indebtedness) and therefore is treated as a payment to A in the year of distribution. Accordingly, in 1981 A will report as payment the cash and the fair market value of the C obligation distributed to A in the liquidation of P.

(4) *Installment obligations attributable to certain sales of inventory*—(i) *In general.* An installment obligation acquired by a corporation, in a liquidation to which section 337 applies, in respect of a sale or exchange of a broken lot of inventory (within the meaning of paragraph (c)(4)(ii)(B) of this section) is not a qualifying installment obligation. In the event that the installment obligation is received in respect of a broken lot of inventory and other assets, only the portion of the installment obliga-

tion received in respect of the broken lot of inventory is not a qualifying installment obligation. The portion of the installment obligation attributable to other assets is a qualifying installment obligation. See paragraph (c)(4)(iii) of this section for rules for determining what portion of an installment obligation is nonqualifying.

(ii) *Definitions.* For purposes of this section, the following definitions shall apply:

(A) *Inventory property.* The term "inventory property" means property described in section 337(b)(1)(A).

(B) *Broken lot of inventory.* The term "broken lot of inventory" means inventory property sold or exchanged in a manner which does not meet the description contained in section 337(b)(2).

(iii) *Rules for determining nonqualifying installment obligation.* If a broken lot of inventory is sold to a purchaser together with other corporate assets and the consideration received includes cash (or other property) the assumption of (or taking subject to) corporate liabilities, or both, as well as an installment obligation, the following rules will apply solely for the purpose of determining the portion of the installment obligation (if any) that is attributable to the broken lot of inventory. First, the buyer's assumption of unsecured liabilities and the buyer's assumption of or taking subject to liabilities encumbering the broken lot of inventory are deemed consideration received for the broken lot of inventory, up to the fair market value thereof (liabilities encumbering only assets other than the broken lot of inventory are not deemed to be consideration received for the broken lot of inventory). Second, the sum of any cash and the fair market value of other property (other than the installment obligation) received is deemed consideration for the broken lot of inventory up to the amount (if any) by which the fair market value of the broken lot of inventory exceeds the previously described liabilities. Accordingly, an installment obligation will be deemed to have been received in respect of a broken lot of inventory only to the extent that the fair market value of the broken lot of inventory exceeds the sum of the cash and fair market value of other property received, and the unsecured liabilities and secured liabilities encumbering the broken lot of inventory assumed or taken subject to by the purchaser.

(iv) *Examples.* The provisions of this paragraph are illustrated by the following examples:

Example (1). (i) P corporation has three operating divisions, X, Y, and Z, each engaged in a separate trade or business, and a minor amount of investment assets. P is not a collapsible corporation (as defined in section 341(b)). On July 1, 1981, P adopts a plan of complete liquidation comporting with section 337. The following sales are promptly made to purchasers unrelated to P: P sells all of the assets of the X division (including all of the inventory property) to B for cash of $30,000 plus an amount to be retained by P to meet certain liabilities, and installment obligations totalling $200,000. P sells substantially all of the inventory property of the Y division (worth $100,000) to C for an installment obligation, and sells all of the other assets of the Y division (excluding cash but including installment receivables previously acquired in the ordinary conduct of the business of the Y division) to D for a $170,000 installment obligation. P sells ⅓ of the inventory property of the Z division to E for $100,000 cash, ⅓ of the inventory property of the Z division to F for a $100,000 installment obligation, and all of the other assets of the Z division (including ⅓ of the inventory property worth $100,000) to G for $60,000 cash, a $240,000 installment obligation, and the assumption by G of the liabilities of the Z division. P promptly completes its liquidation, distributing the cash and installment obligations to A, an individual cash method taxpayer who is its sole shareholder. In the hands of A, the installment obligations issued by B, C, and D are qualifying installment obligations. The installment obligation issued by F is not a qualifying installment obligation. A portion of the installment obligation issued by G is a qualifying installment obligation and a portion is not a qualifying installment obligation, determined as follows: G purchased part of the inventory property and all of the other assets of the Z division by paying cash ($60,000), issuing an installment obligation ($240,000), and assuming the liabilities of the Z division. Liabilities encumbering assets other than inventory property are ignored in the calculation. Assume the unsecured liabilities and any liabilities encumbering the inventory property aggregated $30,000 and thus that the total purchase price paid by G was $330,000 (exclusive of any liabilities encumbering solely noninventory property). Of this aggregate amount, $100,000 was paid for inventory property of the Z division. The payment made by G by assumption of liabilities ($30,000) and in cash ($60,000) will be attributed first to the inventory property. Therefore, only $10,000 of the $240,000 installment obligation will be attributed to inventory property. Accordingly, in the hands of A $10,000 of the installment obligation issued by G is not a qualifying installment obligation and the balance of $230,000 is a qualifying installment obligation.

(ii) In the 1981 liquidation of P, A receives a liquidating distribution as follows (assume all installment obligations bear stated interest equal to or above the section 483 test rate and that all nonqualifying installment obligations have a fair market value equal to their face amount):

Item	*Qualifying Installment Obligations*	*Cash and Other Property*
cash		$190,000
B note	$200,000	
C note	$100,000	
D note	$170,000	
F note		$100,000
G note*	$230,000	$ 10,000
Total	$700,000	$300,000

*face amount $240,000.

Assume that A's basis in the stock of P was $100,000. Under the installment method, A's selling price and contract price are both $1 million, gross profit is $900,000, and the gross profit ratio is ⁹⁰⁄₁₀₀. Accordingly, in 1981 A must report gain of $270,000 (90% of $300,000 payment in cash and other property). A will hold the installment obligations that are entirely qualifying installment obligations at a basis equal to 10% of the face amount. A will hold the F note, a nonqualifying installment obligation, at a basis equal to its $100,000 value when received by A. A will hold the G note, a mixed obligation, at a basis of $33,000 (10% of the $230,000 qualifying installment obligation portion of the note, pluse $10,000 nonqualifying portion of the note).

Example (2). The facts are the same as in example (1), except that in acquiring assets of the Z division (⅓ of the inventory property and all of the other assets of the Z division), G issues two installment obligations (bearing adequate stated interest). One is a $230,000 installment obligation and the other is a $10,000 installment obligation worth its face amount. The agreement between P and G states that the $10,000 installment obligation is issued as consideration for inventory property acquired by G from P. In example (1), in which G issued a single $240,000 installment obligation, it was determined that only $230,000 of this installment obligation would constitute a qualifying installment obligation. However, when separate installment obligations are issued and one such obligation is designated as consideration for inventory property acquired, that designation ordinarily will be given effect by the Internal Revenue Service for the purpose of attributing consideration paid (in excess of the sum of liabilities assumed, cash paid, and other property received for inventory property first to the designated installment obligation. Accordingly, on the facts stated, the entire $10,000 installment obligation is not a qualifying installment obligation and the entire $230,000 installment obligation is a qualifying installment obligation. Thus A will hold the $10,000 G note, a nonqualifying installment obligation, with a basis equal to its $10,000 value when received by A. A will hold the $230,000 G note, a qualifying installment obligation, with a basis of $23,000 (10% of $230,000).

(d) *Liquidation to which section 337 applies—(1) In general.* The term "a liquidation to which section 337 applies" means a complete liquidation to which section 337(a) applies, after taking into account section 337(c), (e), and (g), but without re-

gard to section 337(b), and (f). The liquidation of a collapsible corporation (as defined in section 341(b)) is not a liquidation to which section 337 applies, within the meaning of this paragraph, unless section 337(a) applies by reason of section 341(e)(4). Except as provided in the preceding sentence and paragraph (c)(4) of this section (relating to certain sales of inventory), any installment obligation received in respect of a sale by the corporation during a liquidation described in section 337(a) will be a qualifying installment obligation. Thus, even though the liquidating corporation may recognize gain or loss on certain sales under certain exceptions to section 337(a) (*e.g.* sections 337(c)(2)(B), 341(e)(4), 1245 or 1250), the entire obligation distributed to a qualifying shareholder is reportable on the installment method.

(2) *Special rule for liquidations to which section 337(c)(2) applies.* With respect to a shareholder (other than a corporation which meets the 80% stock ownership requirement specified in section 332(b)(1)) who is a qualifying shareholder, for purposes of this section, a liquidation to which section 337(c)(2) applies is a liquidation to which section 337 applies. An amount equal to the increase described in section 337(d)(1) is deemed to be a cash distribution in liquidation to the shareholder in the first taxable year in which the shareholder actually receives a distribution in liquidation from the corporation.

(e) *Liquidating distributions received in more than one taxable year*—(1) *In general.* If the taxpayer is a shareholder who receives, in a liquidation to which section 337 applies, distributions in more than one taxable year of the taxpayer, then, on completion of the liquidation, basis in the taxpayer's shares previously allocated to property (including qualifying installment obligations) received in an earlier taxable year shall be appropriately reallocated among all property (including qualifying installment obligations) received as a distribution in the liquidation in any taxable year of the taxpayer unless the taxpayer elected out of installment method reporting. If by reason of this basis reallocation it is determined that the taxpayer, or any substituted person (as defined in paragraph (e)(2) of this section), has not fully recognized gain in an earlier taxable year, whichever party did not fully recognize gain shall file an amended return for that earlier year which properly reflects the gain attributable to the distribution received in the earlier year.

(2) *Substituted person.* The term "substituted person" means a person to whom the taxpayer has transferred (directly or indirectly) an installment obligation received by the taxpayer as a liquidating distribution, if, for the purpose of determining gain or loss from a sale or exchange, the substituted person's basis in such installment obligation is determined in whole or in part by reference to the basis of such installment obligation in the hands of the taxpayer. In addition, if during the 12 month period set forth in section 337(a) a shareholder dies, and a liquidating distribution was received by the decedent and a liquidating distribution is thereafter received by the shareholder's estate or other successor to the shares, for purposes of this paragraph the estate or other successor to the shares shall be treated as the taxpayer and the decedent (and any person who is a substituted person with respect to the decedent) shall be treated as a substituted person with respect to the estate or other successor to the shares.

(3) *Examples.* The following examples illustrate the provisions of this paragraph. Assume in each example that the taxpayer receiving the liquidating distribution is a calendar year taxpayer.

Example (1). A, an individual, owns all of the stock of T corporation with a basis of $100,000. A's taxable year is the calendar year. T is not a collapsible corporation (as defined in section 341(b)). On February 1, 1980, T adopts a plan of complete liquidation and sells all of its assets to a single purchaser in a single transaction. In January 1981, T distributes $200,000 cash and a $300,000 qualifying installment obligation to A, thereby completing its liquidation to which section 337 applies. The January 1981 distribution is the only liquidating distribution made by T. For purposes of reporting the liquidating distributions, the selling price is $500,000 ($200,000 cash + $300,000 qualifying obligation), the gross profit is $400,000 ($500,000 − $100,000 basis), and the gross profit ratio is ⅘ ($400,000/$500,000). If before the close of 1981 A receives a $50,000 payment on the installment obligation, $40,000 (⅘ of $50,000) will be reportable under the installment method as gain. In total, A will report gain in 1981 of $200,000, $160,000 (⅘ of $200,000) attributable to the $200,000 cash received in the liquidation and $40,000 (⅘ of $50,000) attributable to $50,000 payment on the installment obligation.

Example (2). The facts are the same as in example (1) except that T distributes $200,000 cash in December 1980, and the $300,000 qualifying installment obligation in January 1981. For purposes of reporting the 1980 distribution, 1981 distributions initially are disregarded. Therefore, in 1980 A recovers A's entire $100,000 basis against the $200,000 cash distribution, and will recognize $100,000 as gain. When A receives the $300,000 installment obligation in 1981, A is required to reallocate A's $100,000 basis in the T shares among all property received in both taxable years. The reallocation will produce the results shown in example (1): a selling price of $500,000, a gross profit of $400,000 and a gross profit ratio of ⅘. If A has filed a tax return for 1980 reporting only $100,000 gain in that year, A is required to file an amended return reporting an additional $60,000 of recognized gain in 1980 (($200,000 × ⅘) − $100,000).

Example (3). The facts are the same as in example (1), except that T distributes the $300,000 qualifying installment obligation to A in June 1980, and distributes the $200,000 cash to A in January 1981. Assume further that in November 1980, A receives a payment of $60,000 on the installment obligation (in addition to the receipt of substantial interest). Because the 1981 distributions initially are disregarded for purposes of reporting in 1980, in 1980 A would allocate the entire $100,000 basis in the T shares to the $300,000 installment obligation. The gross profit ratio thus would be ⅓ ($300,000 − $100,000) ÷ $300,000). A would treat $40,000 (⅔ × $60,000) of the 1980 installment obligation payment as recognized gain in 1980. Upon completion of the liquidation in 1981, A is required to reallocate basis to conform with the results in example (1). The recomputed selling price is $500,000, the recomputed gross profit is $400,000 and the recomputed gross profit ratio is ⅘. Therefore, A should have reported $48,000 (⅘ of $60,000) of the $60,000 payment received in 1980 as gain. Since A reported only $40,000 as gain in that year, if A has filed a return for 1980 A must file an amended return reporting the additional gain of $8,000 ($48,000 − $40,000). Of the $200,000 cash distribution received by A in 1981, $40,000 is return of basis and $160,000 ($200,000 × ⅘) is gain.

Example (4). The facts are the same as in example (3), except that in 1980, before receiving any payment on the installment obligation, A transfers the installment obligation to P partnership in exchange for a partnership interest in P. Under sections 721 and 453B, gain is not recognized on the transfer and P holds the installment obligation at the same basis the obligation had in the hands of A. P is therefore a substituted person with respect to A. Accordingly, the basis recomputation rule applies to P and its partners. If P has filed a return for its taxable year in which it reported $40,000 gain with respect to the $60,000 payment on the installment obligation it must file an amended return reporting an additional $8,000 ($48,000 − $40,000) of gain recognized on that payment. Further, each partner of P who has filed a return for the partner's taxable year in which or with which P's taxable year ends, must file an

amended return reporting the partner's distributive share of the additional gain.

Example (5). The facts are the same as in example (3) except that, in addition, A dies December 1, 1980, and the installment obligation passes by bequest to A's child, D, who receives a $60,000 payment in respect of the obligation in December as well as the cash distribution in January 1981. Because an installment obligation is a right to receive income in respect of a decedent, D reports the installment obligation as A would have. Therefore, in 1980, D would recognize gain of $40,000 (⅔ × $60,000) in 1980. Upon completion of the liquidation in 1981, if D has filed a return reporting only $40,000 gain, an amended return must be filed reporting an additional gain of $8,000 ($48,000 − $40,000). In addition, if A had filed a return reporting only $40,000 gain as amended return must be filed reporting an additional $8,000 ($48,000 − $40,000). In addition, of the $200,000 cash distribution received by D in 1981 $40,000 will be return of basis and $160,000 ($200,000 × ⅘ will be gain.

Example (6). The facts are the same as in example (2), except that on December 31, 1980, after receiving the $200,000 cash distribution but before receiving the $300,000 qualifying installment obligation distribution, A donates all the T shares to Z corporation, a section 501 (c)(3) organization. A midstream carryover basis transfer of shares in a corporation engaged in a section 337 liquidation is an invalid assignment of income. Accordingly, A will be required to reallocate basis and report gain in the manner described in example (2).

Example (7). B owns all of the stock of X corporation with an adjusted basis of $100,000. X is not a collapsible corporation (as defined in section 341(b)). X conducts two separate businesses, the J division worth $100,000 and the K division worth $900,000. On December 1, 1980 X adopts a plan of complete liquidation. On December 15, 1980 X sells the J division to M and receives in exchange a $100,000 qualifying installment obligation which X immediately transfers to B as a first liquidating distribution. On January 15, 1981, X merges with and into unrelated N corporation. Under the plan of merger, N is the surviving corporation, all of the assets of the K division are acquired by N, and N assumes or takes subject to all of the liabilities of the K division, the shares of X are cancelled, and in exchange B receives directly from N a $900,000 installment obligation issued by N. The transaction is a liquidation to which section 337 applies since X, within the 12-month period beginning on December 1, 1980 (the date on which X adopted a plan of complete liquidation), has distributed all of its assets (consisting of the $100,000 M note and the $900,000 N note). Accordingly, B is a qualifying and shareholder and both the M note and the N note are qualifying installment obligations in the hands of B. Since B received no payment in 1980, no amended return is required to be filed by B. However, B must allocate B's total $100,000 basis $10,000 to the M note and $90,000 to the N note.

(f) *Coordination with other provisions*—(1) *In general.* Except as specifically provided in section 453 (h)(1)(C) and proposed §1.453(i) (relating to installment sales of depreciable property to certain closely related persons), whenever it shall be relevant to any determination under any provision of the Internal Revenue Code, a qualifying installment obligation distributed to a qualifying shareholder in a liquidation to which section 337 applies (as defined in paragraph (d) of this section) shall be treated as if the obligation had been received by the shareholder in an installment sale of shares directly to the person issuing the installment obligation.

(2) *Examples.* The following examples illustrate the provision of this paragraph (in each case, it is assumed that the liquidating corporation is not a collapsible corporation (as defined in section 341(b)):

Example (1). A owns all of the stock of T corporation. Substantially all of the assets of T are inventory property. T adopts a plan of complete liquidation, promptly sells all of its assets to B corporation in exchange for a $1 million qualifying installment obligation, and distributes the qualifying installment obligation to A in completion of its liquidation. The installment obligation bears stated interest at less than the test rate prescribed in section 483 and the regulations thereunder. In the hands of T section 483 would have no application to the installment obligation since it was issued in exchange for T's inventory. See section 483(f)(3). However, since in the hands of A the installment obligation will be treated as if received by A on a sale of A's T shares directly to B, section 483 will apply to the installment obligation in A's hands.

Example (2). C owns all of the stock of Y corporation. A substantial part of the assets of Y consists of stocks and securities traded on an established securities market. Y adopts a plan of complete liquidation, sells all of its stock and securities holdings to B corporation (which is closely held) in exchange for a $1 million installment obligation (bearing adequate stated interest), sells all of its other assets to another purchaser for cash, and distributes the cash and qualifying installment obligation to C in completion of its liquidation to which section 337 applies. In the hands of Y, the B installment obligation may carry original issue discount (as defined in section 1232(b)(1)) since the obligation was issued for stock and securities traded on an established securities market. However, in the hands of C the installment obligation is not an original issue discount obligation since it is treated as having been received by C in a direct sale to B corporation of the shares of Y and neither the Y shares nor the B installment obligation is traded on an established securities market.

Example (3). The shares of Q corporation are traded on an established securities market. D owns more than 5% of the shares of Q. The assets of Q consist of normal business properties. Q adopts a plan of complete liquidation and sells all of its assets to L corporation in exchange for cash and qualifying installment obligations that are not readily tradable. Q corporation promptly distributes solely cash to the shareholders of Q holding 5% or less of the outstanding shares of Q, and distributes cash and the L qualifying installment obligations to the shareholders who own more than 5% of the outstanding shares of Q, including D, thereby completing its liquidation to which section 337 applies. In the hands of Q, the L installment obligations would not be original issue discount obligations since they were not part of an issue a portion of which is traded on an established securities market nor issued to Q for stock or securities traded on an established securities market. However, in the hands of D, the L installment obligation may qualify as an original issue discount obligation since the shares of Q were traded on an established securities market and D is treated as having received the L installment obligation in a direct sale of Q shares to L.

(g) *Effective dates*—(1) *In general.* The provisions of this section (§1.453-2) shall apply to distributions of qualifying installment obligations made after March 31, 1980. The date of the distribution of the installment notes, not the date the corporation adopts the plan of complete liquidation, is controlling.

(2) *Examples.* The effective date provisions of section 453(h) are illustrated by the following examples:

Example (1). On December 1, 1979 X corporation adopts a plan of complete liquidation and promptly sells all of its assets to unrelated Z for $400,000 cash and a $600,000 long-term installment note bearing adequate stated interest. On June 1, 1980 X distributes the cash and the note to A, its sole shareholder, completing the liquidation to which section 337 applies. Assume X is not a collapsible corporation. A may elect to report the installment note on the installment method and report gain when payments are received. A must elect installment method reporting because prior to October 20, 1980 installment method reporting was available only to taxpayers who affirmatively elected it. Had X distributed the installment note after October 19, 1980, A would have been required to report the note on the installment method unless A had elected otherwise.

Example (2). The facts are the same as in example (1), except that the long-term installment note does not call for fixed payments aggregating $600,000 (plus interest). Instead, the note calls for annual payments equal to a stated percentage of the income of X for a specified number of years, and $600,000 is the stated maximum amount (exclusive of interest) payable on the note. A may not elect to report the note on the installment method because contingent installment obligations were not eligible for installment method reporting prior to October 20, 1980. Had X distributed the contingent installment obligation after October 19, 1980, however, A would be required to report the note on the installment method unless A had elected otherwise.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 12, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 13, 1984, 49 F.R. 1742)

Notice of Proposed Rulemaking

Installment Obligations Received in Certain Nonrecognition Exchanges

LR-186-80

SUMMARY: This document contains proposed regulations relating to installment obligations received in certain nonrecognition transactions. Changes to the applicable tax law were made by the Installment Sales Revision Act of 1980 [Pub. L. 96-471, 1980-2 C.B. 489]. These regulations would provide guidance to those taxpayers receiving installment obligations in certain nonrecognition exchanges and to personnel of the Internal Revenue Service who administer the installment sale provisions.

DATES: Written comments and requests for a public hearing must be delivered or mailed by July 2, 1984. Except as otherwise provided in this document, the amendments are proposed to apply to certain nonrecognition exchanges occurring after October 19, 1980.

ADDRESS: Send comments and a request for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-186-80), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Linda M. Kroening of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224. (Attention: CC:LR:T) (202-566-3288).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 453(f)(6) of the Internal Revenue Code of 1954 relating to installment obligations received in certain nonrecognition exchanges. These amendments are proposed to reflect the amendment of section 453 by section 2 of the Installment Sales Revision Act of 1980 (94 Stat. 2247). The amendments are to be issued under the authority contained in sections 453(j) and 7805 of the Code (94 Stat. 2247, 68A Stat. 917; 26 U.S.C. 453(j), 7805).

Under prior law, except as otherwise required by the 30-percent initial payment limitation, an installment obligation received as boot in an exchange of like-kind property described in section 1031 qualified for installment method reporting. The value of the like-kind property received by the seller was considered a payment in the year of the exchange and was taken into account in determining both the selling price and the contract price. The Installment Sales Revision Act of 1980 reverses this rule. The value of the like-kind property received is no longer considered a payment in the year of sale nor is it taken into account in determining either the selling price or the contract price. This change in the treatment of the receipt of like-kind property does not change the amount of gain which a taxpayer will recognize on the sale but does defer the time when the taxpayer reports the gain. Under prior law, a taxpayer reported gain upon receipt of the like-kind property. Under the new law, the taxpayer does not report gain with respect to an installment obligation until he receives payment on or disposes of the installment obligation.

Under the Installment Sales Revision Act of 1980, the total contract price in a like-kind exchange in which an installment obligation is received as boot (property received in addition to the like-kind property) is the sum of cash received, the fair market value of other property (i.e., property other than like-kind property) received, and the face amount (less any discount required under section 483) of the installment obligation.

The basis of the like-kind property received (determined under section 1031(d)) will be determined as if the obligation had been satisfied at its face value less any discount for unstated interest. The taxpayer's basis in the transferred property is allocated first to the like-kind property received (but not in excess of its fair market value) and any remaining basis is used to determine the gross profit ratio.

The Act also provides that, under a plan of corporate reorganization, exchanges described in section 356(a) shall be treated similarly to section 1031(b) exchanges if the installment boot is not treated as a dividend. The Act excludes from installment method reporting any installment obligation which is treated as a dividend or would be treated as a dividend if the corporation had had sufficient earnings and profits to distribute a dividend.

These regulations also permit installment method reporting in certain nonrecognition exchanges (for example, section 351(b) exchanges) which are not explicitly dealt with in the Act. For these nonrecognition exchanges, the same basic rules apply: basis in the transferred property is first allocated to the nonrecognition property received, but not in excess of the fair market value of that property. Any excess basis is allocated to the installment note and any nonqualifying property.

Section 1.453-1 contains material relating to installment sales by dealers in personal property. It is intended that eventually all of the regulations relating to installment sales will be amended to reflect the amendments to section 453 made by the Installment Sales Revision Act of 1980. Until those amendments are adopted, provisions in §1.453-1 which relate to matters not covered in this document or other proposed regulations relating to installment method reporting will remain in effect.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis

is required by chapter 5 of title 5, United States Code.

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of this regulation is Phoebe A. Mix of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Proposed amendments to the regulations

Accordingly, the following amendments are proposed to be made to 26 CFR Part 1:

Paragraph. Section 1.453-1 is amended by revising paragraph (f) to read as follows:

§1.453-1 Installment method reporting for sales or real property and casual sales of personal property.

* * * * *

(f) *Installment obligations received in certain nonrecognition exchanges*—(1) *Exchanges described in section 1031(b)*—(i) *In general.* The provisions of paragraph (f)(1) of this section apply to exchanges described in section 1031(b) ("section 1031(b) exchanges") in which the taxpayer receives as boot (property which is "other property" under section 1031 (b)) an installment obligation issued by the other party to the exchange, as well as property with respect to which no gain or loss is recognized ("permitted property" for purposes of paragraph (f)(1) of this section). However, an exchange otherwise described in section 1036 in which the receipt of an installment obligation is treated as a dividend (or would be treated as a dividend if the issuing corporation had adequate earnings and profits) is not a section 1031(b) exchange for purposes of this section.

(ii) *Exclusion from payment.* Receipt of permitted property will not be considered payment for purposes of paragraph (c) of this section.

(iii) *Installment method determinations.* In a section 1031(b) exchange, the taxpayer's basis in the property transferred by the taxpayer, including nondeductible expenses of the exchange, will first be allocated to the permitted property received by the taxpayer up to, but not in excess of, the fair market value of such property. If the taxpayer's basis exceeds the fair market value of the permitted property, that excess amount of basis is "excess basis." In making all required installment method determinations, the exchange is treated as if the taxpayer had made an installment sale of appreciated property (with a basis equal to the amount of excess basis) in which the consideration received was the installment obligation and any other boot. In a section 1031(b) exchange, only net qualifying indebtedness is taken into account in determining the amount of qualifying indebtedness (as defined in §1.453-1A(b)(2)(iv)). For this purpose, net qualifying indebtedness is the excess of—

(A) Liabilities of the taxpayer (or liabilities encumbering the property) assumed or taken subject to by the other party to the exchange as part of the consideration to the taxpayer, over

(B) The sum of any net cash paid (cash paid less any cash received) by the taxpayer in the exchange and any liability assumed or taken subject to by the taxpayer in the exchange.

Therefore, for purposes of installment method determinations, the selling price is the sum of the face value of the installment obligation (reduced by any portion of the obligation characterized as interest by section 483 or 1232), any net qualifying indebtedness, any cash received (in excess of any cash paid) by the taxpayer, and the fair market value of any other boot. The basis is the excess basis. The total contract price is the selling price less any net qualifying indebtedness that does not exceed the excess basis. Finally, payment in the year of exchange includes any net qualifying indebtedness that exceeds the excess basis.

(iv) *Examples.* The provisions of paragraph (f)(1) of this section are illustrated by the following examples:

Example (1). In 1981, A makes a section 1031(b) exchange of real property held for investment (basis $400,000) for permitted property worth $200,000, and an $800,000 installment obligation issued by the other party to the exchange bearing adequate stated interest. Neither the property transferred by A nor the property received in the exchange is mortgaged property. A's basis of $400,000 is allocated first to the permitted property received, up to the fair market value of $200,000. A's excess basis is $200,000 ($400,000—$200,000). Since the installment obligation is the only boot received by A in the exchange, A's entire excess basis of $200,000 is allocable to it. Under the installment method, the selling price is $800,000 (the face amount of the installment obligation), and the contract price is also $800,000 (selling price less qualifying indebtedness, $800,000—0). The gross profit is $600,000 (selling price less excess basis allocated to the installment obligation, $800,000—$200,000), and the gross profit ratio is 75% ($600,000/$800,000). A recognizes no gain until payments are received on the installment obligation. As A receives payments (exclusive of interest) on the installment obligation, 75% of each payment will be gain attributable to the exchange and 25% of each payment will be recovery of basis. A will hold the permitted property received in the exchange with a basis of $200,000.

Example (2). The facts are the same as in example (1), except that in the exchange A receives permitted property worth $200,000, a $600,000 installment obligations, and $200,000 in cash. A is treated as having sold appreciated property (basis equal to the $200,000 excess basis) for $200,000 cash and a $600,000 installment obligation. As in example (1), the contract price and the selling price are $800,000, the gross profit is $600,000, and the gross profit ratio is 75%. Accordingly, A will recognize gain of $150,000 on receipt of the cash (75% of the $200,000 payment). A holds the permitted property with a basis of $200,000.

Example (3). The facts are the same as in example (2), except that A does not receive $200,000 in cash. Instead, the property transferred by A in the exchange was subject to a mortgage (meeting the definition of qualifying indebtedness) of $200,000 to which the other party to the exchange took subject. The permitted property received by A in the exchange was not subject to a mortgage. A is treated as having sold appreciated property (basis equal to $200,000 excess basis) for $600,000 cash and $200,000 net relief of mortgage liability. The mortgage liability of which A is deemed relieved ($200,000), reduced by any cash paid by

A and any mortgage liability encumbering the like-kind property received by A in the simultaneous exchange ($0), is treated as qualifying indebtedness. Since the qualifying indebtedness ($200,000) does not exceed A's excess basis ($200,000), B's taking subject to such indebtedness does not constitute payment to A in the year of exchange. Under the installment method, the selling price is $800,000 and the total contract price is $600,000 (selling price of $800,000 less $200,000 of qualifying indebtedness that does not exceed A's excess basis). Gross profit is also $600,000 ($800,000 selling price less $200,000 excess basis), and the gross profit ratio is 1 ($600,000/$600,000). A recognizes no gain until payments are received on the installment obligation. As A receives payment (exclusive of interest) on the $600,000 installment obligation, the full amount received will be gain attributable to the exchange. A holds the permitted property with a basis of $200,000.

Example (4). The facts are the same as in example (2), except that A's basis in the property transferred by A was only $160,000. Since A's basis first must be allocated to permitted property received in the exchange up to the fair market value ($200,000) of that permitted property, there is no excess basis. Accordingly, A will recognize gain equal to the full amount of cash received ($200,000), and will hold the installment obligation at a basis of zero. A will hold the permitted property at a basis of $160,00.

(2) *Certain exchanges described in section 356(a)*—(i) *In general.* The provisions of paragraph (f)(2) of this section apply to exchanges described in section 356(a)(1) ("section 356(a)(1) exchanges") in which the taxpayer receives as boot (property which is "other property" under section 356(a)(1)(B)) an installment obligation issued by a qualifying corporation which is not treated as a dividend to the taxpayer. For purposes of section 453(f)(6) and paragraph (f)(2) of this section, any such section 356(a)(1) exchange shall be treated as a disposition of property by the taxpayer to the qualifying corporation and an acquisition of such property by the qualifying corporation from the taxpayer. If section 354 would apply to the exchange but for the receipt of boot, the term "qualifying corporation" means a corporation the stock of which could be received by the taxpayer in the exchange without recognition of gain or loss. If section 355 would apply to the exchange but for the receipt of boot, the term "qualifying corporation" means the distributing corporation (referred to in section 355(a)(1)(A)). Receipt of an installment obligation is treated as a dividend if section 356(a)(2) applies (determined without regard to the presence of absence of accumulated earnings and profits), or if section 356(e) (relating to certain exchanges for section 306 stock) applies to the taxpayer's receipt of the installment obligation.

(ii) *Exclusion from payment.* Receipt of permitted property shall not be considered payment for purposes of paragraph (c) of this section. For purposes of paragraph (f)(1) of this section, "permitted property" means property, the receipt of which does not result in recognition of gain under section 356(a)(1) (i.e., stock of a qualifying corporation).

(iii) *Installment method determinations.* Installment method determinations with respect to an installment obligation received in an exchange to which paragraph (f)(2) of this section applies shall be made in accordance with the rules prescribed in paragraph (f)(1)(iii) of this section. In applying such rules, a section 356(a)(1) exchange shall be treated as a section 1031(b) exchange and permitted property shall mean permitted property described in prargraph (f)(2) of this section.

(iv) *Examples.* The provisions of paragraph (f)(2) of this section are illustrated by the following examples:

Example (1). T corporation and P corporation are unrelated closely held corporations. A owns 10% of the stock of T. A is not related to any other T stockholder or to any P stockholder. S corporation is a wholly-owned subsidiary of P. Pursuant to a plan of reorganization, T merges with and into S. In the merger, the T shares held by A are exchanged for shares of P worth $100,000 and a $300,000 installment obligation (bearing adequate interest) issued by P. In the merger the other stockholders of T exchange their T shares solely for P shares worth, in the aggregate, $3,600,000. The merger is a reorganization desribed in sections 368(a)(1)(A) and (a)(2)(D), and T, S, and P each is a party to the reorganization under section 368(b). P is a qualifying corporation and A is party to a section 356(a)(1) exchange in which receipt by A of the installment obligation will not be treated as a dividend to A. Because, for purposes of section 453(f)(6), this transaction is treated as a direct exchange between P and A, no gain or loss is recognized by S with respect to the P obligation. Assume A's basis in the T shares exchanged by A was $150,000. A's basis is allocated first to the permitted property (P shares) received, up to the fair market value of $100,000. A's excess basis is $50,000 ($150,000—$100,000). Since the installment obligation is the only boot received by A in the exchange, the entire excess basis of $50,000 is allocable to it. Under the installment method, the contract price is $300,000 (face amount of the installment obligation), the gross profit is $250,000 (contract price less $50,000 excess basis allocated to the installment obligation), and the gross profit ratio is ⅚ ($250,000/$300,000). A recognizes no gain until payments are received on the installment obligation. As A receives payments (exclusive of interests) on the installment obligation, ⅚ths of each payment will be gain attributable to the exchange and ⅙th of each payment will be recovery of basis. A will hold the permitted property (P stock) received in the exchange at a basis of $100,000.

Example (2). The facts are the same as in example (1). B, who also owns 10% of the stock of T directly and owns no other stock of T by attribution within the meaning of 318(a), exchanges the T shares in the merger for a $400,000 installment obligation issued by P (bearing adequate interest). Although section 356(a)(1) will not apply to this exchange because B receives no P stock in the transaction and the character of the gain is determined under section 302(a), for purposes of section 453 and paragraph (a) of this section, B is treated as having sold the T shares to P in exchange for P's installment obligation. B will report the installment sale on the installment method unless B elects under paragraph (e) of this section not to report the transaction on the installment method. If, by reason of constructive ownership of T shares under section 318(a) and failure to meet the requirements of section 302(c)(2), the character of the transaction as to B were determined under section 302(d), section 453 would not apply to the exchange by B.

Example (3). The facts are the same as in examples (1) and (2), except that the P stock is voting stock and S merges into T in a reorganization described in section 368(a)(2)(E). The results are the same as in examples (1) and (2).

Example (4)(i). T Corporation and larger P Corporation are unrelated public corporations the stock of each of which is widely held. A is a stockholder of T. S Corporation is a wholly owned subsidiary of P. On December 31, 1981, pursuant to a plan of reorganization which provides for a "note option" election, T merges with and into S. In the merger, A exercises the note option and the T shares held by A are exchanged for a $30,000 installment obligation (bearing adequate interest) issued by P, 1,000 P shares (worth $10 per share on the date of merger), and a non-negotiable certificate evidencing a right to receive (within 5 years from the date of merger) up to 1,000 additional P shares (plus adequate interest) if certain earnings conditions are satisfied. Neither the installment obligation nor the certificate evidencing the right to receive additional P shares is readily tradable within the meaning of §1.453-1A(c)(4)(iv)(C). There is a valid business reason for not issuing all of the P shares immediately. Certain of the other T shareholders exercise the note option and exchange their T shares for a similar package. Other T shareholders do not exercise the note option and receive in the merger P shares plus a non-negotiable right to receive up to an equal number of additional P shares (plus adequate interest) within 5 years. In the aggregate, the total outstanding T shares are exchanged for 20% P installment obligations, 40% P shares, and rights to receive an equal number of additional P shares within 5 years. The merger of T into S qualifies as a reorganization under section 368(a)(1)(A) and (a)(2)(D). P is a qualifying corporation, the P shares received and which may subsequently be received by A are permitted property, and the exchange to which A is a party is a section 356(a)(1) exchange.

(ii) Assume A's basis in the T shares exchanged by A was $25,000. A's basis is allocated first to permitted property (P shares) up to fair market value. In the exchange A has re-

ceived 1,000 P shares (worth $10,000) and may receive up to an additional 1,000 P shares in the future. In allocating A's basis, it is assumed that all contingencies contemplated by the merger agreement will be met or otherwise resolved in a manner that will maximize the consideration A will receive. It is further assumed that each P share, when received, will have a fair market value equal to the fair market value ($10) of a P share at the date of merger. Accordingly, since A may receive a maximum of 2,000 P shares, $20,000 (2,000 × $10) of A's basis will be allocated to the 1,000 P shares A has received ($10 per share) and to A's right to receive up to an additional 1,000 P shares (at $10 per share). A's excess basis of $5,000 ($25,000 − $20,000) is allocated to the $30,000 P installment obligation.

(iii) In 1983 the earnings condition is fully satisfied and A receives an additional 1,000 P shares (plus adequate interest). Each P share held by A has a basis of $10.

(iv) Assume instead that the earnings condition is only partly satisfied and, by the close of 1986, A has received only an additional 600 P shares and is not entitled to receive any further P shares. Initially, each P share received by A was assigned a basis of $10. Of A's $25,000 basis in the T shares exchanged, $4,000 ($20,000 initially allocated to P shares received and to be received less $16,000 (1,600 P shares × $10)) now must be accounted for. The $4,000 of remaining basis will be assigned to the P shares then held by A. Thus, if A continues to hold all 1,600 P shares, A's basis in each P share will be increased by $2.50 ($4,000 divided by 1,600 P shares). If A previously sold 800 P shares and retains only 800 P shares, A's basis in each retained P share will be increased by $5 ($4,000 divided by 800 P shares). If A retains no P shares, and if all of the additional 600 P shares were issued to A and sold by A before the final year of the five year earn-out term (*i.e.*, by the end of 1985), A's remaining basis of $4,000 will be added to the basis at which A holds the unpaid portion of the P installment obligation (up to but not in excess of the maximum amount remaining payable under that obligation less A's remaining basis in the installment obligation determined immediately before the addition to basis). If A has previously disposed of the P installment obligation, so that A holds neither P shares nor the P installment obligation to which the remaining $4,000 of A's basis can be allocated, A will be allowed a $4,000 loss in 1986. Similarly, if A continues to hold the P installment obligation but the facts are such that the maximum amount thereafter payable under the obligation is only $3,000 in excess of A's basis in the obligation determined immediately before assignment of A's remaining $4,000 basis, $3,000 of that remaining basis would be assigned to the installment obligation and P would be allowed a $1,000 loss in 1986.

Example (5). Pursuant to a plan to acquire all the stock of T corporation, P purchases 90% of the T stock for cash. To acquire the remaining 10% of T stock P creates S corporation and transfers P stock and P's newly issued installment notes to S in exchange for all of S's stock. The P notes are not readily tradable. Thereafter S merges into T, the P stock and P's installment notes are distributed to the T minority shareholders, and the S stock held by P is automatically converted into T stock. Assume that for federal tax purposes the existence of S is disregarded and the transaction is treated as a sale of T stock to P in exchange for P stock and P's installment notes. The minority shareholders will report the gain realized on the receipt of the P installment notes on the installment method unless they elect otherwise. The receipt of P stock will be treated as a payment in the year of sale.

Example (6). The facts are the same as example (5) except P transferred only P's installment notes to S and only these notes were distributed to T minority shareholders. As in example (5) the transaction is treated as a sale of T stock to P in exchange for P's installment notes. Each minority shareholder realizing gain on the receipt of the installment notes will report the gain on the installment method unless electing otherwise.

(3) *Other partial recognition exchanges*—(i) *In general.* The provisions of paragraph (f)(3) of this section apply to exchanges not described in paragraph (f)(1) or (2) of this section in which a taxpayer, in exchange for appreciated property, receives both permitted property (*i.e.*, property with respect to which no gain or loss would be recognized but which, in the hands of the taxpayer, would have as basis for determining gain or loss the same basis in whole or in part as the property exchanged) and boot that includes an installment obligation issued by the other party to the exchange. Ordinarily, the installment method rules set forth in paragraph (f)(1)(ii) and (iii) of this section will apply to an exchange described in paragraph (f)(3) of this section subject to such variations, if any, as may be required under the applicable provisions of the Code.

(ii) *Exchanges to which section 351 applies.* If a taxpayer receives, in an exchange to which section 351(b) applies (a "section 351(b) exchange"), an installment obligation that is not a security within the meaning of section 351(a), the installment obligation is boot and the stock and securities (within the meaning of section 351(a)) are permitted property (within the meaning of paragraph (f)(1)(ii) of this section). The taxpayer will report the installment obligation on the installment method and any other boot received will be treated as a payment made in the year of the exchange. In applying the rules of paragraph (f)(1)(iii) of this section to a section 351(b) exchange the excess basis is the amount, if any, by which the taxpayer's basis in the property transferred (plus any cash transferred) by the taxpayer exceeds the sum of the transferred liabilities which are not treated as money received under section 357 plus the fair market value of permitted property received by the taxpayer. In determining selling price and total contract price, transferred liabilities which are not treated as money received under section 357 shall be disregarded. For purposes of paragraph (f)(3)(ii) of this section, transferred liabilities are liabilities described in section 357(a)(2). Solely for the purpose of applying section 358(a)(1), the taxpayer shall be treated as if the taxpayer elected not to report receipt of the installment obligation on the installment method. Under section 362(a)(1) the corporation's basis in the property received from the taxpayer is the taxpayer's basis in the property increased by the gain recognized by the taxpayer at the time of the exchange. As the taxpayer recognizes gain on the installment method, the corporation will increase its basis in the property by an amount equal to the amount of gain recognized by the taxpayer.

(iii) *Examples.* The provisions of paragraph (f)(3) of this section are illustrated by the following examples. In each example, assume that adequate stated interest means both a reasonable rate of interest within the meaning of any applicable regulation promulgated under section 385 and a rate of interest not less than the test rate prescribed in the regulations under section 483, and that the debt to equity ratio of the issuing corporation is a permissible ratio under any applicable regulation promulgated under section 385.

Example (1). A owns Blackacre, unimproved real property, with a basis of $300,000. The fair market value of Blackacre is $700,000. Blackacre is encumbered by a longstanding mortgage of $200,000. A transfers Blackacre, subject to the mortgage, to newly organized X corporation. A receives in exchange all of the stock of X, worth $400,000, and a $100,000 installment obligation (bearing adequate stated interest) issued by X. A realizes $400,000 of gain on the exchange. The installment obligation calls for a single payment of the full $100,000 face amount three years following the date of issue. The installment obligation is not a "security" within the meaning of section 351(a), and thus the exchange by A is a transaction described in section 351(b). The installment obligation is boot received by A in the exchange and the X stock is permitted property received by A in exchange. In applying the provisions of paragraph (f)(1)(ii) and (iii) of this section to a section 351(b) exchange, reference is required to section 357(a) under which the $200,000 mortgage liability is not treated as

money or other property received by A in the exchange, and to section 358(a)(1) under which the basis of the X stock in the hands of A will be determined. These rules apply as follows: Neither receipt of the X stock nor relief of the mortgage encumbrance is treated as payment to A and thus A will recognize no gain in the year of the exchange. A's basis of $300,000 in Blackacre is reduced by the $200,000 mortgage from which A is deemed relieved in the exchange. The remaining basis of $100,000 is allocated to the X stock (but not in excess of the fair market value of the X stock); since the fair market value of the X stock is $400,000, the basis of the X stock in the hands of A is $100,000. Accordingly, in A's hands the installment obligation has a basis of zero. In the hands of X, the initial basis of Blackacre, determined under section 362(a), is $300,000 (the basis of the property in the hands of A), increased by the amount of gain recognized by A at the time of the transfer ($0)). As A receives payments on the installment obligation and recognizes gain, X's basis in Blackacre will be increased, at that time, in an amount equal to the gain recognized by A. Thus, if the $100,000 installment obligation is paid in full on the third anniversary date, A will recognize gain of $100,000 (because of A's basis in the installment obligation is zero) and X at that time will increase the basis at which it holds Blackacre by $100,000. If in the third year X had sold the property for cash before making payment on the installment obligation, X would recognize a loss of $100,000 when X paid the obligation in that amount to A on the third anniversary date.

Example (2). B owns Whiteacre, unencumbered, unimproved real property, with a basis of $250,000. The fair market value of Whiteacre is $300,000. A transfers Whiteacre to newly organized Y corporation in exchange for all of the stock of Y corporation (worth $200,000) and a $100,000 installment obligation (bearing adequate interest). The installment obligation is payable in full on the second anniversary of the date of issue. The installment obligation is not a "security" within the meaning of section 351(a), and thus the transaction is a section 351(b) exchange. Applying the rules summarized in example (1) to the facts of this case, receipt of the installment obligation is not treated as payment to A, $200,000 of A's basis of $250,000 in Whiteacre is allocated to the Y stock (equal to the fair market value of the Y stock), and the excess basis of $50,000 is allocated to the installment obligation. In the hands of Y, the basis of Whiteacre initially is $250,000, and will be increased by $50,000 when the installment obligation is paid and A recognizes gain of $50,000.

Example (3). D owns a machine which is unemcumbered 5-year recovery property with an adjusted basis of $500,000. The recomputed basis (as defined in section 1245(a)(2)) of the machine in the hands of D is $1 million. The fair market value of the machine also is $1 million. D transfers the machine to newly organzied X Corporation, and E, an unrelated individual, simultaneously transfers property worth $1 million to X Corporation. D receives in exchange 400 shares of X common stock worth $400,000, a $400,000 15-year debenture issued by X (worth its face amount), and a $200,000 installment obligation (bearing adequate interest) issued by X. The installment obligation calls for a single payment of the full $200,000 face amount two years following the date of issue. E receives in the exchange 1,000 shares of X common stock worth $1 million. D and E are in control (as defined in section 368(c)) of X immediately after the exchange. The debenture received by D is a "security" within the meaning of section 351(a), but the installment obligation received by D is not a "security" within the meaning of that section and thus the exchange by D is a transaction described in section 351(b). The installment obligation is boot received by D in the exchange and the X stock and X debenture are permitted property received by D in the exchange. Since the aggregate fair market value ($800,000) of the X stock ($400,000) and the X debenture ($400,000) received by D exceeds D's $500,000 adjusted basis in the machine, all of that basis is allocated proportionately among the items of permitted property. Thus, D will hold the X stock with a basis of $250,000 and the X debenture with a basis of $250,000. Since there is no excess basis, in the hands of D the installment obligation has a basis of zero. In the hands of X, the adjusted basis of the machine remains $500,000. When D receives payment from X on the $200,000 installment obligation, D will recognize gain of $200,000, all of which gain will be treated as ordinary income. See sections 1245(a)(1) and 453B(a). At that time, X's adjusted basis in the machine will be increased in an amount equal to the $200,000 gain recognized by D.

Example (4). In 1976 H and W purchased Blackacre as their principal residence for $50,000. In 1981 H and W, both of whom are less than 55 years of age, sold Blackacre to A for $90,000: $15,000 cash, A's assumption of the $40,000 mortgage, and A's promise to pay H and W $7,000 (with adequate stated interest) in each of the next 5 years. Within 2 years of the sale of Blackacre, H and W acquire Whiteacre, an unencumbered property, which will be their principal residence, for $80,000. Of the $40,000 gain that H and W realized upon the sale of Whiteacre, $30,000 will not be recognized pursuant to the provisions of section 1034. Unless H and W elect not to report the transaction on the installment method, they will treat the $10,000 gain to be recognized as the gross profit for purposes of calculating the gross profit ratio. Accordingly the gross profit ratio is ⅓ ($10,000 gross profit/$50,000 contract price) and H and W will report as gain $3,000 (⅓ × $15,000) in the year of the sale and $1,400 (⅓ × $7,000) in each of the next five years.

(4) *Installment obligations received as distributions in redemptions of stock pursuant to section 302(a).* If a corporation redeems its stock and the redemption is treated as a distribution in part or full payment in exchange for the stock under section 302(a), then an installment obligation which meets the requirements of section 453 and is distributed in the redemption shall be reported on the installment method unless the taxpayer elects otherwise.

Example. A owns 10% of the stock of X corporation and is not considered as owning (under section 318(a)) any other shares of X corporation. X redeems all of A's X shares and distributes its installment obligation to A in full payment. The reduction is treated as a sale of the X shares by A under section 302(b)(3). A will report any gain realized in the redemption on the installment method unless A elects otherwise.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 2, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 3, 1984, 49 F.R. 18866)

Notice of Proposed Rulemaking

Accelerated Cost Recovery System

LR-185-81

SUMMARY: This document contains proposed regulations relating to the Accelerated Cost Recovery System (hereinafter referred to as ACRS) for recovering capital costs of eligible property. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256] (hereinafter referred to as ERTA), the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462] (hereinafter referred to as TEFRA) and the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. Prior law allowed as a depreciation deduction a reasonable allowance for exhaustion, wear and tear, or obsolescence of eligible property. ERTA replaced this prior law depreciation system with ACRS. Generally, under ACRS cost recovery deductions are determined by the use of tables which reflect the use of accelerated methods of cost recovery over predetermined recovery periods. These recovery periods are generally unrelated to, and shorter than, prior law "useful lives." TEFRA repealed the more accelerated tables for personal property which were to be effective for property placed in service after 1984. These regulations would provide taxpayers with the guidance needed to comply with the Acts.

DATES: Written comments must be delivered or mailed by May 16, 1984. In general, these regulations apply to eligible property placed in service after December 31, 1980.

ADDRESS: Send comments to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-185-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: John A. Tolleris (with respect to §1.168-4 (202-566-3590)), Joseph M. Rosenthal (with respect to the repair allowance, §1.167(a)-11(d)(2) (202-566-3288)), or George T. Magnatta (with respect to all other provisions (202-566-3294)), of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 167, 168, 178, and 1016 of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to sections 201 and 203 of the Economic Recovery Tax Act of 1981(Pub. L. 97-34; 95 Stat. 203, 221) [1981-2 C.B. 256, 275, 283], sections 205 and 206 of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97-248; 96 Stat. 427, 431) [1982-2 C.B. 462, 474, 476], and section 102 of the Technical Corrections Act of 1982 (Pub. L. 97-448; 96 Stat. 2367) [1983-1 C.B. 451, 452]. These amendments are to be issued under the authority contained in section 168 (95 Stat. 203; 26 U.S.C. 168) and section 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

ACCELERATED COST RECOVERY SYSTEM

Section 168, as added by ERTA, is a replacement for the prior law depreciation system for recovering the capital costs of trade or business assets or investment assets. Generally, this new Accelerated Cost Recovery System (ACRS), added by section 168, provides for the recovery of capital costs of eligible property by the use of tables, which reflects the use of accelerated methods of cost recovery over predetermined recovery periods. These recovery periods are generally unrelated to, and shorter than, those under prior law. Unlike prior law, ACRS does not make any distinction between new and used property. This new capital cost recovery system is mandatory for all eligible property, hereinafter referred to as "recovery property." Recovery property includes both real and personal property. Generally, to be eligible for ACRS property must be (1) tangible property of a character subject to the allowance for depreciation, (2) used in a trade or business or held for the production of income, and (3) placed in service by the taxpayer after December 31, 1980. Recovery property does not include (1) tangible depreciable property the taxpayer properly elects to depreciate under a method not expressed in terms of years, (2) public utility property where the taxpayer does not use a normalization method of accounting, and (3) certain pre-1981 property involved in post-1980 "churning" transactions to obtain the benefits of ACRS.

In addition, recovery property does not include intangible property. The Internal Revenue Service is continuing to examine the extent to which certain types of property, such as computer software and master motion picture negatives, may constitute intangible property that is ineligible for ACRS. The Internal Revenue Service is also examining the manner in which other provisions of the Code (such as section 48(k)) may apply if such property is considered eligible for ACRS. Accordingly, these issues have been reserved in these proposed regulations and are the subject of a recently opened project, under which regulations will be issued as soon as possible. In the meantime, the Service will continue to administer the area in accordance with its current position. Comments on these questions from interested persons are welcome.

The allowable ACRS deduction is generally determined by multiplying the unadjusted basis of the property by the applicable percentage contained in the relevant ACRS tables. The prior law concept of salvage value is abolished in determining deductions under this new system. Thus, the entire cost or other basis of the property is recovered under ACRS. The proposed regulations provide rules for determining the allowable deduction when the basis of the property is redetermined (*e.g.*, where there is a readjustment of the purchase price).

Under ACRS, the cost of personal property must be recovered over a 3-year, 5-year, 10-year, or 15-year recovery period (unless the taxpayer elects a longer recovery period under rules described below).

Real property is recovered over a 15-year recovery period (unless a longer period is elected). With respect to personal property, a full year's recovery deduction is allowed in the first recovery year regardless of when the asset is placed in service during that taxable year. No recovery deduction is allowed in the taxable year in which personal property is disposed of. The proposed regulations provide rules for computing the allowable deduction where the taxpayer has a taxable year of less than 12 months. In addition, for real property, the recovery for the year the asset is placed in service or is disposed of is based on the number of months the property is in service during the year, regardless of whether the taxpayer has a normal or short taxable year.

Taxpayers may elect to recover the cost of eligible property using the straight line method over the applicable recovery period or over a longer optional recovery period. For example, taxpayers may recover the capital costs of 5-year recovery property over a 5-year, 12-year, or 25-year period or the cost of real property over a 15-year, 35-year, or 45-year period, using the straight line method. Except for real property, the election applies to all recovery property of the particular class placed in service in the same taxable year. Generally, this election is irrevocable. The proposed regulations provide tables containing the applicable percentages when an optional straight line election is made.

Taxpayers may, under certain conditions, elect to recover the capital costs of certain recovery property in a mass asset account. If the election is made, mass assets which have the same asset depreciation range (ADR) midpoint life as of January 1, 1981,

and which are placed in service in the same taxable year, will be accounted for in a single account. As a consequence of the election, upon the disposition of an asset from that account, the taxpayer will generally include an income the full amount realized on the disposition. The unadjusted basis of the asset disposed of will continue to be included in determining the recovery deduction for the account. The proposed regulations define mass assets, provide rules for determining when dispositions occur for purposes of investment tax credit recapture, and provide rules for recovering any increase in basis resulting from such recapture. The proposed regulations also provide rules relating to the recognition of gain or loss on the disposition of recovery property other than from a mass asset account.

Under ACRS, component cost recovery is not permitted. Thus, the same recovery period and method generally must be used for a building and all structural components. The recovery period for a component generally begins at the later of the time the component or the building is placed in service.

Under the proposed regulations, a building is considered placed in service when a significant portion is made available for use in a finished condition. The taxpayer at that time begins recovery of so much of the capitalized costs as are properly allocable to the portion of the building in service. Similarly, as portions of the building are later made available, recovery of the properly allocable costs will commence.

Capitalized expenditures, which are section 1250 property, paid or incurred after the building is completed are recovered under the same period and method as are used for the building, recovery beginning when the improvement is placed in service. However, if a capitalized expenditure qualifies as a "substantial improvement," a new recovery period and method are permitted, recovery beginning when the improvement is placed in service.

Similarly, with respect to personal property, amounts paid or incurred after the property is placed in service, which are properly chargeable to capital account, are treated as newly-purchased property for ACRS purposes. That property is assigned to the same recovery class as the property to which the expenditure relates. Any applicable recovery period and method may be selected for such improvement, recovery beginning when the improvement is placed in service.

Rules are also provided clarifying the results when a lessee makes improvements on leased property.

The proposed regulations clarify the rules which prevent taxpayers from converting pre-1981 property into post-1980 recovery property. Under those rules, if the taxpayer enters into certain "churning" transactions, the methods of cost recovery provided under ACRS are not available with respect to the property.

ACRS contains special rules for property which is used predominantly outside the United States. The proposed regulations define this type of property and also provide guidance for property which ceases or begins to be used predominantly outside the United States after having been placed in service in a prior taxable year.

Similarly, the proposed regulations provide rules for determining the deductions for other property which changes status under ACRS (*e.g.*, property which ceases to be used in connection with research and experimentation, property converted from personal to business use). Additionally, the proposed regulations provide rules for determining the deductions for property which is used both for personal and business purposes.

ACRS provides special rules for recovery property which is involved in certain nonrecognition and other transactions (section 168(f)(7), (10)). Generally, in these transactions the transferee is bound by the transferor's recovery period and method with respect to so much of the basis of the property in the hands of the transferee as does not exceed its basis in the hands of the transferor. The proposed regulations clarify the class of transactions subject to the rules and the manner of computing the deductions available to the transferor and transferee.

The proposed regulations also clarify the rules with respect to property involved in a transaction to which section 1031 or 1033 applies (section 168(f)(7)). Additionally, the proposed regulations clarify the deductions available with respect to property transferred by gift or bequest and with respect to partnership property to which basis adjustments are made.

The proposed regulations also provide the guidance necessary for making the various elections under section 168.

Since Congress made no change to certain provisions of the Code which require (or allow) a taxpayer to compute depreciation by use of the straight line method over the property's useful life (*e.g.*, section 163(d)(3)(C), 1016(a)(3)), the proposed regulations contain no special rules in that regard. As a result, the rules under prior law continue to apply.

Section 203(b) of ERTA terminated the class life asset depreciation range (ADR) system, authorized by section 167(m) of the Code, for recovery property placed in service after 1980. Additionally, section 201(c) of ERTA repealed the asset guideline class repair allowance, authorized by section 263(e), effective for property placed in service after December 31, 1980. The proposed regulations implement these statutory changes by amending §1.167(a)-11(a)(1) and (d)(2) and by making other conforming amendments. The proposed regulations also clarify that the repair allowance is continued in effect for expenditures made after December 31, 1980, for the repair, maintenance, rehabilitation, or improvement of property placed in service before January 1, 1981.

The proposed regulations provide that the taxpayer may elect the repair allowance for a taxable year by (a) making the election to apply ADR for the taxable year (even if all the property placed in service during the taxable year is recovery property to which the ADR system does not apply), and (b) making an election to

apply the asset guideline class repair allowance for the taxable year.

For periods after December 31, 1980, the proposed regulations provide that expenditures that are property improvements or excluded additions under the repair allowance rules shall generally be treated as separate items of recovery property, as described above.

These regulations concerning ACRS are effective for property placed in service after December 31, 1980. A taxpayer who has filed a return and who either did not claim allowable ACRS deductions, or did not claim the full amount allowable (*e.g.*, because the taxpayer used a different rule for years following a short taxable year than is provided in these regulations), should file an amended return.

NON-APPLICABILITY OF EXECUTIVE ORDER 12291

It has been determined that this notice of proposed rulemaking is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the order dated April 29, 1983.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS—PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying.

PAPERWORK REDUCTION ACT

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal authors of these regulations are John A. Tolleris, George T. Magnatta, Harold T. Flanagan, and Joseph M. Rosenthal of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.167(a)-11 is amended as follows:

1. Paragraph (a)(1) is amended by adding a new sentence at the beginning thereof.

2. Paragraph (d)(2) is amended as follows:

a. A caption is added to paragraph (d)(2)(i)(*a*) and new paragraph (d)(2)(i)(*b*) is added,

b. Paragraph (d)(2)(ii) is amended by adding a new sentence at the end thereof,

c. In paragraph (d)(2)(iii), the tenth sentence is amended by adding "property that is first placed in service (as provided in paragraph (e)(1)(i) and (ii) of this section) before January 1, 1981, and is" immediately after the phrase " 'repair allowance property' means", and

d. New paragraph (d)(2)(viii)(*d*) is added immediately after paragraph (d)(2)(viii)(*c*).

The revised and added provisions read as follows:

§1.167(a)-11 Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

(a) *In general*—(1) *Summary.* This sections does not apply with respect to recovery property (within the meaning of section 168 and the regulations thereunder) placed in service after December 31, 1980.***

* * * * *

(d) *Special rules for salvage, repairs and retirements.* ***

(2) *Treatment of repairs*—(i) *In general—(a) Treatment of repair expenditures.****

(*b*) *Property placed in service after December 31, 1980.* This paragraph (d)(2) does not apply to any expenditures with respect to property first placed in service after December 31, 1980, but may apply to expenditures paid or incurred after such date with respect to property first placed in service before January 1, 1981. Expenditures with respect to property first placed in service after December 31, 1980, shall be treated as capital expenditures or as deductible expenses for the taxable year in which paid or incurred in accordance with the general rules provided in sections 162, 212, 263. Property is considered first placed in service for purposes of this paragraph (d)(2)(i)(*b*) under the rules of paragraph (e)(1)(i) and (ii) of this section.

(ii) *Election of repair allowance.* *** For taxable years ending after December 31, 1980, and before February 16, 1984, notwithstanding paragraph (f)(1) of this section, the taxpayer may elect (in the original return or in an amended return) to apply this section and the asset guideline class repair allowance described in paragraph (d)(2)(iii) of this section on or before the later of the due date (including extensions) of the taxpayer's tax return for the taxable year or November 16, 1984.

* * * * *

(viii) *Treatment of property improvements and excluded additions.* ***

(*d*) Paragraph (d)(2)(viii)(*a*), (*b*),

and (c) of this section does not apply to a property improvement, excluded addition, or part thereof considered first place in service by the taxpayer after December 31, 1980. Such property improvement, excluded addition, or part thereof shall generally be treated as a separate item of recovery property (as defined in section 168(c)(1)), and shall be assigned to the appropriate class of recovery property in accordance with section 168(c)(2). See §1.168-2(e)(2). For taxable years ending after December 31, 1980, notwithstanding the succeeding sentence, for purposes of this paragraph (d)(2)(viii)(*d*), a property improvement, excluded addition, or part thereof is considered first placed in service under the rules provided in paragraph (e)(1)(i) and (ii) of this section and not under the rules provided in paragraph (e)(1)(iii) and (iv) of this section.***

* * * * *

Par. 2. New §§1.168-1 through 1.168-6 are added. The new sections read as follows:

§1.168-1 Accelerated Cost Recovery System; in general.

(a) *Cost recovery deduction allowed.* Section 168 of the Internal Revenue Code of 1954 provides a system for determining cost recovery deductions for recovery property, the Accelerated Cost Recovery System ("ACRS"). The deduction allowable under section 168 is deemed to constitute the reasonable allowance for depreciation allowed as a deduction under section 167(a). Operating rules regarding determination of the allowable cost recovery deduction are provided in §1.168-2. The definition of recovery property and the classification of recovery property into recovery categories of 3, 5, 10, and 15 years are provided in §1.168-3. ACRS must be applied with respect to recovery property placed in service after December 31, 1980, except for certain property which does not qualify under section 168 or which may be excluded from ACRS; §1.168-4 provides rules regarding such exclusions and nonqualifications. Special rules regarding ACRS are provided in §1.168-5. Rules relating to the recognition of gain or loss on dispositions are provided in §1.168-6.

(b) *Cross references.* See §1.167(a)-(11)(d)(2) regarding the election after 1980 of the repair allowance for certain property. See §1.178-1 regarding the availability of ACRS deductions for, or the amortization of, improvements on leased property. See §1.1016-3(a)(3) regarding the basic adjustment for the amount allowable where no ACRS deduction is claimed.

§1.168-2 Amount of deduction for recovery property.

(a) *Computation of recovery allowance*—(1) *General rule.* Except as otherwise provided in section 168 and the regulations thereunder, the recovery allowance for any taxable year equals the aggregate amount determined by multiplying the unadjusted basis (as defined in §1.168-2(d)) of recovery property (as defined in §1.168-3) by the appropriate applicable percentage provided in paragraph (b) of this section. For purposes of determining the recovery allowance, salvage value shall be disregarded.

(2) *No allowance in year of disposition.* Except for 15-year real property and except as otherwise provided in §1.168-5, no recovery allowance shall be allowed in the year of disposition of recovery property.

(3) *Proration of allowance in year of disposition of 15-year real property.* In the taxable year in which 15-year real property is disposed of, the recovery allowance shall be determined by multiplying the allowance (determined without regard to this subparagraph) by a fraction, the numerator of which equals the number of months in the taxable year that the property is in service in the taxpayer's trade or business or for the production of income and the denominator of which is 12. In the case of 15-year real property that is disposed of in the first recovery year, the denominator shall equal the number of months in the taxpayer's taxable year after the recovery property was placed in service by the taxpayer (including the month the property was placed in service). If the recovery allowance for the taxable year is limited by reason of the short taxable year rules of section 168(f)(5) and paragraph (f) of this section (*e.g.*, if the taxpayer dies, or if the taxpayer is a corporation which becomes a member, or ceases being a member, of an affiliated group of corporations filing a consolidated return), then the denominator shall equal the number of months in the taxpayer's taxable year. For purposes of this subparagraph, 15-year real property shall be treated as disposed of as of the last day of the month preceding the month in which it is withdrawn from service.

(b) *Applicable percentage*—(1) *Property other than 15-year real property.* The applicable percentage for recovery property, other than 15-year real property, is as follows:

If the recovery year is:	*And the class of property is*			
	3-year	*5-year*	*10-year*	*15-year Public Utility*
	The applicable percentage is:			
1	25	15	8	5
2	38	22	14	10
3	37	21	12	9
4		21	10	8
5		21	10	7
6			10	7
7			9	6
8			9	6
9			9	6
10			9	6
11				6
12				6
13				6
14				6
15				6

(2) *15-year real property.* (i) The applicable percentage for 15-year real property, other than low-income housing is as follows:

If the recovery year is	*And the month in the 1st recovery year the property is placed in service is:*											
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*
	The applicable percentage is:											
1	12	11	10	9	8	7	6	5	4	3	2	1
2	10	10	11	11	11	11	11	11	11	11	11	12
3	9	9	9	9	10	10	10	10	10	10	10	10
4	8	8	8	8	8	8	9	9	9	9	9	9
5	7	7	7	7	7	7	8	8	8	8	8	8
6	6	6	6	6	7	7	7	7	7	7	7	7
7	6	6	6	6	6	6	6	6	6	6	6	6
8	6	6	6	6	6	6	5	6	6	6	6	6
9	6	6	6	6	5	6	5	5	5	6	6	6
10	5	6	5	6	5	5	5	5	5	5	6	5
11	5	5	5	5	5	5	5	5	5	5	5	5
12	5	5	5	5	5	5	5	5	5	5	5	5
13	5	5	5	5	5	5	5	5	5	5	5	5
14	5	5	5	5	5	5	5	5	5	5	5	5
15	5	5	5	5	5	5	5	5	5	5	5	5
16	—	—	1	1	2	2	3	3	4	4	4	5

(ii) The applicable percentage for 15-year real property that is low-income housing is as follows:

If the recovery year is:	*And the month in the 1st recovery year the property is placed in service is:*											
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*
	The applicable percentage is:											
1	13	12	11	10	9	8	7	6	4	3	2	1
2	12	12	12	12	12	12	12	13	13	13	13	13
3	10	10	10	10	11	11	11	11	11	11	11	11
4	9	9	9	9	9	9	9	9	10	10	10	10
5	8	8	8	8	8	8	8	8	8	8	8	9
6	7	7	7	7	7	7	7	7	7	7	7	7
7	6	6	6	6	6	6	6	6	6	6	6	6
8	5	5	5	5	5	5	5	5	5	5	6	6
9	5	5	5	5	5	5	5	5	5	5	5	5
10	5	5	5	5	5	5	5	5	5	5	5	5
11	4	5	5	5	5	5	5	5	5	5	5	5
12	4	4	4	5	4	5	5	5	5	5	5	5
13	4	4	4	4	4	4	5	4	5	5	5	5
14	4	4	4	4	4	4	4	4	4	5	4	4
15	4	4	4	4	4	4	4	4	4	4	4	4
16	—	—	1	1	2	2	2	3	3	3	4	4

(iii) For purposes of this section, the term "low income housing" means property described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B).

(iv) For purposes of this subparagraph (2), 15-year real property placed in service on or after the first day of a month shall be treated as placed in service in that month.

(c) *Election of optional recovery percentage*—

(1) *Straight line method.* Except as provided by section 168(f)(2) and §1.168-2(g) (relating to property used predominantly outside the United States), in lieu of using the applicable percentages prescribed in section 168(b)(1) and (2) and §1.168-2(b), the taxpayer may elect (in acordance with §1.168-5(e)), for recovery property placed in service during the taxable year, to determine the recovery allowance by using the straight line method over one of the recovery periods elected by the taxpayer and set forth in the following table:

Class of property	*Recovery periods*
3-year property	3, 5, or 12 years
5-year property	5, 12, or 25 years
10-year property	10, 25, or 35 years
15-year real property	15, 35, or 45 years
15-year public utility property	15, 35, 45 years

Such election is irrevocable without the consent of the Commissioner. See subparagraph (4) of this paragraph for tables containing the appliable percentages to be used in computing the recovery allowance.

(2) *Election for property other than 15-year real property.* Except in the case of 15-year real property, a single recovery period must be elected under this paragraph for all recovery property which is in the same recovery class and which is placed in service in the same taxable year. A different recovery period may be elected (or the tables provided in section 168 (b)(1) and §1.168-2(b)(1)may be used) for recovery property in different recovery classes placed in service during the same taxable year, or for recovery property placed in service in different taxable years, whether or not in the same recovery class.

(3) *Election for 15-year real property.* In the case of 15-year real property, the election provided in paragraph (c)(1) may be made separately with respect to each property.

(4) *Applicable percentage.* (i) For property other than 15-year real property—

If the recovery year is:	*And the period elected is:*							
	3	*5*	*10*	*12*	*15*	*25*	*35*	*45*
	The applicable percentage is:							
1	17	10	5	4	3	2	1	1.1
2	33	20	10	9	7	4	3	2.3
3	33	20	10	9	7	4	3	2.3
4	17	20	10	9	7	4	3	2.3
5		20	10	9	7	4	3	2.3
6		10	10	8	7	4	3	2.3
7			10	8	7	4	3	2.3
8			10	8	7	4	3	2.3
9			10	8	7	4	3	2.3
10			10	8	7	4	3	2.3
11			5	8	7	4	3	2.3
12				8	6	4	3	2.2
13				4	6	4	3	2.2
14					6	4	3	2.2
15					6	4	3	2.2
16					3	4	3	2.2
17						4	3	2.2
18						4	3	2.2
19						4	3	2.2
20						4	3	2.2
21						4	3	2.2
22						4	3	2.2
23						4	3	2.2
24						4	3	2.2
25						4	3	2.2
26						2	3	2.2
27							3	2.2
28							3	2.2
29							3	2.2
30							3	2.2
31							3	2.2
32							2	2.2
33							2	2.2
34							2	2.2
35							2	2.2
36							1	2.2
37								2.2
38								2.2
39								2.2
40								2.2
41								2.2
42								2.2
43								2.2
44								2.2
45								2.2
46								1.1

(ii) For 15-year real property—

(A) For which a 15-year period is elected—

If the recovery year is	*And the month in the 1st recovery year that the property is placed in service is:*						
	1	*2-3*	*4*	*5-6*	*7-8*	*9-10*	*11-12*
	The applicable percentage is:						
1	7	6	5	4	3	2	1
2	7	7	7	7	7	7	7
3	7	7	7	7	7	7	7
4	7	7	7	7	7	7	7
5	7	7	7	7	7	7	7
6	7	7	7	7	7	7	7
7	7	7	7	7	7	7	7
8	7	7	7	7	7	7	7
9	7	7	7	7	7	7	7
10	7	7	7	7	7	7	7
11	6	6	6	6	6	6	6
12	6	6	6	6	6	6	6
13	6	6	6	6	6	6	6
14	6	6	6	6	6	6	6
15	6	6	6	6	6	6	6
16		1	2	3	4	6	6

(B) For which a 35-year period is elected—

If the recovery year is:	*And the month in the 1st recovery year that the property is placed in service is:*		
	1-2	*3-6*	*7-12*
	The applicable percentage is:		
1	3	2	1
2	3	3	3
3	3	3	3
4	3	3	3
5	3	3	3
6	3	3	3
7	3	3	3
8	3	3	3
9	3	3	3
10	3	3	3
11	3	3	3
12	3	3	3
13	3	3	3
14	3	3	3
15	3	3	3
16	3	3	3
17	3	3	3
18	3	3	3
19	3	3	3
20	3	3	3
21	3	3	3
22	3	3	3
23	3	3	3
24	3	3	3
25	3	3	3
26	3	3	3
27	3	3	3
28	3	3	3
29	3	3	3
30	3	3	3
31	2	2	2
32	2	2	2

(B)

If the recovery year is:	*And the month in the 1st recovery year that the property is placed in service is:*		
	1-2	*3-6*	*7-12*
	The applicable percentage is:		
33	2	2	2
34	2	2	2
35	2	2	2
36		1	2

(C) For which a 45-year period is elected—

If the recovery year is	*And the month in the 1st recovery year that the property is placed in service is*											
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*
	The applicable percentage is:											
1	2.3	2.0	1.9	1.7	1.5	1.3	1.2	.9	.7	.6	.4	.2
2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
5	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
6	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
7	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
8	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
9	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
10	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
11	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
12	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
13	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
14	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
15	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
16	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
17	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
18	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
19	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
20	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
21	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
22	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
23	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
24	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
25	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
26	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
27	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
28	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
29	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
30	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
31	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
32	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
33	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
34	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
35	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
36	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
37	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
38	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
39	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
40	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
41	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
42	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
43	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
44	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
45	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
46		.3	.4	.6	.8	1.0	1.1	1.4	1.6	1.7	1.9	2.1

(iii) For purposes of this paragraph, 15-year real property that is placed in service on or after the first day of a month shall be treated as placed in service in that month.

(5) *Property financed with the proceeds of industrial development bonds.* If, in accordance with section 168(f)(12) and §1.168-2(m), the recovery allowance for property financed with the proceeds of an industrial development bond (as described in section 103(b)) is determined using the straight line method, then an election as provided in section 168(b)(3) and this paragraph shall be deemed to have been made with respect to such property.

(d) *Unadjusted basis*—(1) *Computation.* Except as provided in paragraph (j)(6)(ii) of this section (relating to change of status), the unadjusted basis of recovery property is equal to the difference between—

(i) The basis of the property for purposes of determining gain under sections 1011 through 1024 but without regard to any adjustments to basis described in section 1016(a)(2) and (3), and

(iii) Any portion of the basis for which the taxpayer properly elects amortization in lieu of cost recovery (*e.g.*, under section 167 (k)) or treatment as an expense under section 179. The unadjusted basis of recovery property shall be first taken into account under this section for the taxable year in which the property is placed in service (as defined in paragraph (l)(2) of this §1.168-2) as recovery property.

(2) *Reductions in basis.* (i) If an investment tax credit is determined under section 46(a)(2) with respect to recovery property, then, unless the taxpayer makes an election provided under section 48(q)(4), for purposes of this section the unadjusted basis shall be reduced by 50 percent of the amount of the credit so determined. In the case of a credit determined under section 46(a)(2) for any qualified rehabilitation expenditure made in connection with a qualified rehabilitated building (other than a certified historic structure), the unadjusted basis shall be reduced by 100 percent of the amount of the credit so determined. See section 48(q) and the regulations thereunder. For rules relating to the treatment of such basis adjustment upon the disposition of an asset from a mass asset account, see §1.168-2(h)(4).

(ii) Subject to the rules of other applicable provisions of the Code (*e.g.*, section 280A), for recovery property which is used in the taxpayer's trade or business (or for the production of income) as well as in a personal or tax-exempt activity throughout a taxable year, the unadjusted basis shall be determined by multiplying the unadjusted basis (determined without regard to this subdivision) by a fraction, the numerator of which equals the taxpayer's use of the property during the taxable year in his trade or business (or for the production of income) and the denominator of which equals the taxpayer's total use of the property during the taxable year. For property converted from personal or tax-exempt use to use in the taxpayer's trade or business (or for the production of income), or for property devoted to increased use in the taxpayer's trade or business (or for the production of income), see §1.168-2(j).

(iii) The provisions of subdivision (ii) may be illustrated by the following example:

Example. In 1981, A, a calendar year taxpayer, purchases a car for $10,000 to be used in his business as well as for his personal enjoyment. During 1981, A drives the car a total of 20,000 miles of which 8,000 miles (*i.e.*, 40 percent) is in the course of A's business. During 1982, A drives the car a total of 30,000 miles of which 21,000 miles (*i.e.*, 70 percent) is in the course of A's business. During 1983, A drives the car a total of 10,000 miles of which 3,000 miles (*i.e.*, 30 percent) is the course of A's business. The optional straight line method provided under §1.168-2(c) is not elected. Thus, A's recovery allowance in 1981 equals $1,000 (*i.e.*, ($10,000 × .40) × .25), in 1982 equals $2,660 (*i.e.*, $10,000 × .70) × .38) and in 1983 equals $1,110 (*i.e.*, ($10,000 × .30) × .37). If A continues to use the car in his business after 1983, additional recovery may be allowed. See §1.168-2(j).

(3) *Redeterminations.* (i) For the taxable year (and subsequent taxable years) in which the unadjusted basis of recovery property is redetermined (*e.g.*, due to contingent purchase price or discharge of indebtedness), the recovery allowance shall be the amount determined by multiplying the redetermined adjusted basis by the redetermined applicable percentage. For purposes of this subparagraph, the redetermined adjusted basis is the unadjusted basis reduced by the recovery allowance previously allowed or allowable to the taxpayer with respect to the property and adjusted to reflect the redetermination. The redetermined applicable percentage is the percentage otherwise provided in subparagraph (b), (c), (g), or (m) of §1.168-2 for the recovery year divided by an amount equal to the unrecovered percentage (*i.e.*, 100 percent minus the applicable percentage for recovery years prior to the year in which the basis is redetermined). Thus, the increase or decrease in basis shall be accounted for over the remaining recovery years beginning with the recovery year in which the basis is redetermined.

(ii) The following examples illustrate the provisions of this subparagraph (3):

Example (1). On July 15, 1984, A places in service 5-year recovery property with an unadjusted basis of $100,000. In order to purchase the property, A borrowed $80,000 from B. On December 1, 1984, B forgives $10,000 of the indebtedness. A makes the election provided in section 108(d)(4). The recovery allowance for the property in 1984 is $15,000. Under section 1017(a), as of January 1, 1985, the adjusted basis of the property is $75,000. In 1985 the recovery allowance is $19,411.77 (*i.e.*, .22/(1.00 − .15) × ($100,000 − ($10,000 + $15,000))). In 1986, 1987, and 1988 the recovery allowance is $18,529.41 in each year (*i.e.*, .21/(1.00 − .15) × ($100,000 − ($10,000 + $15,000))).

Example (2). On July 15, 1984, C purchases and places in service 5-year recovery property with an unadjusted basis of $100,000. In addition to the $100,000, C agrees to pay the seller 25 percent of the gross profits from the operation of the property in the first year. On July 15, 1985, C pays to the seller an additional $10,000. The recovery allowance for the property in 1984 is $15,000. In 1985 the recovery allowance is $24,588.23 (*i.e.*, .22/(1.00 − .15) × ($100,000 + ($10,000 − $15,000))). In 1986, 1987, and 1988 the recovery allowance is $23,470.59 in each year (*i.e.*, .21/(1.00 − .15) × ($100,000 + ($10,000 − $15,000))).

(e) *Components and improvements*—(1) *Component cost recovery not permitted.* In general, the unadjusted basis of structural components (as defined in §1.48-1(e)(2)) of a building must be recovered as a whole. Thus, the same recovery period and method must be used for all structural components, and such components must be recovered as constituent parts of the building of which they are a part. The recovery

period for a component begins on the later of the first day of the month in which the component is placed in service as recovery property or the first day of the month in which the building of which the component is a part is placed in service as recovery property. See subparagraph (3) of this paragraph for the treatment of components of a building which is made available in stages.

(2) *Treatment of amounts added to capital account.* (i) Sections 162, 212, and 263 provide rules for the treatment of certain expenditures for the repair, maintenance, rehabilitation, or improvement of property. An expenditure which is treated as a capital expenditure under such sections (after application of the repair allowance rules of §1.167(a)-11(d)(2)) is treated as the purchase of recovery property if the improvement for which the expenditure is made is placed in service after December 31, 1980. The recovery of such expenditure shall begin when the improvement is placed in service. See subparagraph (3) of this paragraph for the treatment of a building which is made available in stages.

(ii) For capital expenditures (which are section 1250 class property) made with respect to an improvement of a building which is recovery property, the taxpayer must use the same recovery period and method as are used with respect to the building, unless the improvement qualifies as a substantial improvement. See subparagraph (4) of this paragraph. If capital expenditures (which are section 1250 class property) are made with respect to improvements of a building which is not recovery property under section 168(e) and §1.168-4, then the taxpayer may select any applicable recovery period and method for the recovery of the first of such expenditures. The recovery period and method so selected shall apply to each subsequent expenditure (unless the improvement qualifies as a substantial improvement).

(iii) A capital expenditure made with respect to the improvement of property, other than a building, is assigned to the same recovery class (as defined in §1.168-3(b)) as the property of which the improvement is a part. For such an expenditure, the taxpayer need not use the same recovery period and method as are used with respect to the property of which the improvement is a part.

(3) *Recovery for a building which is made available in stages.* This subparagraph (3) (and not subparagraphs (1) and (2) of this paragraph) applies to a building which is made available in stages. For purposes of this section, a building shall be considered placed in service (and, therefore, recovery will begin) only when a significant portion is made available for use in a finished condition (*e.g.*, when a certificate of occupancy is issued with respect to such portion). If less than the entire building is made available, then the unadjusted basis which is taken into account under this section shall be that amount of the unadjusted basis of the building (including capital expenditures for any components) as is properly allocable to the portion made available. If another portion of the building is subsequently made available, then that amount of the unadjusted basis (including capital expenditures for any components) as is properly allocable to the ensuing portion shall be taken into account under this section when such portion becomes available. The taxpayer must use the same recovery period and method for all portions of the building.

(4) *Substantial improvements.* (i) A substantial improvement to a building shall be treated as a separate building. Thus, the taxpayer may use a different period and method for computing the recovery allowance for the substantial improvement than are used for computing the allowance for the building.

(ii) An improvement is a substantial improvement if—

(A) Over 24 consecutive months the aggregate expenditures properly chargeable to the capital account for a building equal at least 25 percent of the adjusted basis of the building (disregarding adjustments provided in section 1016(a)(2) and (3)) as of the day on which the first expenditure is made, and

(B) All expenditures for the improvement are made 3 or more years after the building is placed in service by the taxpayer.

For purposes of the preceding sentence, a building acquired in a transaction to which section 1031 or 1033 applies is considered placed in service when the building that was replaced was placed in service. Similarly, a building acquired in a transaction to which section 168(f)(10)(A) applies is deemed placed in service by the transferee when such building was placed in service by the transferor. An expenditure which is allocated to a 24-month period shall not be allocated to another 24-month period. For example, an expenditure may not be part of one substantial improvement when considered together with an expenditure incurred 15 months earlier and also be part of another substantial improvement when combined with an expenditure incurred 10 months later.

(iii) It is possible that an improvement will not be part of a substantial improvement in the taxable year in which the improvement is placed in service but will become part of a substantial improvement in a subsequent taxable year. In such case, if the taxpayer uses a different method and recovery period with respect to the substantial improvement, then the tax return filed for the taxable year in which the first improvement is placed in service shall be amended accordingly.

(5) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). In 1985, A spends $10,000 to improve machinery used in his trade or business. The $10,000 is added to capital account under the principles of sections 162, 212, and 263. The machinery would be 5-year property if placed in service after 1980. The $10,000 expenditure is treated as the purchase of 5-year recovery property, placed in service in 1985. Any election made by A with respect to the underlying machinery will not affect the recovery allowance for the improvement.

Example (2). B, a calendar year taxpayer, begins constructing a 10-story office building in 1982. All floors will have approximately the same amount of usable floor space. By 1983, B has paid or incurred $10 million for the building's shell (and other items not directly related to any specific portion of the building), $4 million for work with respect to the first three floors, and $5 million for work directly related to other floors (including installation of components). In March 1983, B receives a certificate of occupancy for the first three floors and

begins offering the floors for rental to tenants. The building is considered placed in service in March 1983. No deduction is allowable under this section with respect to the building for 1982. No election is made under §1.168-2(c) to use the optional recovery percentages. B's recovery for 1983 is the properly allocable unadjusted basis times the applicable percentage (10 percent). The properly allocable unadjusted basis is $7 million, consisting of the amount of unadjusted basis directly related to the portion of the building which is made available for use ($4 million), plus that amount of the unadjusted basis which is not directly related to any specific portion of the building ($10 million) properly allocable to the portion which is made available for use (*i.e.*, 3 floors/10 floors equals 30 percent of $3 million). No deduction is allowable in 1983 for the $5 million paid or incurred for work directly related to portions of the building not made available for use. B will recover the $7 million unadjusted basis over the 15-year recovery period, beginning in March 1983.

Example (3). The facts are the same in example (2) except that, in January 1984, B receives a certificate of occupancy for the remaining seven floors and begins offering them for rental to tenants. B has spent an additional $7 million to complete the building as of the date on which the remaining seven floors are offered for rental. In January 1984, B takes into account as unadjusted basis the $12 million not previously taken into account, plus the $7 million of later expenditures. B will recover the $19 million unadjusted basis over a 15-year recovery period beginning in January 1984. B may not use a different recovery period and method for such amount than were used for the amount taken into account in March 1983.

Example (4). The facts are the same as in examples (2) and (3) except that in 1990 B spends $1 million, which is added to capital account to rehabilitate certain portions of the building. The $1 million is treated as the purchase by B of 15-year real property in 1990. B must use the same recovery period and method with respect to that improvement as were used for the underlying building. The improvement has a 15-year recovery period, and the recovery begins when the improvement is placed in service.

Example (5). In 1983 C spends $1 million, which is added to capital account, to rehabilitate certain portions of a building placed in service by C in 1975. The $1 million is treated as the purchase by C of 15-year real property in 1983. C may use any applicable recovery period and method with respect to such expenditure, and the recovery begins when the improvement is placed in service. The recovery period and method selected with respect to such expenditure, however, will apply to all ensuing capital expenditures made by C with respect to the building, unless an expenditure qualifies as part of a substantial improvement. The result in this example would be the same if the building were placed in service by C after 1980, but did not qualify as recovery property by reason of the provisions of section 168(e)(4) and §1.168-4(d).

(f) *Short taxable years*—(1) *General rule.* For any recovery year in which there are less than 12 months (hereinafter in this section referred to as a "short taxable year"), the recovery allowance shall be determined by multiplying the deduction which would have been allowable if the recovery year were not a short taxable year by a fraction the numerator of which equals the number of months and part-months in the short taxable year and the denominator of which is 12. This paragraph shall not apply to 15-year real property for the year the property is placed in service or disposed of.

(2) *Subsequent years' allowance.* Recovery allowances for years in a recovery period following a short taxable year shall be determined in accordance with paragraph (a)(c), (g), or (m) of this section without reference to the short taxable year.

(3) *Unrecovered allowance.* In the taxable year following the last year in the recovery period, a recovery allowance is permitted to the extent of any unrecovered allowance. If the optional recovery percentages are elected under §1.168-2(c) or (g)(3) and the short taxable year is the last recovery year, then the unrecovered allowance shall be allowed in the year following the short taxable year. The term "unrecovered allowance" means the difference between—

(i) The recovery allowance properly allowed for the short taxable year, and

(ii) The recovery allowance which would have been allowable if such year were not a short taxable year.

In no event shall the recovery allowance for any taxable year following the last year in the recovery period be greater than what the recovery allowance would be for the last year in the recovery period assuming that such year consists of 12 months. Any amount in excess of such recovery allowance for the last year in the recovery period shall be taken into account in the following taxable year or years in the same manner as provided in this subparagraph (3).

(4) *When a taxable year begins.* For purposes of this section, a taxable year of a person placing property in service does not include any month prior to the month in which the person begins engaging in a trade or business or holding recovery or depreciable property for the production of income. For purposes of applying the preceding sentence to an employee, an employee is not considered engaged in a trade or business by virtue of his employment except that, for purposes of applying this section to recovery property used for purposes of employment, the taxable year includes any month during which a person is engaged in trade or business as an employee. In addition, if a person engages in a small amount of trade or business activity for the purpose of obtaining a disproportionately large recovery allowance for assets for the taxable year in which they are placed in service, and if placing those assets in service represents a substantial increase in the person's level of business activity, then for purposes of the recovery allowance for such assets the person will not be treated as beginning a trade or business until the increased amount of business activity begins. For property held for the production of income, the principle of the preceding sentence also applies.

(5) *Successive short taxable years.* In applying the rule of subparagraph (1) of this paragraph, no month shall be taken into account more than once. Thus, if a taxpayer has successive short taxable years, with one taxable year ending and the following taxable year beginning in the same calendar month, then the recovery year which is ending shall not include the month in which the taxable year terminates.

(6) *Examples.* The following examples illustrate the application of this paragraph:

Example (1). On October 10, 1983, A and B enter into an agreement to form a partnership (P), for the purpose of leasing sailboats. The partnership adopts a calendar year as its taxable year pursuant to §1.706-1(b)(1). On November 5, 1983, P purchases four sailboats for a total of $20,000 and places the sailboats in service immediately. For purposes of section 168, P's taxable year begins on November 5, 1983. Sailboats are 5-year recovery property as defined in section 168(c)(2). No straight line election is made under §1.168-2(c). The recovery allowance for the sailboats in 1983, a short taxable year, is $500 (*i.e.*, .15 × $20,000 × 2/12). In 1984, the recovery allowance is $4,400 (.22 × $20,000). In 1985, 1986, and 1987, the recovery allowance is $4,200 annually (.21 × $20,000). In 1988, the taxable year following the last year in the recovery period, the unrecovered allowance equal to $2,500 may be deducted by A and B.

Example (2). In November 1984, Corporation L is incorporated and places in service two race horses which it acquired for a total of $18,500. The corporation adopts a calendar year as its taxable year. For purposes of section

168, the race horses are 3-year recovery property. No straight line election is made under §1.168-2(c). In 1984, the recovery allowance permitted to L for the race horses is $770.83 (*i.e.*, (.25 × $18,500) × 2/12). At the close of business on June 30, 1985, all of the stock of L is acquired by Corporation M. M elects in accordance with section 1501 to file a consolidated return with respect to M and L. M's taxable year begins on July 1. By reason of becoming included in the consolidated return, under §1.1502-76 L's second taxable year ending June 30, 1985, is also a short taxable year containing 6 months. In the second taxable year, L is permitted a recovery allowance equal of $3,515 (*i.e.*, .38 × $18,500 × 6/12). In the third taxable year ending June 30, 1986, L is entitled to a recovery allowance of $6,845 (*i.e.*, .37 × $18,500). Thus, the unrecovered allowance as of July 1, 1986, equals $7,369.17. Since the unrecovered allowance exceeds the recovery allowance for the third recovery year (the last year in the recovery period), the recovery allowance for the taxable year ending June 30, 1987, equals the allowance for such year, $6,845. The recovery allowance in the taxable year ending June 30, 1988, equals $524.17, the remaining unrecovered allowance.

Example (3). On August 1, 1984, Partnership M is formed and places in service a warehouse which will be leased to an unrelated person. M acquires the warehouse for $250,000. M adopts a calendar year as its taxable year pursuant to §1.706-1(b)(1). In 1984, M has a short taxable year within the meaning of §1.168-2(f)(1). Since the property is 15-year real property, however, the recovery allowance is computed as though 1984 were a full taxable year. Because the recovery property would have been placed in service in the eighth month of M's normal taxable year, the recovery property is deemed placed in service in the eighth month of the first recovery year. The recovery allowance in 1984 is $12,500 (*i.e.*, .05 × $250,000).

Example (4). In July 1983, D, who has been an employee of Corporation N since 1982, purchases an automobile for use in the performance of his employment for N. On June 5, 1984, D purchases a truck for use in another business. D begins the new business on June 5, 1984. In 1984, D holds no other depreciable or recovery property for the production of income. D does not have a short taxable year for the automobile purchased in 1983 since the automobile is used by D in his trade or business as an employee. Since an employee is not considered engaged in a trade or business by virtue of employment, however, for purposes of determining when a taxable year begins with respect to property not used in the trade or business of employment, D has a short taxable year in 1984 for the truck purchased in that year. The recovery allowance permitted D in 1984 with respect to the truck must be adjusted in accordance with the provisions of §1.168-2(f).

Example (5). A has been actively engaged in the trade or business of selling used cars since 1981. On July 1, 1983, A accepts employment with Corporation M and on that same date purchases a truck for $10,000 for use in the performance of his employment for M. A does not have a short taxable year for the truck because the taxable year of a person placing property in service includes all months during which that person is engaged in a trade or business.

Example (6). In 1983, C graduates from college and on July 1, 1983, is employed by N. On that same day, C purchases an automobile for $10,000 for use in the performance of his employment for N. C has a short taxable year for the automobile purchased in 1983. Although, for recovery property used for purposes of employment, the taxable year includes any month during which a person is an employee, C does not begin that trade or business until July. In addition, C is engaged in no other trade or business (and does not hold any depreciable or recovery property for the production of income) during the taxable year. The recovery allowance permitted C in 1983 with respect to the automobile must be adjusted in accordance with the provisions of §1.168-2(f).

Example (7). Corporation X, a calendar year taxpayer, has been in the trade or business of selling household appliances since 1979. On July 1, 1983, X purchases a restaurant. On that same day, X purchases restaurant equipment for use in its new business. X does not have a short taxable year for the restaurant equipment because the taxable year of a person placing property in service includes all months during which that person is engaged in a trade or business.

(g) *Special rules for property used predominantly outside the United States.* (1) *General rule.* (i) In lieu of the deduction allowed under paragraphs (a) and (c) of this §1.168-2, except as provided in subparagraphs (3) and (4) of this paragraph, and except as otherwise provided in section 168 and the regulations thereunder, the recovery allowance for recovery property used predominantly outside the United States (as described in §1.168-2(g)(5)) during the taxable year equals the aggregate amount determined by multiplying the unadjusted basis (as defined in §1.168-2(d)) of such recovery property by the applicable percentage provided in paragraph (g)(2) of this section. For purposes of determining the recovery allowance, salvage value shall be disregarded.

(ii) The recovery period for recovery property used predominantly outside the United States, other than 15-year real property, shall be the present class life. For recovery property (other than 15-year property) which is not assigned a present class life, the recovery period shall be 12 years. For 15-year real property used predominantly outside the United States, the recovery period shall be 35 years.

(iii) Except for 15-year real property and except as otherwise provided in §1.168-5, no recovery allowance shall be allowed in the year of disposition of recovery property described in this paragraph.

(iv) For purposes of this paragraph, rules similar to the rules of paragraph (e) of this section shall apply.

(2) *Applicable percentages.* (i) For property other than 15-year real property—

If the recovery year is:	*And the recovery period is:*									
	2.5	*3*	*3.5*	*4*	*5*	*6*	*6.5*	*7*	*7.5*	*8*
	The applicable percentage is:									
1	40	33	29	25	20	17	15	14	13	13
2	48	45	41	38	32	28	26	25	23	22
3	12	15	17	19	19	18	18	17	17	16
4		7	13	12	12	12	13	13	13	12
5				6	12	10	10	9	9	9
6					5	10	9	9	9	8
7						5	9	9	8	8
8								4	8	8
9										4

If the recovery year is:	*And the recovery period is:*									
	8.5	*9*	*9.5*	*10*	*10.5*	*11*	*11.5*	*12*	*12.5*	*13*
	The applicable percentage is:									
1	12	11	11	10	10	9	9	8	8	8
2	21	20	19	18	17	17	16	15	15	14
3	16	15	15	14	14	13	13	13	12	12
4	12	12	12	12	11	11	11	11	10	10
5	9	9	9	9	9	9	9	9	9	9
6	8	8	7	7	7	7	7	7	7	7
7	8	7	7	7	7	7	6	6	6	6
8	7	7	7	7	7	6	6	6	6	6
9	7	7	7	7	6	6	6	6	6	5
10		4	6	6	6	6	6	6	6	5
11				3	6	6	6	5	5	5
12						3	5	5	5	5
13								3	5	5
14										3

If the recovery year is:	*And the recovery period is:*									
	13.5	*14*	*15*	*16*	*16.5*	*17*	*18*	*19*	*20*	*22*
	The applicable percentage is:									
1	7	7	7	6	6	6	6	5	5	5
2	14	13	12	12	11	11	10	10	10	9
3	12	11	11	10	10	10	9	9	9	8
4	10	10	9	9	9	9	8	8	8	7
5	8	8	8	8	8	8	7	7	7	6
6	7	7	7	7	7	7	7	6	6	6
7	6	6	6	6	6	6	6	6	6	5
8	6	5	5	5	5	5	5	5	5	5
9	5	5	5	5	5	5	5	5	4	4
10	5	5	5	5	5	4	4	4	4	4
11	5	5	5	5	4	4	4	4	4	4
12	5	5	5	4	4	4	4	4	4	4
13	5	5	5	4	4	4	4	4	4	4
14	5	5	4	4	4	4	4	4	4	3
15		3	4	4	4	4	4	4	3	3
16			2	4	4	4	4	4	3	3
17				2	4	3	4	3	3	3
18						2	3	3	3	3
19							2	3	3	3
20								2	3	3
21									2	3
22										3
23										2

If the recovery year is:	*And the recovery period is:*						
	25	*26.5*	*28*	*30*	*35*	*45*	*50*
	The applicable percentage is:						
1	4	4	4	3	3	2	2
2	8	7	7	6	6	4	4
3	7	7	6	6	5	4	4
4	6	6	6	6	5	4	4
5	6	6	6	5	5	4	3
6	6	5	5	5	4	4	3
7	5	5	5	5	4	3	3
8	5	5	4	4	4	3	3
9	4	4	4	4	4	3	3
10	4	4	4	4	3	3	3
11	4	4	4	3	3	3	3
12	3	3	3	3	3	3	3
13	3	3	3	3	3	3	2
14	3	3	3	3	3	3	2
15	3	3	3	3	3	2	2
16	3	3	3	3	3	2	2
17	3	3	3	3	2	2	2
18	3	3	3	3	2	2	2
19	3	3	3	3	2	2	2
20	3	3	3	3	2	2	2
21	3	3	3	3	2	2	2
22	3	3	2	2	2	2	2
23	3	3	2	2	2	2	2
24	2	2	2	2	2	2	2
25	2	2	2	2	2	2	2
26	1	2	2	2	2	2	2
27		1	2	2	2	2	2
28			2	2	2	2	2
29			1	2	2	2	2
30				2	2	2	2
31				1	2	2	2
32					2	2	2
33					2	2	2
34					2	2	2
35					2	2	2
36					1	2	1
37						1	1
38						1	1
39						1	1
40						1	1
41						1	1
42						1	1
43						1	1
44						1	1
45						1	1
46						1	1
47							1
48							1
49							1
50							1
51							1

(ii) For 15-year real property—

If the recovery year is:	*And the month in the 1st recovery year in which the property is placed in service is:*				
	1	*2,3*	*4,5,6*	*7,8*	*9,10,11,12*
	The applicable percentage is:				
1	4	4	3	2	1
2	4	4	4	4	4
3	4	4	4	4	4
4	4	4	4	4	4
5	4	4	4	4	4
6	3	3	3	4	4
7	3	3	3	3	3
8	3	3	3	3	3
9	3	3	3	3	3
10	3	3	3	3	3
11	3	3	3	3	3
12	3	3	3	3	3
13	3	3	3	3	3
14	3	3	3	3	3
15	3	3	3	3	3
16	3	3	3	3	3
17	3	3	3	3	3
18	3	3	3	3	3
19	3	3	3	3	3
20	3	3	3	3	3
21	3	3	3	3	3
22	3	3	3	3	3
23	3	3	3	3	3
24	3	3	3	3	3
25	3	2	3	2	3
26	2	2	2	2	2
27	2	2	2	2	2
28	2	2	2	2	2
29	2	2	2	2	2
30	2	2	2	2	2
31	2	2	2	2	2
32	2	2	2	2	2
33	2	2	2	2	2
34	2	2	2	2	2
35	2	2	2	2	2
36		1	1	2	2

(3) *Election of optional recovery percentage method.* (i) In lieu of the applicable percentage provided by subparagraphs (1) and (2), the taxpayer may elect (in accordance with §1.168-5(e)), for recovery property used predominantly outside the United States that is placed in service during the taxable year, to determine the recovery allowance by using the straight line method over one of the recovery periods elected by the taxpayer and set forth in the following table:

CLASS OF PROPERTY	*RECOVERY PERIOD*
3-year property	5 or 12 years or present class life
5-year property	12 or 25 years or present class life
10-year property	25 or 35 years or present class life
15-year real property	35 or 45 years
15-year public utility property	35 or 45 years or present class life

Such election is irrevocable without the consent of the Commissioner. See subdivision (iv) of this subparagraph for tables containing the applicable percentages to be used in computing the recovery allowance.

(ii) Except in the case of 15-year real property, a single recovery period must be elected under this subparagraph for all recovery property placed in service in the same taxable year which is in the same recovery class and which has the same present class life. For property other than 15-year real property the recovery period elected may not be shorter

than the present class life (or, if none, 12 years). A different recovery period may be elected (or the tables provided in subparagraph (2) may be used) for recovery property in different recovery classes, or with different present class lives, placed in service during the taxable year, or for recovery property placed in service in a different taxable year, whether or not in the same recovery class or with the same present class life.

(iii) In the case of 15-year real property, the election provided by this subparagraph may be made separately with respect to each property.

(iv)(A) For property other than 15-year real property—

If the recovery year is:	*And the period elected is:*								
	2.5	*3*	*3.5*	*4*	*5*	*6*	*6.5*	*7*	*7.5*
	The applicable percentage is:								
1	20	17	14	13	10	8	8	8	7
2	40	33	29	25	20	17	16	14	14
3	40	33	29	25	20	17	16	14	14
4		17	28	25	20	17	15	14	13
5				12	20	17	15	14	13
6					10	17	15	14	13
7						7	15	14	13
8								8	13

If the recovery year is:	*And the period elected is:*								
	8	*8.5*	*9*	*9.5*	*10*	*10.5*	*11*	*11.5*	*12*
	The applicable percentage is:								
1	6	6	6	5	5	5	5	4	4
2	13	12	11	11	10	10	9	9	9
3	13	12	11	11	10	10	9	9	9
4	13	12	11	11	10	10	9	9	9
5	13	12	11	11	10	10	9	9	9
6	12	12	11	11	10	10	9	9	8
7	12	12	11	10	10	9	9	9	8
8	12	11	11	10	10	9	9	9	8
9	6	11	11	10	10	9	9	9	8
10			6	10	10	9	9	8	8
11					5	9	9	8	8
12							5	8	8
13									4

If the recovery year is:	*And the period elected is:*								
	12.5	*13*	*13.5*	*14*	*15*	*16*	*16.5*	*17*	*18*
	The applicable percentage is:								
1	4	4	4	4	3	3	3	3	3
2	8	8	8	8	7	7	7	6	6
3	8	8	8	7	7	7	6	6	6
4	8	8	8	7	7	7	6	6	6
5	8	8	8	7	7	7	6	6	6
6	8	8	8	7	7	6	6	6	6
7	8	8	7	7	7	6	6	6	6
8	8	8	7	7	7	6	6	6	6
9	8	8	7	7	7	6	6	6	6
10	8	8	7	7	7	6	6	6	6
11	8	7	7	7	7	6	6	6	6
12	8	7	7	7	6	6	6	6	5
13	8	7	7	7	6	6	6	6	5
14		3	7	7	6	6	6	6	5
15				4	6	6	6	6	5
16					3	6	6	6	5
17						3	6	5	5
18								2	5
19									2

If the recovery year is:	*And the period elected is:*							
	19	*20*	*22*	*25*	*26.5*	*28*	*30*	*35*
	The applicable percentage is:							
1	3	3	2	2	2	2	2	1
2	6	5	5	4	4	4	4	3
3	6	5	5	4	4	4	4	3
4	6	5	5	4	4	4	4	3
5	6	5	5	4	4	4	4	3
6	6	5	5	4	4	4	4	3
7	5	5	5	4	4	4	4	3
8	5	5	5	4	4	4	4	3
9	5	5	5	4	4	4	4	3
10	5	5	5	4	4	4	4	3
11	5	5	5	4	4	4	4	3
12	5	5	5	4	4	4	3	3
13	5	5	5	4	4	4	3	3
14	5	5	5	4	4	4	3	3
15	5	5	4	4	4	4	3	3
16	5	5	4	4	4	4	3	3
17	5	5	4	4	4	4	3	3
18	5	5	4	4	4	3	3	3
19	5	5	4	4	4	3	3	3
20	2	5	4	4	4	3	3	3
21		2	4	4	4	3	3	3
22			4	4	3	3	3	3
23			2	4	3	3	3	3
24				4	3	3	3	3
25				4	3	3	3	3
26				2	3	3	3	3
27					3	3	3	3
28						3	3	3
29						2	3	3
30							3	3
31							2	3
32								2
33								2
34								2
35								2
36								1

If the recovery year is:	*And the period elected is:*	
	45	*50*
	The applicable percentage is:	
1	1.1	1
2	2.3	2
3	2.3	2
4	2.3	2
5	2.3	2
6	2.3	2
7	2.3	2
8	2.3	2
9	2.3	2
10	2.3	2
11	2.3	2
12	2.2	2
13	2.2	2
14	2.2	2
15	2.2	2
16	2.2	2
17	2.2	2
18	2.2	2
19	2.2	2
20	2.2	2
21	2.2	2
22	2.2	2
23	2.2	2
24	2.2	2
25	2.2	2
26	2.2	2
27	2.2	2
28	2.2	2
29	2.2	2
30	2.2	2
31	2.2	2
32	2.2	2
33	2.2	2
34	2.2	2
35	2.2	2
36	2.2	2
37	2.2	2
38	2.2	2
39	2.2	2
40	2.2	2
41	2.2	2
42	2.2	2
43	2.2	2
44	2.2	2
45	2.2	2
46	1.1	2
47		2
48		2
49		2
50		2
51		1

(B) *For 15-year real property*—(*1*) If a 35-year period is elected—

If the recovery year is:	*And the month in the 1st recovery year the property is placed in service is:*		
	1-2	*3-6*	*7-12*
	The applicable percentage is:		
1	3	2	1
2	3	3	3
3	3	3	3
4	3	3	3
5	3	3	3
6	3	3	3
7	3	3	3
8	3	3	3
9	3	3	3
10	3	3	3
11	3	3	3
12	3	3	3
13	3	3	3
14	3	3	3
15	3	3	3
16	3	3	3
17	3	3	3
18	3	3	3
19	3	3	3
20	3	3	3
21	3	3	3
22	3	3	3
23	3	3	3
24	3	3	3
25	3	3	3
26	3	3	3
27	3	3	3
28	3	3	3
29	3	3	3
30	3	3	3
31	2	2	2
32	2	2	2
33	2	2	2
34	2	2	2
35	2	2	2
36		1	2

(2) If a 45-year period is elected—

If the recovery year is:	*And the month in the 1st recovery year the property is placed in service is:*											
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*
	The applicable percentage is:											
1	2.3	2.0	1.9	1.7	1.5	1.3	1.2	.9	.7	.6	.4	.2
2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
5	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
6	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
7	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
8	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
9	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
10	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
11	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
12	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
13	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
14	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
15	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
16	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
17	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
18	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
19	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
20	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
21	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
22	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
23	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
24	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
25	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
26	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
27	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
28	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
29	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
30	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
31	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
32	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
33	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
34	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
35	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
36	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
37	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
38	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
39	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
40	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
41	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
42	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
43	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
44	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
45	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
46		.3	.4	.6	.8	1.0	1.1	1.4	1.6	1.7	1.9	2.1

(4) *Rules for year of disposition and placement in service of 15-year real property.* (i) In the taxable year in which 15-year real property is disposed of, the recovery allowance shall be determined by multiplying the allowance (determined without regard to this subdivision) by a fraction, the numerator of which equals the number of months in the taxable year that the property is in service in the taxpayer's trade or business or for the production of income and the denominator of which is 12. In the case of 15-year real property that is disposed of during the first recovery year, the denominator shall equal the number of months in the taxpayer's taxable year after the property was placed in service by the taxpayer (including the month the property was placed in service). If the recovery allowance for the taxable year is limited by reason of the short taxable year rules of section 168(f)(5) and paragraph (f) of this section (*e.g.*, if the taxpayer dies, or if the taxpayer is a corporation which becomes a member, or ceases being a member, of an affiliated group of corporations filing a consolidated return), then the denominator shall equal the number of months in the taxpayer's taxable year.

(ii) For purposes of this paragraph—

(A) 15-year real property that is placed in service on or after the first day of a month shall be treated as placed in service in that month; and

(B) 15-year real property that is disposed of during the recovery year shall be treated as disposed of as of the last day of the month proceding the month in which it is withdrawn from service.

(5) *Determination of whether property is used predominantly outside the United States.* (i) The determination of whether property is used predominantly outside the United States (as defined in section 7701(a)(9)) during the taxable year shall be made by comparing the period in such year during which the property is physically located outside of the United States with the period during which the property is physically located within the United States. If the property is physically located outside the United States during more than 50 percent of the taxable year, such property shall be considered used predominantly outside the United States during the year. If property is placed in service after the first day of the taxable year, the determination of whether such property is physically located outside the United States during more than 50 percent of the taxable year shall be made with respect to the period beginning on the date on which the property is placed in service and ending on the last day of such taxable year.

(ii) This paragraph applies whether recovery property is used predominantly outside the United States by the owner or by the lessee of the property. For recovery property which is leased, the determination of whether such property is physically located outside the United States during the taxable year shall be made with respect to the taxable year of the lessor.

(iii) For purposes of this §1.168-2(g), the following property is not "property used predominantly outside the United States":

(A) Any aircraft which is registered by the Administrator of the Federal Aviation Agency, and which (*1*) is operated, whether on a scheduled or nonscheduled basis, to and from the United States, or (*2*) is operated under contract with the United States, provided that the use of the aircraft under the contract constitutes its principal use outside the United States during the taxable year. The term "to and from the United States" shall not exclude an aircraft which makes flights from one point in a foreign country to another such point, as long as such aircraft returns to the United States with some degree of frequency;

(B) Rolling stock which is used within and without the United States and which is (*1*) of a domestic railroad corporation subject to part I of the Interstate Commerce Act or (*2*) of a United States person (other than a corporation subject to part I of the Interstate Commerce Act) but only if the rolling stock is not leased to one or more foreign persons for periods totaling more than 12 months in any 24-month period. For purposes of this subdivision (iii)(B), the term "rolling stock" means locomotives, freight and passenger train cars, floating equipment, and miscellaneous transportation equipment on wheels, the expenditures for which are of the type chargeable to the equipment investment accounts in the uniform system of accounts for railroad companies prescribed by the Interstate Commerce Commission;

(C) Any vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States. A vessel is documented under the laws of the United States if it is registered, enrolled, or licensed under the laws of the United States by the Commandant, United States Coast Guard. Vessels operated in the foreign or domestic commerce of the United States include those documented for use in foreign trade, coast-wise trade, or fisheries;

(D) Any motor vehicle of a United States person (as defined is section 7701(a)(30)) which is operated to and from the United States with some degree of frequency;

(E) Any container of a United States person which is used in the transportation of property to and from the United States;

(F) Any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented, 43 U.S.C. section 1331), *e.g.*, offshore drilling equipment;

(G) Any property which (*1*) is owned by a domestic corporation (other than a corporation which has an election in effect under section 936 or which is entitled to the benefits of section 934(b)), by a United States citizen (other than a citizen entitled to the benefits of section 931, 932, 933, or 934(c)), or by a domestic partnership, all of whose partners are domestic corporations (none of which has an election in effect under section

936 or is entitled to the benefits of section 934(b)) or United States citizens (none of whom is entitled to the benefits of section 931, 932, 933, or 934(c)) and (*2*) which is used predominantly in a possession of the United States during the taxable year by such a corporation, citizen, or partnership, or by a corporation created or organized in, or under the law of, a possession of the United States. The determination of whether property is used predominantly in a possession of the United States during the taxable year shall be made under principles similar to those described in subdivision (i) of this subparagraph. For example, if a machine is placed in service in a possession of the United States on July 1, 1981, by a calendar year taxpayer and if it is physically located in such a possession during more than 50 percent of the period beginning on July 1, 1981, and ending on December 31, 1981, then such machine shall be considered used predominantly in a possession of the United States during the taxable year 1981;

(H) Any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962, 47 U.S.C. section 702(3)), or any interest therein, of a United States person;

(I) Any cable, or any interest therein, of a domestic corporation engaged in furnishing telephone service to which section 46(c)(3)(B)(iii) applies (or of a wholly owned domestic subsidiary of such corporation), if such cable is part of a submarine cable system which constitutes part of a communications link exclusively between the United States and one or more foreign countries;

(J) Any property (other than a vessel or an aircraft) of a United States person which is used in international or territorial waters within the northern portion of the Western Hemisphere for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or deposits under such waters. The term "northern portion of the Western Hemisphere" means the area lying west of the 30th meridian west of Greenwich, east of the international dateline, and north of the Equator, but not including any foreign country which is a country of South America; and

(K) Any property described in section 48(l)(3)(A)(ix) which is owned by a United States person and which is used in international or territorial waters to generate energy for use in the United States.

(h) *Mass asset accounts.* (1) *In general.* In accordance with the provisions of §1.168-5(e), a taxpayer may elect to account for mass assets (as defined in §1.168-2(h)(2)) in the same mass asset account, as though such assets were a single asset. If such treatment is elected, the taxpayer, upon disposition of an asset in the account, shall include as ordinary income (as defined in section 64) all proceeds realized to the extent of the unadjusted basis in this account (as defined in paragraph (d) of this section), less any amounts previously so included, and shall include as capital gain any excess, unless gain on such disposition is not recognized under another provision of the Code. With respect to the recovery allowance, the account shall be treated as though the asset were not disposed of.

(2) *Definition.* For purposes of this section, the term "mass assets" means a mass or group of individual items of recovery property (i) not necessarily homogenous, (ii) each of which is minor in value relative to the total value of such mass or group, (iii) numerous in quantity, (iv) usually accounted for only on a total dollar or quantity basis, (v) with respect to which separate identification is impracticable, (vi) with the same present class life, and (vii) placed in service in the same taxable year.

(3) *Election.* The election under this paragraph shall be made for the taxable year in which the assets in the account are placed in service. The election shall apply, with respect to the account, throughout the applicable recovery period and for all subsequent taxable years. The taxpayer is not bound by such election with respect to assets placed in service in other taxable years, or with respect to other assets placed in service in the same taxable year, which may properly be included in another mass asset account (*e.g.*, assets with a different present class life).

(4) *Recovery of an increase in basis.* To the extent that §1.168-2(d)(2)(i) (relating to reductions in basis) applies, if as a result of early disposition of an asset in a mass asset account (determined in accordance with the provision of subparagraph (5) of this paragraph), the investment tax credit is recaptured (in accordance with section 47 and the regulations thereunder), then the basis of the account shall be increased by an amount equal to one-half of the amount of the recapture. Such increase shall be treated in a manner similar to §1.168-2(d)(3), relating to redeterminations. For purposes of subparagraph (1) of this paragraph, such increase will be taken into account as unadjusted basis in determining the inclusion of proceeds as ordinary income.

(5) *Identification of dispositions for purposes of basis increase.* For purposes of subparagraph (4) of this paragraph, disposition of assets from a mass asset account shall be determined by the use of an appropriate mortality dispersion table. If the taxpayer adopts recordkeeping practices consistent with his prior practices and consonant with good accounting and engineering practices, and supplies such reasonable information as may be required by the Commissioner, the mortality dispersion table may be based upon an acceptable sampling of the taxpayer's actual experience or other acceptable statistical or engineering techniques. Alternatively, the taxpayer may use the following standard mortality dispersion table:

STANDARD MORTALITY DISPERSION TABLE
PERCENTAGE OF BASIS OF MASS ASSET ACCOUNT
CONSIDERED DISPOSED OF EACH 12-MONTH PERIOD
AFTER THE ACCOUNT IS PLACED IN SERVICE

Present Class Life	1st (1)	2nd (2)	3rd (3)	4th (4)	5th (5)	6th (6)	7th (7)	8th (8)	9th (9)	10th (10)
2.5	3.59	23.84	45.14	23.84	3.59	—	—	—	—	—
3	2.28	13.59	34.13	34.13	13.59	2.28	—	—	—	—
3.5	1.62	8.23	23.51	33.28	23.51	8.23	1.62	—	—	—
4	1.22	5.46	15.98	27.34	27.34	15.98	5.46	1.22	—	—
5	.82	2.77	7.92	15.91	22.58	22.58	15.91	7.92	2.77	.82
6	.62	1.66	4.40	9.19	14.98	19.15	19.15	14.98	9.19	4.40
6.5	.55	1.33	3.38	7.25	12.00	16.39	18.20	16.39	12.00	7.25
7	.51	1.11	2.74	5.49	9.64	13.87	16.64	16.64	13.87	9.64
7.5	.47	.92	2.20	4.49	7.79	11.55	14.65	15.86	14.65	11.55
8	.44	.78	1.85	3.61	6.46	9.52	12.91	14.43	14.43	12.91
8.5	.40	.70	1.52	2.97	5.16	8.19	10.87	13.05	14.28	13.05
9	.38	.61	1.29	2.47	4.43	6.69	9.27	11.93	12.93	12.93
9.5	.37	.52	1.13	2.07	3.69	5.57	8.13	10.44	11.72	12.72
10 and 10.5	.35	.47	.97	1.80	3.09	4.83	6.90	9.01	10.79	11.79
11 and 11.5	.32	.39	.75	1.35	2.24	3.64	5.10	6.82	8.51	10.24
12 and 12.5	.30	.32	.60	1.06	1.73	2.67	3.88	5.31	6.79	8.19
13 and 13.5	.28	.27	.49	.84	1.34	2.04	3.12	4.13	5.37	6.63
14	.27	.24	.40	.71	1.06	1.68	2.32	3.17	4.38	5.26
15	.26	.21	.35	.57	.89	1.31	1.89	2.60	3.43	4.36
16 and 16.5	.25	.18	.29	.49	.75	1.10	1.48	2.13	2.83	3.83
17	.24	.16	.28	.42	.60	.92	1.30	1.67	2.34	2.82
18	.23	.15	.24	.37	.51	.78	1.08	1.39	1.93	2.50
19	.23	.14	.20	.32	.47	.66	.92	1.15	1.61	2.08
20-24	.22	.13	.19	.28	.40	.57	.77	1.03	1.36	1.73
25-29	.20	.09	.12	.18	.23	.31	.41	.53	.67	.85
30-50	.19	.07	.09	.12	.15	.20	.25	.32	.40	.49

Present Class Life	11th (11)	12th (12)	13th (13)	14th (14)	15th (15)	16th (16)	17th (17)	18th (18)	19th (19)	20th (20)
2.5	—	—	—	—	—	—	—	—	—	—
3	—	—	—	—	—	—	—	—	—	—
3.5	—	—	—	—	—	—	—	—	—	—
4	—	—	—	—	—	—	—	—	—	—
5	—	—	—	—	—	—	—	—	—	—
6	1.66	.62	—	—	—	—	—	—	—	—
6.5	3.38	1.33	.55	—	—	—	—	—	—	—
7	5.49	2.74	1.11	.51	—	—	—	—	—	—
7.5	7.70	4.49	2.20	.92	.47	—	—	—	—	—
8	9.52	6.46	3.61	1.85	.78	.44	—	—	—	—
8.5	10.87	8.19	5.16	2.97	1.52	.70	.40	—	—	—
9	11.93	9.27	6.69	4.43	2.47	1.29	.61	.38	—	—
9.5	11.72	10.44	8.13	5.57	3.69	2.07	1.13	.52	.37	—
10 and 10.5	11.79	10.79	9.01	6.90	4.83	3.09	1.80	.97	.47	.35
11 and 11.5	10.64	10.64	10.24	8.51	6.82	5.10	3.64	2.24	1.35	.75
12 and 12.5	9.28	9.87	9.87	9.28	8.19	6.79	5.31	3.88	2.67	1.73
13 and 13.5	7.77	8.62	9.10	9.10	8.62	7.77	6.63	5.37	4.13	3.12
14	6.62	7.25	8.32	8.32	8.32	8.32	7.25	6.62	5.26	4.38
15	5.32	6.23	7.04	7.61	7.93	7.93	7.61	7.04	6.23	5.32

Present Class Life	11th (11)	12th (12)	13th (13)	14th (14)	15th (15)	16th (16)	17th (17)	18th (18)	19th (19)	20th (20)
16 and 16.5	4.22	5.30	6.11	6.80	6.89	7.54	7.54	6.89	6.80	6.11
17	3.71	4.48	4.94	5.93	6.51	6.54	7.14	7.14	6.54	6.51
18	3.12	3.57	4.46	4.81	5.71	6.19	6.21	6.75	6.75	6.21
19	2.60	2.97	3.76	4.37	4.96	5.48	5.53	6.19	6.36	6.36
20-24	2.17	2.66	3.18	3.72	4.25	4.76	5.22	5.57	5.83	5.96
25-29	1.06	1.29	1.55	1.85	2.18	2.50	2.84	3.19	3.54	3.84
30-50	.59	.72	.87	1.02	1.20	1.40	1.60	1.83	2.86	2.30

Present Class Life	21st (21)	22nd (22)	23rd (23)	24th (24)	25th (25)	26th (26)	27th (27)	28th (28)	29th (29)	30th (30)
2.5	—	—	—	—	—	—	—	—	—	—
3	—	—	—	—	—	—	—	—	—	—
3.5	—	—	—	—	—	—	—	—	—	—
4	—	—	—	—	—	—	—	—	—	—
5	—	—	—	—	—	—	—	—	—	—
6	—	—	—	—	—	—	—	—	—	—
6.5	—	—	—	—	—	—	—	—	—	—
7	—	—	—	—	—	—	—	—	—	—
7.5	—	—	—	—	—	—	—	—	—	—
8	—	—	—	—	—	—	—	—	—	—
8.5	—	—	—	—	—	—	—	—	—	—
9	—	—	—	—	—	—	—	—	—	—
9.5	—	—	—	—	—	—	—	—	—	—
10 and 10.5	—	—	—	—	—	—	—	—	—	—
11 and 11.5	.39	.32	—	—	—	—	—	—	—	—
12 and 12.5	1.06	.60	.32	.30	—	—	—	—	—	—
13 and 13.5	2.04	1.34	.84	.49	.27	.28	—	—	—	—
14	3.17	2.32	1.68	1.06	.71	.40	.24	.27	—	—
15	4.36	3.43	2.60	1.89	1.31	.89	.57	.35	.21	.26
16 and 16.5	5.30	4.22	3.83	2.83	2.13	1.48	1.10	.75	.49	.29
17	5.93	4.94	4.48	3.71	2.82	2.34	1.67	1.30	.92	.60
18	6.19	5.71	4.81	4.46	3.57	3.12	2.50	1.93	1.39	1.08
19	6.19	5.53	5.48	4.96	4.37	3.76	2.97	2.60	2.08	1.61
20-24	5.96	5.83	5.57	5.22	4.76	4.25	3.72	3.18	2.66	2.17
25-29	4.13	4.38	4.58	4.70	4.78	4.78	4.70	4.58	4.38	4.13
30-50	2.54	2.78	3.01	3.23	3.42	3.61	3.75	3.86	3.95	3.98

For purposes of applying the standard mortality dispersion table, all assets in a mass asset account placed in service during a taxable year are considered to be placed in service on the same day. If the taxpayer uses the standard mortality dispersion table for a taxable year, such table must be used for all subsequent taxable years unless the taxpayer obtains the consent of the Commissioner.

(6) *Transitional rule.* Unless the taxpayer establishes to the contrary (by statistical methods or otherwise), all proceeds realized upon the disposition of assets from one or more mass asset accounts shall be considered realized with respect to accounts placed in service by the taxpayer after December 31, 1980.

(i) [RESERVED]

(j) *Changes in use*—(1) *Conversion from personal use or use in tax-exempt activity.* If property which was previously used by the taxpayer for personal purposes or in a tax-exempt activity is converted to use in a trade or business or for the production of income during the taxable year, then the recovery allowance for the taxable year (and subsequent taxable years) shall be determined as though the property were placed in service by the taxpayer as recovery property on the date on which the conversion occurs. Thus, the recovery allowance shall be determined by multiplying the unadjusted basis (as provided in subparagraph (6)(ii) of this paragraph) by the applicable percentage.

(2) *Increased business use of property.* If a taxpayer uses property in a trade or business (or for the production of income) and for personal (or tax-exempt) purposes during a recovery period, and increases the business (or income-producing) use of such property after the recovery for that period is completed, then a recovery allowance shall continue to be allowed with respect to such property. The amount of the allowance shall be determined as though, to the extent of the increase in business (or income-producing) use, the property were placed in service by the taxpayer as recovery property at the beginning of the taxable year in which such increased use occurs. Thus, the recov-

ery allowance for the taxable year shall be determined first by multiplying the unadjusted basis (as provided in subparagraph (6)(ii) of this paragraph) by the applicable percentage, and then by the excess of the percentage of the business (or income-producing) use during the taxable year over the average of such use during the prior recovery period (or periods). The combined recovery under this subparagraph and subparagraph (1) shall not exceed the original cost of the property. See Example (2) of subparagraph (7) of this paragraph.

(3) *Domestic property changing recovery classes.* (i) When the class of recovery property not used predominantly outside the United States changes during the taxable year, and the property continues to be used as recovery property by the taxpayer (*e.g.*, when property ceases to be used predominantly in connection with research and experimentation) the following rules apply:

(A) If the change results in the property's being assigned to a class with a shorter recovery period, then the recovery allowance for the taxable year in which the change occurs (and subsequent taxable years) shall be determined as though the property were placed in service as recovery property in the year of the change. Thus, the recovery allowance shall be determined by multiplying the unadjusted basis (as provided in subparagraph (6)(ii) of this paragraph) by the applicable percentage. Alternatively, the taxpayer may continue to treat the property as though the change had not occurred.

(B) If the change results in the property's being assigned to a class with a longer recovery period, then the recovery allowance for the taxable year of the change (and subsequent taxable years) shall be determined as though the property had originally been assigned to that longer recovery class. Proper adjustment shall be made under the principles of §1.168-2(d)(3) (relating to redeterminations) to account for the deductions allowable to the taxpayer with respect to the property prior to the year of the change in excess of those which would have been allowable had the taxpayer used the applicable percentages for the longer recovery class for those years.

(4) *Foreign property.* (i) If recovery property ceases being used predominantly outside the United States during a taxable year, and the property continues to be used as recovery property by the taxpayer, then the recovery allowance for the taxable year (and subsequent taxable years) shall be determined as though the property were placed in service as recovery property in the year of the cessation. Thus, the recovery allowance shall be determined by multiplying the unadjusted basis (as provided in subparagraph (6)(ii) of this paragraph) by the applicable percentage. Alternatively, the taxpayer may continue to treat the property as though the cessation had not occurred. See §§1.168-5(e)(5) and 1.1016-3(a)(3)(iii) and (iv).

(ii) If the recovery property begins to be used by the taxpayer predominantly outside the United States during a taxable year after having been used otherwise by the taxpayer as recovery property in the previous taxable year, then the recovery allowance for the taxable year in which the change occurs (and subsequent years) shall be determined as though the property had originally been placed in service by the taxpayer as recovery property used predominantly outside the United States. Proper adjustment shall be made under the principles of §1.168-2(d)(3) to account for the difference between the deductions allowable with respect to the property prior to the year of the change and those which would have been allowable had the taxpayer used the applicable percentages for property used predominantly outside the United States for those years.

(5) *Low income housing.* If 15-year real property begins or ceases to be low income housing (as defined in §1.168-2(b)(2)(iii)) during a taxable year, then the recovery allowance for the taxable year in which the change occurs (and subsequent taxable years) shall be determined under the principles of paragraph (j)(3)(i)(B) and (4)(ii) of this section.

(6) *Special rules.* (i) For purposes of this paragraph, if, prior to a change in status, the taxpayer used the optional applicable percentages (under paragraph (c) or (g)(3) of this section) with respect to recovery property, then similar optional percentages shall be used with respect to the property after the change.

(ii) For purposes of subparagraphs (1) and (2) of this paragraph, the unadjusted basis shall be the lesser of the fair market value or the adjusted basis of the property (taking into account the adjustments described in section 1016(a)(3)) at the time of conversion to use in the taxpayer's trade or business (or for the production of income), or at the beginning of the taxable year in which the increase in business (or income-producing) use occurs, as the case may be. For purposes of subparagraphs (3)(i)(A) and (4)(i) of this paragraph, the unadjusted basis shall be the adjusted basis of the property (taking into account the adjustments described in section 1016(a) (2) and (3)) at the beginning of the year in which the change or cessation occurs.

(7) *Examples.* The following examples illustrate the application of this paragraph.

Example (1). A, a calendar year taxpayer, purchases a house in 1981 which he occupies as his principal residence. In June 1985, A ceases to occupy the house and converts it to rental property. Under paragraph (j)(1) of this section, for purposes of determining the recovery allowance, A is deemed to have placed the house in service as recovery property in June 1985. A does not elect to compute the recovery allowance by use of the optional recovery method provided in §1.168-2(c). Thus, A's recovery allowance under section 168 for 1985 is determined by multiplying the unadjusted basis of the property by .07. Under paragraph (j)(6)(ii) of this section, the unadjusted basis is the lesser of the property's basis or its fair market value in June 1985. See also section 280A and the regulations thereunder.

Example (2). In 1981, B (a calendar year taxpayer) purchases an automobile for $10,000. In taxable years 1981 through 1983, B's business use of the automobile is 60 percent of his total use. B does not elect use of the optional percentages provided in §1.168-2(c). The fair market value of the automobile at the beginning of 1984 is $7,500. In 1984, B's business use of the automobile is 70 percent of the total. B's allowable deduction for 1984 is $187.50, computed as follows: $7,500 (lesser of basis or fair market value) × .25 (applicable percentage) × .10 (increase in the percentage business use in 1984 (70 percent) over the average business use during 1981-1983 (60 percent)). In 1985, B's business use of the automobile is 50 percent of the total. B is entitled to no recovery allowance with respect to the automobile for 1985 since B's business use of the automobile in that year does not exceed the average business

use during 1981-1983 (60 percent). In 1986, B's business use of the automobile is 75 percent of the total. B's allowable deduction for 1986 is $416.25 computed as follows: $7,500 (lesser of basis or fair market value in 1984) × .37 (applicable percentage) × .15 (increase in the percentage business use in 1986 (75 percent) over the average business use during 1981-1983 (60 percent)).

Example (3). In 1981 C, a calendar year taxpayer, purchases for $20,000 and places in service section 1245 class property used predominantly in connection with research and experimentation. C does not elect to compute the recovery allowance by use of the optional method as provided in §1.168-2(c). In 1981 C's allowable deduction is $5,000 (*i.e.*, .25 × $20,000). In 1982 C continues to use the property as recovery property, but not predominantly in connection with research and experimentation. As a result, in 1982 the property is treated as 5-year property. C's recovery allowance for 1982 (and subsequent taxable years) is determined as though C had placed the property in service in 1981 as 5-year property. The excess recovery allowance allowed in 1981 is accounted for in accordance with §1.168-2(d)(3). Thus, the difference between the recovery allowance which would have been allowed had the applicable percentage for 5-year property been used (*i.e.*, .15 × $20,000 = $3,000) and the recovery allowance allowed in 1981 (*i.e.*, .25 × $20,000 = $5,000) equals $2,000 and is accounted for as follows:

Unadjusted basis × applicable percentage for second recovery year ($20,000.00 × .22)	$4,400.00
Excess allowance × applicable percentage for second recovery year ÷ the sum of the remaining unused applicable percentages (($2,000.00 × .22)/.85)	− 517.65
Difference—allowable deduction for 1982	$3,882.35

Example (4). In 1981 D, a calendar year taxpayer, places in service 5-year recovery property with an unadjusted basis of $100,000 and a present class life of 8 years. D uses the property predominantly outside the United States in 1981, 1982, and 1983. D does not elect to compute the recovery allowance by use of the optional method as proivded in §1.168-2(g)(3). In 1984 D uses the property as recovery property but not predominantly outside the United States. D's allowable deduction for 1984 (and subsequent taxable years) is determined as though D placed the property in service in 1984 as recovery property not used predominantly outside the United States. The basis of the property is deemed to be the adjusted basis in 1984. Thus, D's allowable deduction for 1984 is $7,350 (*i.e.*, .15 × $49,000 (basis)) and for 1985 is $10,780 (*i.e.*, .22 × 49,000 (basis)). If D elected to use the optional method based on the present class life, D would use the optional percentages based on a 5-year recovery period. Alternatively, D may continue to treat the property as though it continued to be used predominantly outside the United States. If so treated D's allowable deductions for 1984 and 1985 would be $12,000 (*i.e.*, .12 × $100,000) and $9,000 (.09 × $100,000), respectively.

Example (5). The facts are the same as in example (4) except that the recovery property is not used predominantly outside the United States for 1981 through 1983. In 1984, however, D begins using the property predominantly outside the United States. D's allowable deduction for 1984 is determined as though D placed the property in service in 1981 as property used predominantly outside the United States. Additionally, D accounts for the difference between the recovery allowance for 1981 through 1983 ($58,000) and the allowance which would have been allowable for those years had the applicable percentages for property used predominantly outside the United States been used ($51,000) in accordance with §1.168-2(d)(3). Thus, the recovery allowance in 1984 is $10,285.71, determined as follows:

Unadjusted basis × applicable percentage for 4th recovery year for property with an 8-year present class life ($100,000.00 × .12)	$12,000.00
Excess recovery from 1981 through 1983 × applicable percentage for 4th recovery year ÷ the sum of the remaining unused applicable percentages (($7,000.00 × .12)/.49)	− 1,714.29
Difference	$10,285.71

If, for 1981 through 1983, D elected to use the optional method based on a 5-year recovery period, then the allowable deduction for 1984 and subsequent taxable years would be determined using the optional percentages over the 8-year present class life.

(k) *Ratable inclusion rule*—(1) *General rule.* In general, the recovery allowance provided by section 168 and this section shall be considered as accruing ratably over the taxable year. Thus, for example, the distributive share of the recovery allowance for each partner in a partnership in which a partner's partnership interest varies so as to be subject to section 706(c)(2)(B) shall be determined by allocating to each partner a pro rata share of such allowance for the entire taxable year of the partnership. This paragraph does not apply, however, in determining the recovery allowance for the taxable year in which 15-year real property is placed in service or disposed of.

(2) *Example.* The provisions of this subparagraph are illustrated by the following example:

Example. In 1978 A and B each acquire 50 percent interests in partnership P which is in the business of renting and managaing beach resort property. On December 1, 1983, C and D each acquire from the partnership 25 percent interests in the partnership. On December 15, 1983, the partnership acquires for rental and places in service two sailboats (5-year recovery property) for $10,000 each. No election is made to use the optional recovery percentages provided by §1.168-2(c). The recovery allowance for P for the sailboats in 1983 equals $3,000 (*i.e.*, .15 × $20,000). The recovery allowance, however, must be allocated pro rata over the taxable year. As such, the distributive share of the recovery allowance for A and B is $1,437.50 each. The distributive share of the recovery allowance for C and D is $62.50 each.

(l) *Definitions.* For purposes of section 168 and §§1.168-1 through 1.168-6—

(1) *Disposition.* The term "disposition" means the permanent withdrawal of property from use in the taxpayer's trade or business or use for the production of income. Withdrawal may be made in several ways, including sale, exchange, retirement, abandonment, or destruction. A disposition does not include a transfer of property by gift or by reason of the death of the taxpayer. See §1.168-5(f)(3) and (4). A disposition also does not include the retirement of a structural component of 15-year real property. The manner of of disposition (*e.g.*, ordinary retirement, abnormal retirement) is not a consideration. For rules relating to nonrecognition transactions see section 168(f)(7) and (10) and the regulations thereunder. For rules relating to the recognition of gain or loss on dispositions, see §1.168-6.

(2) *Placed in service.* The term "placed in service" means the time that property is first placed by the taxpayer in a condition or state of readiness and availability for a specifically assigned function, whether for use in a trade or business, for the production of income, in a tax-exempt activity, or in a personal activity. In the case of a building which is intended to house machinery and equipment, such readiness and availability shall be determined without regard to whether the machinery or equipment which the building houses, or is intended to house, has been placed in service. However, in an appropriate case, as, for example, where the building is essentially an item of machinery or equipment, or the use of the building is so closely related to the use of the machinery or equipment that it clearly can be expected to be replaced or retired when the property it initially houses is replaced or retired, the determination of readiness or availability of the building shall be made by taking into account the readiness and availability of such machinery or equipment. For a building which becomes available for use in separate stages, see paragraph (e) (3) of this section.

(3) *Recovery year.* The term "recovery year" means the taxable year

during which recovery property is placed in service by the taxpayer and each subsequent taxable year for which a deduction is allowable to the taxpayer under this section with respect to such property.

(4) *Recovery period.* The term "recovery period" means the actual period of years assigned, or elected by the taxpayer, for the computation under this section of the recovery allowance with respect to the unadjusted basis of the recovery property (*e.g.*, 3 years, 5 years, 12 years, present class life). The recovery period does not include any year after the end of the period assigned or elected, even though under paragraph (c), (g)(3), or (m) of this section a year following the recovery period may be a recovery year (as defined in subparagraph (3)).

(m) *Limitation on property financed with proceeds of industrial development bonds.* [RESERVED]

(n) *Application to adjustment to basis of partnership property under sections 734(b) and 743(b)*—(1) *Increases in basis.* (i) If, under section 734(b) (relating to the optional adjustment to the basis of undistributed partnership property) or section 743(b) (relating to the optional adjustment to the basis of partnership property), the basis of a partnership's recovery property is increased as a result of the distribution of property to a partner or the transfer of a partnership interest (as the case may be), then the increased portion of the basis shall be taken into account under this section as if it were newly-purchased recovery property placed in service when the distribution or transfer occurs. Any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. No change shall be made for purposes of determining the recovery allowance under this section for the portion of the basis for which there is no increase.

(2) *Decreases in basis.* If, under section 734(b) or section 743(b), the basis of a partnership's recovery property is decreased as a result of the distribution of property to a partner or the transfer of a partnership interest (as the case may be), then such decrease shall be taken into account under the principles of paragraph (d)(3) of this section (relating to redeterminations). See also §1.755-1.

(3) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. On January 1, 1984, A, a partner who owns a 20 percent interest in partnership X, sells his entire interest to B for $400,000. Partnership X has one asset, a building which is recovery property, placed in service by X after 1980. A's adjusted basis in his partnership interest, allocable entirely to the building, is $100,000. A valid election under section 754 is in effect with respect to the sale of the partnership interest. Accordingly, partnership X makes an adjustment, pursuant to section 743(b), to increase the basis of the building with respect to B from $100,000 to $400,000. The amount of the basis adjustment with respect to partner B ($300,000) is taken into account under this section as if it were newly-purchased recovery property placed in service on January 1, 1984. Any applicable period and method may be used with respect to such portion of the basis. Accordingly, if the optional applicable percentages provided under §1.168-2 (c) are not used, the recovery with respect to the basis adjustment for 1984 is $36,000 (*i.e.*, $300,000 × .12). Such portion of the basis will have a 15-year recovery period, beginning January 1, 1984. No change is made with respect to the calculation of the recovery allowance for the portion of the basis of the partnership property (*i.e.*, $100,000) not affected by the basis adjustment under section 743.

§1.168-3 Recovery property.

(a) *Recovery property*—(1) *In general.* Except as provided in §1.168-4, "recovery property" to which ACRS applies means tangible property of a character subject to the allowance for depreciation which is—

(i) Used in a trade or business, or

(ii) Held for the production of income.

Property is considered recovery property only if such property would have been depreciable under section 167. Thus, ACRS applies only to that part of the property which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. ACRS does not apply to inventories or stock in trade, works of art, or to land apart from the improvements or physical development added to it. ACRS does not apply to natural resources which are subject to the allowance for depletion provided in section 611. No deduction shall be allowed under ACRS for automobiles or other vehicles used solely for pleasure, for a building used by the taxpayer solely as his residence, or for furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be recovery property. For rules regarding the recovery allowance for property which is used partly for business and partly for personal purposes, or which is converted from personal to business use, see §§1.168-2(d)(2)(ii) and 1.168-2(j)(1) and (2).

(2) *Intangible property.* [RESERVED]

(3) *Boilers fueled by oil or gas.* The term "recovery property" includes property described in section 167(p), relating to boilers fueled by oil or gas, if such property otherwise qualifies as "recovery property" under section 168 and subparagraph (l) of this paragraph.

(b) *Classes of recovery property.* Each item of recovery property shall be assigned to one of the following classes of property:

(1) 3-year property,

(2) 5-year property,

(3) 10-year property,

(4) 15-year real property, or

(5) 15-year public utility property.

Any property which is treated as included in a class of property by reason of paragraph (c)(1), (2), (3), (4), or (5) of this §1.168-3 shall not be treated as property included in any other class.

(c) *3-, 5-, 10-, and 15-year recovery property; definitions*—(1) *3-year property.* The following recovery property is included in the 3-year class:

(i) Section 1245 class property (as defined in paragraph (c)(6) of this §1.168-3) with a present class life (as defined in paragraph (c)(8)) of 4 years or less,

(ii) Section 1245 class property predominantly used in connection with research and experimentation (as described in section 174 and §1.174-2(a)). Property is used in connection with research and experimentation if the property is used (A) by its owner to conduct research and experimentation in its owner's trade or business, (B) by its owner to conduct research and experimentation for another person, (C) by a lessee to conduct re-

search and experimentation in its trade or business, or (D) by the lessee to conduct research and experimentation for another person, and

(iii) Any race horse which is more than 2 years old at the time the horse is placed in service and any other horse which is more than 12 years old at the time the horse is placed in service. A horse is more than 2 (or 12) years old after 24 (or 144) months after its actual birthdate.

Examples of 3-year recovery property are automobiles and light-duty trucks.

(2) *5-year property.* The following recovery property is included in the 5-year class: Section 1245 class property which is not 3-year property (as defined in paragraph (c)(1)), or 10-year property (as defined in paragraph (c)(3)), or 15-year public utility property (as defined in paragraph (c)(5) and (10)). Included in the 5-year recovery property class are horses which are not included in the 3-year recovery property class, property which, prior to January 1, 1981, may have been depreciated under the retirement-replacement-betterment method (subject to the provisions of §1.168-5(a)), single-purpose agricultural and horticultural structures, and storage facilities (other than buildings and their structural components) used in connection with the distribution of petroleum or any of its primary products. Primary products of petroleum are products described in §1.993-3(g)(3)(i).

(3) *10-year property.* The following recovery property is included in the 10-year class:

(i) Public utility property with a present class life of more than 18 years but not more than 25 years, other than section 1250 class property (as defined in paragraph (c)(7)) or 3-year property,

(ii) Section 1250 class property with a present class life of 12.5 years or less,

(iii) Railroad tank cars,

(iv) Manufactured homes (as defined in 42 U.S.C. section 5402(6)) which are section 1250 class property used as dwelling units, and

(v) Qualified coal utilization property (as defined in paragraph (c)(9)) which would otherwise be 15-year public utility property.

A building (and its structural components, if any) is not treated as having a present class life of 12.5 years or less if, in its original use (as defined in paragraph (c)(11) of this §1.168-3), the building (and its structural components, if any) does not have a present class life of 12.5 years or less. Thus, for example, a theme park structure is considered 10-year property only if the orignal use of such structure is as a theme park structure.

(4) *15-year real property.* Fifteen-year real property is section 1250 class property which does not have a present class life of 12.5 years or less (including section 1250 class property which does not have a present class life). Examples of 15-year real property are office buildings and elevators and escalators.

(5) *15-year public utility property.* Fifteen-year public utility property is public utility property, other than section 1250 class property or 3-year property, with a present class life of more than 25 years. Examples of 15-year public utility property are: most property in electric utility steam production plants, gas utility manufactured gas production plants, water utility property, and telephone distribution plants.

(6) *Section 1245 class property defined.* For purposes of section 168 and §§1.168-1 through 1.168-6, section 1245 class property is tangible property described in section 1245(a)(3) (other than subparagraphs (C) and (D)). See §1.168-4 for exclusion of certain "section 1245 class property" from recovery property.

(7) *Section 1250 class property defined.* For purposes of section 168 and §§1.168-1 through 1.168-6, section 1250 class property is property described in section 1250(c) and property described in section 1245 (a)(3)(C). See §1.168-4 for exclusion of certain "section 1250 class property" from recovery property.

(8) *Present class life defined.* (i) For purposes of section 168 and §§1.168-1 through 1.168-6, present class life is the asset depreciation range (ADR) class life ("midpoint" or "asset guideline period") (if any) applicable with respect to the property as of January 1, 1981, published in Rev. Proc. 83-35 [1983-1 C.B. 745]. No changes will be made to the classes or class lives which are set forth in Rev. Proc. 83-35.

(ii) The application of subdivision (i) may be illustrated by the following example:

Example. X purchases a light-duty truck to be used in his trade or business. The ADR midpoint life of this asset as of January 1, 1981, determined under Rev. Proc. 83-35 is 4 years. Since this truck is section 1245 class property with a present class life of 4 years or less, it is 3-year recovery property under section 168.

(9) *Qualified coal utilization property.* See section 168(g)(8) for the definition of "qualified coal utilization property."

(10) *Public utility property.* (i) For purposes of section 168 and §§1.168-1 through 1.168-6, the term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of—

(A) Electrical energy, water, or sewage disposla services,

(B) Gas or steam through a local distribution system,

(C) Telephone services, or other communication services if furnished or sold by Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. section 701), or

(D) Transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, are regulated, *i.e.*, are established or approved by a State (including the District of Columbia) or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof. A taxpayer's rates are "regulated" if they are established or approved on a rate-of-return basis. Rates regulated on a rate-of-return basis are an authorization to collect revenues that cover the taxpayer's cost of providing goods or services, including a fair return on the taxpayer's investment in providing such goods or services, where the taxpayer's costs and investment are determined by use of a uniform system of accounts prescribed by the regula-

tory body. A taxpayer's rates are not "regulated" if they are established or approved on the basis of maintaining competition within an industry, insuring adequate service to customers of an industry, insuring adequate security for loans, or charging "reasonable" rates within an industry since the taxpayer is not authorized to collect revenues based on the taxpayer's cost of providing goods or services. Rates are considered to be "established or approved" if a schedule of rates is filed with a regulatory body that has the power to approve such rates, even though the regulatory body takes no action on the filed schedule or generally leaves undisturbed rates filed by the taxpayer.

(ii) Public utility property includes property which is leased to others by a taxpayer, where the leasing of such property is part of the lessor's public utility activity, as described in subdivision (i). Public utility property also includes property leased to a person who uses such property predominately in a public utility activity, as described in subdivision (i).

(11) *"Original use"*. The term "original use" means the first use to which the property is put, whether or not such use corresponds to other use of such property by the taxpayer.

§1.168-4 Exclusions from ACRS.

(a) *Property placed in service by the taxpayer before January 1, 1981.* ACRS does not apply with respect to property placed in service by the taxpayer before January 1, 1981. See §1.168-2(l)(2) for when property is placed in service. As provided in paragraph (d) of this section, ACRS does not apply with respect to property placed in service before January 1, 1981, which is transferred in certain "churning" transactions. If property is excluded from ACRS, the provisions of section 167 (and related provisions) apply in determining the allowable depreciation deduction with respect to such property.

(b) *Property amortized or depreciated other than in term of years*—(1) *Depreciation.* If—

(i) Property can property be depreciated under a method not expressed in a term of years (such as unit-of-production) which, before January 1, 1981, was a recognized method within the particular industry for the type of property in question, and

(ii) The taxpayer properly elects such treatment for such property in accordance with section 168(f)(4) and §1.168-5(e) for the first taxable year for which an ACRS deduction would (but for this election) be allowable with respect to such property in the hands of the taxpayer,

then such property shall be entirely excluded from ACRS so long as it remains in the hands of such taxpayer. A taxpayer may elect to apply a depreciation method not expressed in a term of years (and thereby exclude the property from ACRS) with respect to some or all property within the same recovery class and placed in service in the same taxable year.

(2) *Amortization.* If—

(i) The basis of a recovery property may be amortized, in lieu of being depreciated, under any section of the Code (such as section 167(k), relating to expenditures to rehabilitate low-income rental housing, or section 169, relating to pollution control facilities), and

(ii) The taxpayer properly elects to amortize such property in accordance with the relevant amortization provision, then the amount subject to such amortization shall be excluded from the property's unadjusted basis as defined in section 168(d)(1)(A) and §1.168-2(d). A taxpayer may elect amortization with respect to one property (or a portion thereof) and apply ACRS with respect to other property (or the remaining portion) within the same recovery class and placed in service in the same taxable year.

(c) *Special rule for public utility property.* [Reserved]

(d) *Anti-churning rules for certain transactions in property placed in service before 1981*—(1) *In general.* To be eligible for ACRS, property must be placed in service by the taxpayer after 1980. The anti-churning rules of section 168(e)(4) and this paragraph (d) are designed generally to deny ACRS to property in service before 1981 in the absence of a significant change in ownership or use.

(2) *Section 1245 class property*—(i) *In general.* Section 1245 class property, as defined in section 168(g)(3) and §1.168-3(c)(6), acquired by the taxpayer after December 31, 1980, will not qualify for ACRS if—

(A) The property was owned or used at any time during 1980 by the taxpayer or a related person,

(B) The property is acquired from a person who owned such property at any time during 1980, and, as part of the transaction, the user of the property does not change,

(C) The property is leased by the taxpayer for more than 3 months to a person (or a person related to such person) who owned or used such property at any time during 1980, or

(D) The property is acquired in a transaction in which the user of such property does not change, and the property does not qualify for ACRS in the hands of the person from whom the property is so acquired due to subdivisions (B) and (C) of this paragraph (d)(2)(i).

See section 168(e)(4)(D) and subparagraph (6) of this paragraph (d) for definition of the term "related person". See subparagraph (3) of this paragraph (d) for the treatment of the acquisition of section 1245 class property acquired incidental to the acquisition of section 1250 class property. See subparagraph (4) of this paragraph (d) for other special rules.

(ii) *Change in user.* For purposes of subdivision (i) of this paragraph (d)(2), the user of a section 1245 class property shall not be considered to have changed as part of a transaction if the property is physically used, for more than 3 months after its transfer, by the same person (or a related person) who used such property before the transfer, or if such person, pursuant to a plan, resumes use of the property after the transfer. If the former owner (or a related person) continues to operate section 1245 class property through an arrangement such as a management contract for more than 3 months after the transfer, then all facts and circumstances will be taken into account in determining whether the user of the property has changed as part of such transaction for purposes of section

168(e)(4)(A) and subdivision (i) of this paragraph (d)(2). Among the factors which would indicate that the user of section 1245 property has changed in such case are—

(A) The arrangement in question is a customary commercial practice,

(B) The transaction in question has been arranged at arm's length, and

(C) The new owner has assumed all benefits and burdens of ownership. For purposes of this subdivision (ii)(C), the former owner will not be considered to have retained any benefits and burdens of ownership solely by reason of receiving contingent payments if such payments—

(*1*) Represent the real value of services rendered,

(*2*) Are reasonable in amount, and

(*3*) Are ordinary and customary in both nature and amount within the industry and region for the transaction in question.

(3) *Section 1250 class property.* A section 1250 class property, as defined in section 168(g)(4) and §1.168-3(c)(7), acquired by the taxpayer after December 31, 1980, will not qualify for ACRS if—

(i) The property was owned at any time during 1980 by the taxpayer or a related person,

(ii) The property is leased by the taxpayer for more than 3 months to a person (or a person related to such person) who owned such property at any time during 1980, or

(iii) The property is acquired in an exchange described in section 1031 (relating to exchange of property held for productive use or investment), section 1033 (relating to involuntary conversions), section 1038 (relating to certain reacquisitions of real property), or section 1039 (relating to certain sales of low-income housing projects), to the extent that the basis of such property includes an amount representing the adjusted basis of other property owned by the taxpayer or a related person at any time during 1980. The excess of the basis of the property acquired over the adjusted basis of such other property, eligible for ACRS, provided that the exchange is not otherwise treated as a "churning" transaction under section 168(e)(4) and this paragraph. Property which does not qualify for ACRS under this subdivision shall be considered, for purposes of this section, as owned by the taxpayer during 1980.

See section 168(e)(4)(D) and subparagraph (6) of this paragraph (d) for definition of the term "related person". If, in a transaction, section 1245 class property is acquired incidental to the acquisition of section 1250 class property, then the rules of section 168(e)(4)(B) and this subparagraph shall apply with respect to the section 1245 property acquired in such transaction instead of the rules of section 168(e)(4)(A) and paragraph (d)(2) of this section. The preceding sentence will not apply in transactions where section 1245 property constitutes a significant portion of the property acquired.

(4) *Special rules.* (i) Property under construction during 1980. For purposes of paragraph (d)(2) and (3) of this section, a taxpayer shall not be deemed to own property under construction during 1980 until it is placed in service, as described in §1.168-2(l)(2).

(ii) *Entire property excluded.* Except as provided in paragraph (d)(3)(iii) of this section (relating to excess basis in substituted basis transactions), subdivision (iii) of this paragraph (d)(4) (relating to the lease of a portion of section 1250 class property), and paragraph (d)(6)(ii)(C) of this section (relating to transactions between persons related by reason of the application of §1.267(b)-1(b)), if property is acquired in a transaction described in paragraph (d)(2) or (3) of this section, the entire property shall be excluded from ACRS.

(iii) *Lease of portion of section 1250 class property.* Paragraph (d)(3)(ii) of this section (relating to the lease of section 1250 class property) shall apply only with respect to that portion of the property (determined on a fair market value basis) that is leased to the person (or to a person related to such person) who owned the property during 1980. The portion of the property excluded from ACRS shall not exceed the portion of the property which was owned by the lessee (or a person related to the lessee) during 1980.

(iv) *Undivided interests.* Subject to the provisions of paragraph (d)(7) of this section (relating to avoidance), if an undivided interest in property is acquired, and the resulting arrangement is not a partnership for tax purposes, then such interest shall be treated as a separate item of property for purposes of paragraph (d)(2) and (3) of this section.

(v) *Acquisition by or lease to 1980 owner or user.* If recovery property is acquired by, or leased to, its 1980 owner (or, in the case of section 1245 class property, its 1980 owner or user), or a related person, then the property shall cease to qualify for ACRS.

(vi) *Sale-leaseback of disqualified property.* If property which does not qualify for ACRS under this section becomes the subject of a sale-leaseback transaction, then the property shall not become ACRS property by virtue of that transaction.

(5) Certain nonrecognition transactions—(i) *In general.* With respect to property placed in service by the transferor or distributor before January 1, 1981, and which is acquired by the taxpayer after December 31, 1980, in a nonrecognition transaction described in section 168(e)(4)(C) and in subdivision (ii) of this paragraph (d)(5), ACRS shall not apply to the extent that the property's basis in the hands of the taxpayer is determined by reference to its basis in the hands of the transferor or distributor. In such a transaction, the taxpayer shall be treated as the transferor or distributor for purposes of computing the depreciation allowance under section 167 with respect to so much of the basis of the acquired property in the hands of the taxpayer as does not exceed its adjusted basis in the hands of the transferor or distributor. However, the taxpayer shall treat the portion of the basis of the acquired property which exceeds the adjusted basis in the hands of the transferor or distributor as a separate item of property, eligible for ACRS, provided that sale or exchange of such property by the transferor or distributor to the taxpayer would not be treated as a "churning" transaction

under section 168(e)(4) and this paragraph.

(ii) *Nonrecognition transactions affected.* Subdivision (i) of this paragraph (d)(5) applies to transactions described in any of the following provisions:

(A) Section 332 (relating to distributions in complete liquidation of an 80 percent or more controlled subsidiary corporation) except where the basis of the assets distributed is determined under section 334(b)(2) (as in effect on August 31, 1982);

(B) Section 351 (relating to transfer to a corporation controlled by transferor);

(C) Section 361 (relating to exchanges pursuant to certain corporate reorganizations);

(D) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings);

(E) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations);

(F) Section 721 (relating to transfers to a partnership in exchange for a partnership interest); and

(G) Section 731 (relating to distributions by a partnership to a partner).

A distribution of property by a partnership to a partner in liquidation of the partner's interest in the partnership (where the basis of the distributed property to the partner is determined under section 732(b)) is not a transaction described in section 168(e)(4)(C) and this subdivision (ii) since, in such case, the basis of the property is determined by reference to the partner's adjusted basis in his interest in the partnership and not by reference to the basis of the property in the hands of the partnership. However, such distribution may be described in paragraph (d)(2) or (3) of this section.

(iii) *Successive application.* Property which does not qualify for ACRS by reason of its acquisition in a nonrecognition transaction will not qualify for ACRS if it is subsequently transferred in another nonrecognition transaction. The preceding sentence shall apply to the extent that the basis of the property in the hands of the transferee does not exceed the basis that does not qualify for ACRS in the hands of the transferor.

(6) *Related person defined*—(i) *In general.* For purposes of this paragraph (d) except as provided in section 168(e)(4)(E) and in subparagraph (11) of this paragraph (d), persons are related if—

(A) They bear a relationship specified in section 267(b) or section 707(b)(1) and the regulations thereunder, or

(B) They are engaged in trades or businesses under common control (as defined by subsections (a) and (b) of section 52 and the regulations thereunder).

For purposes of applying section 267(b) and 707(b)(1) with respect to this paragraph (d)(6), "10 percent" shall be substituted for "50 percent".

(ii) *Special rules.* (A) In general, persons are related if they are related either immediately before or immediately after the taxpayer's acquisition of the property in question. When a partnership's acquisition of property results from the termination of another partnership under section 708(b)(1)(B), whether the acquiring partnership is related to such other partnership shall be determined by comparing the ownership of the acquiring partnership immediately after the acquisition with that of the terminated partnership as it existed immediately before the event resulting in such termination occurs. Similarly, when the acquisition of property by a partner results from the termination of a partnership under section 708(b)(1)(A), whether the acquiring person is related to the partnership shall be determined immediately before the event resulting in such termination occurs.

(B) If a person would be related to a corporation, partnership, or trust which owned (or, in the case of section 1245 class property, owned or used) property during 1980 but for the fact that such corporation, partnership, or trust is no longer in existence when the taxpayer acquires such property, then, for purposes of this subparagraph (6), such corporation, partnership, or trust is deemed to be in existence when the taxpayer acquires such property. Similarly, when a taxpayer leases property to a newly-created corporation, partnership, or trust, and a person who owned (or, in the case of section 1245 class property, owned or used) such property during 1980 would be related to the lessee but for the fact that such corporation, partnership, or trust is not in existence when the taxpayer acquires such property, then, for purposes of this subparagraph (6), such corporation, partnership, or trust is deemed to be in existence when the taxpayer acquires such property.

(C) If persons are related by reason of the application of §1.267(b)-1(b), then only a portion of the property shall be excluded from ACRS, consistent with the principles of §1.267(b)-1(b). See, however, paragraph (d)(7) of this section (relating to avoidance).

(D) If persons are not considered to be engaged in trades or businesses under common control (as defined by subsections (a) and (b) of section 52 and the regulations thereunder), but are considered to be related persons by substituting "10 percent" for "50 percent" within the provisions of section 267(b) or 707(b)(1), then such persons are considered to be related persons for purposes of this subparagraph (6).

(7) *Avoidance purpose indicated.* Property acquired by the taxpayer after December 31, 1980, does not qualify for ACRS if it is acquired in a transaction one of whose principal purposes is to avoid the operation of the effective date rule of section 168(e)(1) and the "anti-churning" rules of section 168(e)(4), and the rules of this section. A transaction will be presumed to have a principal purpose of avoidance if it does not effect a significant change in ownership or use of property in service before 1981 commensurate with that otherwise required for ACRS to apply. Among the circumstances in which a principal avoidance purpose may be indicated, and in which the property involved in the transfer may therefore be ineligible for ACRS, are—

(i) The same person owns (other than as a nominee), directly or indirectly, more than a 10 percent interest

in the taxpayer (or the taxpayer's lessee) and in a person who owned (or, in the case of section 1245 class property, owned or used) the property during 1980;

(ii) There is a mere change in form of the ownership of property owned by a person during 1980 (such as from a partnership to undivided interests);

(iii) The taxpayer (or the taxpayer's lessee) and a person who owned (or, in the case of section 1245 class property, owned or used) the property during 1980 are engaged in trade or businesses under common control within the meaning of section 52(a) and (b) and the regulations thereunder, substituting a 25 percent test for the 50 percent tests of §1.52-1, or there is a similar 25 percent common ownership in the property (or in a leasehold of the property) and in a person who owned (or, in the case of section 1245 class property, owned or used) the property during 1980;

(iv) The taxpayer (or the taxpayer's lessee) is related during 1980 to the person who owned (or, in the case of section 1245 class property, owned or used) the property during 1980;

(v) Section 1250 class property is operated by a person who owned such property during 1980 (or by a related person) under a management contract and, had such property been section 1245 class property instead of section 1250 class property, the user would be considered not to have changed as part of the transaction (see §1.168-4(d)(2)(ii));

(vi) The taxpayer leases section 1250 class property to a person and, through one or more subleases, the property is leased to a person who owned such property during 1980 (or to a related person); or

(vii) Section 1245 class property is acquired in an exchange described in section 1031, relating to exchange of property held for productive use or investment, to the extent that the basis of such property includes an amount representing the adjusted basis of other property owned by the taxpayer or a related person at any time during 1980. In the case of property which does not qualify for ACRS under this subdivision, rules similar to those of paragraph (d)(3)(iii) of this section shall apply. In general, the avoidance intent indicated in subdivisions (i) through (vii) may be rebutted by evidence of an overriding business purpose (or purposes) for the transaction. However, even if the taxpayer demonstrates an overriding business purpose (or purposes) for the transaction, the property will not qualify for ACRS if the Internal Revenue Service establishes that one of the principal purposes of the transaction is to avoid the operation of the effective date rule of section 168(e)(1) and the "anti-churning" rules of section 168(e)(4), and the rules of this section.

(8) *Adjustment to basis of partnership property.* ACRS shall not apply with respect to any adjustment to the basis of partnership property made under section 734(b) (relating to the optional adjustment to the basis of undistributed partnership property) or section 743(b) (relating to the optional adjustment to the basis of partnership property) if the partnership property itself does not qualify for ACRS because of section 168(e) and this section. If a partnership has property which qualifies for ACRS, see §1.168-2(n) for the application of ACRS to the adjustments, pursuant to section 734(b) or 743(b), to the basis of such property.

(9) *Acquisitions by reason of death.* Property acquired by the taxpayer after December 31, 1980, by reason of death, for which the basis is determined under section 1014(a), is eligible for ACRS.

(10) *Reduction in unadjusted basis.* The unadjusted basis of property for purposes of section 168(d)(1) and §1.168-2(d) shall be reduced to the extent that such property does not qualify for ACRS due to the application of this paragraph (d). The basis not taken into account for ACRS purposes pursuant to the preceding sentence shall be taken into account by the taxpayer for purposes of other provisions of the Code.

(11) *Certain corporate transactions.* For purposes of section 168(e)(4) and §1.168-4(d)(6), a corporation is not related to a distributee (or, in the case of a transaction described in section 338, the new target corporation) if—

(i) Such corporation is a distributing corporation in a transaction to which section 334(b)(2)(B) (as in effect on August 31, 1982) applies, or is a target corporation for which an election under section 338 is made, and at least 80 percent of the stock of such corporation (as described in section 334(b)(2)(B) or 338(d)(3)) is acquired by purchase after December 31, 1980, or

(ii) Such corporation is a distributing corporation in a complete liquidation to which section 331(a) applies, or a partial liquidation to which section 331(a) (as in effect on August 31, 1982) applies, or to which section 302(b)(4) applies, and the distributee (or a related person) by himself or together with one or more persons acquires the amount of stock specified in subdivision (i) of this paragraph (d)(11) by purchase after December 31, 1980.

(e) *Examples.* The application of this section may be illustrated by the following examples:

Example (1). In 1978 A buys a house which he uses as his family residence. In 1983, A's family moves out, and A converts the house into rental property. A may not use ACRS with respect to the property because he placed it in service before 1981. A must depreciate the property in accordance with section 167 and the regulations thereunder, subject to the other applicable provisions of the Code.

Example (2). In 1982 X Corp. purchases and places in service two major pieces of manufacturing equipment. One is newly constructed, while the other is a used machine expected to produce only 5,000 additional units. X elects to depreciate the used machine under the unit-of-production method. Such method was properly used within X's industry before 1981. Assuming that X has met the requirements of section 168(f)(4) and §1.168-5(e), the used machine will not be recovery property as defined in section 168(c)(1) and §1.168-3(a). X will apply ACRS with respect to the new machine even though it properly elected to apply the unit-of-production method with respect to the used machine.

Example (3). On November 15, 1984, B, a calendar year taxpayer, places in service a 10-unit apartment building for individuals and families of low income under section 8 of the United States Housing Act of 1937. B acquired the building for $100,000 and has incurred an additional $100,000 of expenditures for its rehabilitation, which B elects to amortize under section 167(k). In 1984, B is entitled to an allowance under ACRS of $2,000 (*i.e.*, .02 × $100,000). The $100,000 which B amortizes under section 167(k) is not included in the unadjusted basis and therefore is not recovered under the provisions of ACRS.

Example (4). C is an individual engaged in the trucking business. On February 1, 1983, C

purchases a new truck from a dealer. As is his normal business practice, C financed the transaction partly by trading in a truck C had used in his business for the previous 3 years. Although this transaction is described in section 1031, it does not have as one of its principal purposes avoidance of the rules of section 168(e)(1) and (4). C therefore will use ACRS with respect to the entire unadjusted basis of the truck purchased in 1983, including cash paid, indebtedness incurred, and the amount attributable to the adjusted basis of the used truck traded in.

Example (5). On June 1, 1983, in a transaction described in section 1031, Corporation M exchanges a corporate jet, acquired before 1981, for a very similar corporate jet owned and also acquired before 1981 by unrelated Corporation N. There is no significant difference to M or N in the use of the jet acquired from that of the jet exchanged, and the operations of each corporation do not change significantly as a result of the transaction. These facts and circumstances indicate that one of the principal purposes of this transaction is to avoid the principles of paragraphs (1) and (4) of section 168(e). Thus, absent evidence of an overriding business purpose (or purposes) for the transaction, neither of the jets will be treated as recovery property. Further, even if an overriding business purpose (or purposes) for the transaction is (or are) demonstrated, the property will not be eligible for ACRS if the Internal Revenue Service establishes that one of the principal purposes of the transaction is to avoid the principles of paragraphs (1) and (4) of section 168(e). The result in this example would be the same if, after the exchange, M or N sold the acquired property and leased it back, or sold the property to a related person.

Example (6). Z Corp., owner and largest occupant of the Z Building since 1965, sells this building to an institutional investor, M Corp., on May 1, 1983. After this sale, 25 percent of the Z building is leased to Z until May 1, 1985. Because 25 percent of the Z building is leased for more than 3 months by Z, which owned the building during 1980, M may not take ACRS deductions with respect to this 25 percent portion. Such portion must be depreciated in accordance with section 167. However, ACRS will apply with respect to the portion of the Z Building which is not leased by Z for more than 3 months after the above-described sale. If Z had leased the building only until July 31, 1983, then M Corp. would apply ACRS with respect to the entire building.

Example (7). During 1980 O Corp. undertakes construction of a department store which becomes available for its assigned business function on April 1, 1981. For purposes of section 168(e)(4)(B), O is not treated as owning the department store building under construction until it placed it in service on April 1, 1981. Accordingly, ACRS will apply with respect to the building, beginning on the day it is placed in service.

Example (8). On June 1, 1983, P Corp. sells an undivided 70 percent interest in a building it has owned since March 1, 1980, to Q Corp. which is not related to P. R Corp., which is not related to P, has occupied the building as a tenant since June 1980 and will continue to occupy it after this sale. P and Q will own the building as tenants-in-common. Q, but not P, will take ACRS deductions with respect to its portion of the building. The fact that the user of the building did not change will not affect this result. However, if P and Q had formed a partnership which owned the building after the sale, no portion of the building would qualify for ACRS because the taxpayer acquiring the property after 1980 (the partnership) would be related under section 168(e)(4)(D) to a person (P) which owned the building in 1980.

Example (9). On January 1, 1984, D, a 20 percent partner in Partnership W, sells his entire partnership interest to E for $400,000. Partnership W has one asset, a building it placed in service before 1981. D's adjusted basis in his partnership interest, allocable entirely to the building, is $200,000 when it is sold. A valid election under section 754 is in effect with respect to the sale of the partnership interest. Accordingly, Partnership W makes an adjustment pursuant to section 743(b) to increase the basis of the building with respect to E from $200,000 to $400,000. Under the provisions of §1.168-4(d)(8) no portion of the increase in the basis of the partnership property with respect to E is eligible for ACRS because the partnership property itself does not qualify for ACRS due to the provisions of section 168(e)(1) and §1.168-4(a).

Example (10). In 1983, F, an individual, sells a piece of business equipment he placed in service in 1980 to X, a partnership in which F owns a 20 percent interest. No portion of such equipment will qualify for ACRS since it was acquired after 1980 by the taxpayer (Partnership X) and was owned during 1980 by a related person (partner B). The result in this example would not be changed if F owned no interest in X in 1980.

Example (11). G, an individual, has owned an apartment building containing furnished apartments since 1979. On June 1, 1983, G sells the building and its furnishings to unrelated Partnership Y. The furniture was purchased by G before 1981. Most of these apartments will continue to be occupied by the same tenants who occupied them before the sale. For purposes of section 168(e)(4)(I) and §1.168-4(d)(3), the furniture is acquired incidental to the acquisition of the building. Therefore, ACRS will apply with respect to the furniture, notwithstanding that many of the tenants who used the furniture do not change as part of the transaction.

Example (12). On June 1, 1983, Partnership Z purchases a factory which has been leased by Corporation S, an unrelated person, since 1979. Corporation S continues to use this factory for more than 3 months after the sale. The pre-1981 section 1245 class property transferred in this transaction, such as machinery and equipment, represents a significant portion of the unadjusted basis of the property purchased by Z. Since the unadjusted basis of such section 1245 class property is significant in relation to the factory's unadjusted basis, for purposes of section 168(e)(4)(I) and §1.168-4(d)(3), the machinery and equipment are not acquired incidental to the acquisition of the factory. Since the user of such machinery and equipment does not change as part of the transaction, Partnership Z may not use ACRS with respect to such section 1245 class property. However, Z will use ACRS with respect to the factory and the other section 1250 class property acquired.

Example (13). Partnership W, in which Partner E holds a 25 percent interest, has as its sole asset an office building it placed in service in 1980. On May 1, 1983, E dies, and his partnership interest, whose basis is determined under section 1014, passes to his daughter, D. ACRS is not available with respect to any increase in the basis of the partnership property with respect to D, because the partnership property itself does not qualify for ACRS due to the provisions of section 168(e)(1) and §1.168-4(a).

Example (14). On July 1, 1983, Corporation X sells a building it had owned in 1980 to Corporation Y, an unrelated person. X retains an option to repurchase this building within 5 years. This building qualifies as recovery property in Y's hands, and Y will take ACRS deductions under section 168 with respect to it. On July 1, 1985, X exercises its option and repurchases the building. When X repurchases the building, it ceases to be recovery property because the taxpayer (X) owned the building during 1980. X may not take ACRS deductions with respect to the repurchased building. Instead, X must depreciate it under section 167 and the regulations thereunder.

Example (15). F, an individual, sells his business (including section 1245 class property owned in 1980) to G, on August 1, 1983. Under their arrangement, F continues to manage the business for G, using the same equipment he had previously used. F receives as compensation for managing the business a fixed salary plus 5 percent of the gross profits. The arrangement follows customary commercial practice and was negotiated by F and G at arm's length. In addition, the amounts received (including the 5 percent of gross profits) represent the real value of the services rendered by F and are reasonable in amount. Further, receipt of 5 percent of gross profits under these circumstances is an ordinary and customary feature in the sale of a business in the industry and region in question. This arrangement results in a sufficient change in the ownership and use of the equipment that G will recover the cost of such equipment under ACRS.

Example (16). Individuals J and K each own a 50 percent interest in Partnership X, whose only asset is a building placed in service before 1981. On August 1, 1983, H, an individual, purchases a 25 percent interest each from J and K. Partnership X is deemed under section 708(b)(1)(B) to have terminated when H purchases the 50 percent interest. The building is not eligible for ACRS because the taxpayer acquiring the property after 1980 (the new partnership formed by H, J, and K) is related to the person who owned the property during 1980 (the old partnership), since J and K own more than a 10 percent interest in each of the two partnerships.

Example (17). In 1980, individual A owns all of the stock of Corporation T, which in turn owns depreciable property. In 1982, A sells the stock of T to unrelated Corporation V. Shortly thereafter, T sells some of the depreciable property it owned in 1980 to A. Under section 168(e)(4)(D), the property is not owned during 1980 by a person related to the taxpayer (A) since A is not related to the 1980 owner (T) when A acquires the property. However, an avoidance purpose is indicated under §1.168-4(d)(7)(iv) since A was related in 1980 to the 1980 owner (T). Also, A broke the relationship with T shortly before acquiring the property. Accordingly, A may not use ACRS with respect to the property acquired, unless he can demonstrate an overriding business purpose (or purposes) for the transaction. Further, even if an overriding business purpose (or purposes) for the transaction is (or are) demonstrated, the property will not be eligible for ACRS if the Internal Revenue Service establishes that one of the principal purposes of the transaction is to avoid the principles of paragraphs (1) and (4) of section 168(e).

Example (18). In 1980, individual B owns all of the stock of Corporations X and Y. In 1980, X owns depreciable property. In 1981, X liquidates. In 1982, B sells to Y property owned by X in 1980. Y may not use ACRS with respect to

the acquired property. Since the taxpayer (Y) would be related to the 1980 owner (X) but for the fact that X is no longer in existence when Y acquires the property, then, under §1.168-4(d)(6)(ii)(B), X is considered to be in existence for purposes of determining whether the property was owned (or used) by a related person during 1980.

Example (19). In 1980, individual C owns all of the stock of Corporation M, which in turn owns all of the stock of Corporation N. In 1980, N owns depreciable property. In 1981, N distributes such 1980 property to M. In 1982, M sells the N stock to an unrelated person. In 1983, M distributes to C the property it received from N. Under section 168(e)(4)(D), the property is not owned during 1980 by a person related to the taxpayer (C), since C is not related to the 1980 owner (N) when C acquires the property. However, under §1.168-4(d)(7)(iv) an avoidance purpose is indicated since the taxpayer (C) is related in 1980 to the 1980 owner (N). Also, upon acquisition, C is related to the person from whom the property is acquired (M). Therefore, C may not use ACRS with respect to the property unless he demonstrates an overriding business purpose (or purposes) for the transaction. Further, even if an overriding business purpose (or purposes) for the transaction is (or are) demonstrated, the property will not be eligible for ACRS if the Internal Revenue Service establishes that one of the principal purposes of the transaction is to avoid the principles of paragraphs (1) and (4) of section 168(e).

Example (20). D owns 20 percent of Corporation X and a 20 percent interest in Partnership P. X owns depreciable property in 1980. In 1981, X sells the property to P. Under §1.267(b)-1(b), the sale is considered as occurring between X and the members of the partnership (including D) separately. Accordingly, under the principles of §1.267(b)-1(b), 20 percent of the unadjusted basis of the property is excluded from ACRS. In addition, under §1.168-4(d)(7)(i) an avoidance purpose is indicated since D owns more than a 10 percent interest in the taxpayer (P) and the person who owned the property during 1980 (X). Therefore, ACRS is not available with respect to the remainder of the unadjusted basis of the property unless an overriding business purpose (or purposes) for the transaction is (or are) demonstrated. Further, even if an overriding business purpose (or purposes) for the transaction is (or are) demonstrated, the property will not be eligible for ACRS if the Internal Revenue Service establishes that one of the principal purposes of the transaction is to avoid the principles of paragraphs (1) and (4) of section 168(e).

Example (21). In 1980, E leases section 1245 class property to F. In 1982, at the termination of the lease, F purchases the property from E and continues to use it for more than 3 months after the sale. F is not entitled to use ACRS with respect to the property since, as part of the transaction, the user of the property did not change. The result in this example would be the same if, instead of selling the property to F, E sold the property to G, subject to F's lease, with F's use continuing for more than 3 months after the sale.

Example (22). In 1980, H and I each own section 1245 class property which they use in their respective businesses. In 1981, H and I swap titles to the property, with the parties continuing to use the same property as before the exchange. Neither H nor I is entitled to use ACRS with respect to the acquired property, since the user of the property does not change as part of the transaction.

Example (23). A owns section 1250 class property in 1980. In 1981, A sells the property to B who leases it back to A. B later sells the property to C, subject to A's lease. ACRS is not available with respect to the property in the hands of C since the taxpayer (C) leases the property to a person who owned it during 1980 (A).

Example (24). D owns section 1250 class property in 1980. In 1981, D transfers the property to E (an unrelated person) in exchange for property of a like kind in a transaction described in section 1031. Subsequently, D sells to and leases back from F the property acquired from E. Under §1.168-4(d)(3)(iii), the property acquired from E is considered to have been owned by D in 1980. Therefore, ACRS is not available with respect to such property in the hands of F since the taxpayer (F) leases the property to a person who owned it during 1980 (D). The result in this example would be the same if, instead of selling the property to F, D sold it to G (regardless of whether G leased it back to D), a person related to D under section 168(e)(4)(D) and §1.168-4(d)(6).

Example (25). In 1980, Corporation X places in service section 1245 class property. In 1981, X merges into Corporation Y in a transaction described in section 368(a)(1)(A). Subsequently, Y sells to and leases back from Z the 1980 section 1245 class property acquired from X in the merger. Under §1.168-4(d)(4)(vi), ACRS is not available with respect to the property in the hands of Z.

§1.168-5 Special rules.

(a) *Retirement-replacement-betterment (RRB) property*—(1) *RRB replacement property placed in service before January 1, 1985.* (i) Except as provided in subdivision (ii), the recovery deduction for the taxable year for retirement-replacement-betterment (RRB) replacement property (as defined in subparagraph (3) of this paragraph (a)) placed in service before January 1, 1985, shall be (in lieu of the amount determined under section 168(b)) an amount determined by applying to the unadjusted basis (as defined in §1.168-2(d)) of such property the applicable percentage determined in accordance with the following table:

If the recovery year is:	And the year the property is placed in service is:			
	1981	1982	1983	1984
	The applicable percentage is:			
1	100	50	33	25
2	50	45	38	
3	22	25		
4	12			

(ii) The provisions of subparagraph (1)(i) do not apply to any taxpayer who did not use the RRB method of depreciation under section 167 as of December 31, 1980. In such case, RRB replacement property placed in service by the taxpayer after December 31, 1980, shall be treated as other 5-year recovery property under section 168.

(2) *RRB replacement property placed in service after December 31, 1984.* RRB replacement property placed in service after December 31, 1984, is treated as other 5-year recovery property under section 168.

(3) *RRB replacement property defined.* RRB replacement property, for purposes of section 168, means replacement track material (including rail, ties, other track material, and ballast) installed by a railroad (including a railroad switching or terminal company) if—

(i) The replacement is made pursuant to a scheduled program for replacement.

(ii) The replacement is made pursuant to observations by maintenance-of-way personnel of specific track material needing replacement,

(iii) The replacement is made pursuant to the detection by a rail-test car of specific track material needing replacement, or

(iv) The replacement is made as a result of a casualty.

Replacements made as a result of a casualty shall be RRB replacement property only to the extent that, in the case of each casualty, the replacement cost with respect to the replacement track material exceeds $50,000.

(4) *Recovery of adjusted basis of RRB property as of December 31, 1980.* The taxpayer shall recover the adjusted basis of RRB property (as defined in section 168(g)(6)) as of December 31, 1980, over a period of not less than 5 years and not more than 50

years, using a rate of recovery consistent with any method described in section 167(b), including the method described in section 167(b)(2), switching to the method described in section 167(b)(3) at a time to maximize the deduction. For purposes of determining the recovery allowance under this subparagraph, salvage value shall be disregarded. Upon disposition of such RRB property, the usual rules of §§1.168-2(a)(2) and 1.168-6 or, at the taxpayer's election, the rules of §1.168-2(h)(1) (relating to mass assets) will apply. The election to use the rules of §1.168-2(h)(1) shall be made in accordance with the provisions of paragraph (e) of this section, except that the election shall be made on the taxpayer's income tax return for the first taxable year in which a disposition affected by the election occurs. If such return is filed on or before May 16, 1984 the election may be made on a return, as amended, filed within the time prescribed by law (including extensions) for filing the return for such taxable year, or on an amended return for such taxable year. An election under §1.168-2(h)(1) with respect to RRB property shall apply throughout the applicable period of recovery and for all subsequent taxable years.

(5) *RRB property (which is not RRB replacement property) placed in service after December 31, 1980.* Property placed in service by the taxpayer after December 31, 1980, which is not RRB replacement property and which, under the taxpayer's method of depreciation as of December 31, 1980, would have been depreciated by the taxpayer under the RRB method, is treated as other property under section 168.

(b) *Transferee bound by transferor's period and method in certain transactions*—(1) *In general.* In the case of recovery property which is transferred in a transaction described in section 168(f)(10)(B) and subparagraph (2) of this §1.168-5(b), the transferee shall be treated as the transferor for purposes of computing the recovery allowance under section 168(a) and §1.168-2 with respect to so much of the basis of such property in the hands of the transferee as does not exceed its adjusted basis (determined before the application of the section 48(q)(2) adjustment, if any) in the hands of the transferor immediately before the transfer.

(2) *Transactions covered.* The provisions of subparagraph (1) of this paragraph (b) apply to the following transactions:

(i) A transaction described in—

(A) Section 332 (relating to distributions in complete liquidation of an 80 percent or more controlled subsidiary corporation) except where the basis of the assets distributed is determined under section 334(b)(2) (as in effect on August 31, 1982);

(B) Section 351 (relating to transfer to a corporation controlled by transferor);

(C) Section 361 (relating to exchanges pursuant to certain corporate reorganizations);

(D) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings);

(E) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations);

(F) Section 721 (relating to transfers to a partnership in exchange for a partnership interest); and

(G) Section 731 (relating to distributions by a partnership to a partner);

(ii) An acquisition (other than one described in subdivision (i) of this paragraph (2)) from a related person (as defined in section 168(e)(4)(D) and §1.168-4(d)(6)). Property acquired from a decedent is not property acquired in a transaction included in this subdivision (ii); and

(iii) An acquisition followed by a leaseback to the person from whom the property is acquired. A leaseback does not exist for purposes of this subdivision (iii) if the former owner in turn subleases the property to another person.

(3) *Transactions excluded.* The provisions of section 168(f)(10)(A) and paragraph (b)(1) of this section do not apply—

(i) To recovery property which is transferred within 12 months after the property is placed in service by the transferor. The exception of this subdivision (i) shall not apply in the case of a transaction also described in section 168(f)(7) (*i.e.*, a transaction in which gain or loss is not recognized in whole or in part); or

(ii) To any transaction described in section 168(e)(4) and §1.168-4(d).

(4) *Allowable deduction when transferor and transferee are calendar year taxpayers or have the same fiscal year.* When the transferor and transferee are calendar year taxpayers or when both the transferee and transferor have the same fiscal year—

(i) *Allowable deduction in year of transfer.* The allowable deduction for the recovery year in which the property is transferred shall be prorated between the transferor and the transferee on a monthly basis. For property other than 15-year real property, the transferor's deduction for such year is the deduction allowable to the transferor (determined without regard to this subdivision) multiplied by a fraction, the numerator of which is the number of months in the transferor's taxable year before the month in which the transfer occurs, and the denominator of which is the total number of months in the transferor's taxable year. The remaining portion of the transferor's allowable deduction for the taxable year of the transfer (determined without regard to this subdivision) shall be allocated to the transferee. For property transferred in a transaction described in section 332, 361, 371(a), 374(a), or 731, the two preceding sentences shall be applied by disregarding that the taxable year of the transferor may end on the date of the transfer. In the case of 15-year real property, the transferor's deduction for the year of the transfer is the deduction allowable to the transferor under the disposition rules of §1.168-2(a)(3) or (g)(4) (as the case may be). The remaining portion of the transferor's allowable deduction for the taxable year of the transfer (determined as if the transfer had not occurred) shall be allocated to the transferee. See subdivision (ii) of this paragraph (4) for a special rule applicable to certain nonrecognition transactions.

(ii) *Special rule for certain nonrecognition transactions occurring as of the close of business on the last day of*

any calendar month. For purposes of this paragraph (b), in the case of a transaction described in section 168 (f)(10)(B)(i) and paragraph (b)(2)(i) of this section, if the transfer occurs as of the close of business on the last day of any calendar month, such transfer is deemed to occur on the first day of the next calendar month.

(iii) *Transferee's allowable deduction for a taxable year subsequent to the year of transfer.* The allowable deduction to the transferee for taxable years subsequent to the year of transfer shall be determined as if the cost of the property were being recovered in the transferor's hands (*i.e.*, by multiplying the transferor's applicable recovery percentage for the current recovery year by the transferor's unadjusted basis in the transferred property).

Thus, for example, A, a calendar year taxpayer, purchases for $30,000 and places in service 15-year real property (other than low income housing) on February 15, 1981, and transfers the property to partnership B, a calendar year partnership, on March 15, 1981, in a transaction described in section 721. A does not elect to use the optional recovery percentages provided in §1.168-2(c). For 1981, A's allowable deduction is $300 (*i.e.*, $30,000 × .11 × 1/11). B's allowable deductions for 1981 and 1982 are $3,000 (*i.e.*, $3,300 − $300) and $3,000 (*i.e.*, .10 × $30,000), respectively.

(5) *Allowable deduction when transferor and transferee have different taxable years.* When the transferor and the transferee have different taxable years—

(i) *Transferor's allowable deduction.* The allowable deduction to the transferor for any taxable year in which the property is transferred shall be determined as under paragraph (b)(4)(i) and (ii) of this section.

(ii) *Transferee's allowable deduction.* In computing the transferee's allowable deduction for the year of transfer and for subsequent taxable years, the property shall similarly be treated as if its cost were being recovered by the transferor. However, the allowable deduction for any taxable year shall be allocated to the transferee based on the transferee's taxable year.

Thus, for example, B, a calendar year taxpayer, purchases for $30,000 and places in service 15-year real property (other than low income housing) on February 15, 1981. B's allowable deduction for 1981 is $3,300 (*i.e.*, .11 × $30,000). B transfers the property to C on March 15, 1982. C's taxable year is a fiscal year ending June 30. For 1982, B's allowable deduction is $500 (*i.e.*, $30,000 × .10 × 1/12). For fiscal year 1982, C's allowable deduction is $1,000 (*i.e.*, the remainder of B's 1982 deduction ($2,500), allocated to the period March 1 through June 30, 1982 (4 months/10 months)). For fiscal year 1983, C's allowable deduction is $2,850 (*i.e.*, the remainder of B's allowable 1982 deduction ($1,500), plus $1,350 which is B's allowable 1983 deduction of $2,700 ($30,000 × .09) allocated to the period January 1 through June 30, 1983 (*i.e.*, $2,700 × 6 months/12 months).

(6) *Transferee's basis lower than transferor's.* If the adjusted basis of the property in the hands of the transferee is lower than the adjusted basis of the property in the hands of the transferor immediately before the transfer, see §1.168-2(d)(3) for rules relating to redeterminations of basis.

(7) *Portion of basis in hands of transferee which exceeds transferor's adjusted basis.* The transferee shall treat as newly purchased ACRS property that portion of the basis of the property in the hands of the transferee that exceeds the adjusted basis (determined before the application of the section 48(q)(2) adjustment, if any) of the property in the hands of the transferor immediately before the transfer. Thus, such excess shall be treated as recovery property placed in service by the transferee in the year of the transfer. The transferee may choose any applicable recovery period and recovery method with respect to such excess and need not use the transferor's recovery period and recovery method.

(8) *Examples.* The application of this paragraph (b) may be illustrated by the following examples:

Example (1). In 1981, A, a calendar year taxpayer, purchases for $12,000 and places in service 3-year recovery property. Under section 168(b)(1) and §1.168-2(b)(1), the recovery allowances for the first and second recovery years are $3,000 (*i.e.*, .25 × $12,000) and $4,560 (*i.e.*, .38 × $12,000), respectively. On February 15, 1983, A transfers the property to M Corporation, a calendar year taxpayer, in exchange for M's stock and $2,000 cash in a transaction described in section 351. A's recovery allowance for 1983 is $370 (*i.e.*, (1/2 × .37) × $12,000). A's adjusted basis immediately before the exchange is $4,070 (*i.e.*, $12,000 − $7,930). Assume A recognizes gain of $2,000 on the transaction. The basis attributable to the property under section 362 is determined to be $6,070 in the hands of M Corporation. Under the provisions of section 168(f)(10)(A) and this paragraph (b), M, the transferee, is treated the same as A, the transferor, with respect to $4,070, which is so much of M's basis as does not exceed A's adjusted basis. However, in computing the deduction allowable with respect to such basis, A's unadjusted basis ($12,000) is used. Thus, in the third recovery year, M may deduct $4,070 (*i.e.*, 1/2 × .37) × $12,000) under section 168(f)(10)(A) and §1.168-5(b)(1) and (4). The remaining $2,000 of basis in the property is treated as newly purchased ACRS property placed in service in 1983. M may choose any applicable recovery period and recovery method with respect to such $2,000 and need not use A's recovery period and recovery method.

Example (2). In 1983, B, a calendar year taxpayer, purchases for $12,000 and places in service 5-year recovery property. Under section 46, B's investment tax credit for such property is $1,200. Under section 48(q)(1) and §1.168-2(d)(2), B reduces his basis by $600 (*i.e.*, .50 × $1,200). Therefore, B's unadjusted basis for purposes of section 168 is $11,400 (*i.e.*, $12,000 − $600). Under section 168(b)(1) and §1.168-2(b)(1), the recovery allowances for the first and second recovery years are $1,710 (*i.e.*, .15 × $11,400) and $2,508 (*i.e.*, .22 × $11,400), respectively. On February 15, 1985, B sells the property for $13,000 to C, a related party (as defined in section 168(e)(4)(D) and §1.168-4(d)(6)) who is a calendar year taxpayer. B's recovery allowance for 1985 is $199.50 (*i.e.*, (1/2 × .21) × $11,400). B's adjusted basis (determined without regard to the section 48(q)(2) adjustment), immediately before the sale is $6,982.50 (*i.e.*, $11,400 − $4,417.50). The basis of the property under section 1012 is $13,000 in C's hands. Under the provisions of section 168(f)(10)(A) and this paragraph (b), C, the transferee, is treated the same as B, the transferor, with respect to $6,982.50, which is so much of C's basis as does not exceed B's adjusted basis. However, in computing the deduction allowable with respect to such basis, B's unadjusted basis ($11,400) is used. Thus, in the third recovery year, C may deduct $2,194.50 (*i.e.*, (1/2 × .21) × $11,400) under section 168(f)(10)(A) and §1.168-5(b)(1) and (4). In the fourth and fifth recovery years, C may deduct $2,394 (*i.e.*, .21 × $11,400) each year. The remaining basis of $6,017.50 (*i.e.*, $13,000 − $6,982.50) in the property is treated as newly purchased ACRS property placed in service in 1985. C may choose any applicable period and recovery method with respect to such amount and need not use B's recovery period and recovery method.

Example (3). In 1981, D, a calendar year taxpayer, purchases for $12,000 and places in service 5-year recovery property. Under section 168(b)(1) and §1.168-2(b)(1), the recovery allowances for the first and second recovery years are $1,800 (*i.e.*, .15 × $12,000) and $2,640 (*i.e.*, .22 × $12,000), respectively. On

March 15, 1983, D transfers the property to N Corporation, a taxpayer having a fiscal year ending June 30, in exchange for N's stock and $2,000 cash in a transaction described in section 351. D's recovery allowance for 1983 is $420 (*i.e.*, (½ × .21) × $12,000). D's adjusted basis in the property immediately before the exchange is $7,140 (*i.e.*, $12,000 − $4,860). Assume D recognizes gain of $2,000 on the transaction. The basis attributable to the property under section 362 is determined to be $9,140 in the hands of N Corporation. Under the provisions of section 168(f)(10)(A) and this paragraph (b), N, the transferee, is treated the same as D, the transferor, with respect to $7,140, which is so much of N's basis as does not exceed D's adjusted basis. However, in computing the deduction allowable with respect to such basis, D's unadjusted basis ($12,000) is used. Thus, for fiscal year 1983, N Corporation's allowable deduction with respect to the carryover basis is $840 (*i.e.*, (½ × .21) × $12,000). For fiscal years 1984 and 1985, N Corporation's allowable deduction is $2,520 (*i.e.*, [(½ × .21) + (½ × .21)] × $12,000). For fiscal year 1986, N Corporation's allowable deduction is $1,260 (*i.e.*, (½ × .21) × $12,000). The remaining $2,000 of basis in the property is treated as newly purchased ACRS property. N may choose any applicable recovery period and recovery method with respect to such basis and need not use D's recovery period and recovery method. N elects to use the optional recovery percentage based on a 5-year recovery period with respect to the $2,000 of basis which is treated as newly purchased ACRS property. For fiscal years 1983, 1984, 1985, 1986, 1987, and 1988, N's recovery allowances with respect to such $2,000 basis are $200, $400, $400, $400, $400, and $200, respectively. If N's fiscal year ending June 30, 1983, were a short taxable year, the provisions of §1.168-2(f) would apply with respect to the $2,000 considered newly purchased ACRS property, but not with respect to N's basis carried over from D.

Example (4). On May 1, 1981, E, a calendar year taxpayer, purchases for $100,000 and places in service 5-year recovery property. On April 1, 1982, E sells the property for $100,000 to F who leases it back to E. Under the provisions of paragraph (b)(3), section 168(f)(10)(A) and §1.168-5(b)(1) do not apply. Thus, F may choose any applicable recovery period and recovery method with respect to its unadjusted basis of $100,000, with recovery beginning in 1982.

Example (5). Assume the same facts as in example (4), except that the property is sold to F and leased back to E on June 15, 1982. Assume further that F's fiscal year ends on July 31, 1982. For 1981, E's allowable deduction is $15,000 (*i.e.*, .15 × $100,000), and for 1982 is $9,166.67 (*i.e.*, $100,000 × .22 × ½). E's adjusted basis in the property immediately before the transfer is $75,833.33 (*i.e.*, $100,000 − $24,166.67). Under the provisions of section 168(f)(10)(A) and this paragraph (b), F, the transferee, is treated the same as E, the transferor, with respect to $75,833.33 which is so much of F's basis as does not exceed E's adjusted basis. However, in computing the deduction allowable with respect to such basis, E's unadjusted basis ($100,000) is used. Thus, for the fiscal year ending July 31, 1982, F's allowable deduction with respect to the carryover basis is $3,666.66 (*i.e.*, ½ × .22 × $100,000)). For fiscal year 1983, F's allowable deduction is $21,416.67 (*i.e.*, ½ × .22 × $100,000) + (½ × .21 × $100,000)). For fiscal years 1984 and 1985, F's allowable deductions are $21,000 (*i.e.*, (.21 × ½ × $100,000) + (.21 × ½ × $100,000)). For the fiscal year ending July 31, 1986, F's allowable deduction is $8,750 (*i.e.*, ½ × .21 × $100,000). The remaining $24,166.67 of basis is treated as newly-purchased property, placed in service by F in 1981. F may choose any applicable recovery period and method for such amount and need not use E's recovery period and method.

Example (6). On January 1, 1981, G, a calendar year taxpayer, purchases for $1 million and places in service 15-year real property (other than low income housing). On July 15, 1988, G sells the property to H for $1.5 million, who leases it back to G. H's taxable year is a fiscal year ending September 30. G does not elect use of the optional percentages provided by §1.168-2(c). For 1988, G's allowable deduction is $30,000 (*i.e.*, .06 × $1,000,000 × ½). H is treated the same as G with respect to $390,000, which is so much of the basis of the property in the hands of H as does not exceed its adjusted basis to G immediately before the transfer (*i.e.*, $1,000,000 $610,000). H's allowable deduction for its fiscal year ending September 30, 1988, with respect to such basis is $15,000 (*i.e.*, the remainder of G's allowable deduction for 1988 ($30,000) allocated to the period July 1 through September 30, 1988 (3 months/6 months)). For H's fiscal year ending September 30, 1989, H's allowable deduction is $60,000 (*i.e.*, the remainder of G's allowable 1988 deduction ($15,000) plus G's allowable 1989 deduction ($60,000) allocated to the period January 1 through September 30, 1989 (9 months/12 months) or $45,000). For H's fiscal year ending September 30, 1990, H's allowable deduction is $52,500 (*i.e.*, the remainder of G's allowable deduction for 1989 ($15,000), plus G's allowable deduction for 1990 ($50,000), allocated to the period January 1 through September 30, 1990 (9 months/12 months), or $37,500). For H's fiscal year ending September 30, 1996, H is entitled to G's allowable deduction for 1995 ($50,000), allocated to the period October 1 through December 31, 1995 (3 months/12 months), or $12,500. The amount of H's basis in excess of G's adjusted basis (*i.e.*, $1,500,000 less $390,000, or $1,110,000) is treated as newly purchased ACRS property placed in service by H on July 15, 1988. H may use any applicable recovery period and method with respect to such basis. Thus, assuming H does not elect the optional percentages provided by §1.168-2(c), H has an additional allowable deduction for its year ending September 30, 1988, of $33,300 (*i.e.*, .03 × $1,110,000). For its fiscal year ending September 30, 1989, H's allowable deduction with respect to such basis is $122,100 (*i.e.*, .11 × $1,110,000).

Example (7). On January 1, 1981, partnership P, a calendar year taxpayer, purchases for $1,000,000 and places in service 15-year real property (other than low income housing) which is the only asset of the partnership. At no time does the partnership have an election under section 754 in effect. P is owned equally by partners A, B, and C. On April 18, 1985, individual D purchases the interests on B and C for $1,500,000, thereby terminating the partnership under section 708(b)(1)(B). The deduction allowable with respect to the property for 1985 prior to the termination if $17,500 (*i.e.*, $1,000,000 × .07 × ½). The partnership's adjusted basis in the property immediately before the termination is $592,500 (*i.e.*, $1,000,000 - $407,500). Under the provisions of section 168(f)(10)(A) and §.168-5(b)(1), the new partnership which is created by A and D is treated the same as the old partnership with respect to $592,500, which is so much of the adjusted basis of the property to the new partnership as does not exceed its adjusted basis to the old partnership. However, in computing the allowable deduction with respect to such basis the old partnership's unadjusted basis ($1,000,000) is used. Thus, for 1985, the deduction allowable to the new partnership with respect to such basis is $52,500 (*i.e.*, $1,000,000 × .07 × ½) and for 1986 is $60,000 (*i.e.*, $1,000,000 × .06). This result would be the same if D purchased a 95 percent interest in the partnership. Recovery of such basis will be completed in 1995. The new partnership's basis in the property in excess of that of the old partnership is taken into account under ACRS as if it were newly-purchased recovery proerty placed in service in 1985. Any applicable period and method may be used with respect to such basis.

Example (8). In 1981, Corporation X, a calendar year taxpayer, purchases for $100,000 and places in service 5-year recovery property. Under section 1.168(b)(1) and §1.168-2(b)(1), X's recovery allowance for 1981 is $15,000. On March 15, 1982, X merges into Corporation Y in a transaction described in section 368(a)(1)(A) solely in exchange for Y stock. Y's taxable year is a fiscal year ending August 31. X's recovery allowance for 1982 is $3,666.66 (*i.e.*, ½ × .22 × $100,000). Under section 362, Y's basis in the property is the same as the property's adjusted basis in the hands of X immediately before the transfer. Therefore, for fiscal year 1982, Y's allowable deduction is $11,000 which is the remainder of X's allowable deduction for 1982, $18,333.34 (*i.e.*, $22,000 $3,666.66) allocated to the period March 1, 1982, through August 31, 1982 (*i.e.*, 6 months/10 months). For fiscal year 1983, Y's allowable deduction is $21,333.34 which is the remainder of X's allowable deduction for 1982 ($7,333.34) plus the deduction which would be allowable to X in 1983 (*i.e.*, $100,000 × .21, or $21,000) allocated to the period January 1 through August 31, 1983 (*i.e.*, $21,000 × 8 months/12 months or $14,000). In computing the deductions allowable to X and Y, the fact that X's taxable year ends on the date of the merger is disregarded.

(c) *Recovery property reacquired by the taxpayer*—(1) *In general.* Recovery property which is disposed of and then reacquired by the taxpayer shall be treated (for purposes of computing the allowable deduction under section 168(a) and §1.168-2) as if such property had not been disposed of by the taxpayer. This paragraph (c)(1) generally applies only to such much of the taxpayer's adjusted basis in the reacquired property as does not exceed his adjusted basis at the time he disposed of the property.

(2) *Taxpayers to whom provisions apply.* The provisions of section 168(f)(10)(C) and paragraph (c)(1) of this section apply only to a taxpayer who, at the time of the disposition of the property, anticipates a reacquisition of the same property.

(3) *Exceptions.* Section 168(f)(10)(C) and paragraph (c)(1) of this section shall not apply—

(i) To recovery property which is disposed of during the same taxable year that the property is placed in service by the taxpayer, or

(ii) To any transaction described in section 168(e)(4) and §1.168-4(d).

(4) *Taxpayer resumes prior recovery.* For purposes of paragraph (c)(1) of this §1.168-5, the reacquiring taxpayer shall resume the recovery under §1.168-2 applicable at the time of the disposition. For example, if the taxpayer originally uses a 3-year recovery period and the applicable percentages prescribed in section 168 (b)(1) and §1.168-2(b)(1), in the year of reacquisition the recovery allowance is computed by applying the applicable percentage for the year of disposition to the original unadjusted basis (*i.e.*, the unadjusted basis at the time the taxpayer originally placed the recovery property in service).

(5) *Portion of unadjusted basis in reacquired property which exceeds taxpayer's adjusted basis at the time of disposition.* That part of the unadjusted basis in the reacquired property which exceeds the taxpayer's adjusted basis in the property at the time of disposition shall be treated generally as newly purchased ACRS property. For property other than a building, any appropriate recovery period and method may be used with respect to such excess. For a building, the taxpayer must use the same recovery period and method with respect to such excess as are used for the building, unless such excess would qualify as a substantial improvement under §1.168-2(e)(4) if paid or incurred by the taxpayer for an improvement if he had continued to own the building.

(6) *Unadjusted basis in reacquired property lower than taxpayer's adjusted basis at time of disposition.* If the unadjusted basis in the reacquired property is lower than the taxpayer's adjusted basis in the property at the time of disposition, see §1.168-2(d)(3) for rules relating to redetermination of basis.

(7) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). In 1981 A, a calendar year taxpayer, purchases for $6,000 and places in service 3-year recovery property. A does not elect an optional recovery percentage under §1.168-2(c). Under section 168(b)(1) and §1.168-2(b)(1), A's recovery allowance for 1981 is $1,500 (*i.e.*, .25 × $6,000). A wants to change his method of cost recovery from the use of the accelerated percentages to the use of the optional straight line percentages. To effectuate this change, A sells the property to B in 1982 for $7,000 anticipating that B will sell the property back to A. B does not elect to use an optional recovery percentage. B's recovery deduction for 1982 is $1,750 (*i.e.*, .25 × $7,000). In 1983 A reacquires the property from B for $9,000. With respect to that portion of A's unadjusted basis in the reacquired property which does not exceed the adjusted basis at the time of disposition (*i.e.*, $4,500), A's recovery allowance for 1983 is determined as if A had not disposed of the property, that is, by applying the percentage (38 percent) applicable for the second recovery year (*i.e.*, 1982, the year of disposition) to the original unadjusted basis ($6,000). Thus, A's allowable deduction is $2,280 (*i.e.*, .38 × $6,000). That portion of the unadjusted basis in the reacquired property which exceeds A's adjusted basis at the time of disposition (*i.e.*, $4,500) is treated as newly purchased ACRS property placed in service in 1983. A may use any appropriate recovery period and method for such excess. Thus, if A uses the tables under §1.168-2(b)(1), A's recovery allowance for 1983 also includes $1,125 (*i.e.*, .25 × $4,500). A's recovery allowances for 1984 are $2,220 (*i.e.*, .37 × $6,000) plus $1,710 (*i.e.*, .38 × $4,500). A's recovery allowance for 1985 is $1,665 (*i.e.*, .37 × $4,500).

Example (2). In 1981 C, a calendar year taxpayer, purchases for $15,000 and places in service 3-year recovery property and elects under §1.168-2(c) the optional 5-year recovery period using the straight line method. Under §1.168-2(c)(4), C's recovery allowance for 1981 is $1,500 (*i.e.*, .10 × $15,000). C wants to change his method of cost recovery from the use of the optional straight line percentages to the use of the accelerated percentages. Consent to change is not granted to C under section 168(f)(4). Therefore, C tries to effectuate this change by selling the property to D in 1982 for $16,000 anticipating that D will sell the property back to C. D does not to elect to use the optional recovery percentages. D's recovery allowance for 1982 is $4,000 (*i.e.*, .25 × $16,000). In 1983, C reacquires the property from D for $17,000. With respect to that portion of C's unadjusted basis in the reacquired property that does not exceed the adjusted basis at the time of disposition (*i.e.*, $13,500), C must use the optional recovery percentages originally elected. C's recovery allowances for 1983, 1984, 1985, 1986, and 1987 are determined as if C had not disposed of the property, that is, by applying the applicable percentages beginning in the second recovery year to the original unadjusted basis ($15,000). Thus, C's allowable deductions are $3,000, $3,000, $3,000, $3,000, and $1,500, respectively. With respect to that portion of the unadjusted basis in the reacquired property which exceeds C's adjusted basis at the time of disposition (*i.e.*, $3,500), C may use any appropriate recovery period and method. Cost recovery for this portion of the reacquired property begins in 1983 as if C placed the property in service in that year.

Example (3). On February 15, 1981, E, a calendar year taxpayer, purchases for $30,000 and places in service 15-year real property (other than low income housing) and does not elect the optional straight line percentages under §1.168-2(c). Under §1.168-2(b)(2), E's recovery allowance for 1981 is $3,300 (*i.e.*, .11 × $30,000). E wants to change his method of cost recovery from the use of the accelerated percentages to the use of the optional straight line percentages. To effectuate this change, E sells the property to F on February 15, 1983, anticipating that F will sell the property back to E. E's recovery allowance for 1982 is $3,000 (*i.e.*, .10 × $30,000) and for 1983 is $225 (*i.e.*, .09 × ½ × $30,000). In 1984 E reacquires the property from F for $28,000. With respect to that portion of E's unadjusted basis in the reacquired property which does not exceed the adjusted basis at the time of disposition (*i.e.*, $23,475) E's recovery allowance for 1985 is determined as if E had not disposed of the property, that is, by applying the percentage (9 percent) applicable for the third recovery year to the original unadjusted basis ($30,000). The recovery for the year of reacquisition must be adjusted to reflect the number of months the property is used by the taxpayer in that year as recovery property. Thus, if E reacquired the property in July, E's recovery allowance for 1985 would be $1,350 (*i.e.*, .09 × ½ × $30,000). The unrecovered allowance for the third recovery year, $1,125 ($30,000 × .09 × ½), must be recovered in the year following the last recovery year. With respect to that portion of the unadjusted basis in the reacquired property which exceeds E's adjusted basis at the time of disposition (*i.e.*, $4,525), E may not elect an optional recovery period. Cost recovery for this portion of the reacquired property will begin in 1985. Thus, if the reacquisition occurred in July, E's allowable deduction for 1985 with respect to this portion would be $271.50 (*i.e.*, .06 × $4,525).

(d) *Treatment of leasehold improvements*—(1) *In general.* Capital expenditures made by a lessee for the erection of buildings or the construction of other permanent improvements on leased property are recoverable through ACRS deductions or amortization deductions. If the recovery period of such improvements in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, the allowances shall take the form of ACRS deductions under section 168. If, on the other hand, the recovery period of such property in the hands of the taxpayer would be longer than the remaining period of such lease, the allowances shall take the form of annual deductions from gross income in an amount equal to the unrecovered cost of such capital expenditures divided by the number of years remaining on the term of the lease. Such deductions shall be in lieu of ACRS deductions. See section 162 and the regulations thereunder.

(2) *Determination of recovery period.* For purposes of determining whether the recovery period is longer than the lease term, an election of an optional recovery period under sec-

tion 168(b)(3) or (f)(2)(C) shall be taken into account.

(3) *Determination of the effect given to lease renewal options; related lessee and lessor.* Section 178 governs the effect to be given renewal options in determining whether the recovery period of the improvements exceeds the remaining period of the lease. Section 178 also provides rules for determining the period of a lease when the lessee and lessor are related. In making any determination under section 178, the "recovery period" of the improvement shall be taken into account in lieu of its useful life. See §1.178-1.

(4) *Improvements made by lessor.* If a lessor makes an improvement to the leased property, the cost of the improvement must be recovered under the general provisions of section 168. The provisions of 168(f)(6) and this paragraph (d) do not apply to improvements made by the lessor.

(5) *Example.* The application of this paragraph may be illustrated by the following example:

Example. In 1981, A leases B's land for a term of 99 years. The lease provisions do not include any options to renew the lease. In 2034, A places in service 15-year real property which he built on the leased premises. Since the remaining term of the lease (46) years is longer than any recovery period which A could select under section 168 (*i.e.*, 15, 35, or 45 years), A must recover the costs of the improvement under section 168.

(e) *Manner and time for making election*—(1) *Elections to which this paragraph applies.* The rules in this paragraph apply to the following elections provided under section 168:

(i) Section 168(b)(3)(A) and (B)(i) and §1.168-2(c)(1) and (2), relating to election of optional recovery percentage with respect to property in the same recovery class (*i.e.*, all 3-year recovery property);

(ii) Section 168(b)(3)(A) and (B)(ii) and §1.168-2(c)(1) and (3), relating to election of optional recovery percentage on a property-by-property basis for 15-year real property;

(iii) Section 168(d)(2)(A) and §1.168-2(h), relating to election to account for mass assets in the same mass asset account and to include in income all proceeds realized on disposition;

(iv) Section 168(e)(2) and §1.168-4(b), relating to election to exclude property from ACRS by use of a method of depreciation not expressed in a term of years;

(v) Section 168(f)(2)(C)(i) and (ii)(I) and §1.168-2(g)(3)(i) and (ii), relating to election of optional recovery percentage for property used predominantly outside the United States in the same recovery class and with the same present class life (*e.g.*, 3-year recovery property with a present class life of 4 years); and

(vi) Section 168(f)(2)(C)(i) and (ii)(II) and §1.168-2(g)(3)(i) and (iii), relating to election of optional recovery percentage on a property-by-property basis for 15-year real property used predominantly outside the United States.

Use by a taxpayer of a method of cost recovery described in section 168 (b)(1) and (2) and §1.168-2(b)(1) and (2) or section 168(f)(2)(A) and (B) and §1.168-2(g)(1) and (2) (relating to the use of the accelerated percentages) is not an election for purposes of section 168 and this paragraph (e). Thus, no consent will be granted to change from such a method to another method described in section 168. The provisions of section 168(f)(4) and this paragraph (e) do not apply to elections which must be made under another section of the Code. Thus, for example, if a taxpayer wants to amortize property under section 167(k), the rules under section 167(k) apply with respect to such election and the revocation of such election.

(2) *Time for making elections.* Except as provided in subparagraph (4) or (5), the elections specified in subparagraph (1) of this paragraph (e) shall be made on the taxpayer's income tax return filed for the taxable year in which the property is placed in service as recovery property (as defined in §1.168-3(a)) by the taxpayer. If the taxpayer does not file a timely return (taking into account extensions of the time for filing) for such taxable year, the election shall be made at the time the taxpayer files his first return for such year. The election may be made on a return, as amended, filed within the time prescribed by law (including extensions) for filing the return for such taxable year. A separate election may be made for each corporation which is a member of an affiliated group (as defined in section 1504) and which joins in the making of a consolidated return in accordance with section 1502 and the regulations thereunder. See §1.1502-77.

(3) *Manner of making elections.* Except as provided in subparagraph (5), Form 4562 is provided for making an election under this paragraph and for submitting the information required. The taxpayer must specify in the election—

(i) The name of the taxpayer;

(ii) The taxpayer's identification number;

(iii) The year the recovery property was placed in service (or, in the case of 15-year real property, the month the property was placed in service);

(iv) The unadjusted basis of the recovery property; and

(v) Such other information as may be required.

An election will not be rendered invalid so long as there is substantial compliance, in good faith, with the requirements of this subparagraph (3).

(4) *Special rule for qualified rehabilitated buildings.* In the case of any qualified rehabilitated building (as defined in section 48(g)(1)), an election under section 168(b)(3) and §1.168-2(c) (relating to election of optional recovery percentage) may be made at any time before the date 3 years after the building was placed in service by the taxpayer.

(5) *Special rule for foreign taxpayers*—(i) *Foreign corporations subject to section 964.* In the case of a foreign corporation whose earnings and profits are determined under section 964, the elections specified in subparagraph (1) of this paragraph (e) shall be made at the time and in the manner provided in §1.964-1(c). Except as provided in the regulations under section 952 and section 1248, any election made under this subdivision (i) shall apply with respect to the recovery property affected by the election from the taxable year in which such property is placed in service. Such election may be revoked only as provided in §1.964-1(c)(7) and subparagraph (9) of this paragraph.

(ii) *Foreign taxpayers other than corporations subject to section 964.* In the case of a foreign taxpayer other than a corporation described in subdivision (i) of this subparagraph (5), the elections specified in subparagraph (1) of this paragraph (e) shall be made at the time and in the manner provided in subparagraphs (2) and (3) of this paragraph, except that the election shall be made on the taxpayer's income tax return for the later of the taxable year in which the property is placed in service as recovery property by the taxpayer or the first taxable year in which the taxpayer is subject to United States tax. Any election made under this subdivision (ii) shall apply with respect to the recovery property affected by the election from the taxable year in which such property is placed in service. Such election may be revoked only as provided in subparagraph (9) of this paragraph. No election may be made under this subdivision (ii) by a taxpayer who was required to, but did not make the election at the time and in the manner prescribed under subdivision (i). For purposes of this subdivision (ii)—

(A) "Foreign taxpayer" means a taxpayer that is not a United States person as defined in section 7701 (a)(30), and

(B) "United States tax" means tax under subtitle A of the Code (relating to income taxes) other than sections 871(a)(1) and 881 thereof.

(6) *Failure to elect optional recovery percentages.* If a taxpayer does not elect to use the optional recovery percentages within the time and in the manner prescribed in subparagraphs (2), (3), (4), and (5) (or is not considered to have elected under §1.168-2(c)(5)), the amount allowable under section 168 must be determined under section 168(b)(1) or (2) (or under section 168(f)(2)(A) or (B), where applicable) for the year in which the recovery property is placed in service and for all subsequent recovery years. Thus, no election to use such optional percentages may be made by the taxpayer in any other manner (*e.g.*, through a request under section 446(e) to change the taxpayer's method of accounting).

(7) *Individuals, partnerships, trusts, estates, and corporations.* Except as provided in subparagraph (8) of this paragraph with respect to transactions to which section 168 (f)(10)(A) and (B) applies, and subject to other applicable provisions of the Code and regulations, if recovery property is placed in service by an individual, trust, estate, partnership, or corporation, an election under this paragraph shall be made by the individual, trust, estate, partnership, or corporation placing such property in service.

(8) *Transactions to which section 168(f)(10)(A) and (B) applies.* In a transaction to which section 168(f)(10)(A) and (B) and paragraph (b) of this §1.168-5 apply, the transferee is bound by the transferor's election (or nonelection) under this paragraph with respect to the property so acquired. The rule of the preceding sentence shall apply only with respect to so much of the basis of the property in the hands of the transferee as does not exceed the adjusted basis of the property in the hands of the transferor immediately before the transfer.

(9) *Revocation of election.* An election under this paragraph, once made, may be revoked only with the consent of the Commissioner. Such consent will be granted only in extraordinary circumstances. Requests for consent must be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224.

(f) *Treatment of certain nonrecognition transactions*—(1) *Section 1033 transactions*—(i) *Allowable deduction for section 1033 converted property.* For any taxable year in which a transaction described in section 1033 occurs, the full year's allowable deduction shall be prorated on a monthly basis under the principles of paragraph (b)(4)(i) of this section. Thus, for example, on March 3, 1981, A, a calendar year taxpayer, purchases for $25,000 and places in service 3-year recovery property. On August 14, 1981, the property is converted. A's 1981 allowable deduction for the converted property is $3,645.83 (*i.e.*, $25,000 × .25 × 7/12). If the property were 15-year real property (other than low income housing) A's 1981 allowable deduction for the converted property would be $1,250 (*i.e.*, $25,000 × .10 × 5/10).

(ii) *Allowable deduction for section 1033 replacement property in year of replacement and subsequent taxable years.* (A) Replacement property acquired in a transaction to which section 1033 applies, which qualifies as recovery property, shall be treated the same as the converted property. Thus, the replacement property shall be recovered over the remaining recovery period using the same recovery method as the converted property. The preceding sentence applies only with respect to so much of the basis (as determined under section 1033(b)) in the replacement property as does not exceed the adjusted basis in the converted property. Any excess of the unadjusted basis of the replacement property over the adjusted basis of the converted property shall be treated as newly purchased ACRS property. Any excess of the adjusted basis of the converted property over the unadjusted basis of the replacement property shall be recovered under the principles of §1.168-2(d)(3) (relating to redeterminations).

(B) The allowable deduction for the replacement property in the year of replacement (whether such replacement year is the same as the year of conversion or a later year) shall be based on the number of months the replacement property is in service as recovery property during the replacement year.

(*1*) If the number of months in the conversion year after the property is converted (including the month of conversion) is greater than or equal to the number of months the replacement property is in service during the replacement year, the allowable deduction for the replacement year shall equal—

$$(a/b \times c) \times d$$

where

a = number of months replacement property is in service as recovery property during replacement year,

b = 12 or, in the case of 15-year real property converted in the first recovery year, the number of months in the taxpayer's taxable year after the converted property was placed in service by the taxpayer (including the month the property was placed in

service),
c = applicable recovery percentage for converted property in year of conversion, and
d = unadjusted basis of converted property.

An allowance is permitted to the extent of any unrecovered allowance in the taxable year following the final recovery year. The term "unrecovered allowance" means the difference between—

(*i*) The sum of recovery allowances for the year of the conversion and the year of the replacement, and

(*ii*) The recovery allowance which would have been allowable in the year of conversion had such conversion not occurred.

In a year following the year of replacement, the allowable deduction shall be computed by multiplying the applicable recovery percentage for the next recovery year to the unadjusted basis of the converted property.

(*2*) If the number of months in the conversion year after the property is converted (including the month of conversion) is less than the number of months the replacement property is in service during the replacement year, the allowable deduction for the replacement year shall equal—

$$[(a/b \times c) + (d/12 \times e)] \times f$$

where
a = number of months in conversion year after the property is converted (including the month of conversion),
b = 12 or, in the case of 15-year real property converted in the first recovery year, the number of months in the taxpayer's taxable year after the converted property was placed in service by the taxpayer (including the month the property was placed in service),
c = applicable recovery percentage for converted property in year of conversion,
d = number of months replacement property is in service as recovery property during replacement year minus a,
e = applicable recovery percentage for the next recovery year, and
f = unadjusted basis of converted property.

An allowance is permitted to the extent of any unrecovered allowance in the taxable year following the final recovery year. The term "unrecovered allowance" means the difference between—

(*i*) The sum of the recovery allowances for the year of conversion and the year of replacement, and

(*ii*) The sum of the recovery allowances which would have been allowable in the year of conversion and the next recovery year had such conversion not occurred.

In a year following the year of replacement, the allowable deduction shall be computed by multiplying the unadjusted basis of the converted property by the applicable recovery percentage for the second recovery year after the year of conversion.

(iii) *Examples.* The provisions of paragraph (f)(1)(i) and (ii) may be illustrated by the following examples:

Example (1). On January 1, 1981, A, a calendar year taxpayer, purchases for $40,000 and places in service recovery property which is 15-year real property (other than low income housing). Under section 168(b)(2) and §1.168-2(b)(2), the allowable deductions for the first and second recovery years are $4,800 (*i.e.*, .12 × $40,000) and $4,000 (*i.e.*, .10 × $40,000). On March 3, 1983, A's property is involuntarily converted. Under the provisions of subdivision (i), A's 1983 allowable deduction for the converted property is $600 (*i.e.*, 1/2 × .09 × $40,000). On May 15, 1984, A acquires replacement property. A's unadjusted basis in the replacement property is the same as his adjusted basis in the converted property (*i.e.*, $30,600). Under the provisions of subdivision (ii), the replacement property is treated the same as the converted property with respect to such $30,600 of basis. However, in computing the allowable deduction with respect to such basis, A's unadjusted basis in the converted property ($40,000) is used. Thus, A's allowable deduction for 1984 is $2,400 (*i.e.*, 1/2 × .09 × $40,000). Under the provisions of subdivision (ii)(B)(*1*), the unrecovered allowance is $600 (*i.e.*, $3,600 − $3,000), and it must be recovered in the taxable year following the fifteenth recovery year. A's allowable deduction for 1985 is $3,200 (*i.e.*, .08 × $40,000).

Example (2). Assume the same facts as in example (1) except that A acquires the replacement property on January 1, 1984. A's allowable deduction for 1984 is $3,533.33 (*i.e.*, [11/12 × .09) + (1/12 × .08)] × $4,000). Under the provisions of subdivision (ii)(B)(2), the unrecovered allowance is $2,666.67 (*i.e.*, $6,800 − $4,133.33) and it must be recovered in the taxable year following the final recovery year, that is, in the taxable year following the fifteenth recovery year. A's allowable deduction for 1985 is $2,800 (*i.e.*, .07 × $40,000).

Example (3). Assume the same facts as in example (1) except that A acquires the replacement property on the same day as the conversion (March 3, 1983). A's allowable deduction for 1983 for the converted property is $600 (*i.e.*, (1/12 × .09) × $40,000). A's allowable deduction for 1983 for the replacement property is $3,000 (*i.e.*, (11/12 × .09) × $40,000). A's allowable deduction for 1984 is $3,200 (*i.e.*, $40,000 × .08).

Example (4). On February 3, 1981, B, a calendar year taxpayer, purchases for $100,000 and places in service recovery property which is 15-year real property (other than low income housing). On June 25, 1981, B's property is involuntarily converted. On that same day B acquires replacement property with the same basis as the converted property. B's allowable deduction for 1981 for the converted property is $4,000 (*i.e.*, 1/11 × .11 × $100,000). B's allowable deduction for 1981 for the replacement property is $7,000 (*i.e.*, 7/11 × .11 × $100,000). B's allowable deduction for 1982 is $10,000 (*i.e.*, $100,000 × .10).

(2) *Section 1031 transactions*—(i) *Allowable deductions.* In a transaction to which section 1031 applies, the allowable deduction for the exchanged and acquired properties shall be determined under the principles of subparagraph (1) of this paragraph. Similarly, any excess of the unadjusted basis of the acquired property over the adjusted basis of the exchanged property shall be treated as newly purchased ACRS property, and any excess of the adjusted basis of the exchanged property over the unadjusted basis of the acquired property shall be recovered under the principles of §1.168-2(d)(3) (relating to redeterminations).

(ii) *Examples.* The provisions of paragraph (f)(2)(i) may be illustrated by the following examples:

Example (1). In 1981 A, a calendar year taxpayer, purchases for $12,000 and places in service recovery property which is 3-year recovery property. Under section 168(b)(1) and §1.168-2(b)(1), the allowable deductions for the first and second recovery years are $3,000 (*i.e.*, .25 × $12,000) and $4,560 (*i.e.*, .38 × $12,000), respectively. On March 3, 1983, A exchanges this property and $1,000 cash for property of a "like kind." A's 1983 allowable deduction for the exchanged property is $740 (*i.e.*, 1/2 × .37 × $12,000). A's basis in the acquired property is $4,700. The acquired property is treated the same as the exchanged property with respect to $3,700, which is so much of the basis in the acquired property as does not exceed the adjusted basis in the exchanged property. However, in computing the allowable deduction with respect to such basis, A's unadjusted basis in the exchanged property ($12,000) is used. Therefore, A's 1983 allowable deduction for the acquired property with respect to the substituted basis is $3,700 (*i.e.*, 11/12 × .37 × $12,000). The remaining $1,000 of basis in the acquired property is treated as newly purchased ACRS property placed in service in 1983. A may choose any applicable recovery period and recovery method for such basis and need not use the same recovery period and recovery method used for the exchanged property. If A uses the tables provided in section 168(b)(1) and §1.168-2(b)(1), for 1983, 1984, and 1985, A is entitled to additional allowable deductions of $250, $380, and $370, respectively.

Example (2). On February 8, 1981, B, a calendar year taxpayer, purchases for $80,000 and places in service 15-year real property (other than low income housing). Under the provisions of section 168(b)(2) and §1.168-2(b)(2), the allowable deduction for 1981 is $8,800 (*i.e.*, .11 × $80,000). On March 3, 1982, B exchanges this property and $20,000 cash for property of a "like kind." B's 1982 allowable deduction for the exchanged property is

$1,333.33 (*i.e.*, (7/12 × .10 × $80,000). B's basis in the acquired property is $89,866.67. The acquired property is treated the same as the exchanged property with respect to $69,866.67, which is so much of the basis in the acquired property as does not exceed the adjusted basis in the exchanged property. However, in computing the allowable deduction with respect to such basis, B's unadjusted basis in the exchanged property ($80,000) is used. Therefore, B's 1982 and 1983 allowable deductions for the acquired property with respect to the substituted basis are $6,666.66 (*i.e.*, 1 7/12 × .10 × $80,000) and $7,200 (*i.e.*, .09 × $80,000), respectively. The remaining $20,000 of basis in the acquired property is treated as newly purchased ACRS property placed in service in March 1982. B may choose any applicable recovery period and recovery method for this basis and need not use the same period and method used for the exchanged property. If B uses the tables prescribed in §1.168-2(b)(2), B's 1982 allowable deduction for this basis is $2,000 (*i.e.*, $20,000 × .10).

(3) *Transfers of property by gift*—(i) *Allowable deductions.* With respect to recovery property which is transferred by gift (where the donee's basis is determined under section 1015), the allowable deduction for the taxable year of the gift shall be apportioned between the donor and donee under the principles of paragraphs (b) (including paragraph (b)(4)(ii)) and (f)(1) of this section, and the donee shall be treated as the donor for subsequent taxable years to the extent that the donee's basis is carried over from the donor. That portion of the donee's basis (as determined under section 1015) in the property that exceeds the donor's adjusted basis immediately preceding the gift shall be treated as newly purchased ACRS property. The donee may choose any applicable recovery period and recovery method with respect to such excess and need not use the donor's recovery period and recovery method.

(ii) *Example.* The provisions of paragraph (f)(3)(i) may be illustrated by the following example:

Example. In 1981 A, a calendar year taxpayer, purchases for $12,000 and places in service 5-year recovery property. Under section 168(b)(1) and §1.168-2(b)(1), the allowable deduction for 1981 is $1,800 (*i.e.*, .15 × $12,000). On March 15, 1982, A transfers the property by gift to B (another calendar year taxpayer) who continues to use it as recovery property. A's 1982 allowable deduction is $440 (*i.e.*, 7/12 × .22 × $12,000). Under section 1015, B's basis in the property is determined to be $11,000. In the hands of B, the donee, the property is treated the same as in the hands of the donor with respect to $9,760, which is so much of the carryover basis as does not exceed the donor's adjusted basis in the property immediately preceding the gift. However, in computing the allowable deduction with respect to such basis, the donor's unadjusted basis ($12,000) is used. Therefore, B's 1982 allowable deduction with respect to such basis is $2,200 (*i.e.*, 1 7/12 × .22 × $12,000). The remaining $1,240 (*i.e.*, $11,000 − $9,760) of basis is treated as newly purchased ACRS property. B may choose any applicable recovery period and recovery method for such basis and need not use the donor's recovery period and recovery method.

(4) *Transfers of property by reason of death.* Where recovery property is transferred by reason of the death of the taxpayer, the allowable deduction for the taxpayer's taxable year which ends upon his death shall be governed by the rules applicable to short taxable years. See §1.168-2(f).

§1.168-6 Gain or loss on dispositions.

(a) *General rule.* Except as provided in §1.168-2(h) (relating to mass assets), where recovery property is disposed of during a taxable year, the following rules shall apply:

(1) If the asset is disposed of by sale or exchange, gain or loss shall be recognized as provided under the applicable provisions of the Code.

(2) If the asset is disposed of by physical abandonment, loss shall be recognized in the amount of the adjusted basis of the asset at the time of the abandonment. For a loss to qualify for recognition under this subparagraph (2), the taxpayer must intend to discard the asset irrevocably so that he will neither use the asset again, nor retrieve it for sale, exchange, or other disposition.

(3) If the asset is disposed of other than by sale or exchange or physical abandonment (as, for example, where the asset is transferred to a supplies or scrap account), gain shall not be recognized. Loss shall be recognized in the amount of the excess of the adjusted basis of the asset over its fair market value at the time of the disposition. No loss shall be recognized upon the conversion of property to personal use.

(b) *Definitions.* (1) See §1.168-2(l)(1) for the definition of "disposition," which excludes the retirement of a structural component of 15-year real property. Thus, no loss shall be recognized on such retirement, and the unadjusted basis of the property under §1.168-2(d) shall not be reduced. For example, if a taxpayer replaces the roof on 15-year real property, no loss is recognized upon the retirement of the replaced roof, and the unadjusted basis of the property continues to be recovered over the remaining period. For determination of the deductions allowable under section 168 with respect to the expenditures paid or incurred to replace the roof, see §1.168-2(e).

(2) The adjusted basis of an asset at the time of its disposition is its unadjusted basis, as provided in §1.168-2, adjusted as prescribed in §1.1011-1.

Par. 3. Section 1.178-1 is amended as follows:

1. Paragraph (a) is amended by removing the term "section 167 or 611" and inserting "section 167, 168, or 611" in its place.

2. Paragraph (b)(1)(i) and (3) is amended by removing the term "estimated useful life" in each of the three places it appears and removing the term "section 167" in the one place it appears and by inserting "estimated useful life or, in the case of recovery property (as defined in section 168), the recovery period (including, where applicable, any optional recovery period under section 168(b)(3) or (f)(2)(C))" and by inserting "section 167 or 168", respectively, in its place.

3. Paragraph (b)(2) is amended by removing the term "(or depreciation)" and by inserting "(or depreciation under section 167 or accelerated cost recovery under section 168)" in lieu thereof.

4. Paragraph (d)(1)(i) is amended by removing the term "remaining estimated useful life" and by inserting "remaining estimated useful life or, in the case of recovery property (as defined in section 168), the recovery period (including, where applicable, any optional recovery period under section 168(b)(3) or (f)(2)(C)) in its place.

5. Paragraph (b)(6) is amended by adding two examples immediately after example (5), which read as follows:

§1.178-1 Depreciation or amortization of improvements on leased property and cost of acquiring a lease.

* * * * *

(b) *Determination of amount of deduction.****

(6) ***

Example (6). Lessee C, a calendar year taxpayer, constructs a building on land leased from lessor D. The construction is completed and the building is placed in service on January 1, 1984, at which time C has 8 years remaining on the lease with no options to renew. On January 1, 1988, D grants C an option to renew the lease for a 10-year period. As of January 1, 1988, the date the renewal option is granted, section 178(a) and paragraph (b)(1) of this section become applicable, since the portion of the term of the lease remaining upon completion of the building (8 years) is less than 60 percent of any recovery period applicable to the building (60 percent of the shortest recovery period (15 years) is 9 years). As of January 1, 1988, the term of the lease shall be treated as including the remaining portion of the original lease (4 years) and the 10-year renewal, or 14 years, unless C can establish that, as of the close of 1988, it is more probable that the lease will not be renewed than that it will be. In such case, since the term of the lease as of January 1, 1988 (14 years), is less than the ACRS recovery period, a deduction is not allowed under section 168 with respect to such building.

Example (7). The facts are the same as in example (6), except that the option to renew is for 15 years. If, as of the close of 1988, C cannot establish that it is more probable that the lease will not be renewed than that it will be, the term of the lease as of January 1, 1988, will be 19 years. Since the term of the lease would be longer than the ACRS recovery period (unless a 35- or 45-year optional recovery period were desired), the provisions of section 168 will be applicable with respect to this building. For purposes of section 168, C is considered as having placed the building in service on January 1, 1988, with a 15-year recovery period extending from that time. C's unadjusted basis for purposes of section 168 is the adjusted basis in the building as of January 1, 1988.

Par. 4. Paragraph (a)(3) of §1.1016-3 is redesignated as (a)(4), and a new paragraph (a)(3) is added to read as follows:

§1.1016-3 Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.

(a) *In general.****

(3) *Adjustment for amount allowable where no cost recovery deduction claimed under section 168.* (i) Except as provided in subdivision (iii) of this subparagraph (3), if the taxpayer has not taken a deduction under section 168 (hereinafter referred to as ACRS deduction) either in the taxable year or for any prior taxable year, the adjustments to basis of the property for the ACRS deduction allowable shall be determined by using the recovery method described in section 168(b)(1) or (2) or, where applicable, section 168(f)(2)(A) or (B).

(ii) If the taxpayer with respect to any recovery property has properly taken an ACRS deduction under one of the methods provided in section 168 for one or more years but has omitted the deduction in other years, the adjustment to basis for the ACRS deduction allowable in such a case will be the deduction under the method which was used by the taxpayer with respect to that property. Thus, for example, A acquired property in 1981 for which he properly elected to compute his ACRS deduction by use of one of the optional straight line percentages described in section 168(b)(3) for the first recovery year but did not take a deduction in the second and third years of the asset's recovery period. The adjustment to basis for the ACRS deduction allowable for the second and third recovery years will be computed using the optional straight line percentages which were elected.

(iii) If the taxpayer has made an election under §1.168-5(e)(5) (relating to special election rules for foreign taxpayers) to use an optional straight line percentage with respect to recovery property, the adjustments to basis of the property for the ACRS deduction allowable shall be determined pursuant to that election.

(iv) The provisions of subdivision (iii) of this subparagraph (3) may be illustrated by the following example:

Example. In 1981, Corporation F (a calendar year taxpayer) purchases for $100,000 and places in service in a foreign country 5-year recovery property which has a present class life of 7.5 years. F is not subject to United States income tax, other than under section 881, and is not required to compute earnings and profits under section 964. On January 1, 1983, F begins engaging in a trade or business in the United States (making it subject to tax under section 882), and uses the property in the United States in connection with that trade or business. Under §1.168-5(e)(5)(ii), F may elect to use the optional recovery percentages with respect to the property placed in service in 1981 by submitting the requisite information on its income tax return for the taxable year beginning in 1983. That election will apply with respect to such property from the taxable year in which it is placed in service. Thus, if F elects the optional recovery percentages based on a 12-year recovery period under §1.168-2(g)(3), the allowable ACRS deductions for 1981 and 1982 would be $4,000 (*i.e.*, .04 × $100,000) and $9,000 (*i.e.*, .09 × $100,000), respectively, and F's adjusted basis in the property on January 1, 1983, would be $87,000 (*i.e.*, $100,000 − $13,000). For the deduction allowable to F with respect to the property in 1983, see §1.168-2(j)(4)(i) and (j)(6) (relating to change in status).

* * * * *

Par. 5. Section 1.1016-4 is amended by adding a new sentence at the end of paragraph (b) thereof, to read as follows:

§1.1016-4 Exhaustion, wear and tear, obsolescence, amortization, and depletion; periods during which income was not subject to tax.

* * * * *

(b) ***

For purposes of this section, the amount that would have been allowable as a deduction shall be determined without reference to section 168.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 9, 1984, 11:10 a.m., and published in the issue of the Federal Register for February 16, 1984, 49 F.R. 5940)

Notice of Proposed Rulemaking

Transitional Rule for the Increased Annual Gift Tax Exclusion and the Unlimited Exclusion for Certain Transfers

LR-211-81

SUMMARY: This document contains proposed regulations relating to the annual gift tax exclusion and the unlimited exclusion for certain medical and educational transfers. Changes to the applicable law were made by the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256]. The regulations would provide the public with the guidance needed to comply with that Act.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 6, 1984. The amendments are proposed to be effective for gifts made after December 31, 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, 1111 Constitution Avenue, N.W., Atten-

tion: CC:LR:T (LR-211-81) Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Ada S. Rousso of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W. Washington, D.C. 20224, Attention: CC:LR:T:LR-211-81, (202-566-4336), not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Gift Tax Regulations (26 CFR Part 25) under section 2503 of the Internal Revenue Code of 1954 (Code). These amendments are proposed to conform the regulations to section 441 of the Economic Recovery Tax Act of 1981 (P.L. 97-34, 95 Stat. 319) [1981-2 C.B. 256, 333] and are to be issued under the authority contained in section 7805 of the Code (68A Stat. 917, 26 U.S.C. 7805).

In General

Section 441(a) of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 333] increased the annual gift tax exclusion to $10,000 per donee for gifts made during calendar year 1982 and subsequent years. See §25.2503-2(a) and 48 FR 40373 [T.D. 7910, 1983-2 C.B. 161].

Although the increased exclusion generally applies to transfers made after 1981, many existing instruments provide powers of appointment specifically defined in terms of the section 2503(b) annual gift tax exclusion. To ensure that grantors who did not wish to provide powers in excess of $3,000 will not be providing powers subject to the increased exclusion because of the reference to section 2503(b), the proposed regulations include a transitional rule which provides that the increased exclusion does not apply to powers granted under certain instruments created before September 12, 1981.

Finally, section 441(b) of the Act added section 2503(e) to the Code, which generally provides that amounts paid on behalf of any individual as tuition to certain educational organizations or as payment for medical care to any person who provides medical care with respect to that individual will not be considered transfers subject to the gift tax. This exclusion is permitted without regard to the relationship between the donor and donee. Enactment of the new exclusion did not change the rule of prior law that there is no gift if the person paying tuition or medical expenses is discharging a legal obligation of support imposed under applicable local law.

Tuition Payment

Under the proposed regulations, the tuition payment must be made directly to the qualifying educational organization. A payment made directly to the individual for tuition expenses does not qualify for the unlimited exclusion from the gift tax.

Medical Payments

New section 2503(e) exempts from the gift tax amounts paid directly to a medical care provider for qualifying medical expenses on behalf of another individual. However, amounts that are reimbursed by the donee's insurance company are not excluded from the gift tax. Thus, if a donor pays the qualifying medical care expenses of a donee, the unlimited exclusion from the gift tax applies only to that part of the payment which is not reimbursed by the donee's insurance company. To the extent of the reimbursement by the donee's insurance company, the gift is treated as having been made on the date the reimbursement is received by the donee.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

SPECIAL ANALYSES

The Commisisoner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. The Internal Revenue Service has concluded that although this document is a notice of proposed rulemaking that solicits public comment, the regulations proposed herein are interpretative and the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis is required for this rule.

DRAFTING INFORMATION

The principal author of these proposed regulations is Ada S. Rousso of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

* * * * *

Proposed amendments to the regulations.

The proposed amendments to 26 CFR Part 25 are as follows:

Paragraph 1. Section 25.2503-2 is amended by adding paragraphs (d) and (e), immediately after paragraph (c), to read as set forth below.

§25.2503-2 Exclusions from gifts.

* * * * *

(d) *Transitional rule.* The increased annual gift tax exclusion as defined in section 2503(b) shall not apply to any gift subject to a power of appointment granted under an instrument executed before September 12, 1981, and not amended on or after that date, provided that (1) the power is exercisable after December 31, 1981, (2) the power is expressly defined in terms of, or by reference to, the amount of the gift tax exclusion under section 2503(b) (or the corresponding provision of prior law), and

(3) there is not enacted a State law applicable to such instrument which construes the power of appointment as referring to the increased annual gift tax exclusion provided by the Economic Recovery Tax Act of 1981.

(e) *Examples.* The provisions of paragraph (d) of this section may be illustrated by the following examples:

Example (1). A executed an instrument to create a trust for the benefit of B on July 2, 1981. The trust granted to B the power, for a period of 90 days after any transfer of cash to the trust, to withdraw from the trust the lesser of the amount of the transferred cash or the amount equal to the section 2503(b) annual gift tax exclusion. The trust was not amended on or after September 12, 1981. No state statute has been enacted which construes the power of appointment as referring to the increased annual gift tax exclusion provided by the Economic Recovery Tax Act of 1981. Accordingly, the maximum annual gift tax exclusion applicable to any gift subject to the exercise of the power of appointment is $3,000.

Example (2). Assume the same facts as in example (1) except that the power of appointment granted in the trust refers to section 2503(b) as amended at any time. The maximum annual gift tax exclusion applicable to any gift subject to the exercise of the power of appointment is $10,000.

Par. 2. Section 25.2503-6 is added immediately after §25.2503-5 to read as follows:

§25.2503-6 Exclusion for certain qualified transfers for tuition or medical expenses.

(a) *In general.* Section 2503(e) provides that any qualified transfer after December 31, 1981, shall not be treated as a transfer of property by gift for purposes of chapter 12 of subtitle B of the Code. Thus, a qualified transfer on behalf of any individual is excluded in determining the total amount of gifts in calendar year 1982 and subsequent years. This exclusion is available in addition to the $10,000 annual gift tax exclusion. Furthermore, an exclusion for a qualified transfer is permitted without regard to the relationship between the donor and the donee.

(b) *Qualified transfers*—(1) *Definition.* For purposes of this paragraph, the term "qualified transfer" means any amount paid on behalf of an individual—

(i) As tuition to a qualifying educational organization for the education or training of that individual, or

(iii) To any person who provides medical care with respect to that individual as payment for the qualifying medical expenses arising from such medical care.

(2) *Tuition expenses.* For purposes of paragraph (b)(1)(i) of this section, a qualifying educational organization is one which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. See section 170(b)(1)(A)(ii) and the regulations thereunder. The unlimited exclusion is permitted for tuition expenses of full or part-time students paid directly to the qualifying educational organization providing the education. No exclusion is permitted for amounts paid for books, supplies, dormitary fees, board, or other similar expenses which do not constitute direct tuition costs.

(3) *Medical expenses.* For purposes of paragraph (b)(1)(ii) of this section, qualifying medical expenses are limited to those expenses listed in section 213(d)(1) (section 213(e)(1) prior to January 1, 1984) and include expenses incurred essentially for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body. In addition, the unlimited exclusion from the gift tax includes amounts paid for medical insurance on behalf of any individual. The unlimited exclusion from the gift tax does not apply to amounts paid for medical care that are reimbursed by the donee's insurance. Thus, if payment for a medical expense is reimbursed by the donee's insurance company, the donor's payment for that expense, to the extent of the reimbursed amount, is not eligible for the unlimited exclusion from the gift tax and the gift is treated as having been made on the date the reimbursement is received by the donee.

(c) *Examples.* The provisions of paragraph (b) of this section may be illustrated by the following examples.

Example (1). In 1982, A made a tuition payment directly to a foreign university on behalf of B. A had no legal obligation to make this payment. The foreign university is described in section 170(b)(1)(A)(ii) of the Code. A's tuition payment is exempt from the gift tax under section 2503(e) of the Code.

Example (2). C was seriously injured in an automobile accident in 1982. D, who is unrelated to C, paid C's various medical expenses by checks made payable to the physician. D also paid the hospital for C's hospital bills. These medical and hospital expenses were types described in section 213 of the Code and were not reimbursed by insurance or otherwise. Because the medical and hospital bills paid in 1982 for C were medical expenses within the meaning of section 213 of the Code, and since they were paid directly by D to the person rendering the medical care, they are not treated as transfers subject to the gift tax.

Example (3). Assume the same facts as in example (2) except that instead of making the payments directly to the medical service provider, D reimbursed C for the medical expenses which C had previously paid. The payments made by D to C do not qualify for the exclusion under section 2503(e) of the Code and are subject to the gift tax to the extent they exceed the $10,000 annual exclusion provided in section 2503(b).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 5, 1984, 8:45 a.m., and published in the issue of the Federal Register for January 6, 1984, 49 F.R. 896)

Notice of Proposed Rulemaking

Credit for Employment of Certain New Employees

LR-218-81

SUMMARY: This document contains proposed regulations relating to the credit for employment of individuals qualifying as members of a targeted group. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], the Technical Corrections Act of 1979 [Pub. L. 96-222, 1980-1 C.B. 499], the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462], and the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451]. The regulations would provide the public with the guidance needed to comply with the law as amended by these acts.

DATES: Written comments and requests to comment orally at the public hearing must be delivered or mailed by January 23, 1984. The amendments are proposed to be generally effective for certain wages paid or incurred after December 31, 1978

to an individual who begins work for the employer before January 1, 1985.

ADDRESS: Send comments and requests to comment orally at the public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-218-81), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3516).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 51 and 381 of the Internal Revenue Code of 1954. This document also contains proposed amendments to the Temporary Income Tax Regulations under the Revenue Act of 1978 (26 CFR Part 5) under section 51 of the Internal Revenue Code of 1954. Generally these amendments are proposed to conform the regulations to section 321 of the Revenue Act of 1978 (92 Stat. 2830) [1978-3 C.B. (Vol. 1) 1, 64], section 103(a)(6) of the Technical Corrections Act of 1979 (94 Stat. 209) [1980-1 C.B. 499, 507], section 261 of the Economic Recovery Tax Act of 1981 (95 Stat. 260), section 233 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 501) [1982-2 C.B. 462, 510], and section 102(l) of the Technical Corrections Act of 1982 (96 Stat. 2374) [1983-1 C.B. 451, 456] and are to be issued under the authority contained in section 44B, 381, and 7805 of the Internal Revenue Code of 1954 (91 Stat. 141, 26 U.S.C. 44B; 91 Stat. 148, 26 U.S.C. 381(c)(26); 68A Stat. 917, 26 U.S.C. 7805).

IN GENERAL

Section 321 of the Revenue Act of 1978 provides a targeted jobs credit for the employment of individuals qualifying as members of a targeted group. The targeted jobs credit replaces the new jobs credit allowable under section 44B (as in effect prior to enactment of the Revenue Act of 1978). In general, a taxpayer may elect to claim a credit under section 44B for amounts paid or incurred after December 31, 1978, for taxable years ending after that date, to members of a targeted group. Generally, to qualify for the credit, the amounts must be paid or incurred to members of a targeted group first hired after September 26, 1978. However, amounts paid or incurred after December 31, 1978, to a vocational rehabilitation referral hired before September 27, 1978, may qualify for the credit if a credit under section 44B (as in effect prior to enactment of the Revenue Act of 1978) was claimed for the individual by the taxpayer for a taxable year beginning before January 1, 1979.

AMOUNT OF CREDIT

Except in the case of a qualified summer youth employee, the amount of the credit allowable by section 44B for the taxable year is 50 percent of the qualified first-year wages plus 25 percent of the qualified second-year wages. Generally, qualified first-year wages are the first $6,000 of wages paid or incurred by the employer during the taxable year to an individual who is a member of a targeted group for services rendered during the 1-year period beginning with the day the individual begins work for the employer. Qualified second-year wages are the first $6,000 of wages paid or incurred by the employer during the taxable year to an individual who is a member of a targeted group for services rendered during the 1-year period beginning on the day after the last day of the qualified first-year wages period. For taxable years of the employer beginning before January 1, 1982, qualified first-year wages are further limited to 30 percent of the aggregate unemployment insurance wages paid by the employer during the calendar year ending in such taxable year.

Special rules apply to wages that are paid to employees who are qualified summer youths. In general, an employer is entitled to a credit equal to 85 percent of not more than $3,000 of wages paid to a qualified summer youth employee during a 90 day period between May 1 and September 15.

MEMBERS OF A TARGETED GROUP

An individual is a member of a targeted group if the individual is certified as a qualified summer youth employee, a vocational rehabilitation referral, an economically disadvantaged youth, an economically disadvantaged Vietnam-era veteran, an SSI recipient, a general assistance recipient, a youth participating in a cooperative education program, an economically disadvantaged ex-convict, an eligible work incentive employee, or an involuntarily terminated CETA employee. The first category was added by the Tax Equity and Fiscal Responsibility Act of 1982. The last two categories were added by the Economic Recovery Tax Act of 1981. The Economic Recovery Tax Act also amended the definition of a youth participating in a cooperative education program to require the individual to be also a member of an economically disadvantaged family.

The proposed regulations provide rules and definitions relating to the eligibility requirements for several of the targeted groups. In the case of youths participating in a cooperative education program, the proposed regulations define the term "program of vocational education" (a component in the definition of qualified cooperative education program) in accordance with the definition of that term in the Vocational Education Act of 1963 and the Department of Education regulations thereunder because the legislative history of the Revenue Act of 1978 indicates that the term "qualified cooperative education program" in section 51(d)(8) is similar to that term as used in the Vocational Education Act.

The proposed regulations also provide guidance on the issue of second certifications with respect to employees who continue to work for the same employer after the employee no longer meets the requirements for membership in the targeted group for which the employee was originally

certified. For example, a qualified summer youth employee may continue to work for the same employer after the end of the ninety day period described in section 51(d)(12)(B)(iii) and may then qualify as an economically disadvantaged youth. Similarly, a youth certified as participating in a qualified cooperative education program may no longer be actively participating in the program, but may then qualify as an economically disadvantaged youth. The proposed regulations provide that the timely certification rules do not apply to the second certification if the first certification was timely. The proposed regulations also provide that for purposes of eligibility requirements, the "hiring date" will be defined as the day the individual is certified for the second targeted group. Thus, whether an individual meets an age requirement for the second targeted group will be determined as of the date of certification rather than the original hiring date. In addition, in the case of a qualified summer youth employee, the proposed regulations clarify that a second economic eligibility determination must be made on the basis of the six months immediately preceding the month in which the second certification is made. In the case of a recertification of an individual who was originally certified as a member of any targeted group, other than a qualified summer youth employee, however, the proposed regulations provide that no second economic eligibility determination need be made.

In general, the State employment security agency is the agency responsible for certifying an individual as a member of a targeted group. In the case of youths participating in a qualified cooperative education program, the school offering the program must certify the individual as a member of that target group. A school may satisfy the certification requirement by using Form 6199. In either case, a certificate may be revoked if it is discovered that the information supplied by the individual for purposes of issuing the certificate was incorrect or false.

Furthermore, the amendments made by the Economic Recovery Tax Act have the effect of making so-called retroactive certifications invalid unless the employer has requested in writing a certification before the employee began work. Therefore, an individual will not be treated as a member of a targeted group unless, before the day the individual begins work for the employer, the employer receives a certification from the designated local agency or school, or has requested in writing a certification. However, the Tax Equity and Fiscal Responsibility Act of 1982 amended this rule with respect to individuals who begin work for the employer after May 11, 1982 so that certifications will be valid if requested or received on or before the day the individual begins work for the employer. Transitional rules apply with respect to certain employees.

COMMENTS AND PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held. Notice of the time and place for the public hearing is published in this issue of the Federal Register.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer of Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

DRAFTING INFORMATION

The principal author of these proposed regulations is John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Temporary Income Tax Regulations under the Revenue Act of 1978 (26 CFR Part 5) are as follows:

Paragraph 1. There is inserted immediately after §1.50B-1 the following new section:

§1.51-1 Amount of credit.

(a) *Determination of amount*—(1) *General rule.* Except as provided in paragraph (a)(2) of this section, the amount of the targeted jobs credit allowable by section 44B for the taxable year equals 50 percent of the qualified first-year wages (minus any qualified first-year wages paid to individuals while such individuals are qualified summer youth employees) plus 25 percent of the qualified second-year wages.

(2) *Special rule for employment of qualified summer youth employees.* In the case of an employer who pays or incurs qualified wages after April 30, 1983, to a qualified summer youth

employee beginning work for the employer after such date, the amount of the targeted jobs credit allowed by section 44B for the taxable year is equal to the amount determined under paragraph (a)(1) of this section plus an amount equal to 85 percent of the first $3,000 of qualified wages paid to each qualified summer youth employee during the taxable year. Such wages must be attributable to services rendered by the qualified summer youth employee during any 90 day period between May 1 and September 15.

(3) *Limitation.* See section 53 and the regulations thereunder for rules limiting the amount of the credit to a percentage of the amount of the tax imposed by chapter 1 of the Code.

(b) *Definitions*—(1) *Qualified wages.* The term "qualified wages" means wages (as defined in paragraph (b)(4)) paid or incurred by the employer during the taxable year to individuals who are members of a targeted group (within the meaning of section 51(d)).

(2) *Qualified first-year wages*—(i) *General rule.* Except in the case of qualified summer youth employees, the term "qualified first-year wages" means the first $6,000 of wages (as defined in paragraph (b)(4)) attributable to services rendered by a member of a targeted group during the 1-year period beginning with the day the individual first begins work for the employer. In the case of a vocational rehabilitation referral, as defined in section 51(d)(2), the one year period begins with the day the individual begins work for the employer on or after the beginning of such individual's rehabilitation plan. However, with the exception of vocational rehabilitation referrals for whom the employer claimed a credit under section 44B (as in effect prior to enactment of the Revenue Act of 1978) for a taxable year beginning before January 1, 1979, members of a targeted group who are first hired after September 26, 1978, and before January 1, 1979, will be treated as if they first began work for the employer on January 1, 1979. The date on which the wages are paid does not determine whether the wages are first-year wages; rather, the wages must be attributed to the period during which the work was performed. See paragraph (f)(1) of this section for an additional limitation on the term qualified first-year wages. (See examples (1), (2), (3), (4), (5), and (6) in paragraph (g) of this section for examples illustrating the application of the rules in this paragraph (b)(2)).

(ii) *Special rule for qualified summer youth employees.* In the case of a qualified summer youth employee, qualified first-year wages for the purposes of the 85 percent credit referred to in paragraph (a)(2) of this section include only wages attributable to services rendered by a qualified summer youth employee during any 90-day period between May 1 and September 15. If the individual is retained by the employer after the 90-day period and recertified as a member of another targeted group, the term "qualified first-year wages" for the purposes of the 50 percent credit described by section 51(a)(1) has the meaning given that term in paragraph (b)(2)(i) of this section except that the $6,000 limitation for qualified first-year wages shall be reduced by wages up to, but not more than, $3,000 attributable to services rendered during the 90-day period.

(3) *Qualified second-year wages.* The term "qualified second-year wages" means the first $6,000 of wages attributable to services rendered by a member of a targeted group, other than a qualified summer youth employee, during the 1-year period beginning on the day after the last day of the period for qualified first-year wages. The date on which the wages are paid does not determine whether the wages are second-year wages; rather, the wages must be attributed to the period during which the work was performed.

(4) *Wages*—(i) *General rule.* Except as otherwise provided in paragraph (b)(4)(ii) and (iii) of this section, the term "wages" shall only include amounts paid or incurred after December 31, 1978, for taxable years ending after December 31, 1978. For purposes of this section, the term "wages" has the meaning given to such term by section 3306(b) (determined without regard to any dollar limitation contained in such subsection).

(ii) *Special rules.* In the case of agricultural labor or railway labor, the term "wages" means unemployment insurance wages within the meaning of subparagraph (A) or (B) of section 51(h)(1). The term "wages" shall not include any amounts paid or incurred by an employer for any pay period to any individual for whom the employer receives federally funded payments for on-the-job training for such individual for such pay period. (See example (7) in paragraph (g) of this section.) In addition, the term "wages" shall not include any amount paid or incurred by the employer in a taxable year beginning before January 1, 1982, to an individual with respect to whom the employer claims a credit under section 40 (relating to expenses of work incentive programs). For youths participating in a qualified cooperative education program:

(A) Section 3306(c)(10)(C) (relating to the definition of employment for certain students) does not apply in determining wages under this section; and

(B) The term "wages" shall include only those amounts paid or incurred by the employer that are attributable to services rendered by the individual while he or she meets the conditions specified in section 51(d)(8)(A). for purposes of the preceding sentence, an employee who met the requirement in section 51(d)(8)(A)(iv), dealing with economically disadvantages status, when hired, shall be deemed to continuously meet the requirement in section 51(d)(8)(A)(iv) during the time the employee is in the cooperative education program. See also paragraph (e) of this section for rules relating to the exclusion of wages paid to certain individuals.

(iii) *Termination.* The term "wages" shall not include any amount paid or incurred to an individual who begins work for the employer after December 31, 1984.

(5) *Special rule for eligible work incentive employees.* In the case of an eligible work incentive employee (as

defined in §1.51-1(c)(4)), this paragraph (b) shall be applied for taxable years beginning after December 31, 1981, as if such employee had been a member of a targeted group for taxable years beginning before January 1, 1982. (see example (B) in paragraph (g) of this section.)

(c) *Members of targeted groups*—(1) *In general.* An individual is a member of a targeted group if the individual is certified as (i) a vocational rehabilitation referral, (ii) an economically disadvantaged youth, (iii) an economically disadvantaged Vietnam-era veteran, (iv) an SSI recipient, (v) a general assistance recipient, (vi) a youth participating in a cooperative education program, (vii) an economically disadvantaged ex-convict, (viii) an eligible work incentive employee, (ix) a qualified summer youth employee, or (x) an involuntarily terminated CETA employee. Except as provided below, see section 51(d) for a definition of these groups. See paragraph (d) of this section for rules concerning the certification of individuals as members of one of these targeted groups.

(2) *Youths participating in a qualified cooperative education program*—(i) *Student requirements.* For an individual to qualify as a youth participating in a qualified cooperative education program, the individual must meet each of the following conditions (A) through (D)—

(A) The youth must have attained the age of 16 but not 20. (An individual reaching 19 will be treated as a youth participating in a qualified cooperative education program only for wages paid or incurred after November 26, 1979.)

(B) The youth must not have graduated from a high school or vocational school.

(C) The youth must be enrolled in and actively pursuing a qualified cooperative education program (as defined in paragraph (c)(2)(iii) of this section).

(D) With respect to wages paid or incurred after December 31, 1981, the youth must be a member of an economically disadvantaged family when initially hired.

(ii) *Economically disadvantaged family.* See section 51(d)(11) for the rules relating to the determination of whether an individual is a member of an economically disadvantaged family.

(iii) *Qualified cooperative education program.* The term "qualified cooperative education program" means a program of vocational education for individuals who (through written cooperative arrangements between a qualified school and one or more employers) receive instruction (including required academic instruction by alternation of study in school with a job in any occupational field (but only if these two experiences are planned by the school and employer so that each contributes to the student's education and employability). See section 51(d)(8)(C) for a definition of a "qualified school." For purposes of this paragraph, the term "program of vocational education" means an organized educational program which is directy related to the preparation of individuals for employment, or for additional preparation for a career requiring other than a baccalaureate or advanced degree. An "organized educational program" means only instruction related to the occupation or occupations for which the students are in training or instruction necessary for students to benefit from such training. The student's employment contributes to his education and employability only if it is related to the occupation for which the student is in training in school. However, the student's employment need not be directly related to or in the same technical field as the training the student receives in school. For example, a student studying carpentry does not have to work as a carpenter for the program to constitute a "qualified cooperative education program." The program will qualify if, for example, the student works at a hardware store because the student's work would familiarize the student with the materials and tools used by carpenters. The program would not qualify, however, if the student works at a restaurant and generally performs tasks in such employment not related to carpentry.

(3) *General assistance recipients.* In order for an individual to qualify as a general assistance recipient, the individual must receive assistance for a period of not less than 30 days ending within the preemployment period (as defined in section 51(d)(13)) from a qualified general assistance program. A qualified general assistance program is a program of a State or a political subdivision of a State that the Secretary has designated as providing general assistance (or similar assistance) which is based on need and consists of money payments or voucher or scrip. For purposes of the preceding sentences, a program qualifying as a general assistance program by reason of non-cash assistance (*i.e.*, voucher or scrip) shall be so treated only with respect to amounts paid or incurred after July 1, 1982, to individuals beginning work for the employer after such date. For purposes of this subparagraph, the term "money" means cash or an instrument convertible into cash (*e.g.*, a check).

(4) *Eligible work incentive employees.* An eligible work incentive employee means an individual who has been certified by the designated local agency (as defined in paragraph (d)(10) of this section) as—

(i) being eligible for financial assistance under part A of title IV of the Social Security Act and as having continuously received such financial assistance during the 90-day period which immediately precedes the date on which such individual is hired by the employer, or

(ii) having been placed in employment under a work incentive program established under section 432(b)(1) or 445 of the Social Security Act.

The provisions of this paragraph (c)(4) are effective with respect to taxable years of the employer beginning after December 31, 1981. (See paragraph (b)(5) of this section for a special rule relating eligible work incentive employees.)

(5) *Involuntarily terminated CETA employees*—(i) *In general.* An involuntarily terminated CETA employee is an individual who first began work for an employer after August 13, 1981, in taxable years of the employer ending after August 13, 1981, and is certified by the designated local agency (as defined in paragraph (d)(10) of this section) as having been involuntarily terminated after December 31, 1980, from employment financed in whole, or in

part, under a program under part D of title II or title VI of the Comprehensive Employment and Training Act.

(ii) *Termination.* Section 51(d)(10) and this paragraph (c)(5) shall not apply to any individual who begins work for the employer after December 31, 1982.

(d) *Certification*—(1) *General rule.* Except as otherwise provided in this paragraph, an individual shall not be treated as a member of a targeted group unless, on or before the day on which such individual begins work for the employer, the employer has received, or has requested in writing, a certification that the individual is a member of a targeted group from the designated local agency (as defined in paragraph (d)(10) of this section). In addition, the employer must receive a certification before the credit under section 44B can be claimed. However, with respect to individuals who began work for the employer on or before May 11, 1982, the certification will be timely only if requested or received before the day the individual began work for the employer. In the case of a request in writing mailed via the United States Postal Service, the request shall be deemed to be made on the date of the postmark stamped on the cover in which such request was mailed to the designated local agency provided the request is mailed in accordance with the mailing requirements in §301.7502-1(c) and delivered in accordance with the delivery requirements in §301.7502-1(d). In the case of an employee who begins work on a Saturday, Sunday, or a legal holiday, the deadline for making a timely request in writing for a certification or receiving a timely certification shall be the next succeeding day which is not a Saturday, Sunday, or legal holiday. (See section 7503 for a definition of "legal holiday.") See paragraph (d)(2) of this section for transitional rules applicable to certain employees who began work for the employer before September 26, 1981. See paragraph (d)(3) of this section for special rules applicable to cooperative education students, and paragraph (d)(4) of this section for special rules applicable to eligible work incentive employees.

(2) *Transitional rules for certain employees who began work for the employer on or before September 26, 1981.* In the case of an individual, other than a cooperative education student, who began work for the employer before June 29, 1981, the employer must either receive, or request in writing, a certification before July 23, 1981. In the case of an individual, other than a cooperative education student, who began work for the employer after June 28, 1981, and on or before September 26, 1981, the employer must either receive, or request in writing, a certification before September 26, 1981.

(3) *Cooperative education students.* In the case of cooperative education students, the school administering the cooperative education program must issue the certification. Form 6199 is provided for this purpose. If the student begins work for the employer after September 26, 1981, see the general rule in §1.51-1(d)(1) for the date when this certification must be received or requested. If the student begins work for the employer on or before September 26, 1981, the employer must receive the certification or request it in writing before September 26, 1981. In order for an employer to claim a credit on wages paid or incurred to a cooperative education student after December 31, 1981, the employer must receive or request in writing a determination that the student is a member of an economically disadvantaged family. A request for economic eligibility determination for a cooperative education student must be made in writing by the employer to the participating school. If the student begins work for the employer on or before September 26, 1981, the employer must receive or request in writing such determination at any time before September 26, 1981. However, a request in writing on or after August 13, 1981, to a participating school for certification will be deemed to include a request for an economic eligibility determination. In addition, any certification issued by a school after August 13, 1981, will be deemed to be issued in response to a request for certification which includes a request for an economic eligibility determination. The rule in the preceding sentence does not eliminate the requirement that the employer receive a certification that includes an economic eligibility determination in order to claim a credit for wages paid or incurred after December 31, 1981. If a certification issued by a school after August 13, 1981, does not contain an economic eligibility determination and the employer wishes to claim a credit for wages paid or incurred after December 31, 1981, the employer must receive a completed certification before the date on which the credit is claimed.

(4) *Eligible work incentive employees.* In the case of eligible work incentive employees, the employer must either receive, or request in writing, a certification within the time requirements of paragraph (d)(1) or (2) of this section, whichever is applicable. Before October 12, 1981 (the date the Economic Recovery Tax Act of 1981 codified the State employment security agency as the designated local agency for certifying targeted groups), a certificate may be received or requested in writing from either the designated local agency (as defined in paragraph (d)(10) of this section) or the office or agency that properly issued certifications under section 50B(h)(1) relating to the work incentive credit.

(5) *Certifications that are not timely.* Any certification that is not timely received or requested by the employer in accordance with the rules of this paragraph will be treated as invalid. Thus, the employer will not be allowed to claim a credit under section 51 with respect to any wages paid or incurred to an employee whose certification or request for certification is not timely. A timely request for certification does not eliminate the need for the employer to receive a certification before claiming the credit.

(6) *Incorrect certification.* If an individual has been certified as a member of a targeted group, and such certification is incorrect because it was based on false information provided by such individual, the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages. For purposes of this paragraph, a certification will be consid-

ered to be incorrect only if the individual would not have been certified had correct information been provided to the issuer of the certification. Thus, false information that is not material to the issue of an individual's eligibility as a member of a targeted group will not invalidate an otherwise valid certification.

(7) *Certifications issued to certain rehires.* This paragraph (d)(7) applies in the case of an employee who first began work for the employer before October 13, 1981, and was dismissed and rehired by the employer. A certification received or requested by an employer with respect to such an employee will be considered timely only if there was a valid business reason, unrelated to the availability of the credit, for the dismissal and rehire and if the employer did not dismiss and then rehire the employee in order to meet the timing requirement with respect to certification. An individual who is dismissed and then rehired for the purpose described in the preceding sentence will be considered for purposes of section 51(d)(16) and this paragraph to have been continuously employed by the employer during the time between the dismissal and the rehire. Whether the employer was motivated by reason of the certification rules in section 51(d)(16) and this paragraph to dismiss and then rehire an employee is a question of fact to be determined from all the circumstances surrounding the dismissal and rehire. (See paragraph (e)(2) of this section for a separate rule disallowing the credit in the case of nonqualifying rehires).

(8) *Individuals who continue to be employed by the same employer but as a member of another targeted group*—(i) *In general.* This paragraph (d)(8) applies in the case of an employee who continues to be employed by the same employer but no longer qualifies as a member of the targeted group for which such employee was first certified (*e.g.*, the employee was originally certified as a qualified summer youth employee with respect to a ninety-day period between May 1 and September 15, but such ninety-day period has ended). In such case, the employer may request a certification that the employee is a member of another targeted group, and if any wages paid to such individual are qualified first-year wages or are qualified second-year wages, the employer may be entitled to a credit under section 44B with respect to such wages. The second certification will not be invalid merely because it was requested or received after the individual began work for the employer; only the first certification (for example, the certification with respect to an individual hired first as a qualified summer youth employee) must meet the requirement of section 51(d)(16) that a certification must be requested or received by an employer on or before the day on which the individual begins work for the employer.

(ii) *Qualified summer youth employees.* In the case of a former qualified summer youth employee, the term "hiring date" means not the day the individual is hired by the employer but means the day the individual is certified as a member of the new targeted group. Accordingly, the age requirements of section 51(d)(3)(B) shall be applied as of the day the individual is certified as a member of the second targeted group. In addition, if a second economic eligibility determination is required because the 45-day period referred to in section 51(d)(11) has lapsed, section 51(d)(11) shall be applied by taking into consideration the income during the 6 months immediately preceding the month in which the second determination occurs.

(iii) *Other employees.* In the case of an individual originally certified as a member of a targeted group (other than a qualified summer youth employee) such as a youth participating in a qualified cooperative education program, who is sought to be recertified as a member of another targeted group, the eligibility requirements for the recertification shall generally be applied with reference to the date of recertification, rather than the hiring date. However, this rule will not alter the determination described in section 51(d)(11), which is to be made with reference to the hiring date. Accordingly, if the individual was determined to be a member of an economically disadvantaged family when certified for the first targeted group, no second determination of this status need be made.

(9) *Certification where a trade or business has been transferred to a new employer.* In the case of the transfer of a trade or business in which an individual who is a member of a targeted group is retained as an employee in the trade or business, the certification obtained for such employee by the transferor-employer will apply with respect to the transferee-employer. For purposes of determining the amount of the credit allowable to the transferee-employer, the 1-year period referred to in §1.51-1(b)(2)(i) will be considered to begin with the day the employee first began work for the transferor-employer, and the amount of qualified first-year wages and qualified second-year wages paid or incurred to the employee must be reduced by the amount of any such wages paid or incurred by the transferor-employer. See examples (10) and (11) in paragraph (g) of this section.

(10) *Designated local agency*—(i) *In general.* For the period before October 12, 1981, the term "designated local agency" means the agency for any locality designated jointly by the Secretary and the Secretary of Labor to perform certifications of employees for employers in that locality. On or after October 12, 1981, the term "designated local agency" means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49-49n).

(ii) *Jurisdiction.* The designated local agency is the agency that has, pursuant to its charter, jurisdiction over the individual that is sought to be certified. Thus, any certification that is issued with respect to an individual who is not within the jurisdiction of the designated local agency that issued the certification will be invalid. Notwithstanding any other provision of this section, a request in writing for certification to the appropriate designated local agency that is made before January 23, 1984 will be considered to be timely if it is made after an otherwise timely request in

writing for certification was made to a designated local agency that does not have jurisdiction over the individual sought to be certified.

(e) *Certain ineligible individuals*—(1) *Related individuals.* For the purpose of section 51(a), "qualified wages" does not include any amounts paid or incurred by a taxpayer to any of the following individuals:

(i) An individual who is related (within the meaning of any of paragraphs (1) through (8) of section 152(a)) to the taxpayer;

(ii) An individual who is a dependent (within the meaning of section 152(a)(9)) of the taxpayer;

(iii) An individual who is related (within the meaning of any of paragraphs (1) through (8) of section 152(a)) to a shareholder who owns (within the meaning of section 267(c)) more than 50 percent in value of the outstanding stock of the taxpayer, if the taxpayer is a corporation;

(iv) An individual who is a dependent (within the meaning of section 152(a)(9)) of a shareholder described in paragraph (e)(1)(iii) of this section;

(v) An individual who is a grantor, beneficiary or fiduciary of the taxpayer, if the taxpayer is an estate or trust;

(vi) An individual who is a dependent (within the meaning of section 152(a)(9)) of an individual described in paragraph (e)(1)(v) of this section; or

(vii) An individual who is related (within the meaning of any of paragraphs (1) through (8) of section 152(a)) to an individual described in paragraph (e)(1)(v) of this section.

(2) *Nonqualifying rehires.* For purposes of section 51(a), "qualified wages" does not include wages paid to an employee who had been employed by the employer prior to the current hiring date of the employee if at any time during such prior employment the employee was not a member of a targeted group. The preceding sentence shall not apply to an employee who was previously timely certified as a member of a targeted group with respect to the same employer. An employee shall be treated as not having been a member of a targeted group if the certification requirements of section 51(d)(16) were not met. (See example (8) in paragraph (g) of this section).

(3) *Effective date.* The provision of this paragraph (e) are effective with respect to employees first beginning work for an employer after October 12, 1981.

(f) *Limitations*—(1) *Limitation on qualified first-year wages.* With respect to taxable years beginning before January 1, 1982, the amount of the qualified first-year wages which may be taken into account for purposes of the targeted jobs credit for any taxable year shall not exceed 30 percent of the aggregate unemployment insurance wages paid by the employer during the calendar year ending in such taxable year. In the case of a group of trades or businesses under common control (as defined in §1.52-1(b)), the qualified first-year wages cannot exceed 30 percent of the aggregate unemployment insurance wages paid to all employees of that group of trades or businesses under common control during the calendar year ending in such taxable year. For this purpose, the term "unemployment insurance wages" has the same meaning given to the term "wages" as defined in §1.51-1(b)(4). In the case of agricultural or railway labor, see section 51(h)(1) for the applicable definition of unemployment insurance wages. (See examples (13) and (14) in paragraph (g) of this section.)

(2) *Remuneration must be for trade or business employment.* Remuneration paid by an employer to an employee during any taxable year shall be taken into account only if more than one half of the remuneration paid by the employer to an employee is for services in a trade or business of the employer. This determination shall be made by each employer without regard to section 52(a) or (b). Accordingly, employees of corporations that are members of a controlled group or all employees of partnerships, proprietorships, and other trades or businesses (whether or not incorporated) which are under common control will be treated as being employed by each separate employer for this purpose. For this purpose, the term "year" means the taxable year of the employer. (See example (15) in paragraph (g) of this section.)

(g) *Examples.* The application of this section may be illustrated by the following examples which, except as otherwise stated, assume that the limitations imposed by §§1.51-1(f)(2) and 1.53-3 are inapplicable:

Example (1). Corporation M is a calendar year, cash receipts and disbursements method taxpayer. A, an economically disadvantaged youth, first began work for Corporation M on October 1, 1978. Qualified first-year wages with respect to A are wages attributable to the period beginning on January 1, 1979 (since A was first hired after September 26, 1978, he is treated as having begun work on January 1, 1979) and ending on December 31, 1979. In the 1979 taxable year, Corporation M pays A $5,000 of qualified first-year wages attributable to services performed in 1979. Corporation M's allowable credit is equal to $2,500 (50 percent of $5,000).

Example (2). Assume the same facts as in example (1), except that in 1980 Corporation M pays to A $100 in wages attributable to services rendered in 1979. These wages will still be considered as qualified first-year wages, but the credit may not be claimed until the 1980 taxable year.

Example (3). Corporation O is a calendar year, cash receipts and disbursements method taxpayer. C, a vocational rehabilitation referral, first began work for Corporation O on July 1, 1978. Corporation O claimed a credit under section 44B (as in effect prior to enactment of the Revenue Act of 1978) for $3,000 of wages paid to C in the 1978 taxable year. Corporation O paid C $6,000 for services performed from January 1, 1979, to June 30, 1979. The period during which qualified first-year wages are determined begins on July 1, 1978, and ends on June 30, 1979. Amounts paid before January 1, 1979, however, are not taken into consideration in determining the amount of qualified first-year wages. Accordingly, only the wages attributable to services performed from January 1, 1979, through June 30, 1979, are considered as qualified first-year wages. Corporation O's allowable credit is equal to $3,000 (50 percent of $6,000).

Example (4). I first began work for Corporation Q, a cash receipts and disbursements method taxpayer, on January 1, 1981, and was not a member of a targeted group. On March 1, 1981, I was convicted of a felony and sentenced to prison. I quit working for Corporation Q, and served the prison sentence. On November 1, 1981, I again was hired by Corporation Q and began work on that date. On the November 1, 1981, hiring date, I was an economically disadvantaged ex-convict for whom Corporation Q received a certificate. Corporation Q paid I $500 of wages for services performed from November 1, 1981, to December 31, 1981, and $6,000 of wages for services performed during 1982. The $500 of wages paid for services performed from November 1, 1981, to December 31, 1981, would be qualified first-year wages because these qualified wages were paid for services performed during the 1-year period beginning on the date I first began work for Corporation Q (January 1, 1981). The $6,000 of wages paid for services performed during 1982 would be qualified second-year wages because these qualified wages

were paid for services performed during the 1-year period beginning on the day after the first 1-year period. Accordingly, Corporation Q has an allowable credit of $250 attributable to qualified first-year wages and $1,500 attributable to qualified second-year wages.

Example (5). Assume the same facts as in example (4), except that all dates are 1 year later. Thus, I first began work for Corporation Q on January 1, 1982, was convicted on March 1, 1982, and was rehired on November 1, 1982. Under these facts, Q is not entitled to take a targeted jobs credit with respect to I's wages because I is a nonqualifying rehire.

Example (6). J, an economically disadvantaged youth, first began work for Corporation R, a calendar year cash receipts and disbursements method taxpayer, on December 1, 1979. On July 1, 1980, J was laid off by Corporation R and began work for Corporation S, which is unrelated to Corporation R, on July 2, 1980. On November 1, 1980, J again began work for Corporation R and continued working for Corporation R until January 1, 1982. At the time J first began work for Corporation S, J no longer met the qualifications of an economically disadvantaged youth. Corporation S may not claim a credit for wages paid to J because J was not a member of a targeted group at the time he began work for Corporation S. Corporation R, however, may claim a credit for wages paid to J because J was a member of a targeted group when he was hired by Corporation R. Corporation R's qualified first-year wages paid to J are the wages paid for services performed by J from December 1, 1979, to July 1, 1980, and from November 1, 1980, to November 30, 1980. Corporation R's qualified second-year wages paid to J are the wages paid for services performed by J from December 1, 1980, to November 30, 1981. Corporation R may not claim a credit for wages paid for services performed by J after November 30, 1981.

Example (7). K, a member of a targeted group, first began work for Corporation T on January 1, 1979. For the pay periods from January 1, 1979, to March 31, 1979, Corporation T received federally funded payments for on-the-job training for K and paid wages of $2,000 to K. During the remainder of 1979 Corporation T paid wages of $7,000 to K. Corporation T may claim a credit on $6,000 of qualified first-year wages. Amounts paid to K by Corporation T during the pay periods for which Corporation T received federally funded payments for on-the-job training for K are not considered wages for purposes of the credit. However, corporation T may consider $6,000 of the total $7,000 of wages paid after March 31, 1979, as qualified first-year wages.

Example (8). P first began work for Corporation X on January 1, 1981, as an individual who was certified to be an eligible employee for purposes of the WIN credit provided in section 40. Corporation X paid P $6,000 of wages during its taxable year beginning on January 1, 1981, and $6,000 of wages during its taxable year beginning on January 1, 1982. X can claim a credit under section 44B for the wages paid in 1982 if the requirements of section 51 are met. For purposes of section 51(a), P's qualified first-year wages are the wages paid from January 1, 1981, to December 31, 1981, and P's qualified second-year wages are the wages paid from January 1, 1982, to December 31, 1982. Thus, Corporation X is only entitled to claim a credit under section 44B based on P's qualified second-year wages.

Example (9). (i) L, 15 years of age, first began work for Corporation U on August 1, 1979. On September 3, 1979, L began her junior year in high school and enrolled in a qualified cooperative education program that was to run for her junior and senior years. On October 1, 1979, when L turned 16, she met all the requirements of §1.51-1(c)(2)(i) and qualified as a youth participating in a qualified cooperative education program. Corporation U is entitled to claim a credit on wages paid or incurred for services performed by L after September 30, 1979, so long as L meets the requisite requirements. L's summer vacation began on June 1, 1980. The cooperative education program L was enrolled in did not continue during the summer vacation. Thus, during her summer vacation, L did not meet the requirement of actively pursuing a qualified cooperative education program. Accordingly, Corporation U may not claim a credit on wages paid for services performed by L during L's summer vacation. On September 2, 1980, L began her senior year, and again met all the requirements of §1.51-1(c)(2)(i). She continued to meet these requirements until June 5, 1981, when she graduated from high school. Accordingly, Corporation U may claim a credit on wages paid for services performed after September 1, 1980, and before June 5, 1981.

(ii) Assume the same facts as in (i), above, except that all dates are 3 years later. Under these facts, V is not entitled to claim a targeted jobs credit with respect to L's wages because L has not been timely certified under section 51(d)(16) and §1.51-1(d)(3).

Example (10). D began work for a drugstore owned by E as a sole proprietor on January 1, 1979, and was certified as a member of a targeted group with respect to E. On June 1, 1979, E sold the drugstore where D worked to F, who continued to operate the drugstore with D as an employee. D's qualification as a member of a targeted group is not required to be redetermined in order for F to qualify for the targeted jobs credit. F will take into account the certification of D's eligibility that was provided to E. F will have qualified first-year wages consisting of the first $6,000 of wages paid or incurred to D by E and F from January 1, 1979, to December 31, 1979 (reduced by any qualified wages paid or incurred by E to D from January 1, 1979, to May 31, 1979). F's qualified second-year wages will consist of the first $6,000 of wages paid or incurred to D by F from January 1, 1980, to December 31, 1980.

Example (11). G began work in a machine shop owned by H as a sole proprietor on January 1, 1979, and was certified as a member of a targeted group with respect to H. On June 1, 1980, H transferred all the assets of the machine shop to newly formed Corporation P. Corporation P retained G as an employee in the machine shop. G's qualification as a member of a targeted group is not required to be redetermined in order for P to qualify for the targeted jobs credit. H has qualified first-year wages in the amount of the first $6,000 of wages paid or incurred to G by H from January 1, 1979, to December 31, 1979. Corporation P has qualified second-year wages in the amount of the first $6,000 of wages paid or incurred to G by H and Corporation P from January 1, 1980, to December 31, 1980 (reduced by any qualified second-year wages paid by H to G).

Example (12). W operates a retail store as a sole proprietor. On June 1, 1982, W hires S after receiving a written determination from a local community organization that S meets the requirements as an economically disadvantaged youth. W does not request a certification from the State employment security agency as to S's eligibility. W is not entitled to claim a credit with respect to wages paid to S because W did not receive, or request in writing, a certification from the State employment security agency as to S's eligibility on or before the day on which S began work for W.

Example (13). Corporation V is a cash receipts and disbursements method taxpayer with a July 1 through June 30 taxable year. In the taxable year ending June 30, 1980, the aggregate unemployment insurance wages paid by V were $150,000. In calendar year 1979 the aggregate unemployment insurance wages paid by Corporation V were $110,000. Corporation V's qualified first-year wages are limited to 30 percent of the aggregate unemployment insurance wages paid by it in calendar year 1979 or $33,000 (30 percent of $110,000), even though the aggregate unemployment insurance wages paid by it in the taxable year ending June 30, 1980, were $150,000.

Example (14). Assume the same facts as in example (13), except that all dates are 3 years later. Since the limitation on qualified first-year wages does not apply to taxable years beginning after December 31, 1981, Corporation V's qualified first-year wages are $150,000.

Example (15). M operates a retail store as a sole proprietor. N and O, both members of a targeted group, first began work for M on January 1, 1979. M paid N total qualified first-year wages of $6,000 in 1979. Three thousand one hundred dollars of those wages were for services in M's retail store, and $2,900 of those wages were for services as M's maid. M paid O total qualified first-year wages of $6,000 in 1979. Three thousand dollars of those wages were for services in M's store, and $3,000 of those wages were for services as M's chauffeur. M has an allowable credit of $3,000 in 1979 on all $6,000 of qualified first-year wages paid to N because more than one-half of the remuneration paid by M to N was for services in M's trade or business. M may not take into account the wages paid to O because not more than one-half of the remuneration paid by M to O was for services in M's trade or business. Accordingly, M may not claim a credit on wages paid to O.

Par. 2. Section 1.381(c)(26)-1 is amended to read as set forth below:

§1.381(c)(26)-1 Credit for employment of certain new employees.

(a) *Carryovers and carrybacks.* The computation of carryovers and carrybacks of unused targeted jobs credit (new jobs credit in the case of wages paid before 1979) under section 44B in a transaction to which section 381(a) applies shall be made under the principles of §1.381(c)(23)-1 (relating to the computation of carryovers and carrybacks of unused investment credit), except that the provisions of paragraph (c)(4) and paragraph (e)(6), (7), and (8) of such section shall not apply.

(b) *Other items.* See §1.51-1(d)(9) for a rule that applies to certain transfers of a trade or business in which members of a targeted group are employed.

Par. 3. Section 5.51-1 is deleted.

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

Notice of Proposed Rulemaking

Incentive Stock Options

LR-279-81

SUMMARY: This document contains proposed regulations relating to incentive stock options. Changes to the applicable tax law were made by the Economic Recovery Tax Act of 1981. [Pub. L. 97-34, 1971-2 C.B. 256]. The regulations would affect certain taxpayers who participate in the transfer of stock pursuant to the exercise of incentive stock options and provide them with guidance to comply with the law.

DATES: Written comments and requests for a public hearing must be delivered or mailed by April 9, 1984. The amendments are proposed to be effective on the date they are published in the FEDERAL REGISTER as final regulations. In general, they apply to options granted after August 12, 1981, but they also provide transitional rules applicable to certain options granted after December 31, 1975, and before August 13, 1981.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T [LR-279-81], 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Bruce H. Jurist of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Prior to August 13, 1981, the tax treatment of employee stock options generally was governed by section 83 of the Code and the regulations thereunder. Under those rules, the value of a stock option constituted ordinary income to the employee when granted only if the option itself had a readily ascertainable fair market value at that time. If the option did not have a readily ascertainable value when granted, it did not constitute ordinary income until exercised. At the time of exercise, the difference between the value of the stock received and the option price constituted ordinary income to the employee. An employer who granted a stock option generally was allowed a business expense deduction equal to the amount includable in the employee's income in its corresponding taxable year.

Changes to the applicable tax law were made by section 251 of the Economic Recovery Tax Act of 1981 (95 Stat. 172) (ERTA) [Pub. L. 97-34, 1981-2 C.B. 256, 301], which added new section 422A to the Code entitled "Incentive Stock Options," and provided a set of transitional rules for the conversion of certain options granted prior to the August 13, 1981 date of enactment. Related technical changes to section 251 of ERTA were made by section 102(j) of the Technical Corrections Act of 1982 (P. L. 97-448) [1983-1 C.B. 451]. Finally, section 201(b)(1)(C) of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324) (TEFRA) [Pub. L. 97-248, 1982-2 C.B. 462, 468], amended section 57(a) of the Code to include as an item of tax preference the spread (*i.e.*, the amount by which the fair market value of the stock at the time of exercise exceeds the option price) at the time an incentive stock option is exercised. Section 201(b)(1)(C) of TEFRA is effective for taxble years beginning after December 31, 1982.

Section 422A provides for a new statutory stock option under which, pursuant to section 421, there will be no tax consequences when such an option is either granted or exercised (except for potential minimum tax consequences), and the employee will be taxed at capital gain rates when and if the stock received on exercise of the option is sold. Similarly, no business expense deduction will be allowed to the employer with respect to such an option.

On December 21, 1981, the Internal Revenue Service published §14a.422A-1, temporary regulations relating to the transitional rules provided by section 251(c) of ERTA (46 FR 61839) [T.D. 7799, 1982-1 C.B. 67]. The temporary regulations provided guidance to taxpayers who wanted to convert certain existing stock options into incentive stock options. The regulations were drafted in a question and answer format so as to both facilitate their timely publication and limit their scope to the transitional period issues.

The proposed regulations contained in this document represent the complete set of regulations to be promulgated under section 422A. Accordingly, the information contained in the previously published temporary regulations has been incorporated into these proposed regulations. The proposed regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

REQUIREMENTS TO RECEIVE SPECIAL TAX TREATMENT

Section 1.422A-1 of the proposed regulations provides that an individual, in order to receive the special tax treatment available to incentive stock options under section 421(a), must meet the following two conditions:

(1) The individual must not dispose of the stock acquired pursuant to the exercise of an incentive stock option within two years after the option is granted and must hold the stock itself for at least one year. An exception to the above holding period requirements is provided with respect to certain transfers by insolvent individuals.

(2) For the entire time from the date of granting the option until three months (one year if employment ceased because the individual is disabled within the meaning of either section 105(d)(4) or section 37(e)(3)) before the date of exercise, the individual must be an employee either of the corporation granting the option, a parent or subsidiary of that corporation, or a corporation (or parent or subsidiary of that corporation) which has assumed the option of another corporation as a result of a corporate

reorganization, liquidation, etc.

In the case of the death of the individual, both the holding period requirements and the employment requirement are waived.

If all requirements other than the above holding period requirements are met, tax is deferred until disposition of the stock, but gain (to the extent the value of the stock at exercise of the option exceeds the option price) is treated as ordinary income rather than capital gain, and the employer is allowed a deduction for that amount. In the case of certain dispositions where the amount realized on disposition is less than the stock's value at exercise, the amount of ordinary income, and the amount of the employer's deduction, are limited to the difference between the amount realized on the sale and the option price.

INCENTIVE STOCK OPTION DEFINED

Section 1.422A-2 of the proposed regulations provides that for an option to qualify as an incentive stock option, the following conditions must be met:

(1) The option must be granted under a plan specifying the aggregate number of shares of stock which may be issued and the employees or class of employees eligible to receive the options. This plan must be approved by the stockholders of the granting corporation within 12 months before or after the plan is adopted.

(2) The option must be granted within ten years from the date the plan is adopted or the date the plan is approved by the stockholders, whichever is earlier.

(3) The option must by its terms be exercisable only within ten years of the date it is granted.

(4) The option price must equal or exceed the fair market value of the stock at the time the option is granted. This requirement will be deemed satisfied if there has been a good faith attempt to value the stock accurately, even if the option price is less than the stock value.

(5) The option by its terms must be nontransferable other than at death and, during the employee's lifetime, must not be exercisable by any other person.

(6) The employee must not, at the time the option is granted, own stock representing more than ten percent of the voting power of all classes of stock of the employer corporation or its parent or subsidiary. However, the stock ownership limitation will not apply if the option price is at least 110 percent of the fair market value (at the time the option is granted) of the stock subject to the option and the option by its terms is not exercisable more than five years from the date it is granted.

(7) The option by its terms is not exercisable while there is outstanding any incentive stock option which was granted to the employee at an earlier time. For this purpose, an option which has not been exercised in full is outstanding until the expiration of the period during which it could have been exercised under its initial terms. Thus, the cancellation of an earlier option will not enable a subsequent option to be exercised any sooner.

(8) In the case of options granted after 1980, the terms of the plan must limit the aggregate fair market value of the stock (determined at the time of the grant of the option) for which any employee may be granted incentive stock options in any calendar year to not more than $100,000 plus a carryover amount. The carryover amount for an employee from any year after 1980 is one-half of the amount by which $100,000 exceeds the value at time of grant of the stock for which incentive stock options were granted in such prior year. Amounts may be carried over three years. Options granted in any year use up the $100,000 current year limitation first and then the carryover amount from the earliest year. Amounts may be carried over from calendar years after 1980 whether or not the corporation had an incentive stock option plan in effect for the earlier year provided the individual was employed by the corporation (or subsidiary, parent, or predecessor corporation) for some part of the earlier year.

PERMISSIBLE PROVISIONS

Section 1.422A-2 of the proposed regulations also provides that an option will qualify as an incentive stock option even if any of the following provisions are present:

(1) Stock acquired on exercise of an incentive stock option may be paid for with stock of the corporation granting the option.

(2) The employee has the right to receive additional compensation (in cash or other property) at the time of exercise of the option so long as the additional amount is includible in income under the provisions of sections 61 and 83. Thus, the enployer corporation may pay the employee additional amounts (whether or not the amount of additional compensation is determined by reference to the price of the stock and/or the option price) when the employee exercises the option.

(3) The option is subject to a condition not inconsistent with the qualification requirements of section 422A(b). For example, an employee's right to receive a taxable payment of cash or other property (including employer stock) in an amount equal to the difference between the then fair market value of the stock and the option price in exchange for the cancellation or surrender of the option (at a time when it is otherwise exercisable) does not disqualify the option. This applies where the exercise of this alternative right has the same economic and tax consequences as the exercise of the option followed by an immediate sale of the stock to the employer (which would be taxed as ordinary income under section 421(b)). However, an option that includes an alternative right is not an incentive stock option if the requirements of section 422A(b) may be avoided by exercise of the alternative right. For example, an alternative right extending the option term beyond ten years, setting a price below fair market value, permitting transferability, or allowing nonsequential exercise, will prevent an option from qualifying as an incentive stock option.

INCENTIVE STOCK OPTION TRANSITIONAL RULES

Section 1.422A-3 of the proposed regulations provides special rules relating to the conversion of certain existing options into incentive stock options. Pursuant to section 251(c) of ERTA, the proposed regulation provides the following guidelines for the conversion of options:

(1) Only options originally granted after December 31, 1975, will be eligible for conversion into incentive stock options.

(2) Options granted during the years 1976 through 1980 will be eligible for conversion only if the option was outstanding on January 1, 1981, and the granting corporation elects to convert the option. The aggregate value (determined at the time of grant) of stock the options for which may be converted into incentive stock options by such an election may not exceed $50,000 per calendar year and $200,000 in the aggregate for the five-year period 1976-1980. The election may be made with respect to those options (or portions of options) which the granting corporation selects. The taxation of options with respect to which no election is made will not be affected.

(3) In the case of an option granted after December 31, 1975, and outstanding on August 13, 1981, the option terms (or the terms of the plan under which the option was granted) may be changed, or shareholder approval obtained, to conform to the incentive stock option rules, by August 13, 1982, without the change giving rise to a new option requiring the setting of an option price based on the valuation of the stock on the date of change. All such changes relate back to the time of grant of the original option.

(4) Generally, an exercised option must have met the incentive stock option qualification requirements of section 422A(b), at the time it was exercised, to be eligible for conversion into an incentive stock option.

(5) For incentive stock options exercised prior to 1983, the difference between the option price and the value of the stock on the date of exercise is not an item of tax preference. However, for incentive stock options exercised after 1982 (which are not later subject to a disqualifying disposition), such difference is an item of tax preference subject to the alternative minimum tax under section 55 of the Code.

TECHNICAL AND CONFORMING AMENDMENTS

Finally, because new section 422A interacts directly with other sections of the Code, the proposed regulations provide technical and conforming amendments to a number of existing regulations under sections 421, 425, and 6039.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that these proposed rules are not major rules as defined in either Executive Order 12291 or the Treasury and OMB implementation of that order dated April 29, 1983. Accordingly, a Regulatory Impact Analysis is not required. Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the notice and public procedure requirements of 5 U.S.C. 553 do not apply because the rules proposed are interpretative. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act of 1980. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Office for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Philip R. Bosco of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, other personnel in the Internal Revenue Service and Treasury Department participated in developing the regulations on matters of both substance and style.

* * * * *

Proposed amendments to the Regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.422A-1 is added to read as follows:

§1.422A-1 Incentive stock options—general rules.

(a) *Applicability of section 421 (a)(1)(i)* Section 421(a) applies with respect to the transfer of a share of stock to an individual pursuant to the exercise of an incentive stock option if the following conditions are satisfied—

(A) The individual makes no disposition of such share before the later of the expiration of the 2-year period beginning on the day of the grant of the option pursuant to which such share was transferred, or the expiration of the 1-year period beginning on the day of the transfer of such share, and

(B) At all times during the period beginning on the day of the grant of the option and ending on the day 3 months before the date of such exercise, the individual was an employee of either the corporation granting the

option, a related corporation of such corporation, or a corporation (or a related corporation of such corporation) issuing or assuming a stock option in a transaction to which section 425(a) applies.

(ii) For rules relating to the disposition of shares of stock, see paragraph (c) of §1.425-1. For rules relating to the requisite employment relationship, see paragraph (h) of §1.421-7.

(2)(i) The holding period requirement of section 422A(a)(1), set forth in paragraph (a)(1)(i)(A) of this section, does not apply to certain transfers by insolvent individuals. If an insolvent individual holds a share of stock acquired pursuant to the exercise of an incentive stock option, and if such share is transferred to a trustee, receiver, or other similar fiduciary in any proceeding under the Bankruptcy Act or any other similar insolvency proceeding, neither such transfer, nor any other transfer of such share for the benefit of the insolvent individual's creditors in such proceeding shall constitute a disposition of such share for the purpose of section 422A(a)(1). For the purpose of this paragraph (a)(2) an individual is an insolvent only if his liabilities exceed his assets, or if the individual is unable to satisfy his liabilities as they become due.

(ii) A transfer by the trustee or other fiduciary that is not treated as a disposition for the purpose of section 422A(a)(1) may be a sale or exchange for purposes of recognizing capital gain or loss with respect to the share transferred. For example, if the trustee transfers the share to a creditor in the insolvency proceeding in complete or partial satisfaction of such creditor's claim against the insolvent individual, capital gain or loss must be recognized by the insolvent individual to the extent of the difference between the amount realized from such transfer and the adjusted basis of such share. To the extent any transfer by the trustee or other fiduciary (other than a transfer back to the insolvent individual) is not for the exclusive benefit of the creditors in the insolvency proceeding, such transfer will be treated as a disposition for purposes of section 422A(a)(1). Similarly, if the trustee or other fiduciary transfers the share back to the insolvent individual, any subsequent disposition of the share which is not made in respect of the insolvency proceeding and for the exclusive benefit of the creditors in such proceeding will be treated as a disposition for purposes of section 422A(a)(1).

(3) If the employee exercising an option ceased employment because of permanent and total disability within the meaning of either section 37(e)(3) or section 105(d)(4), 1 year is substituted for 3 months in the employment period requirement of section 422A(a)(2) and paragraph (a)(1)(i)(B) of this section.

(b) *Failure to satisfy holding period requirement.* (1) A disqualifying disposition of a share of stock acquired by the exercise of an incentive stock option (*i.e.*, a disposition before the expiration of the holding periods as determined under section 422A(a)(1) and paragraph (a)(1)(i)(A) of this section) makes section 421(a) inapplicable to the transfer of such share. Pursuant to section 421(b), the income attributable to such transfer shall be treated by the individual as income received in the taxable year in which such disqualifying disposition occurs. Similarly, a deduction under section 162 attributable to the transfer of the share of stock pursuant to the exercise of the option shall be allowable for the taxable year in which such disqualifying disposition occurs to the employer corporation (or to a corporation issuing or assuming the option in a transaction to which section 425(a) applies). In such cases, no amount shall be treated as income, and no amount shall be allowed as a deduction, for any taxable year other than the taxable year in which the disqualifying disposition occurs. Except as provided by section 421(b) and paragraph (b) of this section, the effects of a disqualifying disposition shall be determined pursuant to section 83 and the regulations thereunder.

(2) If an individual makes a disqualifying disposition of a share of stock acquired by the exercise of an incentive stock option, and if such disposition is a sale or exchange with respect to which a loss (if sustained) would be recognized to the individual, then, under section 422A(c)(2), the amount includible in the gross income of such individual, and deductible from the income of the employer corporation (or of a corporation issuing or assuming the option in a transaction to which section 425(a) applies) as compensation attributable to the exercise of such option, shall not exceed the excess (if any) of the amount realized on such sale or exchange over the adjusted basis of such share. Thus, the limitation does not apply when the disqualifying disposition is a sale described in section 1091 (relating to loss from wash sales of stock or securities), a gift, or a sale described in section 267(a)(1) (relating to sales between related persons), since a loss sustained in any such transaction would not be recognized. Subject to the limitation provided by section 422A(c)(2) and this paragraph (b)(2), the amount of compensation attributable to the exercise of the option is determined under §1.83-7.

(3) The application of this paragraph may be illustrated by the following examples:

Example (1). On June 1, 1982, X Corporation grants an incentive stock option to A, an employee of X Corporation, entitling A to purchase one share of X Corporation stock. On August 1, 1982, A exercises the option and the share of X Corporation stock is transferred to A on that date. In order to meet the holding period requirements of section 422A(a)(1), A must not dispose of the share acquired by exercise of the incentive stock option before June 1, 1984.

Example (2). Assume the same facts as in example (1) except that A exercises the option on June 1, 1983, and the share of X Corporation stock is transferred to A on June 10, 1983. In order to meet the holding period requirements of section 422A(a)(1), A must not dispose of the share acquired by exercise of the incentive stock option before June 10, 1984.

Example (3). Assume the same facts as in example (1) and assume further that the option price was $100, the fair market value of X Corporation stock on June 1, 1982, and that the fair market value of X Corporation stock was $200 on August 1, 1982, the date of exercise. Assume further that the share of X Corporation stock transferred to A was transferable and not subject to a substantial risk of forfeiture. A makes a disqualifying disposition by selling the share on June 1, 1983, for $250. Under section 83(a) and paragraph (a) of §1.83-7 (relating to options to which section 421 does not apply) the amount of compensation attributable to A's exercise is $100 (the difference between the fair market value of the share at

the date of exercise, $200, and the amount paid for the share, $100). Because the amount realized, $250, is greater than the value of the stock at exercise, section 422A(c)(2) does not apply and thus does not affect the amount includible as compensation in A's gross income and deductible by X. A must include in gross income for the taxable year in which the sale occurred $100 as compensation and $50 as capital gain ($250, the amount realized from the sale, less A's basis of $200 (the $100 paid for the share plus the $100 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option)). For its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $100 for compensation attributable to A's exercise of the incentive stock option provided the withholding requirements of §1.83-6 are met.

Example (4). Assume the same facts as in example (3), except that A sells the share for $150. Under section 422A(c)(2), A must include only $50 (the excess of the amount realized on such sale, $150, over the adjusted basis of the share, $100) in gross income as compensation attributable to the exercise of the incentive stock option instead of the $100 which otherwise would have been includible as compensation under section 83(a). A realizes no capital gain or loss as a result of the sale, since A's basis for the share is $150 (the $100 which A paid for the share, plus the $50 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option). For its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $50 for compensation attributable to A's exercise of the incentive stock option provided the withholding requirements of §1.83-6 are met.

Example (5). Assume the same facts as in example (3), except that A sells the share for $50. The limitation of section 422A(c)(2) applies and A is not required to include any amount in gross income as compensation attributable to the exercise of the incentive stock option. A is allowed a capital loss of $50 (the difference between the amount realized on the sale, $50, and the adjusted basis of the share, $100). X Corporation is not allowed any deduction for compensation attributable to A's exercise of the incentive stock option and disqualifying disposition.

Example (6). Assume the same facts as in example (4) except that A sells the share to A's son for $150. Under section 267, a loss sustained in such a sale would not be recognized. Therefore, the limitation of section 422A(c)(2) does not apply. Accordingly, under section 83(a), A must include $100 (the difference between the fair market value of the share at date of exercise, $200, and the amount paid for the share, $100) in gross income as compensation attributable to the exercise of the incentive stock option in the taxable year in which the disqualifying disposition occurred. A will recognize no capital gain or loss on the transaction. X Corporation will be allowed a $100 deduction for compensation paid to A in its taxable year in which the disqualifying disposition occurred provided the withholding requirements of §1.83-6 are met.

Example (7). Assume the same facts as in example (4), except assume that, as a result of the failure of a good-faith attempt to set the option price at the fair market value of X Corporation stock on the date of grant, the option price was set at $90 instead of $100. The requirement that the option price be not less than the fair market value of the stock at the time such option is granted, shall be considered to have been met pursuant to section 422A(c)(1). Upon sale of the share, A will include $60 (the excess of the amount realized on such sale, $150, over the adjusted basis of the share, $90) in gross income as compensation attributable to the exercise of the incentive stock option, in the taxable year in which the disqualifying disposition occurs. A will have no capital gain or loss as a result of such sale. Under section 422A(c)(2), X Corporation will be allowed a deduction of $60 as compensation attributable to A's exercise, in the taxable year of A's disqualifying disposition, provided the withholding requirements of §1.83-6 are met.

Example (8). Assume the same facts as in example (3), except that the share of X Corporation stock transferred to A is subject to a substantial risk of forfeiture and not transferable for a period of six months after such transfer. Assume further that the fair market value of X Corporation stock was $225 on February 1, 1983, the date the six-month restriction lapsed. Under section 83(a) and paragraph (a) of §1.83-7, the amount of compensation attributable to A's exercise of the option and subsequent disqualifying disposition is $125 (the difference between the fair market value of the share on the date the restriction lapsed, $225, and the amount paid for the share, $100). A must include in gross income for the taxable year in which the sale occurred $125 as compensation and $25 as capital gain ($250, the amount realized from the sale, less A's basis of $225 (the $100 paid for the share plus the $125 increase in basis resulting from the inclusion of that amount in A's gross income as compensation attributable to the exercise of the option)). For its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $125 for compensation attributable to A's exercise of the option provided the withholding requirements of §1.83-6 are met.

(c) *Failure to satisfy employment requirement.* Section 421 does not apply to the transfer of a share of stock acquired by the exercise of an incentive stock option if the employment requirement as determined under section 422A(a)(2) and paragraph (a)(1)(i)(B) of this section is not met at the time of transfer. Consequently, the effects of such a transfer shall be determined pursuant to section 83 and the regulations thereunder.

Par. 2. Section 1.422A-2 is added after §1.422A-1 to read as follows:

§1.422A-2 Incentive stock options defined.

(a) *Incentive stock option defined.* (1)(i) In general, the term "incentive stock option" means an option that meets the requirements of section 422A(b) and this section at the time of grant and that is granted to an individual after August 13, 1981. In addition, certain stock options granted to an individual after December 31, 1975, that were not incentive stock options at the time of grant, may be converted into incentive stock options. See §1.422A-3 for special rules relating to such options. Section 422A(b)(1) requires that an incentive stock option be granted pursuant to a plan which meets certain requirements. See paragraph (b) of this section. Section 422A(b)(2) provides that in order for an option to be an incentive stock option it must be granted within 10 years of the adoption of the plan or the date of stockholder approval, whichever is earlier. See paragraph (c) of this section. In order to grant incentive stock options after the expiration of such 10-year period, a new plan must be adopted and approved. Such new plan may retain all of the terms of the old plan or may include new terms. Paragraphs (3), (4), (5), and (7) of section 422A(b) establish certain requirements which must be met by the terms of an incentive stock option. An option which, when granted, does not by its terms meet these requirements cannot be an incentive stock option. See paragraphs (d), (e), (f), and (g) of this section. However, an amendment of the terms of an option at any time to permit such option to meet the requirement of section 422A(b)(5) will be given retroactive effect. See section 425(h)(3)(B) and paragraph (e)(5)(iii) of §1.425-1. Section 422A(b)(6) generally bars the grant of an incentive stock option to any employee whose stock ownership exceeds the limits provided by such section. An option granted to an employee whose stock ownership exceeds such limits cannot be an incentive stock option unless the special rule of section 422A(c)(8) applies. See paragraph (h) of this section. Section 422A(b)(8) bars the grant of an incentive stock option to any employee whose annual grants of incentive stock options exceed the limits provided by such section. An option granted to an employee whose annual grants exceed such limits cannot be an incentive stock option. See paragraph (b)(4) of this section. Section 422A(c)(5) provides that an incentive stock option may contain a number of permissible provisions that will not affect the option's status as an incen-

tive stock option. See paragraph (i) of this section.

(ii) Whether a particular option is an incentive stock option is determined at the time such option is granted. Accordingly, except as otherwise specifically provided by sections 421 through 425 and the regulations thereunder, events subsequent to the grant of an option cannot affect the status of the option. For example, an option which is granted at a fair market value option price to an employee whose stock ownership exceeds the limitation provided by section 422A(b)(6) is not an incentive stock option when granted and can never become an incentive stock option, even if the individual's stock ownership is within the limitation at the time such option is exercised.

(iii) Except as otherwise specifically provided by sections 421 through 425 and the regulations thereunder, an incentive stock option must meet the requirements of section 422A(b) and this section at all times during the period beginning on the date of the granting of the option and ending on the date of the exercise or expiration of the option. Accordingly, such requirements must be met even during periods when section 421(a) would not apply to the transfer of stock on exercise of the option. For example, an option which provides that the sequential exercise restriction of section 422A(b)(7) will cease to have effect 3 months and a day after an optionee terminates employment is not an incentive stock option when granted and can never become an incentive stock option.

(iv) An option granted after April 9, 1984 which meets the requirements of section 422A(b) and this section at the time of grant is an incentive stock option irrespective of any option or plan labeling to the contrary.

(2) Section 422A and this section do not apply to an option which is a restricted or qualified stock option.

(b) *Option plan.* (1) An incentive stock option must be granted pursuant to a written plan which meets the requirements of section 422A(b) and this paragraph (b). The authority to grant other stock options or rights pursuant to the plan, where the exercise of such other options or rights does not affect the exercise of incentive stock options granted pursuant to the plan, will not disqualify such incentive stock options.

(2) The plan required by section 422A must be approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted. Ordinarily, a plan is adopted when approved by the board of directors and the date of such board action will be the reference point for determining whether stockholder approval occurs within the 12-month period. However, if the board's action is subject to a condition, such as stockholder approval, or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs, unless the board's resolution fixes the date of approval as the date of the board's action. The approval of stockholders must comply with all applicable provisions of the corporate charter, bylaws and applicable State law prescribing the method and degree of stockholder approval required for the granting of incentive stock options. Absent any such prescribed method and degree of stockholder approval, an incentive stock option plan must be approved by a simple majority vote of stockholders, voting either in person or by proxy, at a duly held stockholders' meeting.

(3)(i) The plan required by section 422A must designate the aggregate number of shares which may be issued under the plan and the employees or class of employees eligible to receive options under the plan. Unless otherwise specified, the terms designated shall apply to all options that may be granted under the plan, including options other than incentive stock options. If options other than incentive stock options may be granted, the plan may separately designate terms for each type of option. If individuals other than employees may be granted options, the plan must separately designate the employees or class of employees eligible to receive incentive stock options.

(ii) A plan which merely provides that the number of shares which may be issued under options shall not exceed a stated percentage of the shares outstanding at the time of each offering or grant under the plan will not satisfy the requirement that the plan state the aggregate number of shares which may be issued under the plan. However, the maximum number of shares which may be issued under the plan may be stated in terms of a percentage of either the authorized, issued or outstanding shares at the date of the adoption of the plan.

(iii) The requirement that the plan as adopted and approved must indicate the class of employees (or the employees) eligible to receive options will be considered satisfied by a general designation of the class of employees eligible to receive options under the plan. Thus, such designations as "key employees of the grantor corporation," "all salaried employees of the grantor corporation and its subsidiaries, including subsidiaries which become such after adoption of the plan" or "all employees of the corporation" will meet this requirement. Moreover, this requirement will be considered satisfied although the board of directors or another group is given authority to select the particular employees who are to receive options from a described class and to determine the number of shares to be optioned to each such employee.

(iv) The provisions relating to the aggregate number of shares to be issued under the plan and the class of employees (or the employees) eligible to receive options under the plan are the only provisions of a stock option plan which require stockholder approval for purposes of section 422A(b)(1). Any increase in the aggregate number of shares which may be issued under the plan (other than an increase merely reflecting a change in capitalization such as a stock dividend or stock split), or change in the designation of the employees or class of employees eligible to receive options under the plan will be considered as the adoption of a new plan requiring stockholder approval within the prescribed 12-month period. Any other changes in the terms of an incentive stock option plan are not considered the adoption of a new plan. An option intended by the grantor

corporation to be an incentive stock option will be treated as having been granted pursuant to a plan notwithstanding that the terms of the option conflict with terms of the plan unless such option is granted to an employee not eligible to receive options under the plan or options have been granted on stock in excess of the aggregate number of shares which may be issued under the plan.

(4)(i) The plan required by section 422A must, by its terms, provide that the aggregate fair market value (determined at the time of grant of the option) of stock for which an employee may be granted incentive stock options in any calendar year after 1980, under all such plans of the employer corporation (or its parent or subsidiary corporations, or a predecessor corporation (as defined in paragraph (f)(2) of this section) of any such corporation), shall not exceed $100,000 plus any unused limit carryover to such year.

(ii) The unused limit carryover is an amount determined for a calendar year after 1980 equal to one-half of the amount by which $100,000 exceeds the aggregate fair market value (determined at the time of grant of the option) of stock for which an employee was granted incentive stock options in such calendar year. The unused limit carryover for a calendar year may be applied to each of the 3 succeeding calendar years, reduced each calendar year by the amount of such carryover which was used in a prior calendar year. For purposes of this paragraph, the amount of incentive stock options granted during any calendar year shall be treated as first using up the $100,000 limit for such calendar year, and then any unused limit carryover to such calendar year in the order in which the carryovers arose.

(iii) Amounts may be carried over from calendar years after 1980 whether or not the granting corporation had an incentive stock option plan in effect for the year of the unused limit carryover, provided that the individual was employed by such corporation (or its parent or subsidiary corporations, or a predecessor corporation (as defined in paragraph (f)(2) of this section) of any such corporation) for some part of such year.

(iv) If an option intended to be an incentive stock option is granted to an employee, but such option gives the employee the right to buy stock in excess of the amount permitted by this paragraph (b)(4), no portion of such option is an incentive stock option. However, if the amount permitted has been exceeded because there was a failure of an attempt, made in good faith, to meet the option price requirements of section 422A (b)(4) and paragraph (e)(1) of this section, the requirements of this paragraph (b)(4) shall be considered to have been met. To determine whether there was a good-faith attempt to meet the option price requirements of section 422A(b)(4) and paragraph (e)(1) of this section, see paragraph (e)(2)(ii) of this section.

(c) *Duration of option grants under the plan.* An incentive stock option must be granted within 10 years from the date the plan required by section 422A is adopted, or the date such plan is approved by the stockholders, whichever is earlier.

(d) *Period for exercising options.* An incentive stock option by its terms must not be exercisable after the expiration of 10 years from the date the option is granted. An option which does not contain such a provision when granted cannot be an incentive stock option.

(e) *Option price.* (1) Except as provided by section 422A(c)(1) and paragraph (e)(2) of this section, the option price of an incentive stock option must not be less than the fair market value of the stock subject to the option at the time the option is granted. For general rules relating to the option price, see paragraph (e) of §1.421-7. For rules relating to the determination of when an option is granted, see paragraph (c) of §1.421.7. The option price may be determined in any manner so long as the minimum price possible under the terms of the option cannot be less than the fair market value of the stock at the date of grant.

(2)(i) Under section 422A(c)(1), if a share of stock is transferred to an individual pursuant to the exercise of an option which would fail to qualify as an incentive stock option because there was a failure of an attempt, made in good faith, to meet the requirements of section 422A(b)(4) and paragraph (e)(1) of this section, the requirements of such section and paragraph shall be considered to have been met.

(ii) Whether there was a good-faith attempt to set the option price at not less than the fair market value of the stock subject to the option at the time the option was granted depends on the facts and circumstances surrounding the case. For example, in the case of a publicly held stock that was actively traded in an established market at the time the option was granted, determining the fair market value of such stock by any reasonable method using market quotations would establish that a good-faith attempt to meet the requirements of section 422A (b)(4) and this paragraph was made. On the other hand, in the case of a stock which is not publicly traded, if it is shown, for example, that the fair market value of the stock at the date of grant was based upon an average of the fair market values as of such date set forth in the opinions of completely independent and well-qualified experts, such a showing will establish that there was a good-faith attempt to meet the requirements of section 422A(b)(4) and this paragraph. However, amounts treated as unstated interest under section 483 and the regulations thereunder, and amounts paid as interest under a deferred payment arrangement are not includible as part of the "option price." See paragraph (e)(1) of §1.421-7. An attempt to set the option price at not less than fair market value will not be regarded as made in good faith where an adjustment of the option price to allow for the application of section 483 results in the option price being lower than the fair market value on which the option price was based.

(f) *Prior outstanding options.* (1)(i) Section 422A(b)(7) provides that an incentive stock option must, by its terms, not be exercisable while there is outstanding any incentive stock option which was granted, be-

fore the granting of the new incentive stock option, to the individual to purchase stock in the employer corporation, or in a corporation which, at the time of the granting of the new incentive stock option, is a parent or subsidiary corporation of the employer corporation, or a predecessor corporation of any of such corporations. Thus, in general, under section 422A(b)(7), an incentive stock option must not be exercisable until all incentive stock options which were previously granted to the individual by the grantor corporation, or by related or predecessor corporations, have been exercised in full or have expired solely by reason of the lapse of time. The limitation of section 422A(b)(7) applies irrespective of whether the transfer of stock pursuant to such prior outstanding incentive stock options can qualify for the special tax treatment of section 421. The exercisability of an incentive stock option is not affected by options which are not incentive stock options.

(ii) The restriction imposed by section 422A(b)(7) must be set forth in the terms of the option unless the individual in fact has no prior outstanding incentive stock options to purchase stock of the grantor corporation, a related corporation, or a predecessor corporation of any of such corporations at the time the new incentive stock option is granted. An option which incorporates by reference the provision of a plan containing the restrictions required by section 422A(b)(7) will be treated as an option which by its terms sets forth such restrictions. Except as provided by this paragraph (f)(2)(ii), an option which does not contain the restriction imposed by section 422A(b)(7), either expressly or incorporated by references, cannot be an incentive stock option, irrespective of whether such restriction is in fact complied with at the time the option is exercised and irrespective of whether the plan under which the option is granted contains the restriction required by section 422A(b)(7).

(iii) For purposes of section 422A(b)(7) and this paragraph (f), options granted or exercised on the same day are considered simultaneously granted or exercised.

(2) For purposes of section 422A(b)(7) and this paragraph (f), the term "predecessor corporation" means a corporation which was a party to a transaction described in section 425(a) (or which would be so described if a substitution or assumption under such section had been effected) with the grantor corporation, or a corporation which, at the time the new incentive stock option is granted, is a related corporation of the grantor corporation, or a predecessor corporation of any of such corporations.

(3) Except as is otherwise provided by this paragraph (f)(3), for purposes of section 422A(b)(7), an incentive stock option is treated as outstanding according to its original terms until such option is exercised in full or expires by reason of the lapse of time. Thus, for example, if an option outstanding according to its terms for 10 years is revised to shorten to 1 year the period during which it may be exercised, such option is treated as outstanding for 10 years from the original date of grant for purposes of section 422A(b)(7), notwithstanding the revision. If any portion of such an option is not exercised, such portion will be treated as outstanding until the expiration of the maximum period during which such portion, according to the terms of the option when granted, could have been exercised under any circumstances. An incentive stock option previously held by an individual and replaced in a transaction to which section 425(a) applies will not thereafter be treated as outstanding. However, if an incentive stock option is modified and under section 425(h) such modification is considered as the granting of a new option (even though for other purposes only one option is regarded as being in existence), the original incentive stock option continues for the purposes of section 422A(b)(7) to be outstanding, and may prevent an exercise of the new incentive stock option until the original option has, by its original terms, expired.

(4) The application of this paragraph may be illustrated by the following examples:

Example (1). S Corporation is a subsidiary of P Corporation. In 1982 E was an employee of S Corporation and was granted an incentive stock option by S to buy S stock. In June of 1983 E left S and became an employee of X Corporation, where he was granted an incentive stock option to purchase X stock. X Corporation is neither a related nor predecessor corporation of P or S. On June 1, 1984, E leaves X to become an employee of P Corporation, and on such date E is granted an incentive stock option by P to purchase P stock. Both E's incentive stock option on S stock and his incentive stock option on X stock are outstanding on June 1, 1984. In order to meet the requirements of section 422A(b)(7), E's incentive stock option on P stock must, by its terms, not be exercisable until E's incentive stock option on S stock is exercised in full or expires solely by reason of the lapse of time. This requirement must be met even though at the time E's incentive stock option on P stock is granted, E's incentive stock option on S stock no longer qualifies for the special tax treatment of section 421.

Example (2). E is an employee of P Corporation. E holds an incentive stock option granted June 1, 1982, and an incentive stock option granted June 1, 1983. Both options were granted to him by P to purchase P stock. E has been granted no other incentive stock options by P, a related corporation, or a predecessor corporation of any of such corporations. On November 30, 1984, P cancels E's 1982 incentive stock option and in exchange therefor issues a new incentive stock option to E. Assume that each incentive stock option runs 10 years from grant. The 1982 incentive stock option, according to its terms when granted, would have expired solely by reason of the lapse of time at the close of business on May 31, 1992. Under section 422A(b)(7) and (c)(7), E's 1982 incentive stock option is treated as outstanding according to its original terms when granted, and E cannot exercise any of his incentive stock options until June 1, 1992 (the first day after the expiration of the original period for which E's 1982 incentive stock option was granted). On June 1, 1992, E's 1983 incentive stock option will be fully exercisable. E's 1984 incentive stock option will not be exercisable until after the full exercise or expiration of E's 1983 incentive stock option.

Example (3). Assume the same facts as in example (2). On June 1, 1986, P Corporation sells all of its assets to M Corporation, and on such date E becomes an employee of M Corporation. Assume further that M Corporation substitutes new options to purchase M stock for those options held by E in a transaction to which section 425(a) applies. For purposes of section 422A(b)(7), each M Corporation option received by E in substitution for a P Corporation option will be treated as outstanding to the same extent and in the same manner as the P option which it replaces. Thus, none of the M options received by E in substitution for his P options may be exercisable before June 1, 1992, and the M option issued in substitution for E's 1984 P option may be exercisable only after the full exercise or expiration of the M option issued in substitution for E's 1983 P option. If, in 1987, E is granted another incentive stock option by M Corporation, such option may be exercisable only after the full exercise or expiration of the incentive stock options granted by M to E in 1986 in substitution for E's options to purchase P stock. The options to

purchase P stock which were replaced by M in the transaction to which section 425(a) applied will not be treated as outstanding for any purposes under section 422A(b)(7).

Example (4). Assume the same facts as in example (3) except assume that M does not effect a substitution or assumption of E's P Corporation incentive stock options under section 425(a). Although P is neither a parent nor subsidiary of M, for purposes of section 422A(b)(7), P is a predecessor corporation of M Corporation. Accordingly, any incentive stock options granted to E by M (or its parent or subsidiary corporations, or a predecessor corporation of any of such corporations) must, by their terms, not be exercisable until the expiration of the option periods for all of E's incentive stock options granted to E by P Corporation.

Example (5). F is an employee of N Corporation. On January 1, 1982, N granted an incentive stock option to F to purchase 100 shares of N Corporation stock at a price of $100 per share. The option is exercisable in installments as follows: 20 shares on or after June 1, 1983; another 40 shares on or after June 1, 1984; and the last 40 shares on or after June 1, 1985. Under section 422A(b)(7), the entire option is treated as being outstanding as of the January 1, 1982 date of grant. Thus, under the facts given, any incentive stock options granted to F after January 1, 1982, may not be exercised until the full exercise or expiration of all installments of F's January 1, 1982 incentive stock option.

Example (6). F is an employee of N Corporation. On January 1, 1982, N grants F an incentive stock option to purchase 100 shares on N Corporation stock at a price of $100 a share at any time prior to January 1, 1992. The stock is then selling at $100 a share. On January 1, 1983, when the stock was selling at $95 a share, N modified the option to permit F to purchase 100 shares of N Corporation stock at a price of $95 a share and to exercise the option at any time prior to January 1, 1993. Under section 425(h) N's modification is treated as the granting of a new option to F. Although for other purposes F, after the modification, has one option to purchase 100 shares of N Corporation stock at a price of $95 a share at any time prior to January 1, 1993, for purposes of section 422A(b)(7), F is regarded as having two options. Thus, F may not exercise the modified option until January 1, 1992, because until that date the original option is regarded as outstanding. If the option period had not been extended, F would never have been able to exercise the modified option because of the limitation of section 422A(b)(7) and the existence, for the purposes of that section, of a prior outstanding option having the same expiration date as the new option.

(g) *Restriction on transferability.* An incentive stock option, by its terms, must not be transferable by the individual to whom it is granted otherwise than by will or the laws of descent and distribution, and, during the lifetime of such individual, must not be exercisable by any other person. For general rules relating to the restriction on transferability required by section 422A(b)(5), see paragraph (b)(2) of §1.421-7 and paragraph (c) of §1.421-8. For a limited exception to the requirement of section 422A(b)(5), see section 425(h)(3).

(h) *Options granted to certain shareholders.* (i)(1) Except as provided in paragraph (h)(2) of this section, an option is not an incentive stock option if, immediately before such option is granted, the optionee owns stock possessing more than 10 percent of the total combined voting power of all classes of stock either of the employer corporation or of its parent or subsidiary corporation. In applying the limitations of section 422A(b)(6), the rules of section 425(d) (relating to attribution of stock ownership) shall apply in determining the stock ownership of the individual, and stock that the individual may purchase under outstanding options shall not be treated as stock owned by the individual.

(ii) The determination of the percentage of the total combined voting power of all classes of stock of the employer corporation (or of its parent or subsidiary corporations) that is owned by the individual is made with respect to each such corporation in the related group by comparing the voting power of the shares owned (or treated as owned) by the individual to the aggregate voting power of all shares actually issued and outstanding immediately before the grant of the option to such individual. The aggregate voting power of all shares actually issued and outstanding immediately before the grant of the option does not include the voting power of treasury shares or shares authorized for issue under outstanding options held by the individual or any other person.

(2) Paragraph (h)(1) of this section does not apply to an option if at the time such option is granted the option price is at least 110 percent of the fair market value at such time of the stock subject to the option and such option by its terms is not exercisable after the expiration of 5 years from the date such option is granted. The rules of paragraph (e)(2) of this section relating to option price shall not apply to the determination of the minimum option price for purposes of this paragraph (h)(2).

(3) The application of this paragraph may be illustrated by the following examples:

Example (1). E, an employee of M Corporation, owns 15,000 shares of the common stock of M Corporation, the only class of M stock outstanding. M has 100,000 shares of its common stock outstanding. Since E owns stock comprising more than 10 percent of the total combined voting power of all classes of M Corporation stock, M cannot grant an incentive stock option to E unless such option is granted at an option price of at least 110 percent of the fair market value of the stock subject to the option and such option would expire no later than 5 years from its date of grant. An option is granted to E which purports to be an incentive stock option but which fails to meet the above option-price and term requirements. Such option is not an incentive stock option and is, therefore, subject to section 83(a). If E's father and brother each owned 7,500 shares of M Corporation stock, and E owned no M stock in E's own name, the result in this case would be the same, since under section 425(d) a person is treated as owning stock held by parents and siblings.

Example (2). Assume the same facts as in example (1) and assume further that M is a subsidiary corporation of P Corporation. Irrespective of whether E owns any P stock and irrespective of the number of P shares outstanding, an option granted to E by P Corporation which purports to be an inventive stock option, but which fails to meet the 110-percent-option-price and 5-year-term requirements, is not an incentive stock option. This results from E's ownership of more than 10 percent of the total combined voting power of all classes of stock of a subsidiary of P Corporation (*i.e.*, M Corporation). Thus, an individual who owns (or is treated as owning) stock in excess of the limitation of section 422A(b)(6), in any corporation in a group of corporations consisting of the employer corporation and its parent and subsidiary corporations, cannot receive an incentive stock option from any corporation in the group unless such option meets the 110-percent-option-price and 5-year-term requirements of section 422A(b)(6).

Example (3). F is an employee of R Corporation. R has only one class of stock, of which 100,000 shares are issued and outstanding. F owns no stock in R Corporation or in any parent or subsidiary of R Corporation for purposes of section 422A(b)(6). On January 1, 1983, R grants a 10-year incentive stock option to F to purchase 50,000 shares of R stock at $1 per share, the fair market value of R stock on the date of grant of the option. On April 1, 1983, F exercises half of the January option and receives 25,000 shares of R stock. On July 1, 1983, R grants a second 50,000 share option to F which purports to be an incentive stock option. All of the terms of the July option are identical to the terms of the January option, including an option price of $1 per share, the fair market value of R stock on the date of grant of the second option. Pursuant to section 422A(b)(6), the July option is not an incentive stock option because on the date such option was granted F owned 20 percent (25,000 shares owned by F divided by 125,000 shares of R stock issued and outstanding) of the total combined voting power of all classes of R Corporation stock. The unexercised portion of the January option, because it was an incentive stock option on the date it was granted, remains an incentive stock option regardless of changes in the employee's percentage of stock ownership after grant of the option.

Example (4). Assume the same facts as in example (3) except that the partial exercise of the January incentive stock option on April 1, 1983, was for only 10,000 shares. Under these circumstances, the July option is an incentive stock option because on the date such option was granted, F did not own more than 10 percent of the total combined voting power of all classes of R Corporation stock.

(i) *Permissible provisions.* (1)(i) Pursuant to section 422A(c)(5)(A), an option which otherwise meets the requirements of section 422A(b) and this section will be an incentive stock option even if the employee has the right to exercise the option with previously acquired stock of the corporation which granted the option. For special rules relating to the transfer of statutory option stock as payment in connection with the exercise of an incentive stock option, see section 425(c) and the regulations thereunder.

(ii) All stock transferred pursuant to the exercise of an incentive stock option is subject to the holding period requirements of section 422A(a)(1) and paragraph (a) of §1.422A-1, and the disqualifying disposition rules of section 421(b) and paragraph (b) of §1.422A-1, regardless of whether such option is exercised with previously acquired stock of the corporation which granted the option. If an incentive stock option is exercised with previously acquired stock of the corporation which granted the option, and such exercise results in the basis allocation described in paragraph (i)(1)(iii) of this section, a disqualifying disposition of stock transferred pursuant to such exercise will be a disqualifying disposition of the stock with the lowest basis.

(iii) If the exercise of an incentive stock option with previously acquired stock of the corporation which granted the option is comprised in part of an exchange to which section 1036 (and so much of section 1031 as relates to section 1036) applies, then—

(A) The employee's basis in the incentive stock option stock transferred pursuant to the section 1036 exchange shall be the same as the employee's basis in the stock exchanged increased, if applicable, by any amount included in gross income as compensation pursuant to either sections 421 through 425 or section 83. Except for purposes of section 422A(a)(1) and paragraph (a) of §1.422A-1, the holding period of the stock shall be determined pursuant to section 1223. For purposes of section 421(b), paragraph (b) of §1.422A-1, and section 83 and the regulations thereunder, the amount paid for the stock shall be the fair market value of such stock on the date of the exchange.

(B) The employee's basis in the incentive stock option stock not transferred pursuant to the section 1036 exchange shall be zero. For all purposes, the holding period of the stock shall begin as of the date such stock is transferred. For purposes of section 421(b), paragraph (b) of §1.422A-1, and section 83 and the regulations thereunder, the amount paid for the stock shall be zero.

(2) Pursuant to section 422A(c)(5)(B), an option which otherwise meets the requirements of section 422A(b) and this section will be an incentive stock option even if the employee has the right to receive additional compensation, whether in cash or other property, at the time the option is exercised, provided such additional compensation is includible in income under the provisions of sections 61 and 83. The additional compensation may be determined in any manner including by reference to the fair market value of the stock at the time of exercise, or by reference to the option price.

(3)(i) Pursuant to section 422A(c)(5)(C), an option which otherwise meets the requirements of section 422A(b) and this section will be an incentive stock option even if the option is subject to a condition, or grants a right, not inconsistent with the requirements of section 422A(b) and this section.

(ii) An option that includes an alternative right is not an incentive stock option is the requirements of section 422A(b) and this section may be avoided by exercise of the alternative right. For example, an alternative right extending the option term beyond ten years, setting a price below fair market value, permitting transferability, or allowing nonsequential exercise, will prevent an option from qualifying as an incentive stock option. If either of two options can be exercised, but not both, each such option is a disqualifying alternative right with respect to the other even though one or both options would individually satisfy the requirements of section 422A(b) and this section.

(iii) An alternative right to receive a taxable payment of cash and/or other property in exchange for the cancellation or surrender of the option does not disqualify the option as an incentive stock option if the right is exercisable, the right is transferable only when the then fair market value of the stock exceeds the exercise price of the option and the option is otherwise exercisable only when the option is otherwise transferable, and the exercise of the right has the same economic and tax consequences as the exercise of the option followed by an immediate sale of the stock. For this purpose, the exercise of the alternative right does not have the same economic and tax consequences if the payment exceeds the difference between the then fair market value of the stock and the exercise price of the option. If the above conditions have been met, the exercise of the alternative right will be considered to be the exercise of the option for purposes of the sequencing provisions of section 422A(b)(7).

(iv) Section 425(h)(1) shall not apply to the amendment of an alternative right described in paragraph (i)(3)(iii) of this section in order to conform the terms of the alternative right to the technical requirements of such paragraph. This paragraph (iv) shall apply only to options granted after August 13, 1981, and before January 21, 1982, that are amended before [INSERT DATE 60 DAYS AFTER THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER AS FINAL REGULATIONS].

(4) The application of this paragraph may be illustrated by the following examples:

Example (1). On June 1, 1984, X Corporation grants an incentive stock option to A, an employee of X Corporation, entitling A to purchase 100 shares of X Corporation common stock at $10 per share. The option provides that A may exercise the option with previously

acquired X Corporation common stock. X Corporation has only one class of common stock outstanding. The stock transferable to A pursuant to the exercise of the incentive stock option is transferable and not subject to a substantial risk of forfeiture. On June 1, 1985, when the fair market value of X Corporation stock is $25 per share, A exercises the option and the 100 shares are transferred to A on that date. To exercise the option, A transferred to X Corporation 40 shares of X Corporation common stock that A had purchased on the open market on June 1, 1982, for $5 per share. After exercising the option, A owns 100 shares of incentive stock option stock. Pursuant to section 1036 (and so much of section 1031 as relates to section 1036), 40 shares have a $200 carryover basis and a three-year holding period, and 60 shares have a zero basis and a holding period beginning June 1, 1985.

Example (2). Assume the same facts as in example (1) and assume further that A sells 75 shares of the incentive stock option stock on September 1, 1985, for $30 per share. On that date, A has made a disqualifying disposition of the 75 shares of stock. Pursuant to paragraph (i)(l)(ii) of ths section, A has sold all 60 of the non-section-1036 shares and 15 of the 40 section-1036 shares. Therefore, pursuant to paragraph (i)(l)(iii) of this section and section 83(a), the amount of compensation attributable to A's exercise of the option and subsequent disqualifying disposition of 75 shares is $1500 (the difference between the fair market value of the stock on the date of exercise, $1875 (75 shares at $25 per share), and the amount paid for the stock, $375 (60 shares at $0 per share plus 15 shares at $25 per share)). In addition, A must recognize a long-term capital gain of $375 ($450, the amount realized from the sale of 15 shares, less A's basis of $75), and a short-term capital gain of $300 ($1800, the amount realized from the sale of 60 shares, less A's basis of $1500 resulting from the inclusion of that amount in income as compensation). Accordingly, A must include in gross income for the taxable year in which the sale occurs $1500 as compensation, $375 as long-term capital gain, and $300 as short-term capital gain. For its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $1500 for compensation paid to A provided the withholding requirements of §1.83-6 are met.

Example (3). Assume the same facts as in example (2), except that instead of selling the 75 shares of incentive stock option stock on September 1, 1985, A uses those shares to exercise a second incentive stock option. The second option was granted to A by X Corporation on January 1, 1985, entitling A to purchase 100 shares of X Corporation common stock at $22.50 per share. As in example (2), A has made a disqualifying disposition of the 75 shares of stock. Pursuant to paragraph (i)(l)(ii) of this section, A has disposed of all 60 of the non-section-1036 shares and 15 of the 40 section-1036 shares. Therefore, pursuant to paragraph (i)(l)(iii) of this section and section 83(a), the amount of compensation attributable to A's exercise of the first option and subsequent disqualifying disposition of 75 shares is $1500 (the difference between the fair market value of the stock on the date of exercise, $1875 (75 shares at $25 per share), and the amount paid for the stock, $375 (60 shares at $0 per share plus 15 shares at $25 per share)). Unlike example (2), A does not recognize any capital gain as a result of exercising the second option because, for all purposes other than the determination of whether the exercise is a disposition pursuant to section 425(c), such exercise is an exchange to which section 1036 applies. Accordingly, A must include in gross income for the taxable year in which the disqualifying disposition occurs $1500 as compensation. For its taxable year in which the disqualifying disposition occurs, X Corporation is allowed a deduction of $1500 for compensation paid to A provided the withholding requirements of §1.83-6 are met. After exercising the second option, A owns a total of 125 shares of incentive stock option stock. Pursuant to section 1036 (and so much of section 1031 as relates to section 1036), the 100 "new" shares of incentive stock option stock have the following bases and holding periods: 15 shares have a $75 carryover basis and a three-year-and-three-month holding period, 60 shares have a $1500 basis resulting from the inclusion of that amount in income as compensation and a three-month holding period, and 25 shares have a zero basis and a holding period beginning September 1, 1985.

Example (4). Assume the same facts as in example (2), except that instead of selling the 75 shares of incentive stock option stock on September 1, 1985, A uses those shares to exercise a non-statutory stock option. The non-statutory stock option was granted to A by X Corporation on January 1, 1985, entitling A to purchase 100 shares of X Corporation common stock at $22.50 per share. Unlike example (3), A has not made a disqualifying disposition of the 75 shares of stock. After exercising the non-statutory stock option, A owns a total of 100 shares of incentive stock option stock and 25 shares of non-statutory stock option stock. Pursuant to section 1036 (and so much of section 1031 as relates to section 1036), the 75 "new" shares of incentive stock option stock have the same basis and holding period as the 75 "old" shares used to exercise the non-statutory stock option. The additional 25 shares of stock received upon exercise of the non-statutory stock option are compensation for services pursuant to section 83(a). Accordingly, A must include in gross income for the taxable year in which the transfer of such shares occurs $750 (25 shares at $30 per share) as compensation. A's basis in such shares is the same as the amount included in gross income. For its taxable year in which the transfer occurs, X Corporation is allowed a deduction of $750 for compensation paid to A provided the withholding requirements of §1.83-6 are met.

Example (5). Assume the same facts in example (1), except that the stock transferred pursuant to the exercise of the incentive stock option is subject to a substantial risk of forfeiture and not transferable for a period of six months after such transfer. Assume further that the shares that A uses to exercise the incentive stock option are similarly restricted. Such shares were transferred to A on January 1, 1985, pursuant to the exercise of a non-statutory stock option granted to A on January 1, 1984. A paid $5 per share for the stock when its fair market value was $22.50 per share. A did not file a section 83(b) election to include the $700 spread (the difference between the option price and the fair market value of the stock on date of exercise of the option) in gross income as compensation. After exercising the incentive stock option with the 40 shares of restricted stock, A owns 100 shares of restricted incentive stock option stock. Section 1036 (and so much of section 1031 as relates to section 1036) applies to the 40 shares exchanged in exercise of the incentive stock option. However, pursuant to section 83(g), the stock received in such exchange, because it is incentive stock option stock, is not subject to restrictions and conditions substantially similar to those to which the stock was given in such exchange was subject. For purposes of section 83(a) and §1.83-1(b)(1), therefore, A has disposed of the 40 shares of restricted stock on June 1, 1985, and must include in gross income as compensation $800 (the difference between the amount realized upon such disposition, $1000, and the amount paid for the stock, $200). Accordingly, 40 shares of the incentive stock option stock have a $1000 basis (the $200 original basis plus the $800 included in income as compensation) and 60 shares of the incentive stock option stock have a zero basis. For its taxable year in which the disposition of the restricted stock occurs, X Corporation is allowed a deduction of $800 for compensation paid to A provided the withholding requirements of §1.83-6 are met.

Par. 3. Section 1.422A-3 is added after §1.422A-2 to read as follows:

§1.422A-3 Incentive stock option transitional rules.

(a) *In general.* (1) This section provides special rules pursuant to section 251(c) of the Economic Recovery Tax Act of 1981 (95 Stat. 172 (Pub. L. 97-34, 1981-2 C.B. 256, 301) for converting stock options into incentive stock options. These special rules apply to stock options granted after December 31, 1975, and either exercised on or after January 1, 1981, or outstanding on such date, if such stock options—

(i) Were granted prior to January 1, 1981;

(ii) Were exercised before January 21, 1982 and did not meet the requirements of section 422(b) and §1.422A-2 at the time of exercise;

(iii) Did not meet the requirements of section 422A(b) and §1.422A-2 when granted and were outstanding on August 13, 1981; or

(iv) Were granted after December 31, 1980, and before August 14, 1981, and otherwise met the requirements of section 422A(b) and §1.422A-2 when granted.

(2) Stock options granted before January 1, 1981, may be converted into incentive stock options, but only if the corporation that granted such options makes an election under paragraph (b) of this section. The aggregate fair market value of stock the options for which may be converted into incentive stock options by such an election is subject to an annual and a cumulative restriction. Such aggregate fair market value (determined as of the time the options were granted) may be not exceed $50,000 per employee for options granted in any cal-

endar year and $200,000 per employee for all options granted in the 5-year period ending December 31, 1980.

(3) Stock options that were exercised before January 21, 1982, and that did not meet certain requirements of section 422A(b) and §1.422A-2 at the time of exercise may be converted into incentive stock options if the requirements of paragraph (c)(3) of this section are met.

(4) Stock options that did not meet the requirements of section 422A(b) and §1.422-2 when granted and that were outstanding on August 13, 1981, may be converted into incentive stock options in accordance with paragraph (d) of this section. Section 425(h)(l) (relating to the modification of statutory stock options) shall not apply to any change in the terms of an option (or the terms of the plan under which the option was granted) or shareholder approval of such change required to convert such option into an incentive stock option if such change or shareholder approval occurs on or before August 13, 1982.

(5) Stock options that were granted after December 31, 1980, and before August 14, 1981, are incentive stock options if they otherwise met the requirements of section 442A(b) and §1.422A-2 when granted. No election is necessary to convert such options into incentive stock options.

(b) *Election procedure and requirements.* (1) A corporation may make only one election to convert stock options granted before 1981 into incentive stock options and such election must include all options granted by the corporation before 1981 that are to be converted into incentive stock options. Thus, a corporation that makes an election with respect to certain options granted before 1981 may not make any subsequent election with respect to other options granted before 1981. An election shall be made by attaching an election statement to the granting corporation's income tax return either for the first taxable year during which an incentive stock option (including an option treated as an incentive stock option by reason of the election or the other provisions of this section) is exercised, or for any prior taxable year. An election shall be made no later than the due date (taking extensions into account) of the income tax return. If such due date occurs before August 14, 1982, the granting corporation will be permitted to make the election at any time prior to August 14, 1982, on an election statement attached to an amended return. In any event, no election will be permitted after the due date (taking extensions into account) of the income tax return for the taxable year including December 31, 1982. The election statement must—

(i) Contain the name, address, and taxpayer identification number of the corporation;

(ii) Identify the election as an election under section 251(c)(1)(B) of the Economic Recovery Tax Act of 1981; and

(iii) Specify, by employee, the options to which the election applies and state, for each such option, the date of original grant (and, if applicable, date of most recent modification) and total exercise price (*i.e.*, the total number of shares subject to the option multiplied by the price per share).

All options to which the election applies must meet the section 422A qualification requirements (other than the requirement of securing stockholder approval) at the time the election statement is filed.

(2) In its election under this paragraph, a corporation may generally select any eligible option (or portion of such option). The selection is, however, subject to the $50,000 annual and $200,000 cumulative limits applicable to each employee, and also subject to any existing plan requirements relating to who must be benefited under such plan as among different classes of employees. Eligible options (or portions of such options) may be selected on an option-by-option basis and/or an employee-by-employee basis. If only a portion of an option is selected and such portion is not exercised prior to January 21, 1982, the option must be amended prior to the exercise of such portion so as to clearly identify it as an incentive stock option. Whenever such a dual option is exercised, separate stock certificates must be issued (or reissued). See §1.422A-3(c)(3)(iv) for the deadlines for amending options.

(c) *Eligibility issues: pre-enactment modifications, dollar limitations.* (1) An option is not eligible for incentive stock option conversion unless it was originally granted after December 31, 1975. A modification, extension, or renewal on or after January 1, 1976, of an option originally granted prior to that date, will not make such option eligible for conversion into an incentive stock option, regardless of whether the option as so modified, extended, or renewed would be treated as newly granted within the meaning of section 425(h).

(2) An amendment to an otherwise eligible option (or plan) prior to August 13, 1981, will be subject to the rules of section 425(h). If, pursuant to section 425(h), the amendment is a modification, extension, or renewal of the option, such amendment shall be considered as the grant of a new option. Such an option is not eligible for conversion into an incentive stock option unless the option (and plan) comply with the section 422A qualification requirements. Since the option will be considered to have been granted on the date it was amended, the option price cannot be less than the fair market value of the stock on that date. If the option price is less than the fair market value of the stock on the date the option was amended, the corporation may qualify the option by adjusting the option price, so long as such adjustment occurs prior to the earliest of the exercise of the option, the date of the election under paragraph (b) of this section (if applicable), or August 14, 1982. If the corporation wishes to retain the original grant price (and grant date) of the option, the corporation may do so by rescinding the amendment, so long as such rescission occurs prior to the earliest of the exercise of the option, the date of the election under paragraph (b) of this section (if applicable), or August 14, 1982. If only a portion of an option is to become an incentive stock option, the adjustment of the option price or the rescission of the amendment need apply only to that portion. If an

amendment is rescinded as to only a portion of an option so as to restore the original date of grant for that portion, the balance of the option is not eligible for conversion into an incentive stock option. For example, in the case of a $100,000 option granted in 1978 and amended in 1980, the corporation could not rescind the modification as to only half of the option, and then elect to convert into incentive stock options both the $50,000 portion of the option treated as granted in 1978 and the $50,000 portion of the option treated as granted in 1980.

(3)(i) Except as provided in this paragraph (c)(3), an option is eligible for incentive stock option conversion only if, at the time of exercise, such option (and its plan) conform to all of the section 422A qualification requirements and the transitional rule limitations. It is not possible to amend an exercised option retroactively to correct nonconforming or missing terms, or to rescind an improper exercise.

(ii) An option exercised prior to January 21, 1982, may be converted into an incentive stock option even if the option does not contain the sequential exercise restriction required by section 422A(b)(7). Incentive stock option conversion will be available, however, only if the employee in fact had no prior outstanding incentive stock options at the time the option in question was exercised. An option exercised on or after January 21, 1982, without containing the sequential exercise restriction may not be converted into an incentive stock option unless the employee in fact had no prior outstanding incentive stock options at the time the option in question was granted. In order to identify prior outstanding incentive stock options it will be necessary to take into account all options elected or amended to become incentive stock options and all options granted as incentive stock options.

(iii) An option granted after 1980 and exercised prior to January 21, 1982, may be converted into an incentive stock option even if the plan does not contain at the time of exercise the $100,000 annual plus carryover limit required by section 422A(b)(8). Incentive stock option conversion will be available, however, only for exercised amounts that do not exceed such limit. Where the limit has been exceeded, separate stock certificates must be issued (or reissued) no later than March 15, 1982. An option exercised on or after January 21, 1982, and before the plan has been amended to include the $100,000 annual plus carryover limit, may not be converted into an incentive stock option. Incentive stock option conversion is not available for such an option regardless of whether the limit is exceeded. An option exercised on or after January 21, 1982, and after the plan has been amended to include the $100,000 annual plus carryover limit, may not be converted into an incentive stock option where such limit has been exceeded. An option in excess of the limit must be amended, before it is exercised, so as clearly to identify that portion of the option intended to become an incentive stock option. Upon exercise of the option, separate stock certificates must be issued. An amended option that was required by its original terms to be exercised in full, must still be required to be exercised in full after it is amended.

(iv) An option granted before 1981 and exercised prior to January 21, 1982, may be converted into an incentive stock option even if the $50,000 annual limit or the $200,000 cumulative limit of paragraph (a)(2) of this section was exceeded. Incentive stock option conversion will be available, however, only for exercised amounts that do not exceed such limits. If either limit has been exceeded, separate stock certificates must be issued (or re-issued) no later than March 15, 1982. An option exercised on or after January 21, 1982, where either the $50,000 annual limit or the $200,000 cumulative limit was exceeded, may not be converted into an incentive stock option. An option in excess of such limits must be amended, before it is exercised, so as clearly to identify that portion of the option intended to become an incentive stock option. Upon exercise of the option, separate stock certificates must be issued. An amended option that was required by its original terms to be exercised in full, must still be required to be exercised in full after it is amended.

(4) The $50,000 annual and the $200,000 cumulative limits apply only to options granted prior to 1981 that are converted into incentive stock options by reason of an election under paragraph (b) of this section. Additionally, the limits relate only to the year of grant of an option, not to the year in which an option vests (as in the case of an installment option) or the year of exercise. Unlike the $100,000 annual limit for options granted after 1980, the $50,000 annual limit does not incorporate an unused limit carryover from prior years. Both the $50,000 and the $200,000 limits apply to the fair market value of the stock at the time the options are granted, not to the option price of the options granted. Thus, in the case of an employee who is a 10 percent stockholder, an election would be permitted with respect to an option to purchase $50,000 worth of stock at an option price of $55,000. The requirement that options for which the election is made not exceed the $50,000 annual limit and the $200,000 cumulative limit will be deemed to have been satisfied if, at the time of grant, there was a good-faith attempt to value the stock accurately even if such valuation should subsequently prove to be in error.

(d) *Required option and plan amendments.* (1) The transitional rule waives the applicability of section 425(h) with respect to amendments of an option or a plan that are necessary to meet the minimum qualification requirements of section 422A. An amendment to add, modify, or delete a permissible term that is not necessary to meet such minimum qualification requirements does not fall within the waiver of section 425(h).

(2) The transitional rule waives the applicability of section 425(h) with respect to option and plan amendments only with respect to options outstanding on August 13, 1981. An option granted after August 13, 1981, and amended prior to exercise so as to qualify it as an incentive stock option, does not fall within the waiver of section 425(h). Such an option,

therefore, will be treated as having been granted on the date it was amended. Consequently, the option price cannot be less than the fair market value of the stock as of the date of amendment. The option as originally granted, since it was not an incentive stock option at that time, will not be treated as still outstanding for purposes of the sequential exercise restriction of section 422A(b)(7).

(3) Amendments to an option plan, so as to meet the qualification requirements of section 422A, will apply to previously granted and outstanding options only if such amendments, by their terms, are clearly intended to have retroactive effect. Even if such amendments are intended to have retroactive effect, they need not apply to all previously granted options.

(4) The grant of an incentive stock option in exchange for the cancellation of an outstanding nonincentive stock option will not violate either the qualification requirements of section 422A or the transitional rules, provided the outstanding option is cancelled prior to the grant of the incentive stock option. The cancelled option will not be treated as still outstanding for purposes of the sequential exercise restriction of section 422A(b)(7).

(e) *Stockholder approval issues.* (1) If an option plan received stockholder approval within 12 months before or after the date such plan was originally adopted and it is amended so as to qualify it as an incentive stock option plan, new stockholder approval will be required only if the original plan either did not specify the aggregate number of shares which may be issued under the plan or did not identify the employees or class of employees eligible to receive options under the plan, or if either of such terms is modified. The amendment of an option plan to add the $100,000 annual plus carryover limit, applicable to incentive stock options granted after 1980, will not require new stockholder approval.

(2) If a plan never received stockholder approval, or did not receive such approval within 12 months before or after such plan was adopted, the plan will qualify as an incentive stock option plan if stockholder approval is obtained prior to August 14, 1982, but only if an option granted pursuant to the plan was outstanding on August 13, 1981, and such option is to become an incentive stock option. If no option granted pursuant to the plan was outstanding on August 13, 1981, or no option outstanding on August 13, 1981, is to become an incentive stock option, the plan must be re-adopted by the granting corporation and, if necessary, amended to meet the qualification requirements of section 422A. Stockholder approval must be obtained with 12 months before or after the plan is re-adopted. Consequently, any option granted after August 13, 1981, and before the date the plan is re-adopted, that is to become an incentive stock option will be treated as having been granted on the date of re-adoption of the plan. The option price of such an option, therefore, cannot be less than the fair market value of the stock as of the date of re-adoption of the plan. The option as originally granted, since it was not an incentive stock option at that time, will not be treated as still outstanding for purposes of the sequential exercise restriction of section 422A(b)(7).

(3) If an option was granted pursuant to no plan at all and such option was outstanding on August 13, 1981, a plan may be adopted and stockholder approval obtained in order to qualify the option as an incentive stock option. The adoption of an incentive stock option plan and the obtaining of stockholder approval will be treated as amendments permitted under the transitional rules if they occur prior to August 14, 1982.

(4) Options granted under a plan that must be approved by stockholders to qualify as an incentive stock option plan and outstanding on August 13, 1981, are eligible to become incentive stock options even if they are exercised prior to the obtaining of stockholder approval provided stockholder approval is obtained before August 14, 1982.

(5) If, pursuant to paragraph (e) of this section, new stockholder approval is required in order to qualify a plan as an incentive stock option plan, see paragraph (b)(2) of §1.422A-2 for the prescribed method and degree of stockholder approval.

(f) *Sequential exercise issues.* (1) The original grant dates (or later grant dates for options with pre-enactment modifications) of options that are converted into incentive stock options will determine the sequencing order for purposes of the sequential exercise restriction of section 422A(b)(7). For example, in the case of options granted in 1977, 1978, and 1979, assume that in 1980 the 1978 option was amended to add a term beneficial to the employee. Such an amendment would be a modification under the rules of section 425(h) and would cause the option to be treated as newly granted in 1980. If the 1977, 1978 (as modified), and 1979 options are converted into incentive stock options, the sequencing order would be as follows: the 1977 option must be exercised first, the 1979 option second, and the 1978 option (as modified) third.

(2) Options granted prior to 1981 that are converted into incentive stock options must be exercised prior to the exercise of any incentive stock options granted after 1980. For example, assume that an option granted and exercised during January of 1982 automatically qualifies, by its terms, as an incentive stock option. During February of 1982, the employer elected to convert an option granted to the employee during 1978 into an incentive stock option. For purposes of this section only, such an election will retroactively disqualify the 1982 option as an incentive stock option. If the 1982 option is to qualify as an incentive stock option, it cannot be exercised prior to the exercise or expiration of all incentive stock options previously granted and outstanding on the date the 1982 option was granted. When the 1982 option was granted during January of 1982, the 1978 option was already granted and outstanding for purposes of the sequential exercise restriction of section 422A(b)(7).

(3) The existence (or exercise) of stock options that are not converted into incentive stock options will not

prevent the exercise of an incentive stock option because of the sequential exercise restriction of section 422A(b)(7). However, if an option that is converted into an incentive stock option contains other sequencing restrictions, the option will continue to be burdened by such restrictions. The deletion of such sequencing restrictions is not an amendment necessary in order to qualify the option as an incentive stock option. Consequently, the rules of section 425(h) would apply to such an amendment.

Par. 4. Section 1.421-7 is amended by revising paragraphs (b)(1), (b)(2), (d), (e)(1), (e)(2), and (h)(2) to read as follows:

§1.421-7 Meaning and use of certain terms.

* * * * *

(b) *Statutory options.* (1) The term "statutory option", used for purposes of convenience hereinafter in this section and in §§1.421-8 through 1.425-1, means a qualified stock option, as defined by section 422(b) and §1.422-2; an incentive stock option, as defined by section 422A(b) and §1.422A-2; an option granted under an employee stock purchase plan, as defined by section 423(b) and §1.423-2; and a restricted stock option, as defined in section 424(b) and §1.424-2.

(2) An option may qualify as a statutory option only if the option is not transferable (other than by will or by the laws of descent and distribution) by the individual to whom it is granted, and is exercisable, during the lifetime of such individual, only by him. See sections 422(b)(6), 422A(b)(5), 423(b)(9), and 424(b)(2). Accordingly, an option which is transferable by the individual to whom it is granted during his lifetime, or is exercisable during such individual's lifetime by another person, is not a statutory option. However, in case the option or the plan under which the option was granted contains a provision permitting the individual to whom the option was granted to designate the person who may exercise the option after his death, either such provision, nor a designation pursuant to such provision, disqualifies the option as a statutory option.

* * * * *

(d) *Stock and voting stock.* For purposes of sections 421 through 425, the term "stock" means capital stock of any class, including voting or nonvoting common or preferred stock. Except as otherwise provided, the term includes both treasury stock and stock of original issue. Special classes of stock authorized to be issued to and held by employees are within the scope of the term "stock" as used in such sections, provided such stock otherwise possesses the rights and characteristics of capital stock. For purposes of determining what constitutes voting stock in ascertaining whether a plan has been approved by stockholders or whether the limitations pertaining to voting power contained in sections 422(b)(7), 422A(b)(6), 423(b)(3) and 424(b)(3) and the regulations thereunder have been met, stock which does not have voting rights until the happening of an event, such as the default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Moreover, stock which does not possess a general voting power, and may vote only on particular questions, is not voting stock. However, if such stock is entitled to vote on whether a stock option plan is to be adopted, it is voting stock for the purpose of ascertaining whether the plan has been approved by the shareholders.

(e) *Option price.* (1) For purposes of sections 421 through 425, the term "option price" or "price paid under the option" means the consideration if money or other property which, pursuant to the terms of the option, is the price at which the stock subject to the option is purchases. The term "option price" does not include amounts paid as interest under a deferred payment arrangement or treated as unstated interest under section 483 and the regulations thereunder. Thus, for example, section 483 is applicable in determining whether the pricing requirements of section 422(b)(4), 422A(b)(4) and (c)(8), 423(b)(6), 424(b)(1), or 424(c) are met and is applicable in determining the basis of any stock acquired pursuant to the exercise of a statutory option. However, with respect to statutory options granted prior to January 1, 1965, the determination of whether the applicable pricing requirements are met shall be made without regard to section 483, but section 483 shall be taken into consideration in determining basis for purposes of determining gain or loss.

(2) In the case of a statutory option, any reasonable valuation method may be used for the purpose of determining whether at the time the option is granted the option price satisfies the pricing requirements of section 442(b)(4) (relating to qualified stock options), section 422A(b)(4) and (c)(8) (relating to incentive stock options), section 423(b)(6) (relating to employee stock purchase plans), or section 424(b)(1) (relating to restricted stock options), whichever is applicable, with respect to the stock subject to the option. Such methods include the valuation methods described in §20.2031-2 of this chapter (Estate Tax Regulations).

* * * * *

(h) *Employment relationships.****

(2) In order to qualify for the special tax treatment of section 421, in addition to meeting the requirements of subparagraph (1) of this paragraph, an individual exercising a qualified stock option, an incentive stock option, or an option granted under an employee stock purchase plan must, at all times during the period beginning with the date of the granting of such option and ending at the time of such exercise or on the day 3 months before the date of such exercise, be an employee of either the corporation granting such option, a related corporation of such corporation, or a corporation or a related corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies. For this purpose, the employment relationship in respect of an option granted in accordance with the requirements of subparagraph (1) of this paragraph will be treated as continuing intact while the individual is

on military, sick leave or other bona fide leave of absence (such as temporary employment by the Government) if the period of such leave does not exceed 90 days, or if longer, so long as the individual's right to reemployment with the corporation granting the option (or a related corporation of such corporation, or a corporation, or a related corporation of such corporation issuing or assuming a stock option in a transaction to which section 425(a) applies) is guaranteed either by statute or by contract. Where the period of leave exceeds 90 days and where the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship will be deemed to have terminated on the 91st day of such leave.

* * * * *

Par. 5. Section 1.421-8 is amended by revising paragraphs (a)(1), (b)(1), and (b)(2), adding new paragraph (b)(4), and revising paragraphs (c)(1) and (d) to read as follows:

§1.421-8 General rules.

(a) *Effect of qualifying transfer.* (1) If a share of stock is transferred to an individual pursuant to his exercise of a statutory option, and if the requirements of section 422(a) (relating to qualified stock options), section 422A(a) (relating to incentive stock options) section 423(a) (relating to employee stock purchase plans), or section 424(a) (relating to restricted stock option), whichever is applicable, are met, then—

(i) Except as provided in section 422(c)(1) (relating to exercise of option when price is less than value of stock), and paragraph (e)(2) of §1.422-2, no income shall result at the time of the transfer of such share to the individual upon his exercise of the option with respect to such share;

(ii) No deduction under section 162 or the regulations thereunder (relating to trade or business expenses) shall be allowable at any time to the employer corporation, a related corporation of such corporation, or a corporation issuing or assuming a stock option in a transaction to which section 425(a) and paragraph (a) of §1.425-1 (relating to corporate reorganizations, liquidations, etc.) applies, with respect to the share so transferred; and

(iii) No amount other than the price paid under the option shall be considered as received by any of such corporations for the share so transferred.

* * * * *

(b) *Effect of disqualifying disposition.* (1) The disposition of a share of stock, acquired by the exercise of a statutory option before the expiration of the applicable holding period as determined under section 422(a)(1), 422A(a)(1), 423(a)(1), or 424(a)(1), makes section 421 inapplicable to the transfer of such share. The income attributable to such transfer shall be treated by the individual as income received in the taxable year in which such disposition occurs. Similarly, a deduction under section 162 attributable to the transfer of the share of stock pursuant to the exercise of the option shall be allowable for the taxable year in which such disposition occurs to the employer corporation, its parent or subsidiary corporation or a corporation issuing or assuming a stock option in a transaction to which section 425(a) applies. In such cases, no amount shall be treated as income, and no amount shall be allowed as a deduction, for any taxable year other than the taxable year in which the disposition occurs. If the stock was transferred pursuant to the exercise of the option in a taxable year other than the taxable year of the disposition, the amount of the deduction shall be determined as if the employee had been paid compensation at the time provided in paragraph (d) of §1.421-6.

(2) Section 421 is not made inapplicable by a transfer before the expiration of the applicable holding period as determined under section 422(a)(1), 422A(a)(1), 423(a)(1), or 424(a)(1), if such transfer is not a disposition of the stock as defined in section 425(c) and paragraph (c) of §1.425-1, for example, a transfer from the decendent to his estate or a transfer by bequest or inheritance. Similarly, a disposition by the executor, administrator, heir, or legatee is not a disposition by the decedent. In case a statutory option is exercised by the estate of the individual to whom the option was granted, or by a person who acquired the option by bequest or inheritance or by reason of the death of such individual, see paragraph (c) of this section.

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(4) For special rules relating to a disqualifying disposition of a share of stock acquired by exercise of an incentive stock option, see paragraph (b) of §1.422A-1.

(c) *Exercise by estate.* (1) If a statutory option is exercised by the estate of the individual to whom the option was granted, or by any person who acquired such option by bequest or inheritance or by reason of the death of such individual, section 421(a) applies to such exercise in the same manner as if such option had been exercised by such deceased individual. Consequently, except as provided by section 422(c)(1) and paragraph (e)(2) of §1.422-2, neither the estate nor such person is required to include any amount in gross income as a result of a transfer of stock pursuant to such exercise of the option. Nor does section 421(a) become inapplicable if such executor, administrator, or person disposes of the stock so acquired before the expiration of the applicable holding period as determined under section 422 (a)(1), 422A(a)(1), 423(a)(1), or 424(a)(1). This special rule does not affect the applicability of section 1222, relating to what constitutes a short-term and long-term capital gain or loss. The executor, administrator, or such person need not exercise the option within three months after the death of the individual to whom the option was granted for section 421(a) to be applicable. However, the exercise of the option must be pursuant to the terms of the option, and any change in the terms of the option is subject to the rules of paragraph (e) of §1.425-1, relating to the modification, extension, or renewal of the option. Section 421(a) is applicable even though such executor, administrator, or person is not employed by the corporation granting the option, or a related oorporation, either when the op-

tion is exercised or at any time. However, section 421(a) is not applicable to an exercise of the option by the estate or by such person, unless the individual to whom the option was granted met the employment requirements of section 422(a)(2), 422A (a)(2), 423(a)(2), or 424(a)(2), whichever is applicable, either at the time of his death or within three months before such time. If the option is exercised by a person other than the executor or administrator, or other than a person who acquired the option by bequest or inheritance or by reason of the death of such deceased individual, section 421(a) is not applicable to the exercise. For example, if the option is sold by the estate, section 421(a) does not apply to an exercise of the option by such buyer; but if the option is distributed by the administrator to an heir as part of the estate, section 421(a) is applicable to an exercise of the option by such heir.

* * * * *

(d) *Exercise by deceased employee during lifetime.* If a statutory option is exercised by an individual to whom the option was granted and the individual dies before the expiration of the applicable holding period as determined under section 422(a)(1), 422A(a)(1), 423(a)(1), or 424(a)(1), section 421(a) does not become inapplicable if the executor or administrator of the estate of such individual, or any person who acquired such stock by bequest or inheritance or by reason of the death of such individual, disposes of such stock before the expiration of such applicable holding period. This rule does not affect the applicability of section 1222, relating to what constitutes a short-term and long-term capital gain or loss.

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Par. 6. Section 1.425-1 is amended by revising paragraph (a)(6), redesignating paragraph (c)(3) as paragraph (c)(4) and revising paragraph (c)(4), adding new paragraph (c)(3), and revising paragraphs (d), (e)(1), (e)(5) and (e)(6) to read as follows:

§1.425-1 Definitions and special rules applicable to statutory options.

(a) *Corporate reorganizations, liquidations, etc.****

(6) In order to have a substitution of an option under section 425(a) the optionee must, in connection with the corporate transaction, lose his rights under the old option. There cannot be a substitution of a new option for an old option within the meaning of section 425(a) if it is contemplated that the optionee may exercise both the old option and the new option. It is not necessary, however, to have a complete substitution of a new option for the old option. However, if the old option was a qualified, incentive, or restricted stock option, any portion of such option which is not substituted or assumed in a transaction to which section 425(a) applies will be treated as an outstanding option to purchase stock of a predecessor corporation of the new employer or grantor corporation. See section 422 (b)(5) and (c)(2) and paragraph (f) of §1.422-2 and section 422A(b)(7) and (c)(7) and paragraph (f) of §1422A-2. For example, assume that X Corporation forms a new corporation, Y Corporation, by a transfer of certain assets and distributes the stock of Y Corporation to the shareholders of X Corporation. Assume further that E, an employee of X Corporation, is thereafter an employee of both X Corporation and Y Corporation. Y Corporation wishes to substitute an option to purchase some of its tock for the statutory option which E has, entitling him to purchase 100 shares of the stock of X Corporation. The option to purchase the stock of X Corporation, at $50 a share, was granted when the stock had a fair market value of $50 a share, and the stock was worth $100 a share just before the distribution of the new corporation's stock to the shareholders of X Corporation. The stock of X Corporation and of Y Corporation is worth $50 a share just after such distribution, which also is the time of the substitution. On these facts an option to purchase 200 shares of stock of Y Corporation at $25 a share could be given to the employee in complete substitution for the old option. It would also be permissible to give the employee an option to purchase 100 shares of stock of Y Corporation at $25 a share in substitution for his right to purchase 50 of the shares covered by the old option. However, if the option to purchase X stock was a qualified, incentive, or restricted stock option, then to the extent the old option is not assumed or a new option issued in substitution therefor in a transaction to which section 425(a) applies, such old option will be treated as an outstanding option under either section 422(c)(2) for purposes of section 422(b)(5), or section 422A(c)(7) for purposes of section 422A(b)(7). See paragraph (f) of §1.422-2 and paragraph (f) of §1.422A-2.

* * * * *

(c) *Disposition of stock.****

(3)(i) If there is a transfer of statutory option stock in connection with the exercise of any incentive stock option, and the applicable holding period requirements (under section 422(a)(1), 422A(a)(1), 423(a)(1), or 424(a)(1)) are not met before such transfer, then no section referred to in paragraph (c) (1)(ii) of this section shall apply to such transfer for purposes of determining whether there has been a disposition of such stock.

(ii) For purposes of this paragraph (c)(3), the term "statutory option stock" means any stock acquired through the exercise of a qualified stock option, an incentive stock option, an option granted under an employee stock purchase plan, or a restricted stock option.

(iii) This paragraph (c)(3) applies only with respect to transfers of statutory option stock in connection with the exercise of an incentive stock option occurring after March 15, 1982.

(4) ***

Example (7). On January 1, 1982, the X Corporation grants to E, an employee, an incentive stock option to purchase 100 shares of X Corporation stock at $100 per share, the fair market value of X Corporation stock on that date. According to the terms of the option, E can exercise the option by using previously acquired X Corporation stock. On January 1, 1983, while employed by X Corporation, E exercises part of the option and pays X Corporation $5,000 in cash. On that day, X Corporation transfers to E 50 shares of its stock having a fair market value of $6,000. Before January 1, 1984, E makes no disposition of the 50 shares so purchased. E realizes no income with respect to the transfer of the 50 shares of X Corporation stock on January 1, 1983. X Corporation is not entitled to any deduction at any time with respect to its transfer to E of the stock. E's ba-

sis for such 50 shares is $5,000.

Example (8). Assume the same facts as in example (7), except assume that on December 1, 1983, one year and 11 months after the grant of the incentive stock option and 11 months after the transfer of the 50 shares, E transfers 25 of the shares, having a fair market value of $5,000, to X Corporation as payment for the balance of the incentive stock option still outstanding. On that day, X Corporation transfers to E 50 shares of its stock having a fair market value of $10,000. The special rules of section 421(a) are not applicable to the transfer of 25 of the shares transferred on January 1, 1983, because disposition of such shares was made by E within two years of grant of the option and one year of exercise of the option.

(d) *Attribution of stock ownership.* Section 425(d) provides that in determining the amount of stock owned by an individual for purposes of applying the percentage limitations of secton 422(b)(7), 422A(b)(6), 423(b)(3), and 424(b)(3), stock of the employer corporation or of a related corporation which is owned (directly or indirectly) by or for such individual's brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants, shall be considered as owned by such individual. Also, for such purpose, if a domestic or foreign corporation, partnership, estate, or trust owns (directly or indirectly) stock of the employer corporation or of its parent or subsidiary, such stock shall be considered as being owned proportionately by or for the shareholders, partners, or beneficiaries of the corporation, partnership, estate, or trust.

(e) *Modification, extension, or renewal of option.* (1) Section 425(h) provides the rules for determining whether a share of stock transferred to an individual upon his exercise of an option, after the terms thereof have been modified, extended, or renewed, is transferred pursuant to the exercise of a statutory option. Such rules and the rules of this section are applicable to modifications, extensions, or renewals (or to changes which are not treated as modifications) of an option in any taxable year of the optionee which begins after December 31, 1963, except that section 425(h)(1) and this paragraph shall not apply to any change made before January 1, 1965, in the terms of an option granted after December 31, 1963, to permit such option to meet the requirements of section 422(b)(3), (4), or (5), and the regulations thereunder. See paragraphs (d), (e), and (f), of §1.422-2, relating to period for exercising options, option price, and prior outstanding options, respectively, in the case of qualified stock options.

In addition, section 425(h)(1) and this paragraph shall not apply to any change made after August 13, 1981, and before August 14, 1982, in the terms of an option granted after December 31, 1975, and outstanding on August 13, 1981, necessary to permit such option to meet the requirements of section 422A and the regulations thereunder. See §1.422A-3 for special rules relating to the conversion of existing options into incentive options.

* * * * *

(5)(i) The time or date when an option is modified, extended, or renewed shall be determined, insofar as applicable, in accordance with the rules governing determination of the time or date of granting an option provided in paragraph (c) of §1.421-7. For purposes of sections 421 through 425, the term "modification" means any change in the terms of the option (or change in the terms of the plan pursuant to which the option was granted) which gives the optionee additional benefits under the option regardless of whether the optionee in fact benefits from the change in the terms. For example, a change in the terms of the option, which shortens the period during which the option is exercisable, is not a modification. However, any one of the following changes is a modification: a change which provides more favorable terms for payment for the stock purchased under the option, such as the right to tender previously acquired stock; a change which provides an extension of the period during which an option may be exercised, such as after termination of employment; a change which provides an additional benefit upon exercise of the option, such as the payment of a cash bonus; and a change which provides an alternative to the exercise of the option, such as a stock appreciation right. Finally, a change which provides, either by its terms or in substance, that the optionee may receive an additional benefit under the option at the future discretion of the grantor, is a modification both at the time the option is changed and at the time the benefit is actually granted. Where an option is amended solely to increase the number of shares subject to the option, such increase shall not be considered as a modification of the option, but shall be treated as the grant of a new option for the additional shares.

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(iii) Any change in the terms of an option for the purpose of qualifying the option as a statutory option grants additional benefits and, therefore, is a modification. However, if the terms of an option are changed to provide that the optionee cannot transfer the option except by will or by the laws of descent and distribution in order to meet the requirements of section 422(b)(6), 422A(b)(5), 423(b)(9), or 424(b)(2), such change is not a modification, provided that in any case where the purpose of the change is to meet the requirements of section 424(b)(2) the option is at the same time changed so that it is not exercisable after the expiration of ten years from the date the option was granted. Where an option is not immediately exercisable in full, a change in the terms of such option to accelerate the time at which the option (or any portion thereof) may be exercised is not a modification for purposes of section 425(h) and this section. A modification results where an option is revised to insert the language required by section 422(c)(6)(B).

* * * * *

(6) A statutory option may, as a result of a modification, extension, or renewal, thereafter cease to be a statutory option, or any option may, by modification, extension, or renewal, thereafter become a statutory option. Moreover, a qualified option after a modification may not be exercisable in accordance with its terms because of the requirements of section 422(b)(5) and section 422(c)(6). See paragraph (f)(3)(i) of §1.422-2 and examples (8) and (9) of paragraph (f)(4) of §1.422-2.

Similarly, an incentive stock option

after a modification may not be exercisable in accordance with its terms because of section 422A(b)(7). See paragraph (f)(3) of §1.422-2 and example (6) of paragraph (f)(4) of §1.422A-2.

* * * * *

Par. 7. Section 1.6039-1 is amended by revising that part of paragraph (a) preceding paragraph (a)(1), and by revising that part of paragraph (b)(1) preceding paragraph (b)(1)(i) to read as follows:

§1.6039-1 Information returns required of corporations with respect to certain stock option transactions occurring on or after January 1, 1964.

(a) *Requirement of return under section 6039(a)(1).* Every corporation which transfers stock to any person before January 1, 1980, pursuant to such person's exercise on or after January 1, 1964, of a qualified stock option described in section 422(b), or a restricted stock option described in section 424(b), shall make, for each calendar year in which such a transfer occurs, an information return on Form 3921 with respect to each transfer made during such year. The return shall include the following information:

* * * * *

(b) *Requirement of return under section 6039(a)(2).* (1) Every corporation which records, or has by its agent recorded, before January 1, 1980, a transfer of the title to stock acquired by the transferor pursuant to his exercise on or after January 1, 1964, of—

* * * * *

Par. 8. Section 1.6039-2 is amended by revising paragraph (a), redesignating paragraphs (b) and (c) as paragraphs (c) and (e), respectively, and adding new paragraphs (b) and (d) to read as follows:

§1.6039-2 Statements to persons with respect to whom information is furnished.

(a) *Requirement of statement under section 6039(a)(1).* Every corporation which transfers stock to any person after December 31, 1979, pursuant to such person's exercise of a qualified stock option described in section 422(b), and incentive stock option described in section 422A(b), or a restricted stock option described in section 424(b), shall furnish to such transferee, for each calendar year in which such a transfer occurs, a written statement with respect to the transfer or transfers made during such year. This statement shall include the following information:

(1) The name, address, and employer identification number of the corporation transferring the stock;

(2) The name, address, and identifying number of the person to whom the share or shares of stock were transferred;

(3) The name and address of the corporation the stock of which is the subject of the option (if other than the corporation transferring the stock);

(4) The date the option was granted;

(5) The date the shares were transferred to the person exercising the option;

(6) The fair market value of the stock at the time the option was exercised;

(7) The number of shares of stock transferred pursuant to the option;

(8) The type of option under which the transferred shares were acquired; and

(9) The total cost of all the shares.

(b) *Requirement of statement under section 6039(a)(2).* (1) Every corporation which records, or has by its agent recorded, a transfer after December 31, 1979, of the title to stock acquired by the transferor pursuant to the transferor's exercise on or after January 1, 1964, of—

(i) An option granted under an employee stock purchase plan which meets the requirements of section 423(b), and with respect to which the special rule of section 423(c) applied, or

(ii) A restricted stock option which meets the requirements of section 424(b) and with respect to which the special rule of section 424(c)(1) applies,

shall furnish to such transferor, for each calendar year in which such a recorded transfer of title to such stock occurs, a written statement with respect to the transfer or transfers containing the information required by paragraph (b)(2) of this section.

(2) The statement required by paragraph (b)(1) of this section shall contain the following information:

(i) The name and address of the corporation whose stock is being transferred;

(ii) The name, address and identifying number of the transferor;

(iii) The date such stock was transferred to the transferor;

(iv) The number of shares to which title is being transferred; and

(v) The type of option under which the transferred shares were acquired.

(3) If the statement required by this paragraph is made by the authorized "transfer agent" of the corporation, it shall be deemed to have been made by the corporation. The term "transfer agent," as used in this paragraph means any designee authorized to keep the stock ownership records of a corporation and to record a transfer of title of the stock of such corporation on behalf of such corporation.

(4) A statement is required by reason of a transfer described in section 6039(a)(2) of a share only with respect to the first transfer of such share by the person who exercised the option. Thus, for example, if the owner has record title to a share or shares of stock transferred to a recognized broker or financial institution and the stock is subsequently sold by such broker or institution (on behalf of the owner) the corporation is only required to furnish a written statement to the owner relating to the transfer of record title to the broker or financial institution. Similarly, a written statement is required when a share of stock is transferred by the optionee to himself and another person (or persons) as joint tenants, tenants by the entireties or tenants in common. However, when stock is originally issued to the optionee and another person (or persons) as joint tenants, or as tenants by the entirety, the written statement required by this paragraph shall be furnished (at such time and in such manner as is provided by this section) with respect to the first transfer of the title to such stock by the optionee.

(c) *Time for furnishing statements*—(1) *In general.* Each statement required by this section to be furnished to any person for a calendar year shall be furnished to such person on or before January 31, of the year following the year for which the statement is required.

(2) *Extension of time.* For good cause shown upon written application of the corporation required to furnish statements under this section, the district director may grant an extension of time not exceeding 30 days in which to furnish such statements. The application shall be addressed to the district director with whom the income tax returns of the applicant-corporation are filed and shall contain a full recital of the reasons for requesting the extension to aid the district director in determining the period of the extension, if any, which will be granted. Such a request in the form of a letter to the district director signed by the applicant (or its agent) will suffice as an application. The application shall be filed on or before the date prescribed in subparagraph (1) of this paragraph for furnishing the statements required by this section.

(3) *Last day for furnishing statement.* For provisions relating to the time for performance of an act when the last day prescribed for performance falls on Saturday, Sunday, or a legal holiday, see §301.7503-1 of this chapter (Regulations on Procedures and Administration).

(d) *Statements furnished by mail.* For purposes of this section, a statement shall be considered to be furnished to a person if it is mailed to such person's last known address.

(e) *Penalty.* For provisions relating to the penalty provided for failure to furnish a statement under this section, see §301.6678-1 of this chapter (Regulations on Procedures and Administration).

JAMES I. OWENS,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 3, 1984, 9:47 a.m., and published in the issue of the Federal Register for February 7, 1984, 49 F.R. 4504)

Notice of Proposed Rulemaking

Possessions tax credit: definition of product, significant business presence test, and cost sharing and profit split elections.

LR-194-82

SUMMARY: These proposed regulations are being issued to conform to changes made by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462] involving possessions corporations. The regulations provide rules for determining whether a possessions corporation has a significant business presence in a possession with respect to a product. These regulations also provide rules which implement the cost sharing and profit split elections with respect to the possessions tax credit.

DATES: Written comments must be delivered or mailed by March 12, 1984. The regulations generally would be effective for taxable years of possessions corporations beginning on or after January 1, 1983.

ADDRESS: Send comments to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-194-82), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Jacob Feldman of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-194-82), 202-566-3289, concerning intangible property income in the absence of an election under section 936(h)(5), the cost sharing and profit split elections, and covered intangibles (§§1.936-4, 1.936-6, and 1.936-7); or Carol T. Doran of the same office concerning the definition of product, the significant business presence test, and contract manufacturing (§1.936-5).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 936(h) of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to changes made to the Internal Revenue Code by section 213 of the Tax Equity and Fiscal Responsibility Act of 1982 (the Act) (Pub. L. 97-248, 96 Stat. 452) [1982-2 C.B. 462, 486] and are to be issued under the authority contained in section 936(h) (96 Stat. 452) and section 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805). These regulations apply to taxable years beginning on or after January 1, 1983. Therefore, in particular, the rules concerning the definition of a product, the significant business presence test, and the attribution of income to a possessions corporation have no application for taxable years beginning before January 1, 1983.

EXPLANATION OF PROVISIONS

Section 936(h) of the Code provides that the intangible property income of a possessions corporation generally is treated as income of the corporation's U.S. shareholders, with proration of income on the basis of shareholdings. If a shareholder is a foreign person or is not subject to U.S. tax on such income, the possessions corporation is taxable on that shareholder's pro rata amount of the intangible property income. Income attributable to intangible assets is defined in section 936(h)(3).

However, the taxpayer may elect out of the general rule and treat certain income attributable to intangible property as income of the possessions corporation eligible for the possessions tax credit if the possessions corporation has a significant business presence in a possession with respect to a product or type of service. The election out may be made under one of two options: the cost sharing option or the profit split option.

Section 936 provides that a possessions corporation has a significant business presence in a possession if it satisfies either the value added test or the direct labor test. The value added

test is satisfied if total production costs incurred in a possession with respect to a product in a taxable year are not less than 25 percent of the difference between gross receipts from sales of the product by members of the affiliated group to third parties, and the direct material costs of the affiliated group for materials purchased for that product from third parties. The direct labor test is satisfied if no less than 65 percent of the direct labor costs of the affiliated group for units of the product produced or services rendered during the taxable year in whole or in part by the possessions corporation is incurred by the possessions corporation and is compensation for services performed in the possession.

The proposed regulations would provide an additional significant business presence test. A possessions corporation would satisfy this test if 50 percent of the direct labor costs of the affiliated group for units of the product produced, in whole or in part, during the taxable year by the possessions corporation is incurred by the possessions corporation as compensation for services performed in the possession; and if the sum of the direct labor costs incurred in the possession plus the base period construction costs incurred in the possession is no less than 70 percent of the sum of base period construction costs incurred in the possession and the direct labor costs of the affiliated group.

The proposed regulations would define the term "product." A product is any item of property which is the result of a manufacturing process. The term includes a component product, an integrated product, or an end-product form. A component product is a product which is subject to further transformation before sale to unrelated parties. An integrated product is a product which is not subject to further transformation before sale to unrelated parties and which includes all component products from which it is manufactured. An end-product form is a product which is not subject to further transformation before sale to unrelated parties, which includes component products, but which is treated as not including certain of its component products for all purposes of section 936(h)(5).

The term "product" will have the same meaning for all purposes of section 936(h). Once the specific product is identified and the significant business presence test is satisfied with respect thereto, then it is that item with respect to which the possessions corporation will compute its return, if it uses the cost sharing option, or combined taxable income, if it uses the profit split option. Products whose manufacturing processes are similar may be grouped, provided that any grouping which materially distorts a taxpayer's income or the application of the significant business presence test may be disallowed.

Under the cost sharing option, the possessions corporation is required to make a cost sharing payment with respect to manufacturing intangibles equal to a fraction of the current year's worldwide direct and indirect product area research expenditures of the affiliated group. The fraction is equal to the ratio of third party sales of units of the product produced or services rendered in whole or in part in the possession, to third party sales of all products produced or services rendered in the product area by the possessions corporation and all its U.S. and foreign affiliates. The cost sharing payment determined under the formula will reduce the amount of deductions otherwise allowable to the U.S. affiliates. The possessions corporation will be treated as the owner of manufacturing intangibles related to the units of the product produced or services rendered, in whole or in part, in the possession by the possession corporation. Section 482 will be used for purposes of intercompany pricing.

If the profit split option is elected, 50 percent of the combined taxable income of the possessions corporation and its U.S. affiliates derived from units of the product produced or services rendered in whole or in part in the possession and sold to foreign affiliates or unrelated third parties will be allocated to the possessions corporation, and the remainder will be allocated to the U.S. affiliates. This method avoids section 482 uncertainties and permits the possessions corporation to obtain a return on both manufacturing and marketing intangibles.

Section 936(h) provides that an election to use the cost sharing or profit split method must cover all products within a broad product area, except that a different election may be made for export sales than domestic sales. Under this provision, a taxpayer may thus elect the cost sharing option for export sales even if it elects the profit split option for domestic sales. Export sales are defined as sales of a product or type of service for ultimate use or consumption outside the United States.

The proposed regulations are being issued in the form of questions and answers.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted [preferably seven copies] to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held on *** [April 3, 1984]. Notwithstanding these proposed regulations, we invite additional submissions for our consideration with respect to possible inclusion in subsequent regulations; see 48 FR 34569 [Notice 83-14, 1983-2 C.B. 413].

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6), and a Regulatory Flexibility Analysis is not required. The Commissioner of Internal Revenue has determined that this proposed rule is not a major regulation as defined in Executive Order 12291, and therefore a regulatory impact analysis is not required.

DRAFTING INFORMATION

The principal authors of these proposed regulations are Jacob Feldman and Carol T. Doran of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue and Treasury Department participated in developing the regulation, both on matters of substance and style.

* * * * *

Proposed amendments to the regulations.

26 CFR Part 1 is proposed to be amended by addition of the following new sections immediately after §1.936-1.

INCOME TAX REGULATIONS

§1.936-4 Intangible property income in the absence of an election out.

The rules in this section apply for purposes of section 936(h) and also for purposes of section 934(e), where applicable.

QUESTION 1: If a possessions corporation and its affiliates do not make an election under either the cost sharing or 50/50 profit split option, what rules will govern the treatment of income attributable to intangible property owned or leased by the possessions corporation?

ANSWER 1: Intangible property income will be allocated to the possessions corporation's U.S. shareholders with the proration of income based on shareholdings. If a shareholder of the possessions corporation is a foreign person or a tax-exempt person, the possessions corporation will be taxable on that shareholder's pro rata amount of the intangible property income. For these purposes, a United States shareholder includes any shareholder who is a United States person as described under section 7701 (a)(30). The term "intangible property income" means the gross income of a possessions corporation attributable to any intangible property other than intangible property which has been licensed to such corporation since prior to 1948 and which was in use by such corporation on September 3, 1982.

QUESTION 2: What is the source of the intangible property income described in question 1?

ANSWER 2: The intangible property income is U.S. source, whether taxed to U.S. shareholders or taxed to the possessions corporation. Such intangible property income, if treated as income of the possessions corporation, does not enter into the calculation of the 80-percent possession source test or the 65-percent active trade or business test of section 936(a)(2)(A) and (B).

QUESTION 3: How will the amount of income attributable to intangible property be measured?

ANSWER 3: Income attributable to intangible property includes the amount received by a possessions corporation from the sale, exchange, or other disposition of any product or from the rendering of a service which is in excess of the reasonable costs it incurs in manufacturing the product or rendering the service (other than costs incurred in connection with intangibles) plus a reasonable profit margin. A reasonable profit margin shall be computed with respect to direct and indirect costs other than (i) costs incurred in connection with intangibles, (ii) interest expense, and (iii) the cost of materials which are subject to processing or which are components in a product manufactured by the possessions corporation. Notwithstanding the above, certain taxpayers who have been permitted by the Internal Revenue Service in taxable years beginning before January 1, 1983, to use the cost-plus method of pricing without reflecting a return from intangibles, but including the cost of materials in the cost base, will not be precluded from doing so. (Sec. 3.02(3), Rev. Proc. 63-10, 1963-1 C.B. 490.) Thus, the Internal Revenue Service may continue in appropriate cases to permit such taxpayers to continue to report their income as they have been under existing procedures described in the previous sentence if it is appropriate under all the facts and circumstances and does not distort the income of the taxpayer.

QUESTION 4: If there is no intangible property related to a product produced in whole or in part by a possessions corporation, what method may the possessions corporation use to compute its income?

ANSWER 4: The taxpayer may use the method described in this section or may elect the cost sharing or profit split method. No other method will be permitted.

§1.936-5 Intangible property income when an election out is made: Product, business presence, and contract manufacturing.

The rules in this section apply for purposes of section 936(h) and also for purposes of section 934(e), where applicable.

(a) *Definition of product.*

QUESTION 1: What does the term "product" mean?

ANSWER 1: The term "product" means an item of property which is the result of a manufacturing process. The term "product" includes component products, integrated products, and end-product forms. A component product is a product which is subject to further transformation before sale to an unrelated party. A component product may be manufactured from other items of property, and if it is so manufactured, may be treated as including or not including

(at the choice of the possessions corporation) such other items of property for all purposes of section 936(h)(5). An integrated product is a product which is not subject to any further transformation before sale to an unrelated party and which includes all component products from which it is manufactured. An end-product form is a product which—

(1) Is not subject to any further transformation before sale to an unrelated party;

(2) Is manufactured from a component product or products; and

(3) Is treated as not including certain component products for all purposes of section 936(h)(5).

QUESTION 2: If a possessions corporation manufactures both a component product and an integrated product (which by definition includes the end-product form), may the possessions corporation use the options under section 936(h)(5) to compute its income with respect to either the component product, the integrated product or the end-product form?

ANSWER 2: Yes. The possessions corporation may choose to treat the component product, the integrated product, or the end-product form as the product for purposes of determining whether the possessions corporation satisfies the significant business presence test. The possessions corporation must specify its choice on a statement attached to its return (Schedule P of Form 5735). Once a possessions corporation has determined which item of property it will treat as its product (the possession product) for purposes of the significant business presence test, then the possessions corporation must treat that item of property as its product for all purposes of section 936(h)(5) for that taxable year, including the possessions sales calculation under section 936(h)(5)(C)(i)(I), the determination of income under section 936(h)(5)(C)(i)(II), and the combined taxable income computations under section 936(h)(5)(C)(ii). Although the possessions corporation must treat the same item of property as its product for all purposes of section 936(h)(5) in a particular taxable year, its choice of the component product, integrated product or end-product form may be different from year to year.

Example (1). A possessions corporation, S, manufactures a bulk pharmaceutical in a possession. S transfers the bulk pharmaceutical to its U.S. parent, P, for encapsulation and sale by P to customers. S satisfies the significant business presence test with respect to the bulk pharmaceutical (the component product), and the combination of the bulk pharmaceutical and the capsule (the integrated product). S may use the cost sharing or profit split method to compute its income with respect to either the component product or the integrated product.

Example (2). The facts are the same as in example (1) except that S does not satisfy the significant business presence test with respect to the integrated product. S may use the cost sharing or profit split method to compute its income only with respect to the component product. However, if in a later taxable year S satisfies the significant business presence test with respect to the integrated product, then S may use the cost sharing or profit split method to compute its income with respect to that integrated product for that later taxable year.

Example (3). P, a domestic corporation, produces in bulk form in the United States the active ingredient for a pharmaceutical product. P transfers the bulk form to S, a wholly owned possessions corporation. S uses the bulk form to produce in Puerto Rico the finished dosage form drug. S transfers the drug in finished dosage form to P, which sells the drug to unrelated customers in the U.S. The direct labor costs incurred in Puerto Rico by S during its taxable year in formulating, filling and finishing the dosage form are at least 65 percent of the total direct labor costs incurred by the affiliated group in producing the bulk and finished forms during that period. S manufactures (within the meaning of section 954(d)(1)(A)) the finished dosage form. S has elected out under section 936(h)(5) under the profit split option for the drug product area (SIC 283). P and S may treat the bulk and finished dosage forms as parts of an integrated product. Since S satisfies the significant business presence requirement with respect to the integrated product, it is entitled to 50 percent of the combined taxable income on the integrated product.

Example (4). A possessions corporation, S, produces the keyboard of an electric typewriter and incorporates the keyboard with components acquired from a related corporation into finished typewriters. S does not satisfy the significant business presence test with respect to the typewriters (the integrated product). Therefore, S may use the cost sharing or profit split method to compute its income only with respect to a component product or end-product form. For taxable year 1983, S specifies on a statement attached to its return (Schedule P of Form 5735) that the possession product is the end-product form. The statement identifies the components—for example, the keyboard structure and frame—which are included in the possession product. S's definition of the possession product will apply to all units of the electric typewriters which S produces in whole or in part in the possession and which are sold in 1983. Thus, all units of a given component incorporated into such typewriters will be treated in the same way. For example, all keyboards and all frames will be included in the possession product, and all electric drive mechanisms and rollers will be excluded from the possession product.

QUESTION 3: May an affiliated group establish groupings of items of property and treat the groupings as single products?

ANSWER 3: An affiliated group may establish reasonable groupings of items of property based on similarities in the manufacturing processes of such items. Any grouping which materially distorts a taxpayer's income or the application of the significant business presence test may be disallowed by the Commissioner. In addition, the Commissioner may require grouping of items of property based on similarities in the manufacturing processes when necessary to prevent a material distortion of the taxpayer's income or the application of the significant business presence test. The mere fact that a grouping, or a failure to group, results in an increased allocation of income to the possessions corporation does not, of itself, necessarily create a material distortion of income. The implementation of the above rules is illustrated by the following examples.

Example (1). The following are examples of items of property the processes of manufacture of which are sufficiently similar that they may be grouped and treated as a single product:

(A) Beverage bases or concentrates for different soft drinks or soft drink syrups, regardless of whether some include sweeteners and some do not;

(B) Different styles of clothing;

(C) Different styles of shoes;

(D) Equipment which relies on gravity to deliver solutions to patients intravenously;

(E) Equipment which relies on machines to deliver solutions to patients intravenously;

(F) Video game cartridges, even though the concept and design of each game title is, in part, protected against infringement by separate copyrights;

(G) All integrated circuits;

(H) All printed circuit boards; and

(I) Hardware and software, if software is sold only with the hardware and a purchaser of the hardware ordinarily will not purchase alternative software. In all other cases, hardware and software may not be grouped and treated as a single product.

Groupings (D) and (E) do not include any solutions which are delivered through the equipment described therein.

Example (2). A possessions corporation produces in Puerto Rico non-programmable, interactive cathode ray tube computer terminals that vary in price. These terminals all interact with a computer or controller to perform their functions of data entry, graphics word processing, and program development. The terminals can be purchased with options that include a built-in printer, different language keyboards, specialized cathode ray tubes, and different power supply features. All terminals are produced in one integrated process requiring the same skills and operations. The differ-

ıces in the production of the terminals include ifferences in the number of printed circuit oards incorporated in each terminal, the use f unique keyboards, and the installation and sting of the built-in printer. Some difference ı direct labor time to manufacture the termials occurs, primarily due to the differing numer and complexity of printed circuit boards inorporated into each terminal. Different model umbers are assigned to various computer terinals. A grouping by the taxpayer of all of the rminals as one product will be respected by ıe Service, unless the Service establishes that a ıbstantial distortion results. This grouping is roper because the processes of producing each f the terminals are similar.

Example (3). A possessions corporation, S, nd its U.S. affiliate produce several models of rial matrix impact printers and teleprinters. hese products have differing performance andards based on such factors as speed (in ıaracters per second), numbers of columns, nd cost. The manufacturing process perormed by S and its U.S. affiliate for all types f printers involves production of three basic ements: electronic circuitry, the printing ead, and the mechanical parts. The process of ıanufacturing all the printers is similar. Thus, ll printers could be grouped and treated as a single product. S purchases electronic circuitry and mechanical parts from its U.S. affiliate. S performs manufacturing functions relative to the printing head and assembles and tests the finished printers. S does not satisfy the significant business presence test with respect to the integrated products. S therefore specifies on a statement attached to its return (Schedule P of Form 5735) that the possession product for both the serial matrix printers and the teleprinters is the end-product form. The statement identifies the components which are included in each possession product. S may group and treat as a single product the serial matrix printers and the teleprinters if both end-product forms include and exclude the same components. Thus, if the end-product form for both the serial matrix printers and the teleprinters includes the mechanical parts and excludes the electronic circuitry, then S may group and treat as a single product the two end-product forms. If, however, the end-product forms for the two items of property contain different components and as a result of this definition of the end-product forms the manufacturing processes involved in producing the two end-product forms are not similar, then S may not group the end-product forms.

QUESTION 4: What factors should be disregarded in determining whether a particular grouping of similar items of property is reasonable?

ANSWER 4: In general, differences in the following factors will be disregarded in determining whether a particular grouping of items of property is reasonable:

(1) Differences in testing requirements (*e.g.*, some products sold for military use may require more extensive or different testing than products sold for commercial use);

(2) Differences in the product specifications that are designed to accommodate the product to its area of use or for conditions under which used (*e.g.*, electrical products designed for ultimate use in the United States differ from electrical products designed for ultimate use in Europe);

(3) Differences in packaging or labeling (*e.g.*, differences in the number of units of the items shipped in one package); and

(4) Minor differences in the operations of the items of property.

QUESTION 5: Is an affiliated group permitted to group and treat as a single product drugs or medicinal preparations based on the active ingredient contained in the drug or based on both the active ingredient contained in the drug and the delivery form of the drug?

ANSWER 5: An affiliated group is permitted to group and treat as a single product drugs and medicinal preparations which contain the same active ingredient or ingredients. Alternatively, the affiliated group is permitted to group and treat as a single product drugs and medicinal preparations containing the same active ingredient or ingredients which are delivered in the same form if the manufacturing processes are similar. For purposes of the preceding sentence, each of the following groups of items shall be considered to be delivered in the same form:

(1) Capsules, tablets, and pills;

(2) Liquids, ointments, and creams; and

(3) Preparations for delivery through injection or intravenous equipment.

No distinctions should be based on packaging, list numbers, or size of dosage.

QUESTION 6: Will the fact that a manufacturer of a drug must submit a New Drug Application ("NDA") or a supplemental NDA to the Food and Drug Administration have any effect on the definition or grouping of a product?

ANSWER 6: No.

Example (1). Company S manufactures pharmaceutical X in tablet form in Puerto Rico. The FDA has approved the tablet form of X. S subsequently plans to manufacture X in Puerto Rico in an injectable form. This will require an NDA. If S has elected to distinguish drugs on the basis of both the delivery form and the active ingredient, then the injectable form will be a separate product. If S has elected to distinguish drugs only on the basis of their containing the same active ingredient or ingredients, then the injectable form will not be a separate product. The fact that S must obtain an NDA for the injectable form is not relevant to the determination of whether the injectable constitutes a separate product.

Example (2). A possessions corporation, S, manufactures two active bulk chemicals, X and Y, and produces X in tablet and ointment form and Y in tablet and ointment form. S. subsequently plans to manufacture X and Y separately in injectable form. This will require NDAs. If S has elected to distinguish separate products on the basis of both the delivery from of the end-product and the active ingredient, then the injectable forms of X and Y will each be separate products. If S has instead elected to distinguish separate products only on the basis of their containing the same active ingredient or ingredients, then the injectable forms of X and Y will not be separate products.

QUESTION 7: A possessions corporation which produced a product or rendered a type of service in a possession on or before September 3, 1982, is not required to meet the significant business presence test in a possession with respect to such product or type of service for its taxable years beginning before January 1, 1986 (the interim period). During such interim period, how will the term "product" be defined for purposes of allocating income under the cost sharing or profit split methods?

ANSWER 7: During the interim period the product will be determined based on the activities performed by the possessions corporation within a possession on September 3, 1982. During the interim period the possessions corporation may compute its income under the cost sharing or profit split method only with respect to the product that is produced or manufactured within the meaning of section 954(d)(1)(A) within the possession. If the product is manufactured from a component or components produced by an affiliated corporation or a contract manufacturer, then the product will not be treated as including such component or components for purposes of the computation of income under the cost sharing or profit split methods. Thus, the possessions corporation is not entitled to any return on the intangibles associated with the component or components. Notwithstanding the preceding sentences, for taxable years beginning before January 1, 1986, a possessions corporation may compute its income under

the cost sharing or profit split method with respect to a product which includes a component or components produced by an affiliated corporation or contract manufacturer if the possessions corporation satisfies with respect to such product the significant business presence test described in section 936(h)(5)(B)(ii) and the regulations thereunder.

Example (1). A possessions corporation, S, was manufacturing (within the meaning of section 954(d)(1)(A)) integrated circuits in a possession on September 3, 1982. S transferred those integrated circuits to related corporation P. P incorporated the integrated circuits into central processing units (CPUs) in the United States and sold the CPUs to unrelated parties. S continued to manufacture integrated circuits in the possession through January 1, 1986. For taxable years beginning before January 1, 1986, S may compute its income under the cost sharing or profit split method with respect to the integrated circuits regardless of whether S satisfies the significant business presence test. However, unless S satisfies the significant business presence test with respect to the central processing units, S may not compute its income under the cost sharing or profit split methods with respect to the CPUs, and thus, S is not entitled to any return on manufacturing intangibles associated with CPUs to the extent that they are not related to the integrated circuits produced by S, nor (except as provided in the profit split method) to any return on marketing intangibles.

Example (2). A possessions corporation, S, was engaged on September 3, 1982, in the manufacture (within the meaning of section 954(d)(1)(A)) of a bulk pharmaceutical in Puerto Rico from raw materials. S sold the bulk pharmaceutical to its U.S. parent, P, for encapsulation and sale by P to customers as the product X. Because S was not engaged in the encapsulation of X, S is not considered to have manufactured the integrated product, X, in Puerto Rico. During the interim period, S may compute its income under the cost sharing or profit split methods with respect to the integrated product, X, only if S satisfies the significant business presence test with respect to X. S may compute its income under the cost sharing or profit split methods with respect to the component product (the bulk pharmaceutical).

Example (3). P is a domestic corporation that is not a possessions corporation. P manufactures a bulk pharmaceutical in the United States. P transfers the bulk pharmaceutical to its wholly owned subsidiary, S, a possessions corporation. On September 3, 1982, S was engaged in the encapsulation of the bulk pharmaceutical in Puerto Rico in a manner which satisfies the test of section 954(d)(1)(A). For taxable years beginning before January 1, 1986, S may compute its income under the cost sharing or profit split methods with respect to the end-product form (the encapsulated drug) regardless of whether S meets the significant business presence test. However, unless S satisfies the significant business presence test with respect to the integrated product, S may not compute its income under the cost sharing or profit split methods with respect to the integrated product, and thus, S is not entitled to any return on the intangibles associated with the bulk pharmaceutical.

QUESTION 8: On September 3, 1982, a possessions corporation, S, was engaged in the manufacture (within the meaning of section 954(d)(1)(A)) of X in a possession. During the interim period, after September 3, 1982, but before January 1, 1986, S produced Y, which differs from X in terms of minor design features. S did not produce Y in a possession on September 3, 1982. Will S be considered to have commenced production of a new product after September 3, 1982, for purposes of the application of the significant business presence test for the interim period?

ANSWER 8: No. X and Y will be considered to be a single product, and therefore S will not be required to satisfy the business presence test with respect to Y during the interim period. In all cases in which the items of property produced on or before September 3, 1982 and the items of property produced after that date could have been grouped together under the guidelines provided in §1.936-5(a) questions and answers 3 through 5, the possessions corporation will not be considered to manufacture a new product after September 3, 1982.

QUESTION 9: May the term "product" be defined differently for export sales than for domestic sales?

ANSWER 9: No.

(b) *Requirement of significant business presence.*

QUESTION 1: In general, a possessions corporation may compute its income under the cost sharing or profit split methods with respect to a product or type of service only if the possessions corporation has a significant business presence in a possession with respect to such product or service. For purposes of the cost sharing method, the significant business presence test is met if the possessions corporation satisfies either a value added test or a direct labor test. For purposes of the profit split method, the possessions corporation must satisfy either a value added test or a direct labor test, and must manufacture the product in a possession within the meaning of section 954(d)(1)(A). To determine whether a possessions corporation satisfies the value added or direct labor test, the corporation must compute its total production costs, direct material costs, and direct labor costs with respect to the product. How are these terms defined?

ANSWER 1: The terms "total production costs," "direct material costs," and "direct labor costs" are defined in §1.471-11, inventories of manufacturers. Total production costs include direct production costs and fixed and variable indirect production costs. Direct material costs include the cost of those materials which become an integral part of the specific product and those materials which are consumed in the ordinary course of manufacturing and can be identified or associated with particular units or groups of units of that product. See §1.471-3 for the elements of direct material costs. Direct labor costs, as defined in §1.471-11(b)(2)(i), include the cost of labor which can be identified or associated with particular units or groups of units of a specific product. The elements of direct labor costs include such items as basic compensation, overtime pay, vacation and holiday pay, sick leave pay (other than payments pursuant to a wage continuation plan under section 105(d)), shift differential, payroll taxes, and payments to a supplemental unemployment benefit plan paid or incurred on behalf of employees engaged in direct labor. The possessions corporation must file a separate Schedule P for each product to which the cost sharing or profit split method is applied. The taxpayer must attach to such schedule detailed computations indicating how the significant business presence test is satisfied with respect to the possession product.

QUESTION 2: For purposes of determining whether a possessions corporation satisfies the significant business presence test, how shall the possessions corporation treat the cost of components transferred to the possessions corporation by a member of the affiliated group?

ANSWER 2: The treatment of the cost of components transferred from an affiliate depends on whether the possession product is treated as including the component for purposes

of section 936(h). If it is, then for purposes of the value added test, the production costs associated with the component shall be treated as production costs of the affiliated group that are not incurred by the possessions corporation. Production costs shall not be treated as a cost of materials. For purposes of the direct labor test, the direct labor costs associated with such component shall be treated as direct labor costs of the affiliated group that are not incurred by the possessions corporation. If the possession product is treated as not including such component for purposes of section 936(h), then for purposes of the value added test, the cost of the component shall be treated as a cost of materials. For purposes of the direct labor test, the direct labor costs associated with such component shall not be treated as direct labor costs of the affiliated group. If the possession product is treated as not including such component, then the possessions corporation shall not be entitled to any return on the intangibles associated with the manufacturing or marketing of the component.

QUESTION 3: May the members of the affiliated group include as direct labor costs the labor element in indirect production costs?

ANSWER 3: No. The labor element of indirect production costs may not be considered as part of direct labor costs. In determining whether a possessions corporation satisfies the value added test, however, all production costs, direct and indirect, incurred in a possession shall be taken into account.

QUESTION 4: When is the quality control and inspection of a product considered to be part of the manufacturing activity for that product?

ANSWER 4: Quality control and inspection of a manufactured product before its sale or other disposition by the manufacturer, or before its incorporation into other products, are considered to be part of the indirect manufacturing activity for that initial product. Subsequent testing of a product to ensure that the product is compatible with other products is not a part of the manufacturing activity for the initial product. When a component is incorporated into an end-product form and the end-product form is then tested, the latter testing will be considered to be a part of the indirect manufacturing activity for the end-product form and will not be considered to be a part of the manufacturing activity for the component.

QUESTION 5: For purposes of the significant business presence test, do direct labor costs of the possessions corporation include only the costs which were actually incurred or do they take into account, in addition, any labor savings which result because the activities were performed in a possession rather than in the United States?

ANSWER 5: Direct labor costs include only the costs which were actually incurred.

QUESTION 6: For purposes of the significant business presence test and the allocation of income to a possessions corporation, what is the treatment of the cost of installation of a product that is manufactured by a possessions corporation, sold or otherwise transferred to an affiliated corporation, and installed by the affiliated corporation for the customer?

ANSWER 6: For the purposes of the significant business presence test and the allocation of income to a possessions corporation, product installation costs that are incurred after the product is transferred to an affiliated corporation need not be taken into account as costs incurred in the manufacture of that product, provided that the taxpayer keeps such permanent books of account or records as are suffcient to establish the fair market price of the uninstalled product. In such a case, the cost of installation materials, the cost of the labor for installation, and a reasonable profit for installation will not be included in the costs and income associated with the product.

QUESTION 7: What is the test for determining, within the meaning of section 954(d)(1)(A), whether a product is manufactured or produced by a possessions corporation in a possession?

ANSWER 7: A product is considered to have been manufactured or produced by a possessions corporation in a possession within the meaning of section 954(d)(1)(A) and §1.954-3(a)(4) if—

(1) The property has been substantially transformed by the possessions corporation in the possession;

(2) The operations conducted by the possessions corporation in the possession in connection with the property are substantial in nature and are generally considered to constitute the manufacture or production of property; or

(3) The conversion costs sustained by the possessions corporation in the possession, including direct labor, factory burden, testing of components before incorporation into an end product or testing of the manufactured product before sales account for 20 percent or more of the total cost of goods sold by the possessions corporation.

In no event, however, will packaging, repackaging, labeling, or minor assembly operations constitute manufacture or production of property. See particularly examples (2) and (3) of §1.954-3(a)(4)(iii).

QUESTION 8: Does the requirement that a possession product be produced or manufactured in a possession within the meaning of section 954(d)(1)(A) apply to taxable years beginning before January 1, 1986?

ANSWER 8: A possessions corporation must satisfy this requirement if the possessions corporation makes a separate election under section 936(h)(6)(F)(iv)(II) with respect to export sales. In addition, for taxable yers beginning before January 1, 1986, the possession product is defined with reference to the product produced within the meaning of section 954(d)(1)(A), unless the possessions corporation satisfied the significant business presence test (see §1.936-5(a) question and answer (7). In the latter case, if the possessions corporation computes its income under the profit split method with respect to a product, the section 954(d)(1)(A) requirement must be satisfied.

QUESTION 9: With respect to products not produced (and types of services not rendered) in the possession on or before September 3, 1982, when must a possessions corporation first

satisfy the 25 percent value added test or the 65 percent direct labor test?

ANSWER 9: A transitional period is established such that a possessions corporation engaged in start-up operations with respect to a product or service need not satisfy the 25 percent value added test or the 65 percent labor test until the third taxable year following the taxable year in which such product or service is first sold by the possessions corporation. During the transitional period, the applicable percentages for these tests will be as follows:

Year	*1*	*2*	*3*
Value Added Test	10	15	20
Labor Test	35	45	55

A possessions corporation is engaged in start-up operations if it begins operations in a possession with respect to a product or type of service after September 3, 1982. A possessions corporation will be considered to begin operations with respect to a product only if, under the rules of §1.936-5 (a) questions and answers 3 through 6, such product could not be grouped with any other item of property manufactured in whole or in part in the possessions by any member of the affiliated group in any preceding taxable year. If any member of an affiliated group actually groups two or more items of property then, solely for the purposes of determining whether any item of property in that group is a new product, that grouping shall be respected. However, the fact that an affiliated group does not actually group two or more items of property shall be disregarded in determining whether any item of property is a new product. Any improvement or other change in a possession product which does not substantially change the production process would not be deemed to create a new product. A change in the division of manufacturing activity between the possessions corporation and its affiliates with respect to an item of property will not give rise to a new product. Notwithstanding the above, if a possessions corporation is producing a possession product in one possession and such corporation or a member of its affiliated group begins operations in a different possession, regardless of whether the items of property could be grouped, the affiliated group may treat the units of the item of property produced at the new site of operations as a new product.

QUESTION 10: Will the Secretary adopt a significant business presence test other than those set forth in section 936(h)(5)(ii)?

ANSWER 10: Yes. The following significant business presence test is adopted both for the transitional period and thereafter. A possessions corporation will have a significant business presence in a possession for a taxable year with respect to a product or type of service if—

(1) No less than 50 percent of the direct labor costs of the affiliated group for units of the product produced, in whole or in part, during the taxable year by the possessions corporation or for the type of service rendered by the possessions corporation during the taxable year, is incurred by the possessions corporation as compensation for services performed in the possession; and

(2) The direct labor costs of the possessions corporation for units of the product produced or the type of service rendered plus the base period construction costs are no less than 70 percent of the sum of such base period construction costs and the direct labor costs of the affiliated group for such units of the product produced or the type of service rendered.

Notwithstanding satisfaction of the above test, for purposes of determining whether a possessions corporation may compute its income under the profit split method, a possessions corporation will not be treated as having a significant business presence in a possession with respect to a product unless the possessions corporation manufactures the product in the possession within the meaning of section 954(d)(1)(A).

QUESTION 11: For purposes of the preceding question and answer, how is the term "base period construction costs" defined?

ANSWER 11: The term "base period construction costs" means the average construction costs incurred by or on behalf of the possessions corporation for services in the possession during the taxable year and the preceding four taxable years for section 1250 property (as defined in section 1250(c) and the regulations thereunder) that is used for the production of the product or the rendering of the service in the possession, and which represents the original use of the section 1250 property. For purposes of the preceding sentence, if the possessions corporation was not in existence during one or more of the four preceding taxable years, its construction costs for that year or years shall be deemed to be zero. Construction costs include architects' and engineers' fees, labor costs, and overhead and profit (if the construction is performed by a person that is not a member of the affiliated group).

QUESTION 12: Must the significant business presence test be met with respect to all units of the product produced during the taxable year by the affiliated group?

ANSWER 12: No. The significant business presence test must be met with respect to only those units of the product produced during the taxable year in whole or in part by the possessions corporation in a possession.

(c) *Definition and treatment of contract manufacturing.*

QUESTION 1: For purposes of determining whether a possessions corporation satisfies the significant business presence test with respect to a product, the costs incurred by the possessions corporation or by any of its affiliates in connection with contract manufacturing which is related to that product and is performed outside the possession shall be treated as direct labor costs of the affiliated group and shall not be treated as production costs of the possessions corporation or as material costs. How is the term "contract manufacturing" to be defined?

ANSWER 1: The term "contract manufacturing" includes any arrangement between a possessions corporation (or another member of the affiliated group) and an unrelated person if the unrelated person:

(1) Performs work on inventory owned by a member of the affiliated

group for a fee without the passage of title;

(2) Performs manufacturing activities under the direct supervision and control of a member of the affiliated group;

(3) Does not undertake any significant risks in manufacturing its product (e.g., it is paid by the hour); or

(4) Uses intangibles which are related to its product, and such intangibles are owned or licensed by a member of the affiliated group.

QUESTION 2: For purposes of the significant business presence test, how shall a possessions corporation treat the cost of contract manufacturing performed within a possession?

ANSWER 2: If the possessions corporation uses the value added test, it will be permitted to treat the cost of the contract manufacturing performed in a possession, not including material costs, as a production cost of the possessions corporation. If it uses the direct labor test, it is permitted to treat the direct labor costs of the contract manufacturer associated with such contract manufacturing as a cost of direct labor of the possessions corporation (see question and answer 3, below).

QUESTION 3: How are the amounts paid by a possessions corporation to a contract manufacturer for services rendered in a possession to be treated by the possessions corporation in computing the direct labor cost of the product to which such contract manufacturing relates?

ANSWER 3: If the possessions corporation can establish the contract manufacturer's direct labor cost which was incurred in the possession, such cost will be treated as incurred by the possessions corporation as compensation for services performed in the possession. If the possessions corporation cannot establish such cost, then 50 percent of the amount paid to such contract manufacturer may be treated as incurred by the possessions corporation as compensation for services performed in the possession; provided, that not more than 50 percent of the fair market value of the product manufactured by the contract manufacturer is attributable to articles shipped into the possession, and the possessions corporation receives a statement from the contract manufacturer that this test has been satisfied. If this fair market test is not satisfied, then the cost of contract manufacturing performed within a possession shall not be treated as a production cost or as a direct labor cost of either the possessions corporation or the affiliated group.

QUESTION 4: A possessions corporation, S, purchases raw materials and components from an unrelated corporation which conducts business outside of a possession. The unrelated corporation is not a contract manufacturer. What is the treatment of such raw materials and components for purposes of the significant business presence test?

ANSWER 4: Where Company S purchases raw materials or components from an unrelated corporation which is not a contract manufacturer, the raw materials and components are treated as materials, and the costs (including direct labor costs) related thereto are treated as a cost of materials.

QUESTION 5: For purposes of the significant business presence test, what is the treatment of costs which are incurred by a member of the affiliated group for contract manufacturing performed outside of the possession with respect to an item of property which is a component of the possession product?

ANSWER 5: If the possession product is treated as including such component, then the cost of the contract manufacturing shall be treated as a direct labor cost of the affiliated group and shall not be treated as a direct labor cost incurred by the possessions corporation (see §1.936-5(b) question and answer (2)). If the possession product is treated as not including such component, then the cost of the contract manufacturing shall be treated as a cost of materials of the affiliated group (see §1.936-5(b) question and answer (2)).

§1.936-6 Intangible property income when an election out is made: cost sharing and profit split options; covered intangibles.

The rules in this section apply for purposes of section 936(h) and also for purposes of section 934(e), where applicable.

(a) *Cost sharing option.*—(1) *Product area research.*

QUESTION 1: Cost sharing payments are based on research undertaken by the affiliated group in the "product area" which includes the possession product. The term "product area" is defined by reference to the three-digit classification under the Standard Industrial Classification (SIC) code. Which governmental agency has jurisdiction to decide the proper SIC category for any specific product?

ANSWER 1: Solely for the purpose of determining the tax consequences of operating in a possession, the Secretary or his delegate has exclusive jurisdiction to decide the proper SIC category under which a product is classified. For this purpose, the product area under which a product is classified will be determined according to the 1972 edition of the SIC code. From time to time and in appropriate cases, the Secretary may prescribe regulations or issue rulings determining the proper SIC category under which a particular product is to be classified, and may prescribe regulations for aggregating two or more three-digit classifications of the SIC code and for classifying product areas according to a system other than under the SIC code.

QUESTION 2: How is the term "affiliated group" defined for purposes of the cost sharing option?

ANSWER 2: For purposes of the cost sharing option, the term "affiliated group" means the possessions corporation and all other organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, within the meaning of section 482.

QUESTION 3: Are research and development expenditures that are included in product area research limited to research and development expenditures that are deductible under section 174 or that are incurred by U.S. affiliates?

ANSWER 3: No, product area research is not limited to product area research expenditures deductible under section 174 or to expenses incurred by U.S. affiliates. Product area research also includes deductions permitted under section 168 with respect to research property which are not deductible under section 174; qualified research expenses within the meaning of section 44(F)(b); payments (such as royalties) for the use of, or right to use, a patent, invention, formula, process, design, pattern or know-how; and a proper allowance for amounts incurred in the acquisition of intangible property. In the case of an acquisition of depreciable or amortizable intangible property, the annual amount of product area research shall be equal to the allowable depreciation on the intangible property for the taxable year. In the case of an acquisition of nondepreciable or nonamortizable intangible property, the amount expended for the acquisition shall be included in product area research in the year of the acquisition.

QUESTION 4: Does royalty income from a person outside the affiliated group with respect to manufacturing intangibles within a product area reduce the product area research pool within the same product area?

ANSWER 4: Yes.

QUESTION 5: What is the treatment of product area research expenses attributable to a component where the component and the integrated product fall within different product areas?

ANSWER 5: For purposes of the computation of product area research and total sales in the product area by the affiliated group, the product area in which the component falls is aggregated with the product area in which the integrated product falls.

(2) *Possession sales and total sales.*

QUESTION 1: The cost sharing payment is the same proportion of the total cost of product area research which the amount of "possession sales" of the affiliated group bears to the "total sales" of the affiliated group within the product area. How are "possession sales" defined for purposes of the cost sharing fraction?

ANSWER 1: The term "possession sales" means the aggregate sales or other dispositions of the possession product, less returns and allowances and less indirect taxes imposed on the production of the product, for the taxable year to persons who are not members of the affiliated group. The sales price to be used is the sales price received by the affiliated group from persons who are not members of the affiliated group.

QUESTION 2: For purposes of the numerator of the cost sharing fraction, how are possession sales computed where the possession product is a component product or an end-product form?

ANSWER 2: The sales price of the component product or end-product form is determined as follows. An independent sales price from comparable uncontrolled transactions must be used if such price can be determined in accordance with §1.482-2(e)(2). If an independent sales price from comparable uncontrolled transactions cannot be determined, then the sales price for the component product or end-product form will be the same proportion of the sales price for the integrated product which the production costs attributable to the component product or end-product form bears to the total production costs for the integrated product. Production costs will be the sum of direct and indirect production costs as defined for inventory accounting purposes under section 1.471-11(b), (c), and (d), except that such costs will not include costs of materials.

Example. The production costs for a component produced by a possessions corporation and its affiliated corporations are $600. The total production costs of the integrated product are $900. The sales price for the integrated product is $1500. The sales price for the component product would be $1000 ($600/$900 × $1500).

QUESTION 3: For purposes of determining possessions sales in the numerator of the cost sharing fraction, will the replacement part price of the product be treated as a price from comparable uncontrolled transactions?

ANSWER 3: Prices for replacement parts are generally higher than prices for equipment sold as part of an original system. Thus, prices for replacement parts cannot generally be used directly as prices for comparable uncontrolled transactions. However, replacement part prices may be used for estimating comparable uncontrolled prices where the price differential can be reasonably determined and taken into account under §1.482-2(e)(2).

QUESTION 4: For purposes of determining possession sales in the cost sharing fraction, what is the treatment of components that are purchased by one possessions corporation from a second possessions corporation and which are incorporated into a possession product?

ANSWER 4: When one possessions corporation purchases components from a second possessions corporation, the purchase price of the components paid to the second possessions corporation is subtracted from the sales proceeds of the product produced in the possession by the first possessions corporation, and only the remainder is included in the numerator of the cost sharing formula for the first corporation. For example, assume that N corporation manufactures a component for sale to O corporation for $100 (a price which reflects prices in comparable uncontrolled transactions). Both N and O are possessions corporations. O then incorporates that product into a second product which is sold to customers for $300. N and O must make separate cost sharing payments. The cost sharing payment of N corporation is determined by including $100 as possession sales, and the payment of O is determined by subtracting that $100 purchase price from the $300 received from customers. Thus, the possessions sales amount of O is $200. This rule is intended to prevent the double counting of the sales of a component produced by one possessions corporation and incorporated into another product by an affiliated possessions corporation.

QUESTION 5: How are "possession sales" determined under the cost sharing formula if members of the affiliated group (other than the possessions corporation) include purchases of the possession product, X, in a

dollar-value LIFO inventory pool (as provided under §1.472-8)?

ANSWER 5: With respect to each affiliate, "possession sales" are determined by multiplying total sales of X by the affiliate (regardless of where the units of X were obtained) during the taxable year by a fraction. The numerator of the fraction is the dollar-value amount of units of X or components of X purchased from the possessions corporation by the affiliate during the taxable year. The dollar-value amount will be determined on the basis of the possessions corporation's cost for its inventory purposes, plus any production costs (as defined in section 1.471-11(b), (c), and (d) but not including costs of materials) incurred by the affiliate during the same period. The denominator of the fraction is the dollar-value amount of units of X purchased by the affiliate in the same period from all sources, with purchases of units of X and any value added by the affiliate in production during the same period, valued as described above.

QUESTION 6: How are "total sales" defined for purposes of the cost sharing fraction?

ANSWER 6: The term "total sales" means aggregate sales or other dispositions of products in the same product area as the possession product, less returns and allowances and less indirect taxes imposed on the production of the product, for the taxable year to persons who are not members of the affiliated group. The sales price to be used is the sales price received by the affiliated group from persons who are not members of the affiliated group.

QUESTION 7: In computing the cost sharing payment, how are "total sales" computed if the dollar-value LIFO inventory pool includes some products which are not included in the product area (determined under the 3-digit SIC code) on which the denominator of the cost sharing fraction is based?

ANSWER 7: In such case, the amount of the total sales within the product area to persons who are not members of the affiliated group by persons who are members of the affiliated group is determined by multiplying the total sales of the products within the dollar-value LIFO inventory pool by a fraction. The numerator of the fraction includes the dollar-value of purchases by members of the affiliated group (including the possessions corporation) of products within the product area made during the year, plus any added production costs (as defined in §1.471-11(b), (c), and (d) but not including the costs of materials) incurred by the affiliates during the same period. The denominator of the fraction includes the dollar-value of purchases by members of the affiliated group (including the possessions corporation) of products within the dollar-value LIFO inventory pool made during the same period (including any production costs, as described above, incurred by the affiliate during the same period). For these purposes, purchases of a possession product are determined on the basis of the possessions corporation's cost for its inventory purposes.

(3) *Credits against cost sharing payments.*

QUESTION 1: Is the cost of product area research paid or accrued by the possessions corporation in a taxable year creditable against the cost sharing payment?

ANSWER 1: Yes, if the cost of the product area research is paid or accrued solely by the possessions corporation. Thus, payments by the possessions corporation under cost sharing arrangements with, or royalties paid to, unrelated persons are so creditable. However, amounts (such as royalties) paid directly or indirectly to, or on behalf of, related persons and amounts paid under any cost sharing agreements with related persons are not creditable against the cost sharing payment.

QUESTION 2: Do royalties or other payments made by an affiliate of the possessions corporation to another member of the affiliated group reduce the cost sharing payment if such royalties or other payments are based, in part, on activity of the possessions corporation?

ANSWER 2: No. Payments made between affiliated corporations do not reduce the cost sharing payment. Thus, for example, if a possessions corporation sells a component to a foreign affiliate for incorporation by the foreign affiliate into an integrated product sold to unrelated persons, and the foreign affiliate pays a royalty to the U.S. parent of the possessions corporation based on the total value of the integrated product, the cost sharing payment of the possessions corporation is not reduced.

(4) *Computation of cost sharing payment.*

QUESTION 1: S is a possessions corporation engaged in the manufacture and sale of four products (A, B, C, and D) all of which are classified under the same three-digit SIC code. S sells its production to a U.S. affiliate, P, which resells it to unrelated parties in the United States. P's third party sales of each of these products produced in whole or in part by S (computed as provided under paragraph (a)(2) of §1.936-6) are $1 million; P's other sales of products in the same SIC code are $3,000,000; and the defined worldwide product area research of the affiliated group is $350,000. How should S compute the cost sharing amount for products A, B, C, and D?

ANSWER 1: The cost sharing amount is computed separately for each product on Schedule P of Form 5735. S should use the following formula for each of the products A, B, C, and D:

$$\frac{\text{Sales to Unrelated Persons of Possession Product}}{\text{Total Sales of Products in SIC code}} \times \text{Worldwide Product Area Research}$$

$$\frac{\$1,000,000}{\$7,000,000} \times \$350,000 = \$50,000$$

QUESTION 2: The facts are the same as in question 1 except that S manufactures product D under a license from an unrelated person. S pays the unrelated party an annual license fee of $20,000. Thus, the worldwide product area research expense of the affiliated group is $370,000. How should the cost sharing payment be adjusted?

ANSWER 2: The cost sharing fee should be reduced by the $20,000 license fee made as a direct annual payment to a third party on account of product D. The cost sharing payment with respect to product D in this example will be adjusted as follows:

$$\frac{\text{Sales to Unrelated Persons of Possession Product}}{\text{Total Sales of Products in SIC code}} \times \text{Worldwide Product Area Research} - \text{Amount paid by the possessions corporation to an unrelated party}$$

$$\frac{(\$1,000,000}{(\$7,000,000} \times \$370,000) - \$20,000 = \$32,857$$

QUESTION 3: The facts are the same as in question 1 except that S also manufactures and exports product E to a foreign affiliate, which resells it to unrelated persons for $1 milion. S makes a separate election for its export sales. How should S compute the cost sharing amount for product E?

ANSWER 3: The numerator of the cost sharing fraction is the aggregate sales or other dispositions by members of the affiliated group of the units of product E produced in whole or in part in the possession to persons who are not members of the affiliated group. The cost sharing amount for *product E* would be computed as follows:

$$\frac{\text{Export Sales of E}}{\text{Total Sales}} \times \text{Worldwide Product Area Research of products in SIC code (In this example, U.S. Sales of A, B, C, and D + Export Sales of E)}$$

or

$$\frac{\$1,000,000}{(\$7,000,000 + \$1,000,000)} \times \$350,000 = \$43,750$$

QUESTION 4: The facts are the same as in question 1, except that S also receives $10,000 in royalty income from unrelated persons for the licensing of certain manufacturing intangible property rights. What is the amount of the product area research that must be allocated in determining the cost sharing amount?

ANSWER 4: If the affiliated group receives royalty income from unrelated persons with respect to manufacturing intangibles in the same product area, then the product area research to be considered shall be first reduced by such royalty income. In this case, the amount of product area research to be used in determining S's cost sharing payment should be reduced by the $10,000 royalty payment received to $340,00.

(5) *Effect of election under the cost sharing method.*

QUESTION 1: What is the effect of the cost sharing method?

ANSWER 1: The cost sharing payment reduces the amount of deductions (and the amount of reductions in earnings and profits) otherwise allowable to the U.S. affilitates (other than tax-exempt affiliates) within the affiliated group as determined under section 936(h)(5)(C)(i)(I)(*b*) which have incurred research expenditures (as defined in §1.936-6(a)(1), question and answer 3) in the same product area for which the cost sharing option is elected, during the taxable year in which the cost sharing payment accrues. If there are no such U.S. affiliates, the reductions with respect to deductions and earnings and profits, as the case may be, are made with respect to foreign affiliates within the same affiliated group which have incurred product research expenditures in such product area attributable to a U.S. trade or business. If there are no affiliates which have incurred research expenditures in such product area, the reductions are then made with respect to any other U.S. affiliate and, if there is no such U.S. affiliate, then to any other foreign affiliate. The allocations of these reductions in each case shall be made in proportion to the gross income of the affiliates. In the case of foreign affiliates, the allocation shall be made in proportion to gross income attributable to the U.S. trade or business or worldwide gross income, as the case may be. With respect to each group above, the reduction of deductions shall be applied first to deductions under section 174, then to deductions under section 162, and finally to any other deductions on a pro rata basis.

QUESTION 2: For purposes of estimated tax payments, when is the cost sharing amount deemed to accrue?

ANSWER 2: The cost sharing

amount is deemed to accrue to the appropriate affiliated corporations on the last day of the taxable year of each such corporation.

QUESTION 3: If the cost sharing method is elected and the year of accrual of the cost sharing payment to the appropriate affiliated corporations (described in question and answer 1 of this paragraph (a)(5)) differs from the year of actual payment by the possessions corporation, in what year are the deductions of the recipients reduced?

ANSWER 3: In the year the cost sharing payment has accrued.

QUESTION 4: What is the treatment of income from intangibles under the cost sharing method?

ANSWER 4: Under the cost sharing method, a possessions corporation is treated as the owner, for purposes of obtaining a return thereon, of manufacturing intangibles related to a possession product. The term "manufacturing intangible" means any patent, invention, formula, process, design, pattern, or know-how. The possessions corporation will not be treated as the owner, for purposes of obtaining a return thereon, of any manufacturing intangibles related to a component product produced by an affiliated corporation and transferred to the possessions corporation for incorporation into the possession product, except in the case that the possession product is treated as including such component product for all purposes of section 936(h)(5). Further, the possessions corporation will not be treated as the owner, for purposes of obtaining a return thereon, of any marketing intangibles except "covered intangibles." (See §1.936-6(c).)

QUESTION 5: If the cost sharing option is elected, is it necessary for the possessions corporation to be the legal owner of the manufacturing intangibles related to the possession product in order for the possessions corporation to receive a full return with respect to such intangibles?

ANSWER 5: No. There is no requirement that manufacturing intangibles be owned by the possessions corporation.

QUESTION 6: How is income attributable to marketing intangibles treated under the cost sharing method?

ANSWER 6: Except in the case of "covered intangibles" (see section 1.936-6(c)), the possessions corporation is not treated as the owner of any marketing intangibles, and income attributable to marketing intangibles will be allocated to the possessions corporation's U.S. shareholders with the proration of income based on shareholdings. If a shareholder of the possessions corporation is a foreign person or is otherwise tax-exempt, the possessions corporation is taxable on that shareholder's pro rata amount of the intangible property income.

QUESTION 7: What is the source of the intangible property income described in question and answer 6?

ANSWER 7: The intangible property income is U.S. source whether taxed to the U.S. shareholder or taxed to the possessions corporation. Such intangible property income, if treated as income of the possessions corporation, does not enter into the calculation of the 80-percent possession source test or the 65-percent active trade or business test.

QUESTION 8: May marketing intangible income, if any, be allocated to the possessions corporation with respect to custom-made products?

ANSWER 8: No. If the cost sharing option is elected, then income attributable to marketing intangibles (other than "covered intangibles" described in §1.936-6(c)) will be taxed as discussed in questions and answers 6 and 7 of this subparagraph (a)(5). It is immaterial whether the product is custom-made.

QUESTION 9: In order to sell a pharmaceutical product in the United States, a New Drug Application ("NDA") for the product must be approved by the U.S. Food and Drug Administration. Is an NDA considered a manufacturing or marketing intangible for purposes of the allocation of income under the cost sharing method?

ANSWER 9: A manufacturing intangible.

QUESTION 10: Can a copyright be, in whole or in part, a manufacturing intangible for purposes of the allocation of income under the cost sharing method?

ANSWER 10: In general, a copyright is a marketing intangible. See §936(h)(3)(B)(ii). However, copyrights may be treated either as manufacturing intangibles or nonmanufacturing intangibles (or as partly each) depending upon the function or the use of the copyright. If the copyright is used in manufacturing, it will be treated as a manufacturing intangible; but if it is used in marketing, even if it is also classified as know-how, it will be treated as a marketing intangile.

QUESTION 11: If the cost sharing option is elected and a patent is related to the product produced by the possessions corporation, does the return to the possessions corporation with respect to the manufacturing intangible include the make, use, and sell elements of the patent?

ANSWER 11: Yes. A patent confers an exclusive right for 17 years to sell a product covered by the patent. During this period, the return to the possessions corporation includes the make, use, and sell elements of the patent.

QUESTION 12: For purposes of the cost sharing option, may a safe haven rule be applied to determine the amount of marketing intangible income?

ANSWER 12: No. The amount of marketing intangible income is determined on the basis of all relevant facts and circumstances. The section 482 regulations will continue to apply except to the extent modified by the election. Rev. Proc. 63-10 and Rev. Proc. 68-22 do not apply for this purpose.

QUESTION 13: If a product covered by the cost sharing election is sold by a possessions corporation to an affiliated corporation for resale to an unrelated party, may the resale price method be used to determine the intercompany price of the possessions corporation?

ANSWER 13: In general, the resale price method may be used if (a) no comparable uncontrolled price for the product exists, and (b) the affiliated corporation does not add a substantial amount of value to the prod-

uct by manufacturing or by the provision of services which are reflected in the sales price of the product to the customer. The possessions corporation will not be denied use of the resale price method for purposes of such intercompany pricing merely because the reseller adds more than an insubstantial amount to the value of the product by the use of intangible property.

QUESTION 14: If a possessions corporation makes the cost sharing election and uses the cost-plus method under section 482 to determine the arm's-length price of a possession product, will the cost base include the cost of materials which are subject to processing or which are components in the possession product?

ANSWER 14: A taxpayer may include the cost of materials in the cost base if it is appropriate under the regulations under §1.482-2(e)(4).

QUESTION 15: If the possessions corporation computes its income with respect to a product under the cost sharing method, and the price of the product is determined under the cost-plus method under section 482, does the cost base used in computing cost-plus under section 482 include the amount of the cost sharing payment?

ANSWER 15: No.

QUESTION 16: If a member of the affiliated group transfers to a possessions corporation a component which is incorporated into a possession product, how will the transfer price for the component be determined?

ANSWER 16: The transfer price for the component will be determined under section 482, and as follows. If the possession product is treated as not including such component for purposes of section 936(h)(5), the transfer price paid for the component will include a return on all intangibles related to the component product. If the possession product is treated as including such component for purposes of section 936(h)(5), then the transfer price paid for the component by the possessions corporation will not include a return on any manufacturing intangible related to the component product, and the possessions corporation will obtain the return on the manufacturing intangibles associated with the component.

(b) *Profit split option*—(1) *Computation of combined taxable income.*

QUESTION 1: In determining combined taxable income from sales of a possession product, how are the allocations and apportionments of expenses, losses, and other deductions to be determined?

ANSWER 1: Expenses, losses, and other deductions are to be allocated and apportioned on a "fully-loaded" basis under §1.861-8 on a separate company basis to combined gross income of the possessions corporation and other members of the affiliated group (other than foreign affiliates). The amount of research, development, and experimental expenses allocated and apportioned to combined gross income is to be determined under §1.861-8(e)(3), but shall in no event be less than the amount of the cost sharing payment that would have been required under the rules set forth in section 936(h)(5)(C)(ii)(II) and paragraph (a) of this section if the cost sharing option had been elected. Other expenses which are the subject to §1.861-8(e) are to be allocated and apportioned in accordance with that section. For example, interest expense (including payments made with respect to bonds issued by the Puerto Rico Industrial, Medical and Environmental Control Facilities Authority (AFICA)) is to be allocated and apportioned under §1.861-8(e)(2). The class of gross income to which marketing and distribution expenses relate and shall be allocated is generally to be defined by the same "product area" as is determined for the relevant research, development, and experimental expenses (*i.e.*, the appropriate 3-digit SIC code) but shall include only gross income generated or reasonably expected to be generated from the geographic area or areas to which the expenses relate. Marketing and distribution expenses shall be apportioned on a fully-loaded basis which reflects, to a reasonably close extent, the factual relationship between these deductions and the statutory and residual groupings of gross income. Apportionment methods based upon comparisons of amounts incurred before ultimate sale of a product (including apportionment on a basis of comparison of costs of goods sold, other expenses incurred, or other comparisons set forth in §1.861-8(c)(1)(v), such as time spent) are not on a fully-loaded basis and do not reflect this required factual relationship. A comparison of units sold may be used only where the units are of the same or similar value and are, thus, in fact comparable. These deductions shall be apportioned on a basis of comparison of the amount of gross sales or receipts or another method which similarly reflects the required factual relationship.

The rules for allocation and apportionment of marketing and distribution expenses may be illustrated by the following example:

Example. Assume that possessions corporation A manufactures pharmaceutical product #1 for resale by B, its U.S. parent corporation, in the United States, that B manufactures pharmaceutical products #2 and #3 in the United States for sale there, that all three products are within the same product area, and that marketing and distribution expenses are internally divided by B among the three products on the basis of time spent by sales persons of B on marketing of the three products, as follows:

Product #1	50x
Product #2	80x
Product #3	110x
TOTAL	240x

These expenses of 240x are allocated to gross income generated by all three products and shall be apportioned on the basis of gross sales or receipts of product #1 as compared to products #2 and #3 or another method which similarly reflects the factual relationship between these expenses and gross income derived from product #1 and products #2 and #3. Thus, if a sales method were used and sales of product #1 accounted for one-third of sales receipts from the three products, 80x (240 ÷ 3) of marketing and distribution expenses would be apportioned to the combined gross income from product #1.

The allocation of the remaining expenses, definitely related to a class of gross income, shall be made to the class of gross income to which they are definitely related. These expenses are apportioned on the basis of any reasonable method, as described §1.861-8(b)(3) and (c)(1). Examples of such methods may include, but are not limited to, those specified in §1.861-8(c)(1)(i) through (vi).

QUESTION 2: How may the allocation and apportionment of expenses to combined gross income be verified?

ANSWER 2: Substantiation of the allocation and apportionment of expenses will be required upon audit of the possessions corporation and affiliates. Detailed substantiation may be necessary, particularly where the entities are engaged in multiple lines of business involving distinct product areas. Sources of substantiation may include certified financial reports, Form 10-K's, annual reports, internal production reports, product line assembly work papers, and other relevant materials. In this regard, see §1.861-8(f)(5).

QUESTION 3: Does section 936(h) override the moratorium provided by section 223 of the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256, 297]?

ANSWER 3: Yes. Thus, the allocation and apportionment of product area research described in question and answer 1 must be made without regard to the moratorium

QUESTION 4: If a possessions corporation uses the profit split method to determine its taxable income from sales of a product, how does it determine its gross income for purposes of the 80-percent possession source test and the 65-percent active trade or business test of section 936(a)(2)?

ANSWER 4: One-half of the deductions of the affiliated group (other than foreign affiliates) which are used in determining the combined taxable income from sales of the product are added to the portion of the combined taxable income allocated to the possessions corporation in order to determine the possessions corporation's gross income from sales of such product.

QUESTION 5: How will income from intangibles related to a possession product be treated under the profit split method?

ANSWER 5: Combined taxable income of the possessions corporation and affiliated corporations from the sale of the possession product will include income attributable to all intangibles, including both manufacturing and marketing intangibles, associated with the product.

QUESTION 6: Can a possessions corporation apply the profit split option to a possession product if no U.S. affiliates derive income from the sale of the possession product?

ANSWER 6: Yes.

QUESTION 7: With respect to the factual situation discussed in question and answer 6, how is combined taxable income computed?

ANSWER 7: The profit split option is applied to the taxable income of the possessions corporation from sales of the possession product to foreign affiliates and unrelated persons. Fifty percent of that income is allocated to the possessions corporation, and the remainder is allocated to the appropriate affiliates as described in question and answer 11 of this paragraph (b)(1).

QUESTION 8: Does combined taxable income under the profit split option include amounts received from the sale of a possession product to other members of the affiliated group (other than foreign affiliates) if the possession product is not resold to a foreign affiliate or unrelated person?

ANSWER 8: No. Combined taxable income is computed only with respect to sales by members of the affiliated group (other than foreign affiliates) to persons who are not members of the affiliated group or to foreign affiliates. See section 936(h)(5)(C)(ii)(IV).

QUESTION 9: If the possession product is a component product, how is combined taxable income for such product to be determined?

ANSWER 9: The combined taxable income for the component product may be determined by actual prices from comparable uncontrolled transactions under §1.482-2(e)(2). If no comparable uncontrolled price for the possession product exists, then the gross receipts from sales of the possession product will be deemed to be the same proportion of the gross receipts from sales of the integrated product which the production costs for the possession product bear to the total production costs for the integrated product. The possessions corporation will determine its costs (other than costs incurred for materials purchased from a U.S. affiliate) attributable to the possession product and its expenses allocable and apportionable to the possession product under §1.861-8, as described in question and answer 1 of this paragraph (b)(1). Each member of the affiliated group that is a United States person, other than the possessions corporation, shall determine its costs (other than costs incurred for materials purchased from a U.S. affiliate) attributable to the possession product, and its expenses allocable and apportionable to the integrated product under §1.861-8, as described in question and answer 1 of this paragraph (b)(1). Each such United States person (other than the possessions corporation) shall apportion to the possession product, on the basis of the ratio of the production costs for the possession product to the total production costs for the integrated product, the expenses that such affiliate allocated and apportioned to the integrated product. Production costs will be the sum of direct and indirect production costs as defined for inventory accounting purposes under section 1.471-11(b), (c), and (d), except that they will not include the costs of materials.

Example. A possessions corporation, S, is engaged in the manufacture of microprocessors. S obtains a component from a U.S. affiliate, O. S sells its production to another U.S. affiliate, P, which incorporates the microprocessors into central processing units (CPUs). P transfers the CPUs to a U.S. affiliate, Q, which incorporates them into computers for sale to unrelated customers. S chooses to define the possession product as the CPUs. The combined taxable income for the CPUs is computed below on the basis of the given production, sales, and cost data:

Production costs (excluding costs of materials)	
1. O's costs for the component	75
2. S's costs for the microprocessors	400
3. P's costs for the CPUs	125
4. Q's costs for the computers	150
5. Total (add lines 1 through 4)	750
6. Combined production costs for the CPUs (add lines 1 through 3)	600
7. Ratio of production costs for the CPUs (the possession product) to the production costs for the computers (the integrated product)	0.8
Sales	
8. Total sales by Q to unrelated customers and foreign affiliates of computers containing microprocessors produced by S	5,000
9. Sales value of the CPUs (line 8 multiplied by line 7)	4,000
Total costs of S (excluding costs of materials obtained from U.S. affiliates)	
10. Production costs of S (enter from line 2)	400
11. Materials costs (excluding materials obtained from U.S. affiliates)	100
12. Research expenses	0
13. Other expenses (general and administrative, interest, etc.)	500

14. Total (add lines 10 through 13) . . .	1,000
Research expenses of the affiliated group allocable and apportionable to the CPU's	
15. Total sales in the 3-digit SIC code .	8,000
16. Possession sales (enter from line 9)	4,000
17. Cost sharing fraction (divide line 16 by line 15)	0.5
18. Research expenses incurred by the affiliated group in the 3-digit SIC code	600
19. Cost sharing amount (multiply line 17 by line 18)	300
20. Research of the affiliated group (other than foreign affiliates) allocable and apportionable under §1.861-8(e)(3) to the computers (the integrated product)	350
21. Research apportionable to the CPUs (multiply line 20 by line 7). .	280
22. Enter the greater of line 19 or line 21	300
Other expenses of the affiliated group (other than S and foreign affiliates) allocable or apportionable to the CPUs	
23. Marketing, general and administrative, interest and other expenses of the affiliated group (other than S and foreign affiliates) which are allocable and apportionalbe to the computers or to any components thereof	500
24. Expenses apportionable to the CPUs (multiply line 23 by line 7). .	400
Combined taxable income attributable to the CPUs	
25. Combined taxable income (line 9 minus lines, 1, 3, 14, 22 and 24) . .	2,100
26. Share of combined taxable income apportioned to S (50% of line 25) .	1,050
Share of combined taxable income apportioned to U.S. affiliates of S	
27. Adjustment to research expense (Enter the greater of zero or line 19 minus line 21)	20
28. Adjusted combined taxable income (line 27 plus line 25)	2,120
29. Share of combined taxable income apportioned to U.S. affiliates of S (line 28 less line 26)	1,070

QUESTION 10: If the possession product is an end-product form, how is the combined taxable income from the product determined?

ANSWER 10: Assume that the possessions corporation purchases components from a U.S. affiliate and incorporates them into a product X which is sold without further transformation to unrelated customers and foreign affiliates. The combined taxable income for the end-product form shall be determined by subtracting from the third party sales price or comparable uncontrolled sales price of X the following amounts: (1) the comparable uncontrolled sales price of the components and (2) all other costs allocable or apportionable to the end-product form. If no comparable uncontrolled prices for the components exist, then the combined taxable income for the possession product will be computed under the rules described in question and answer 9 of this §1.936-5(b)(1).

QUESTION 11: If the profit split option is elected, how is the portion of combined taxable income not allocated to the possessions corporation to be treated?

ANSWER 11: The income shall be allocated (1) to U.S. affiliates (other than tax-exempt affiliates) within the group (as determined under section 482) which derive income from the active conduct of a trade or business in the same product area as the possession product; or (2) if there are no such affiliates, to other U.S. affiliates (other than tax-exempt affiliates); or (3) if there are no U.S. affiliates (other than tax-exempt affiliates), to foreign affiliates which derive income from the active conduct of a trade or business in the same product area as the possession product (or, if the foreign members are resident in a country with which the U.S. has an income tax convention, then to those foreign members which have a permanent establishment in the U.S. which derives income in the same product area as the possession product); or (4) if there are no affiliates described in (1) through (3) above, then to all other affiliates. The allocations made under (1) and (3) above shall be made on the basis of the relative gross income derived by each such affiliate from the active conduct of the trade or business in the same product area, and allocations made under (2) and (4) above shall be made on the basis of the relative total gross income of each such affiliate. Income allocated to foreign affiliates shall be treated as effectively connected with the conduct of a trade or business in the United States. For purposes of determining a corporation's estimated tax liability with respect to income thus allocated, the general rules applicable to estimated tax payments shall apply.

QUESTION 12: How is the profit split option to be applied to properly account for costs incurred in a year with respect to products which are sold by the possessions corporation to a U.S. affiliate during such year, but are not resold by the U.S. affiliate to persons who are not members of the affiliated group or to foreign affiliates until a later year?

ANSWER 12: The rules under §1.994-1(c)(5) are to be applied. Incomplete transactions will not be taken into consideration in computing combined taxable income. Thus, for example, if in 1983, A, a possessions corporation, sells units of a product with a cost to A of $5000 to B corporation, its U.S. affiliate, which uses the dollar-value LIFO method of costing inventory, and B sells units with a cost of $4000 (representing A's cost) to C corporation, a foreign affiliate, only $4000 of such costs shall be taken into consideration in computing the combined taxable income of the possessions corporation and U.S. affiliates for 1983. If a specific goods LIFO inventory method is used by B, the determination of whether A's goods remain in B's inventory shall be based on whether B's specific goods LIFO grouping has experienced an increment or decrement for the year on the specific LIFO cost of such units, rather than on an average unit cost of such units. If the FIFO method of costing inventory is used by B, transfers may be based on the cost of the specific units transferred or on the average unit production cost of the units transferred, but in each case a FIFO flow assumption shall be used to identify the units transferred. For a determination of which goods are sold by taxpayers using the LIFO method, see question and answer 15.

QUESTION 13: If a possessions corporation purchases materials from an affiliate and computes combined taxable income for the possession product including such materials, how are those materials to be valued in the possessions corporation's inventory?

ANSWER 13: The cost of those materials is considered to be equal to the affiliate's FIFO cost, regardless of its inventory method.

QUESTION 14: If the possessions corporation uses the FIFO method of costing inventory and the U.S. affiliate uses the LIFO method of costing inventory, or *vice versa*, what method of costing inventory should be used in computing combined taxable in-

come?

ANSWER 14: The possessions corporation's method of costing inventory determines the cost of the inventory for purposes of computing combined taxable income. However, the affiliate's method of costing determines when the possession product purchased by such affiliate is sold to a foreign affiliate or unrelated person. Thus, if the possessions corporation uses the dollar-value LIFO method, the cost of its inventory for purposes of computing combined taxable income will depend on whether its LIFO pool or pools experienced an increment or decrement in the year in which sales of its products are made to its U.S. affiliate. Appropriate ratios must be used in years where the sales of the possessions corporation come out of both current year's production and LIFO layers built up in prior years.

QUESTION 15: How are sales of a possession product by a U.S. affiliate determined for purposes of the profit split option if the U.S. affiliate includes purchases of the possession product in a dollar-value LIFO inventory pool (as provided under §1.472-8))?

ANSWER 15: The determination of whether the product acquired from the possessions corporation is sold by the U.S. affiliate is based on the U.S. affiliate's dollar-value LIFO pool. Thus, if there is no change in the level of the U.S. affiliate's pool which includes the possession product, or if any layers of the U.S. affiliate's pool are liquidated, then all units of the product acquired from the possessions corporation during that taxable year, as well as units of the product acquired from the possessions corporation in prior years based on any layers of the U.S. affiliate that are liquidated, are presumed to have been sold by the U.S. affiliate. If the inventory pool of the U.S. affiliate has an increment, the increment attributable to the possession product is determined by multiplying the increment by a fraction. The numerator of the fraction includes the purchases of the product made by the U.S. affiliate during the taxable year from the possessions corporation (determined on the basis of the possessions corporation's cost for its inventory purposes) plus any production costs (as defined in §1.471-11(b), (c), and (d), but not including costs of materials) incurred by the U.S. affiliate during the same period. The denominator of the fraction is the total purchases of the product made by the U.S. affiliate for the same period from all sources, with purchases of units of the possession product and any value added by the affiliate in production during the same period, valued as described above. Sales of a possession product are then determined by multiplying the total sales of the product by the U.S. affiliate by a fraction, the numerator of which is the increment in the U.S. affiliate's pool attributable to the possession product and the denominator of which is the increment in the U.S. affiliate's pool attributable to purchases from all sources.

(2) *Pre-TEFRA inventory.*

QUESTION 1: How is pre-TEFRA inventory to be determined if the profit split option is elected and the FIFO method of costing inventory is used by the U.S. affiliate?

ANSWER 1: Pre-TEFRA inventory is inventory which was produced by the possessions corporation and transferred to a U.S. affiliate prior to the possessions corporation's first taxable year beginning after December 31, 1982. Pre-TEFRA inventory will not be included for purposes of the profit split option. If the U.S. affiliate uses the FIFO method of costing inventory, the pre-TEFRA inventory will be treated as the first inventory sold by the U.S. affiliate during the first year in which section 936(h) applies and will not be included in the computation of combined taxable income for purposes of the profit split option. The treatment of pre-TEFRA inventory when FIFO costing is used by both the U.S. affiliate and the possessions corporation is illustrated by the following example in which FIFO unit costing is used:

Example. Assume the following:

	X *Possessions corporation*		Y *U.S. affiliate*	
	No. of Units	Cost per Unit	No. of Units	Cost per Unit
Beginning inventory	500	$150	200	$225
Units produced during 1983	1000	$200	—	—
Ending inventory	400	$200	300	—

In 1983, the beginning inventory of X, a possessions corporation, is 500 units with a unit cost of $150 and the beginning inventory of Y, the U.S. affiliate, is 200 units with a unit cost of $225 which represents the section 482 price paid by Y. Y's beginning inventory in 1983 represents purchases made in 1982 of products produced by X in that year. Y sells all the units it purchases from X to Z, a foreign affiliate. In 1983, X produces 1000 units at a unit cost of $200 and sells 1100 units to Y (the difference between 1500 units representing X's 1983 beginning inventory (500) and the units produced by X in 1983 (1000) less X's ending inventory of 400 units). Of the 1100 units sold by X to Y in 1983, only 800 units (and not 1000 units) which were sold by Y to Z are taken into consideration in computing combined taxable income for 1983. Since FIFO costing by the possessions corporation is used, the cost is $150 per unit for the first 500 units and $200 per unit for the remaining 300 units. The 200 units sold by X to Y in 1982 are pre-TEFRA inventory and are not included in the computation of combined taxable income for 1983. They are also treated as the first units sold by Y to Z in 1983. This inventory has a unit cost of $225, which reflects the section 482 transfer price from X to Y in 1982. Y's 1983 ending inventory of 300 units will not be taken into consideration in computing the combined taxable income of X and Y for 1983 because the units have not been sold to a foreign affiliate or to persons who are not members of the affiliated group. In a subsequent year when the units are sold to Z, the cost to X and selling price to Z of these units will enter into the computation of combined taxable income for that year.

QUESTION 2: How is pre-TEFRA inventory to be determined if the profit split option is elected and the LIFO method of costing inventory is used by the U.S. affiliate?

ANSWER 2: Pre-TEFRA inventory will not be included for purposes of the profit split option. If the U.S. affiliate uses the LIFO method (either dollar-value or specific goods LIFO), pre-TEFRA inventory will be treated as inventory sold by the U.S. affiliate in the year in which the U.S. affiliate's LIFO layer containing pre-TEFRA LIFO inventory is liquidated, and shall not be included in the computation of combined taxable

income for such years for purposes of the profit split option. The treatment of pre-TEFRA inventory where the dollar-value LIFO method is used by both the U.S. affiliate and the possessions corporation is illustrated by the following example:

Example. Assume the following for 1983:

	X *Possessions Corporation Dollar-Value LIFO Cost of Inventory*	Y *U.S. Affiliate Dollar-Value LIFO Cost of Inventory*
Beginning inventory	$ 5,000*	$ 4,000*
Dollar-value LIFO cost of inventory produced during 1983	$20,000	$ 5,000
Ending inventory	$ 4,000	$ 3,000

At the beginning of 1983, X, a possessions corporation, has a dollar-value LIFO pool containing a possession product with a single base layer of $5000. The beginning inventory of Y, its U.S. affiliate, in the preceding year consists of a single pool containing such possession product in a single base layer in the amount of $4000, which represents the section 482 price paid by Y. Y sells all its purchases of the possession product to Z, a foreign affiliate. In 1983, X produces additional inventory of the product with a cost of $20,000 and sells inventory with a dollar-value LIFO cost of $21,000 to Y. X's inventory at the end of 1983 has a dollar-value LIFO cost of $4000. In 1983, Y incurs $5000 of production costs and sells inventory with a dollar-value LIFO cost of $27,000 to Z, of which $26,000 of inventory is taken into consideration in computing combined taxable income. $1000 of inventory represents pre-TEFRA inventory resulting from the liquidation of a LIFO layer and is not included in the computation of combined taxable income for 1983. Instead, any income associated with the sale of the pre-TEFRA inventory is taxed to the U.S. affiliate in the year of sale (in this case, 1983).

(c) *Covered Intangibles.*

QUESTION 1: What are "covered intangibles" under section 936(h)(5)(C)(i)(II)?

ANSWER 1: The term "covered intangibles" means (1) intangible property developed in a possession solely by the possessions corporation and owned by it (2) manufacturing intangible property (described in section 936(h)(3)(B)(i)) which is acquired by the possessions corporation from unrelated persons, and (3) any other intangible property (described in section 936(h)(3)(B)(ii) through (v), to the extent not described in section 936(h)(3)(B)(i)) which relates to sales of products or services to unrelated persons for ultimate consumption or use in the possession in which the possessions corporation conducts its business. The possessions corporation is treated as the owner of covered intangibles for purposes of obtaining a return thereon.

QUESTION 2: Do covered intangibles include manufacturing intangible property which is acquired by a U.S. affiliate and subsequently transferred to the possessions corporation?

ANSWER 2: No. In order for a manufacturing intangible to be treated as a covered intangible, the intangible property must be acquired directly by the possessions corporation from an unrelated person.

QUESTION 3: If a possessions corporation licenses a manufacturing intangible from an unrelated party, will the licensed intangible be treated as a covered intangible?

ANSWER 3: No.

QUESTION 4: How is ultimate consumption or use determined for purposes of the definition of covered intangibles?

ANSWER 4: A product will be treated as having its ultimate use or consumption in a possession if it is sold by the possessions corporation to an unrelated person in a possession and is not resold or used or consumed outside of the possession within one year after the date of the sale.

QUESTION 5: Are sales of products that relate to covered intangibles excluded from the cost sharing fraction?

ANSWER 5: If no intangibles other than covered intangibles are associated with the possession product, then sales of such product will be excluded from the cost sharing fraction. If both covered and non-covered intangibles are associated with the possession product, then sales of such product will be included in the cost sharing fraction.

QUESTION 6: If the cost sharing option is elected, is it necessary for the possessions corporation to be the legal owner of covered intangibles described in section 936(h)(5)(C)(i)(II)(*c*) related to the product in order for the possessions corporation to receive a full return with respect to such intangibles?

ANSWER 6: No. For purposes of section 936(h), it is immaterial whether such covered intangibles are owned by the possessions corporation or by another member of the affiliated group. Moreover, if the legal owner of such covered intangibles which are subject to section 936(h)(5) is an affiliate of the possessions corporation, such person will not be required to charge an arm's-length royalty under section 482 to its possessions corporation.

§1.936-7 Manner of making election under section 936(h)(5); special election for export sales; revocation of election under section 936(a).

The rules in this section apply for purposes of section 936(h) and also for purposes of section 934(e), where applicable.

(a) *Manner of making election.*

QUESTION 1: How does a possessions corporation make an election to use the cost sharing method or profit split method?

ANSWER 1: A possessions corporation makes an election to use the cost sharing or profit split method by filing Form 5712-A and attaching it to its tax return. Form 5712-A must be filed on or before the due date (including extensions) of the tax return of the possessions corporation for its first taxable year beginning after December 31, 1982. The electing corporation must set forth on the form the name and the taxpayer identification number or address of all members of the affiliated group (including foreign affiliates not required to file a U.S. tax return). All members of the affiliated group must consent to the election. An authorized officer of the electing corporation must sign the statement of election and must

*Assume that there is no layer of increment and that this represents the base layer.

declare that he has received a signed statement of consent from an authorized officer of each member of the affiliated group. The election is not valid unless all affiliates consent, and unless an amended Form 5712-A is filed and attached to the timely filed possessions corporation's income tax return (including extensions) to reflect any changes in the names or number of corporations in the affiliated group.

QUESTION 2: May the "election out" under section 936(h)(5) be made on a product-by-product basis, or must it be made on a wider basis?

ANSWER 2: An electing corporation is required to treat products in the same product area in the same manner. Similarly, all possessions corporations in the same affiliated group that produce any products or render any services in the same product area must make the same election for all products that fall within the same product area. However, §1.936-7(b) provides that the electing corporation may make a different election for export sales than for domestic sales. The electing corporation or corporations may also make different elections for products that fall within different product areas.

QUESTION 3: May the possessions corporation elect to define product area more narrowly than the 3-digit SIC code?

ANSWER 3: No. Certain alternatives, such as the 4-digit SIC code, would not be permitted under the statute. However, other methods for defining product area may be considered by the Commissioner in the future.

QUESTION 4: May a possessions corporation make an election out under the cost sharing method with respect to a product area if the affiliated group incurs no research, development or experimental costs in that product area?

ANSWER 4: Yes. In that case the cost sharing payment will be zero.

QUESTION 5: If the significant business presence test is not satisfied for a product or type of service within the product area covered by the election, what rules will apply with respect to that product?

ANSWER 5: If a cost sharing election has been made with respect to the product area, the cost sharing payment will not be reduced. However, with respect to the product which does not satisfy the significant business presence test, the provisions of section 936(h)(1) through (h)(4) will apply to the allocation of income.

QUESTION 6: Is a taxpayer permitted to make a change of election on a prospective basis with respect to the cost sharing and profit split methods?

ANSWER 6: In general, once the election is properly made, it is binding (including upon any later created affiliates), and revocation is only permitted with the consent of the Commissioner of Internal Revenue. However, a taxpayer will be permitted to change its election once from the cost sharing method to the profit split method, or *vice versa*, without consent of the Commissioner if the change is made before January 1, 1986, or within 90 days after [the date of publication of final regulations under section 936(h)(5)(C)(i) and (ii)], whichever is later. A change of election will be treated as an election subject to the procedures set forth above and to section 481 of the Internal Revenue Code.

QUESTION 7: If the Commissioner determines that a possessions corporation does not meet the 80-percent possession source test or the 65-percent active trade or business test (the "qualification tests") for any taxable year beginning after 1982, under what circumstances is the possessions corporation permitted to make a distribution of property after the close of its taxable year to meet the qualification tests?

ANSWER 7: A possessions corporation may make a pro rate distribution of property to its shareholders after the close of the taxable year if the Commissioner determines that the possessions corporation does not satisfy the qualification tests (a) by reason of the exclusion from gross income of intangible income under section 936(h)(1)(B) or section 936(h)(5)(C)(i)(II) or (b) by reason of the allocation to the shareholders of the possessions corporation of income under section 936(h)(5)(C)(ii)(III); provided, however, that the determination of the Commissioner does not contain a finding that the failure of such corporation to satisfy the qualification tests was due, in whole or in part, to fraud with intent to evade tax or willful neglect on the part of the possessions corporation. The possessions corporation must designate the distribution at the time the distribution is made as a distribution to meet qualification requirements, and it will be subject to the provisions of section 936(h)(4). Such distributions will not qualify for the dividends received deduction.

(b) *Separate election for export sales.*

QUESTION 1: What methods of computing income can a possessions corporation use under the separate election for export sales?

ANSWER 1: The only two methods which are available under the separate election for export sales are the cost sharing method and the profit split method.

QUESTION 2: What is the definition of export sales for purposes of the separate election for export sales?

ANSWER 2: The determination of export sales is based upon the destination of the product, *i.e.*, where it is to be used or consumed. If the product is sold to a U.S. affiliate, it will be treated as an export sale only if resold or otherwise transferred abroad to a foreign person (including a foreign affiliate or foreign branch of a U.S. affiliate) within one year from the date of sale to the U.S. affiliate for ultimate use or consumption outside the United States as provided under §1.954-3(a)(3)(ii).

QUESTION 3: Assume that a possessions corporation sells a product to both foreign affiliates and foreign branches of U.S. affiliates. In addition, it sells the product to its U.S. parent for resale in the U.S. The possessions corporation makes a profit split election for domestic sales and a cost sharing election for export sales. Will the sales to foreign branches of U.S. affiliates be treated as exports subject to the cost sharing method or as domestic sales subject the profit split method?

ANSWER 3: The sales to a foreign

branch of a U.S. corporation are exports if for ultimate use or consumption outside of the United States as provided under §1.954-3(a)(3)(ii).

QUESTION 4: Under what circumstances may a possessions corporation make the separate election under section 936(h)(5)(F)(iv)(II) for computing its income from products exported to a foreign person when the income derived by such foreign person on the resale of such products is included in foreign base company income under section 954(a)?

ANSWER 4: If the income derived by a foreign person on the resale of products manufactured, in whole or in part, by a possessions corporation is included in foreign base company income under section 954(a), then the possessions corporation may make the separate export election under section 936(h)(5)(F)(iv)(II) for computing its income from such products only if such foreign person has been formed or is availed of for substantial business reasons that are unrelated to an affiliated corporation's U.S. tax liability. For purposes of the preceding sentence, a foreign person will be considered to be formed or availed of for such substantial business reasons if the foreign person in the normal course of business purchases substantial quantities of products from both the possessions corporation and its affiliates for resale, and, in addition, provides support services for affiliated companies such as centralized testing, marketing of products, management of local currency exposures, or other similar services. However, a foreign person that purchases and resells products only from a possessions corporation is presumed to be formed or availed of for other than such substantial business reasons, even if the foreign person provides additional services.

QUESTION 5: When will the "manufacturing" test set forth in subsection (d)(1)(A) of section 954 be applicable to the export sales of a product of a possessions corporation which makes a separate election for export sales?

ANSWER 5: An electing corporation will be required to meet the "manufacturing" test set forth in subsection (d)(1)(A) of section 954 with respect to export sales of its product in each taxable year in which the separate election for export sales is in effect.

(c) *Revocation of election under section 936(a).*

QUESTION 1: When may an election under section 936(a) be revoked?

ANSWER 1: An election under section 936(a) may be revoked during the first ten years of section 936 status only with the consent of the Commissioner, and without the Commissioner's consent after that time. The Commissioner hereby consents to all requests for revocation that are made with respect to the taxpayer's first taxable year beginning after December 31, 1982 provided that the section 936(a) election was in effect for the corporation's last taxable year beginning before January 1, 1983, if the taxpayer agrees not to re-elect section 936(a) prior to its first taxable year beginning after December 31, 1988. A taxpayer that wishes to revoke a section 936(a) election under the terms of the blanket revocation must attach a "Statement of Revocation—Section 936" to the taxpayer's timely filed return (including extensions) and must state that in revoking the election the taxpayer agrees not to re-elect section 936(a) prior to its first taxable year beginning after December 31, 1988. Other requests to revoke not covered by the Commissioner's blanket consent should be addressed to the District Director having jurisdiction over the taxpayer's tax return.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue

(Filed by the Office of the Federal Register on January 5, 1984, 4:41 p.m., and published in the issue of the Federal Register for January 10, 1984, 49 F.R. 1227)

Notice of Proposed Rulemaking

Information Returns Required of Certain Foreign-owned Corporations and Information Returns Required of United States Persons With Respect to Certain Foreign Corporations

LR-201-82

SUMMARY: This document contains proposed regulations relating to information returns required of United States persons with respect to certain foreign corporations, and information returns required of certain foreign-owned corporations with respect to transactions with related corporations, under sections 6038 and 6038A, respectively, of the Internal Revenue Code of 1954. These proposed regulations set forth the requirements for who must report, the information required to be reported, the time and manner for filing the information returns, and penalties for failure to report information. Changes to the applicable tax law were made by the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. These regulations would provide the public with the guidance needed to comply with that Act.

DATES: Written comments and requests for a public hearing must be delivered or mailed by February 17, 1984. The amendments under section 6038 with respect to penalties are proposed to be effective for information required with respect to annual accounting periods of the foreign corporations ending after September 3, 1982. The remaining amendments under section 6038 are proposed to be effective for taxable years beginning after the date that is 30 days after publication of final regulations pursuant to this notice of proposed rulemaking. The amendments under section 6038A are proposed to be effective for taxable years beginning after December 31, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-201-82), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: David J. Dean of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-

201-82), (202) 566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 6038 and 6038A of the Internal Revenue Code of 1954. These amendments are proposed to conform the regulations to sections 338 and 339 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 631) [1982-2 C.B. 462, 576, 577] and are to be issued under the authority contained in sections 6038 (74 Stat. 1010, 26 U.S.C. §6038), 6038A (96 Stat. 631, 26 U.S.C. §6038A), and 7805 (68A Stat. 917, 26 U.S.C. §7805) of the Internal Revenue Code of 1954.

DESCRIPTION OF PROPOSED REGULATIONS

PROPOSED AMENDMENTS TO REGULATION §1.6038-2

Section 6038 requires that certain information be reported by every United States person with respect to any foreign corporation which such person controls. Current regulations under section 6038 describe the taxpayers that must report, the information to be reported, the time and manner for filing returns, and a penalty of reduction of creditable foreign taxes for failure to furnish required information. The Tax Equity and Fiscal Responsibility Act of 1982 added a dollar amount penalty to section 6038 of the Code, in addition to the existing foreign tax credit penalty, because the existing penalty is complicated and was perceived as being unduly harsh or potentially ineffective depending on the circumstances. The new penalty can be more uniformly applied to various taxpayers, while the other penalty is retained as an alternative for its potentially significant effect. If creditable taxes are reduced under the foreign tax credit penalty, the amount of the reduction is decreased by the amount of the dollar amount penalty which is imposed.

The proposed amendments incorporate the new penalty provision into the regulation and also update the regulation to reflect other changes in the relevant tax law and tax forms. Changes have also been made to clarify the descriptions of the information that should be reported concerning sales and purchases of stock in trade and other tangible property and concerning loan transactions.

PROPOSED REGULATION §1.6038A-1

Section 6038A requires that certain information be reported by every corporation that is controlled by a foreign person and is either a domestic corporation or is a foreign corporation engaged in a trade or business within the United States (reporting corporations). Section 6038A gives the Secretary authority to prescribe by regulations: (1) the information which is required to be reported with respect to identification of related corporations (domestic or foreign) with which the reporting corporation has had transactions, and with respect to transactions between the reporting corporation and related foreign corporations, and (2) the time and manner for reporting such information. The purpose of this requirement is to facilitate determinations by the Internal Revenue Service as to whether income is being accurately reported and whether adjustments under section 482 are needed to prevent evasion of taxes or clearly to reflect the income of certain corporations.

The proposed regulation requires every reporting corporation to make a separate annual information return for each related corporation with which the reporting corporation has had a transaction during the taxable year. The proposed regulation describes reporting corporations and related corporations, and requires reporting of information about the reporting corporation and the related corporation. It also requires reporting of information about transactions between the reporting corporation and each related corporation that is a foreign corporation. The information to be reported includes the location of the related corporation's books and records, the relationship between the reporting corporation and related corporation, a summary of the monetary consideration paid and monetary consideration received for transactions between the reporting corporation and related foreign corporations, and a description of any transactions between the reporting corporation and related foreign corporations which involved non-monetary consideration or no consideration. An exception is provided for transactions which would not affect any United States income tax liability.

The proposed regulation prescribes that the required returns are to be filed with the reporting corporation's income tax return. The proposed regulation also sets forth the penalties for failure to timely provide information required under section 6038A, and describes how those penalties may be avoided or reduced by showing reasonable cause for failure to comply with this reporting requirement. The regulation is proposed to be effective for taxable years beginning after December 31, 1982.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting as final regulations the proposed regulations referred to in this document, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The In-

ternal Revenue Service requests that persons submtting comments on these requirements to OMB also send copies of those comments to the Service.

CERTIFICATION OF NONAPPLICABILITY OF REGULATORY FLEXIBILITY ACT OF 1980 AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that these regulations will not have a significant economic impact on a substantial number of small entities and are, therefore, not subject to the requirements of the Regulatory Flexibility Act of 1980 (5 U.S.C. chapter 6). These regulations will generally only affect United States persons that have significant holdings in foreign corporations and certain foreign-owned corporations that have transactions with related corporations. The Commissioner of Internal Revenue has determined that these proposed rules are not major regulations subject to Executive Order 12291.

DRAFTING INFORMATION

The principal author of these proposed regulations is David J. Dean of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

Proposed amendments to the regulations.

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph 1. Section 1.6038-2 is revised to read as follows:

§1.6038-2 Information returns required of United States persons with respect to annual accounting periods of certain foreign corporations beginning after December 31, 1962.

(a) *Requirement of return.* Every U.S. person shall make a separate annual information return with respect to each annual accounting period (described in paragraph (e) of this section) beginning after December 31, 1962, of each foreign corporation which that person controls (as defined in paragraph (b) of this section) for an uninterrupted period of 30 days or more during such annual accounting period. Such information shall not be required to be furnished, however, with respect to a corporation defined in section 1504(d) of the Code which makes a consolidated return for the taxable year. The return shall be made, with respect to annual accounting periods ending with or within the United States person's taxable year, on—

(1) Form 2952 if such taxable year ends before December 31, 1982,

(2) Form 5471 if such taxable year ends on or after December 31, 1983, or

(3) Either Form 5471 or Form 2952 if such taxable year ends on or after December 31, 1982 and before December 31, 1983.

(b) *Control.* A person shall be deemed to be in control of a foreign corporation if at any time during that person's taxable year it owns stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote, or more than 50 percent of the total value of shares of all classes of stock of the foreign corporation. A person in control of a corporation which, in turn, owns more than 50 percent of the combined voting power, or of the value, of all classes of stock of another corporation is also treated as being in control of such other corporation. The provisions of this paragraph may be illustrated by the following example:

Example. Corporation A owns 51 percent of the voting stock in Corporation B. Corporation B owns 51 percent of the voting stock in Corporation C. Corporation C in turn owns 51 percent of the voting stock in Corporation D. Corporation D is controlled by Corporation A.

(c) *Attribution rules.* For the purpose of determining control of domestic or foreign corporations the constructive ownership rules of section 318(a) shall apply, except that:

(1) Stock owned by or for a partner or a beneficiary of an estate or trust shall not be considered owned by the partnership, estate, or trust when the effect is to consider a United States person as owning stock owned by a person who is not a United States person;

(2) A corporation will not be considered as owning stock owned by or for a 50 percent or more shareholder, when the effect is to consider a United States person as owning stock owned by a person who is not a United States person; and

(3) If 10 percent or more in value of the stock in a corporation is owned, directly or indirectly by or for any person, section 318(a)(2)(C) shall apply.

The constructive ownership rules of section 318(a) apply only for purposes of determining control as defined in paragraph (b) of this section.

(d) *U.S. person.* For purposes of section 6038 and this section, the term "United States person" has the meaning assigned to it by section 7701(a)(30) of the Code, except that—

(1) With respect to a corporation organized under the laws of the Commonwealth of Puerto Rico, such term does not include an individual who is a bona fide resident of Puerto Rico, if a dividend received by such individual during the taxable year from such corporation would be excluded from gross income under section 933(1),

(2) With respect to a corporation organized under the laws of the Virgin Islands, such term does not include an individual who is a bona fide resident of the Virgin Islands and whose income tax obligation under subtitle A (relating to income taxes) of the Code for the taxable year is satisfied pursuant to section 28(a) of the Revised Organic Act of the Virgin Islands, approved July 22, 1954 (48 U.S.C. 1642), by paying tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands,

(3) With respect to a corporation organized under the laws of Guam or the Northern Mariana Islands, such term does not include an individual who is a bona fide resident of Guam or the Northern Mariana Islands, respectively, and who is relieved of liability for income tax to the United States under section 935(c)(3) of the

Code or section 601 of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (P.L. 94-241), respectively, for such individual's taxable year referred to in paragraph (e) of this section, and

(4) With respect to a corporation organized under the laws of any possession of the United States (other than Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands), such term does not include an individual who is a bona fide resident of such possession for the entire taxable year and whose income derived from sources within any possession of the United States is not, by reason of section 931(a), includible in gross income under subtitle A (relating to income taxes) of the Code for the taxable year.

An individual for whom an election under section 6013(g) or (h) is in effect shall, subject to the exceptions contained in this paragraph (d), be considered a United States person for purposes of section 6038 and this section.

(e) *Period covered by return.* The information required under paragraphs (f) and (g) of this section with respect to a foreign corporation shall be furnished for the annual accounting period of the foreign corporation ending with or within the United States person's taxable year. For purposes of this section, the annual accounting period of a foreign corporation is the annual period on the basis of which that corporation regularly computes its income in keeping its books. The term "annual accounting period" may refer to a period of less than one year, where, for example, the foreign income, war profits, and excess profits taxes are determined on the basis of an accounting period of less than one year as described in section 902(c)(2). If more than one annual accounting period ends with or within the United States person's taxable year, separate annual information returns shall be submitted for each annual accounting period.

(f) *Contents of return.* The return on Form 2952 or Form 5471 shall contain the following information with respect to each foreign corporation:

(1) The name, address, and employer identification number, if any, of the corporation;

(2) The principal place of business of the corporation;

(3) The date of incorporation and the country under whose laws incorporated;

(4) The name and address of the foreign corporation's statutory or resident agent in the country of incorporation;

(5) The name, address, and identifying number of any branch office or agent of the foreign corporation located in the United States;

(6) The name and address of the person (or persons) having custody of the books of account and records of the foreign corporation, and the location of such books and records if different from such address;

(7) The nature of the corporation's business and the principal places where conducted;

(8) As regards the outstanding stock of the corporation—

(i) A description of each class of the corporation's stock, and

(ii) The number of shares of each class outstanding at the beginning and end of the annual accounting period;

(9) A list showing the name, address, and identifying number of, and the number of shares of each class of the corporation's stock held by, each United States person who is a shareholder owning at any time during the annual accounting period 5 percent or more in value of any class of the corporation's outstanding stock;

(10) For the annual accounting period, the amount of the corporation's:

(i) Current earnings and profits;

(ii) Foreign income, war profits, and excess profits taxes paid or accrued;

(iii) Distributions out of current earnings and profits for the period; and

(iv) Distributions other than those described in paragraph (f)(10)(iii) of this section and the source thereof;

(11) A summary showing the total amount of each of the following types of transactions of the corporation, which took place during the annual accounting period, with the person required to file this return, any other corporation controlled by that person, or any United States person owning at the time of the transaction 10 percent or more in value of any class of stock outstanding of the foreign corporation; or of any corporation controlling that foreign corporation:

(i) Sales and purchases of stock in trade;

(ii) Purchases of tangible property other than stock in trade;

(iii) Sales and purchases of patents, inventions, models, or designs (whether or not patented), copyrights, trademarks, secret formulas or processes, or any other similar property rights;

(iv) Compensation paid and compensation received for the rendition of technical, managerial, engineering, construction, scientific, or like services;

(v) Commissions paid and commissions received;

(vi) Rents and royalties paid and rents and royalties received;

(vii) Amounts loaned and amounts borrowed (except open accounts resulting from sales and purchases reported under other items listed in this paragraph (f)(11) that arise and are collected in full in the ordinary course of business);

(viii) Dividends paid and dividends received;

(ix) Interest paid and interest received; and

(x) Premiums received for insurance or reinsurance; and

(12) Such other information as the form shall prescribe which is similar or related in nature to that specified in paragraph (f)(1) through (f)(11) of this section.

For purposes of paragraph (f)(11) of this section, if the United States person is a bank, as defined in section 581, or is controlled within the meaning of section 368(c) by a bank, the term "transactions" shall not, as to a corporation with respect to which a return is filed, include banking transactions entered into on behalf of customers; in any event, however, de-

posits in accounts between a foreign corporation, controlled (within the meaning of paragraph (b) of this section) by a United States person, and a person described in paragraph (f)(11) of this section and withdrawals from such accounts shall be summarized by reporting end-of-month balances.

(g) *Financial statements.* The following information with respect to the foreign corporation shall be attached to and filed as part of the return required by this section:

(1) A statement of the corporation's profit and loss for the annual accounting period;

(2) A balance sheet as of the end of the annual accounting period of the corporation showing—

(i) The corporation's assets,

(ii) The corporation's liabilities,

(iii) The corporation's net worth;

(3) An analysis of changes in the corporation's surplus accounts during the annual accounting period including both opening and closing balances. This information listed in this paragraph (g) shall be prepared in conformity with generally accepted accounting principles, and in such form and detail as is customary for the corporation's accounting records.

(h) *Method of reporting.* All amounts furnished under paragraphs (f) and (g) of this section shall be expressed in United States currency with a statement of the exchange rates used. All statements submitted on or with the return required under this section shall be rendered in the English language.

(i) *Time and place for filing return.* Returns on Form 2952 or Form 5471 required under paragraph (a) of this section shall be filed with the United States person's income tax return on or before the date required by law for the filing of that person's income tax return. District directors are authorized to grant reasonable extensions of time for filing returns on Form 2952 or Form 5471 in accordance with the applicable provisions of §1.6081-1 of this chapter. An application for an extension of time for filing a return of income shall also be considered as an application for an extension of time for filing returns on Form 2952 or Form 5471.

(j) *Two or more persons required to submit the same information*—(1) *Return jointly made.* If two or more persons are required to furnish information with respect to the same foreign corporation for the same period, such persons may, in lieu of making separate returns, jointly make one return. Such joint return shall be filed with the income tax return of any one of the persons making such joint return.

(2) *Persons excepted from furnishing information*—(i) *Conditions.* Any person required to furnish information under this section with respect to a foreign corporation need not furnish that information provided all of the following conditions are met:

(A) Such person does not directly own an interest in the foreign corporation;

(B) Such person is required to furnish the information solely by reason of attribution of stock ownership from a United States person under paragraph (c) of this section; and

(C) The person from whom the stock ownership is attributed furnishes all of the information required under this section of the person to whom the stock ownership is attributed.

(ii) *Illustrations.* The rule of this paragraph (j)(2) is illustrated by the following examples:

Example (1). A, a U.S. person owns 100 percent of the stock of M, a domestic corporation. A also owns 100 percent of the stock of N, a foreign corporation organized under the laws of foreign country Y. A, in filing the information return required by this section with respect to N Corporation, in fact furnishes all of the information required of M Corporation with respect to N Corporation. M Corporation need not file the information.

Example (2). X, a domestic corporation, owns 100 percent of the stock of Y, a domestic corporation. Y Corporation owns 100 percent of the stock of Z, a foreign corporation. X Corporation is not excused by this paragraph (j)(2) from filing information with respect to Z Corporation because X Corporation is deemed to control Z Corporation under the provisions of paragraph (b) of this section without recourse to the attribution rules in paragraph (c) of this section.

(3) *Statement required.* Any United States person required to furnish information under this section with his return who does not do so by reason of the provisions of paragraph (j)(1) or (j)(2) of this section shall file a statement with his return indicating that such liability has been (or, in the case of a joint return made under paragraph (j)(1) of this section, will be) satisfied and identifying the return with which the information was or will be filed and the place of filing.

(k) *Failure to furnish information—*

(1) Dollar amount penalty—(i) *In general.* If any person required to file Form 2952 or Form 5471 under section 6038 and this section fails to furnish any information described in paragraphs (f) and (g) of this section within the time prescribed by paragraph (i) of this section, such person shall pay a penalty of $1,000 for each annual accounting period of each foreign corporation with respect to which such failure occurs.

(ii) *Increase in penalty for continued failure after notification.* If a failure described in paragraph (k)(1)(i) of this section continues for more than 90 days after the date on which the district director mails notice of such failure to the person required to file Form 2952 or Form 5471, such person shall pay a penalty of $1,000, in addition to the penalty imposed by section 6038(b)(1) and paragraph (k)(1)(i) of this section, for each 30-day period (or fraction thereof) during which such failure continues after such 90-day period has expired. The additional penalty imposed by section 6038(b)(2) and this paragraph (k)(1)(ii) shall be limited to a maximum of $24,000 for each failure.

(iii) *Effective date.* The penalty imposed by section 6038(b) and this paragraph (k)(1) shall apply with respect to information for annual accounting periods ending after September 3, 1982.

(2) *Penalty of reducing foreign tax credit*—(i) *Effect on foreign tax credit.* Failure of a United States person to furnish, in accordance with the provisions of this section, any return or any information in any return, required to be filed for a taxable year under authority of section 6038 on or before the date prescribed in paragraph (i) of this section may affect the application of section 901 as provided in paragraph (k)(2)(ii) of this section and may affect the application of sec-

tions 902 and 960 as provided in paragraph (k)(2)(iii) of this section. Such failure may affect the application of sections 902 and 960 to any such United States person which is a corporation or to any person who acquires from any other person any portion (but only to the extent of such portion) of the interest of such other person in any such foreign corporation.

(ii) *Application of section 901.* In the application of section 901 to a United States person referred to in paragraph (k)(2)(i) of this section, the amount of taxes paid or deemed paid by such person for any taxable year, with or within which the annual accounting period of a foreign corporation for which such person failed to furnish information required under this section ended may be reduced by 10 percent. However, no tax reduced under paragraph (k)(2)(iii) of this section or deemed paid under section 904(c) shall be reduced under the provisions of this paragraph (k)(2)(ii).

(iii) *Application of sections 902 and 960.* In the application of sections 902 and 960 to a United States person referred to in paragraph (k)(2)(i) of this section for any taxable year, the amount of taxes paid or deemed paid by each foreign corporation for the accounting period or periods for which such person was required for the taxable year of the failure to furnish information under this section may be reduced by 10 percent. The 10-percent reduction is not limited to the taxes paid or deemed paid by the foreign corporation with respect to which there is a failure to file information but may apply to the taxes paid or deemed paid by all foreign corporations controlled by that person. In applying subsections (a) and (b) of section 902, and in applying subsection (a) of section 960, the reduction provided by this paragraph (k)(2) shall not apply for purposes of determining the amount of accumulated profits in excess of income, war profits, and, excess profits taxes.

(iv) *Reduction for continued failure after notice.* (A) If the failure referred to in paragraph (k)(2)(i) of this section continues for more than 90 days after the date on which the district director mails notice of such failure to such United States person, then the amount of the reduction referred to in paragraph (k)(2)(ii) and (iii) of this section may be 10 percent plus an additional 5 percent for each 3-month period, or fraction thereof, during which such failure continues after the expiration of such 90-day period.

(B) No taxes shall be reduced under this paragraph (k)(2) more than once for the same failure. Taxes paid by a foreign corporation when once reduced for a failure shall not be reduced again for the same failure in their status as taxes deemed paid by a corporate shareholder. Where a failure continues, each additional periodic 5-percent reduction, referred to in paragraph (k)(2)(iv)(A) of this section, shall be considered as part of the one reduction.

(v) *Limitation on reduction of foreign tax credit.* The amount of the reduction under this paragraph (k)(2) for each failure to furnish information with respect to a foreign corporation as required under this section shall not exceed the greater of:

(A) $10,000, or

(B) The income of the foreign corporation for its annual accounting period with respect to which the failure occurs.

For purposes of this section if a person is required to furnish information with respect to more than one foreign corporation, controlled (within the meaning of paragraph (b) of this section) by that person, each failure to submit information for each such corporation constitutes a separate failure.

(vi) *Offset for dollar amount penalty imposed.* The total amount of the reduction or reductions which, but for this paragraph (k)(2)(vi), may be made under this paragraph (k)(2) with respect to any separate failure, shall not exceed the maximum amount of such reductions which may be imposed, reduced (but not below zero) by the amount of the dollar amount penalty imposed by paragraph (k)(1) of this section with respect to such separate failure.

(3) *Reasonable cause*—(i) For purposes of section 6038(b) and (c) and this section, the time prescribed for furnishing information under paragraph (i) of this section, and the beginning of the 90-day period after mailing of notice by the district director under paragraph (k)(1)(ii) and (k)(2)(iv)(A) of this section, shall be treated as being not earlier than the last day on which reasonable cause existed for failure to furnish the information.

(ii) To show that reasonable cause existed for failure to furnish information as required by section 6038 and this section, the person required to report such information must make an affirmative showing of all facts alleged as reasonable cause for such failure in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return is required to be filed. The district director or the director of the service center shall determine whether the failure to furnish information was due to reasonable cause, and if so, the period of time for which such reasonable cause existed.

(4) *Other penalties.* The information required by section 6038 and this section must be furnished even though there are no foreign taxes which would be reduced under the provisions of this section, and even though the information required may not affect the amount of any tax due under the Internal Revenue Code.

For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207 of the Code.

(5) *Illustrations.* The provisions of this paragraph may be illustrated by the following examples.

Example (1). M, a domestic corporation, owns 100 percent of the stock of N, a foreign corporation. Both M and N use the calendar year as a taxable year and annual accounting period, and all of the following events occur in or with respect to the 1980 taxable year. The dividend from N is the only dividend from a foreign corporation received by M during the taxable year, and the foreign taxes listed are the only foreign taxes paid or deemed paid by M and N for the taxable year. On March 15, 1981, M filed its income tax return and paid its income tax, but M did not file Form 2952 with respect to N's 1980 annual accounting period. On June 1, 1981, the district director mailed notice to M of M's failure to file Form 2952 with respect to N. On November 30, 1981, M filed a

complete Form 2952 with respect to N's 1980 annual accounting period.

(a) Gains, profits, and income of N	$100,000
(b) Foreign tax paid by N with respect to such gains, profits, and income	40,000
(c) Reduction of foreign tax paid by N (for purposes of M's section 902 deemed paid credit) resulting from M's failure to file information with respect to N as required under section 6038(a) and this section: failure to file within the time prescribed in paragraph (i) of this section, 10-percent reduction; continued failure for one additional 3-month period after 90-day period after notice mailed, 5-percent reduction; total reduction, 15 percent ($40,000 times 15 percent)	6,000
(d) Foreign tax paid by N after section 6038(c)(1)(B) reduction	34,000
(e) Dividend paid by N to M	45,000
(f) Accumulated profits of N as defined in section 902(c)(1) (determined without regard to the section 6038(c)(1)(B) reduction)	100,000
(g) Accumulated profits of N as described in section 902(a) (determined without regard to the section 6038(c)(1)(B) reduction)	60,000
(h) For purposes of the section 902 credit, M is deemed to have paid the same proportion of foreign taxes paid (reduced as provided under section 603(c)) with respect to the accumulated profits described in section 902(a) (determined without regard to the reduction provided under section 6038(c)) as the amount of the dividend (determined without regard to section 78) bears to such amount of accumulated profits	25,500

(45,000 ÷ 60,000) × 34,000

M must include $25,500 in gross income as a dividend under the provisions of section 78 of the Code. This example illustrates that the reductions in foreign taxes paid by the foreign corporation provided under section 6038(c) are taken into account in determining the amount included in gross income of the domestic corporation under section 78 of the Code as foreign taxes deemed paid, but such reductions are not taken into account in computing accumulated profits for purposes of determining the portion of foreign taxes deemed paid with respect to a particular dividend. The dollar amount penalty imposed by section 6038(b) and paragraph (k)(1) of this section does ot apply with respect to information for annual accounting periods ending before September 4, 1982, and therefore does not apply to M with respect to M's failure to file Form 2952 in this example.

Example (2). The facts are the same as in example (1) except that all of the events occur in or with respect to the 1982 taxable year. On March 15, 1983, M filed its income tax return and paid its income tax, but M did not file Form 2952 or Form 5471 with respect to N's 1982 annual accounting period. On June 1, 1983, the district director mailed notice to M of M's failure to file Form 2952 or Form 5471 with respect to N. On November 30, 1983, M filed a complete Form 5471 with respect to N's 1982 annual accounting period. Under paragraph (k)(1)(i) of this section, M is subject to a penalty of $1,000. Under paragraph (k)(1)(ii) of this section, that penalty is increased by $4,000 because the failure continued for 92 days (three full 30-day periods and a fraction of a fourth 30-day period) after the end of the 90-day period following mailing of the notice by the district director, bringing M's dollar amount penalty under paragraph (k)(1) of this section to $5,000. For purposes of determining the foreign tax credit available to M, there may be imposed a reduction of foreign tax paid by N of $6,000, which would be the total of reductions under paragraph (k)(2) of this section with respect to M's failure to file under section 6038 for N's 1982 annual accounting period, before application of paragraph (k)(2)(vi) of this section. Under said paragraph (k)(2)(vi), the amount of the foreign tax reduction imposed is reduced by the amount of the dollar amount penalty, leaving a foreign tax reduction penalty of $1,000 which may be imposed in addition to the $5,000 dollar amount penalty. If imposed, the $1,000 tax reduction would then be applied in the calculation of taxes deemed paid by M under section 902, as in example (1), items (c), (d), and (h).

Par. 2. There is added after §1.6038-2 the following new section.

§1.6038A-1 Information returns required of certain foreign-owned corporations.

(a) *Requirement of return.* Every corporation which at any time during its taxable year is a reporting corporation (described in paragraph (b)(1) of this section) shall make a separate annual information return on Form 5472 with respect to each related corporation (described in paragraph (b)(4) of this section) with which such reporting corporation has had any transaction described in paragraph (c)(2) of this section during such taxable year.

(b) *Definitions*—(1) *Reporting corporation.* For purposes of section 6038A and this section, a corporation is a reporting corporation if—

(i) It is a domestic corporation or is a foreign corporation engaged in a trade or business within the United States, and

(ii) It is controlled (as defined in paragraph (b)(2) of this section) by a foreign person. Nevertheless, a foreign corporation all of whose income is not subject to United States taxation is not a reporting corporation for purposes of section 6038A and this section.

(2) *Control*—(i) *Generally.* A corporation shall be deemed to be controlled by a foreign person if at any time during that corporation's taxable year such foreign person owns stock possessing at least 50 percent of the total combined voting power of all classes of outstanding stock of the corporation entitled to vote, or stock possessing at least 50 percent of the total value of outstanding shares of all classes of stock of the corporation. A corporation that is controlled (by this same test) by another corporation, which, in turn, is controlled by a foreign person, is also treated as being controlled by such foreign person. The provisions of this paragraph (b)(2)(i) are illustrated by the following example:

Example. F, a foreign person, owns 50 percent of the voting stock of X, a domestic corporation. X owns 50 percent of the total value of shares of all classes of stock of Y, also a domestic corporation. Y is controlled by F for purposes of section 6038A and this section.

(ii) *Attribution rules.* For the purpose of determining ownership of stock of domestic or foreign corporations under section 6038A and this section, the constructive ownership rules of section 318(a) shall apply, except that section 318(a)(2)(C) shall be applied by substituting the phrase "10 percent" for the phrase "50 percent".

(3) *Foreign person.* For purposes of section 6038A and this section, a foreign person is—

(i) Any individual who is not a citizen or resident of the United States, including any individual who is a citizen of any possession of the United States but is not otherwise a citizen of the United States and is not a resident of the United States;

(ii) Any partnership, association, company, or corporation which is not created or organized in the United States or under the law of the United States or any State thereof; or

(iii) Any foreign trust or foreign estate, as defined in section 7701(a)(31).

(4) *Related corporation.* For purposes of section 6038A and this section, a related corporation is any corporation which is a member of the same controlled group (as defined in paragraph (b)(5) of this section) as the reporting corporation. The term "member" shall include any component member, excluded member, or additional member (as defined in sec-

tion 1563(b)) of such group.

(5) *Controlled group.* For purposes of section 6038A and this section, the term "controlled group" has the meaning given to such term by section 1563(a), except that—

(i) Section 1563(a)(1) shall be applied by substituting the term "at least 50 percent" for the term "at least 80 percent" each time it appears;

(ii) Section 1563(a)(2)(B) shall be applied by substituting the term "at least 50 percent" for the term "more than 50 percent" each time it appears; and

(iii) Section 1563(a)(4), (b)(2)(C), and (e)(3)(C) shall not apply.

(c) *Contents of return*—(1) *The related corporation.* The return on Form 5472 shall contain such information as the form shall prescribe, with respect to each related corporation with which the reporting corporation has had a transaction required to be reported under paragraph (c)(2) of this section during its taxable year, relating to:

(i) The name, address, and U.S. employer identification number, if any, of the corporation;

(ii) The nature of the corporation's business or businesses and the principal place or places where conducted;

(iii) The country in which the corporation is organized, and each country in which the corporation is resident (as determined under the laws of such country);

(iv) If the corporation is a foreign corporation, the name and address of the corporation's statutory or resident agent in its country of organization and each country of residence, and the name and address of the principal branch office or agent of such corporation located in the United States;

(v) If the corporation is a domestic corporation for which an address in the United States was not provided under paragraph (c)(1)(i) or (ii) of this section, the name and address of such corporation's office or agent in the United States;

(vi) The name and address of the person or persons having custody of the books of account and records of the corporation, and the location of such books and records if different from such address; and

(vii) The relationship of the reporting corporation to the related corporation (such as reporting corporation controls related corporation, reporting corporation is controlled by related corporation, or reporting and related corporations are under common control).

(2) *Transactions with related foreign corporations*—(i) *Transactions for which monetary consideration was paid or received.* If the related corporation is a foreign corporation, the return on Form 5472 shall contain, with respect to transactions (other than transactions excepted by paragraph (c)(2)(iii) of this section) of the reporting corporation with the related corporation, a summary showing the total dollar amount of each of the following types of transactions for which monetary consideration (U.S. currency and/or foreign currency) was the sole consideration paid or received, during the taxable year of the reporting corporation:

(A) Sales and purchases of stock in trade;

(B) Sales and purchases of tangible property other than stock in trade;

(C) Rents and royalties paid and received (other than amounts reported under paragraph (c)(2)(i)(D) of this section);

(D) Sales, purchases, and amounts paid and received as consideration for the use of intangible property such as copyrights, designs, formulas, inventions, models, patents, processes, trademarks, and other similar property rights;

(E) Consideration paid and received for the rendition of accounting, clerical, construction, engineering, managerial, scientific, technical, and other types of services;

(F) Commissions paid and received;

(G) Amounts loaned and borrowed (except open accounts resulting from sales and purchases reported under other items listed in this paragraph (c)(2)(i) that arise and are collected in full in the ordinary course of business;

(H) Interest paid and received;

(I) Premiums paid and received for insurance and reinsurance; and

(J) Such other transactions as the form shall prescribe.

(ii) *Transactions involving nonmonetary consideration or no consideration.* If the related corporation is a foreign corporation, the return on Form 5472 shall contain descriptions of any transactions of the types listed in paragraph (c)(2)(i) of this section (other than transactions excepted by paragraph (c)(2)(iii) of this section), of the reporting corporation with the related corporation, for which any consideration paid or received was other than monetary consideration described in paragraph (c)(2)(i) of this section, or for which no consideration was paid or received. A description of a transaction required under this paragraph (c)(2)(ii) shall describe—

(A) All property (including monetary consideration), rights, or obligations transferred from the reporting corporation to the related corporation and from the related corporation to the reporting corporation,

(B) All services performed by the reporting corporation for the related corporation and by the related corporation for the reporting corporation, and

(C) The fair market value of all such property, rights, obligations, and services that are involved in the transaction.

(iii) *Exception.* This paragraph (c)(2) shall not apply to any transaction if neither party to the transaction is a United States person and the transaction—

(A) Does not give rise to any income or gain which is from sources within the United States or which is effectively connected with the conduct of a trade or business within the United States,

(B) Does not give rise to any expense, loss, or other deduction properly allocable or apportionable to such income, and

(C) Does not, in any way, affect any United States income tax obligation of either party to the transaction or any person that controls either party to the transaction in any taxable year.

(iv) *Accrued payments and re-*

ceipts. For purposes of this section, in the case of an accrual basis taxpayer the terms "paid" and "received" shall include accrued payments and receipts, respectively.

(d) *Method of reporting.* All statements required on or with the return on Form 5472 under this section shall be rendered in the English language. All amounts of consideration or value required to be reported under this section shall be expressed in terms of United States currency, with a statement of any exchange rates used.

(e) *Time and place for filing return.* Returns on Form 5472 required under this section shall be filed with the reporting corporation's income tax return on or before the date required by law (including extensions of time) for the filing of such income tax return or March 15, 1984, whichever is later.

(f) *Penalty for failure to furnish information*—(1) *In general.* If a corporation required to file Form 5472 under section 6038A and this section fails to furnish any information described in paragraph (c) of this section within the time prescribed by paragraph (e) of this section, such corporation shall pay a penalty of $1,000 for each taxable year with respect to which such information is not timely reported.

(2) *Increase in penalty for continued failure after notification.* If a failure described in paragraph (f)(1) of this section continues for more than 90 days after the date on which the district director mails notice of such failure to the reporting corporation, that corporation shall pay a penalty of $1,000, in addition to the penalty imposed by section 6038A(d)(1) and paragraph (f)(1) of this section, for each 30-day period (or fraction thereof) during which such failure continues after such 90-day period has expired. The additional penalty imposed by section 6038A(d)(2) and this paragraph (f)(2) shall be limited to a maximum of $24,000 for each failure.

(3) *Reasonable cause*—(i) For purposes of section 6038A(d) and this section, the time prescribed for furnishing information under paragraph (e) of this section, and the beginning of the 90-day period after mailing of notice by the district director under paragraph (f)(2) of this section, shall be treated as being not earlier than the last day on which reasonable causes existed for failure to furnish the information.

(ii) To show that reasonable cause existed for failure to furnish information as required by section 6038A and this section, the reporting corporation must make an affirmative showing of all facts alleged as reasonable cause for such failure in a written statement containing a declaration that it is made under the penalties of perjury. The statement must be filed with the district director for the district or the director of the service center where the return is required to be filed. The district director or the director of the service center shall determine whether the failure to furnish information was due to reasonable cause, and if so, the period of time for which such reasonable cause existed.

(4) *Other penalties.* The information required by section 6038A and this section must be furnished even though it may not affect the amount of any tax due under the Internal Revenue Code. For criminal penalties for failure to file a return and filing a false or fraudulent return, see sections 7203, 7206, and 7207 of the Code.

(g) *Effective date.* This regulation is effective for taxable years beginning after December 31, 1982.

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the office of the Federal Register on December 16, 1983; 8:45 a.m., and published in the issue of the Federal Register for December 19, 1983, 48 F.R. 56076)

Notice of Proposed Rulemaking

Corporate Estimated Income Tax

LR-228-82

SUMMARY: This document contains proposed regulations which provide guidance to corporations with respect to estimated tax requirements. Changes to the applicable tax law were made by the Omnibus Reconciliation Act of 1980 [Pub. L. 96-499, 1980-2 C.B. 509], the Economic Recovery Tax Act of 1981 [Pub. L. 97-34, 1981-2 C.B. 256], and the Tax Equity and Fiscal Responsibility Act of 1982 [Pub. L. 97-248, 1982-2 C.B. 462]. The regulations would provide corporations with the guidance needed to comply with applicable provisions of these acts.

DATES: Written comments and requests for a public hearing must be delivered by May 25, 1984. Generally, these regulations are proposed to be effective for taxable years beginning after December 31, 1982. The regulations providing guidance to "large corporations" are proposed to be effective for taxable years beginning after December 31, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-228-82), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George T. Magnatta of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 6152, 6164, 6654, and 6655 of the Internal Revenue Code of 1954 and to the Regulations on Procedure and Administration (26 CFR Part 301) under section 6655 of the Code. These amendments are proposed to conform the regulations to section 1111 of the Omnibus Reconciliation Act of 1980 (Pub. L. 96-499; 94 Stat. 2681) [1980-2 C.B. 509, 523], section 731 of the Economic Recovery Tax Act of 1981 (Pub. L. 97-34; 95 Stat. 346) [1981-2 C.B. 256, 347], and section 234 of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97-248; 96 Stat. 503) [1982-2 C.B. 462, 511] and are to be issued under

the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

GENERAL RULES

A corporation is required to make payments of estimated tax if it reasonably expects to have an estimated tax liability for the taxable year of $40 or more (*see* section 6154). Generally, a corporation is required to pay a percentage of its current year's tax liability in quarterly estimated tax installments. Under section 6655, if a corporation fails to pay its estimated tax installment when due and does not meet any exception to an underpayment, the corporation is subject to a penalty for underpayment of estimated taxes. The amount of the penalty is determined at the rate established under section 6621.

Under prior law, the penalty with respect to any underpayment of any installment was not imposed in any case where the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installment equalled or exceeded the amount which would have been due had the estimated tax been based on any of the following: (1) the tax shown on the return for the preceding taxable year, if a return showing a tax liability was filed for the preceding taxable year and such preceding year was a taxable year of 12 months; (2) the tax computed at the rates applicable to the current taxable year but using the facts and law applicable to the preceding taxable year; or (3) 80 percent of the taxes which would have been due if the corporation's taxable income for specified preceding periods of the taxable year were annualized (annualization exception).

Additionally, for taxable years beginning prior to 1983, a corporation could elect under section 6152 to pay only half of its unpaid tax 2½ months after the end of its taxable year and the remaining one-half 3 months later.

The Omnibus Reconciliation Act of 1980 amended section 6655 to provide that, in order to come within exception (1) (relating to the preceding year's tax) or (2) (relating to the preceding year's facts and law), described above, a large corporation's estimated tax payments must in no event be less than 60 percent of the current year's tax. The Economic Recovery Tax Act of 1981 further amended section 6655 to provide that for taxable years beginning in 1984 and thereafter exceptions (1) and (2) are no longer available to large corporations. A transitional rule provides that for taxable years beginning in 1981, 1982, or 1983, a large corporation's estimated tax payments shall in no event be less than 60 percent, 65 percent, and 75 percent, respectively, of the current year's tax in order to come within exception (1) or (2). Exception (3) (relating to the annualization of income) is still available to a large corporation.

For purposes of section 6655, a corporation is considered a large corporation if it (or its predecessor) had taxable income of at least $1 million or more in any of the 3 taxable years immediately preceding the taxable year involved ("testing period").

In determining a corporation's taxable income for any of the taxable years during the testing period, the proposed regulations provide that items which may be carried back under other Code provisions (*e.g.*, those described in sections 172 and 1212) from one of the years in the testing period to another year in the testing period are taken into account. Additionally, if a corporation's taxable income for a year during the testing period is redetermined during that testing period, by reason of an examination by the Internal Revenue Service or otherwise, such redetermination shall be taken into account in determining whether the corporation is "large" for its present taxable year. Any items that are carried forward under other Code provisions are also taken into account in determining a corporation's taxable income during the testing period.

In the case of component members of a controlled group of corporations (as defined in section 1563), the proposed regulations provide that the $1 million amount for any taxable year in the 3-year testing period is divided equally among the component members of such group unless all of such component members consent to an apportionment plan providing for an unequal allocation of such amount. There are special rules for the computation of taxable income for a year in the 3-year testing period where a transaction described in section 381(a) occurs.

For taxable years beginning after December 31, 1982, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) increases from 80 percent to 90 percent the amount of a corporation's current tax liability that must be paid in installments. If a corporation makes estimated tax payments of at least 80 percent of its tax liability, the penalty for underpayment of estimated taxes is imposed at three-quarters of the full rate on underpayments determined under section 6621.

Similarly, TEFRA increases from 80 percent to 90 percent the amount of taxes that must be paid under the annualization exception.

An additional exception to the underpayment penalty is added by TEFRA. This new exception applies to a corporation with recurring seasonal income. Under this exception, income may be annualized by assuming that income earned in the current year is earned in the same pattern as in the 3 preceding taxable years. Thus, if a corporation pays its estimated tax installments as if taxable income for the taxable year is earned in the same seasonal pattern as in the preceding 3 years, no penalty for underpayment will be imposed. This exception is available to a large corporation.

TEFRA repealed section 6152 as it applies to corporations. The proposed regulations reflect this change.

Finally, the proposed regulations provide guidance with respect to how a corporation must compute its taxable income for a period of less than a full taxable year when using the annualization exceptions to the underpayment penalty.

REGULATORY FLEXIBILITY ACT

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal

Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

NON-APPLICATION OF EXECUTIVE ORDER 12291

The Treasury Department has determined that this proposed regulation is not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

Paperwork Reduction Act

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB. Attention: Desk Officer for Internal Revenue Service. New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is George T. Magnatta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Parts 1 and 301 are as follows:

PART 1—INCOME TAX REGULATIONS

Paragraph 1. Paragraph (a)(1) of §1.6152-1, relating to privilege of corporation to elect to make installment payments, is amended by removing "ending on or after December 31, 1954," and adding "beginning before January 1, 1983," in lieu thereof.

Par. 2. Paragraph (a) of §1.6164-4 is amended to read as follows:

§1.6164-4 Payment of remainder of tax where extension relates only to part of the tax.

(a) *Time for payment.* If an extension of time relates only to part of the tax, the time for payment of the remainder of the tax shall be considered to be the date on which payment would have been required if such remainder had been the tax.

* * * * *

Par. 3. Paragraph (a) of §1.6164-8 is amended to read as follows:

§1.6164-8 Payments on termination.

(a) *In general.* If an extension of time under section 6164 is terminated with respect to any amount either (1) by the filing of a new statement by the taxpayer under section 6164(e) extending the time for payment of a lesser amount than was extended in a prior statement, or (2) by action of the district director under section 6164(f) after making an examination of the statement filed by the corporation, no further extension of time may be made under section 6164 with respect to such amount. The time for payment of such amount shall be the date on which payment would have been required if there had been no extension with respect to such amount.

* * * * *

Par. 4. Paragraph (d)(1)(i) of §1.6654-2 is amended to read as follows:

§1.6654-2 Exceptions to imposition of the addition to the tax in the case of individuals.

* * * * *

(d) *Determination of taxable income for portion of taxable year*—(1) *In general.* (i) In determining the applicability of the exceptions described in paragraph (a)(2) and (3) of this section, there must be a reasonably accurate determination of the amount of income and deductions for the calendar months in the calendar year preceding the installment date as of which the determination is made, that is, for the period terminating with the last day of the third, fifth, or eighth month of the taxable year. See paragraph (e) of §1.6655-2 (relating to a similar requirement with respect to corporations) for special rules to be used in computing such income and deductions.

* * * * *

Par. 5. Section 1.6655-1 is amended to read as follows:

§1.6655-1 Addition to the tax in the case of a corporation.

(a) *In general.* Section 6655 imposes an addition to the tax under chapter 1 of the Code in the case of any underpayment of estimated tax by a corporation (with certain exceptions described in section 6655(d) and (e)). This addition to the tax is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment.

(b) *Amount of underpayment*—(1) *Installments for taxable years beginning after January 1, 1983.* In the case of an installment for a taxable year beginning before January 1, 1983, the amount of the underpayment for any installment date is the excess of—

(i) 80 percent of the tax shown on the return for the taxable year or, if no return was filed, 80 percent of the tax for such year, multiplied by the

percentage of estimated tax required to be paid on or before the installment date, over

(ii) The amount, if any, of the installment paid on or before the last date prescribed for such payment.

(2) *Rate of addition and period of underpayment—Installments due for taxable years beginning before January 1, 1983.* With respect to an amount of underpayment determined under subparagraph (1), the amount of the addition is determined at the annual rate referred to in the regulations under section 6621 upon the underpayment of any installment of estimated tax for the period from the date such installment is required to be paid until the 15th day of the 3rd month following the close of the taxable year, or the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment, (i) the date prescribed for payment of any installment of estimated tax shall be determined without regard to any extension of time, and (ii) a payment of estimated tax on any installment date, to the extent that it exceeds the amount of the installment determined under subparagraph (1)(i) of this paragraph for such date, shall be considered a payment of the previous underpayment, if any.

(3) *Installments for taxable years beginning after December 31, 1982.* In the case of an installment for a taxable year beginning after December 31, 1982, the amount of the underpayment for any installment date is the excess of—

(i) 90 percent of the tax shown on the return for the taxable year or, if no return was filed, 90 percent of the tax for such year, multiplied by the percentage of estimated tax required to be paid on or before the installment date, over

(ii) The amount, if any, of the installment paid on or before the last date prescribed for such payment.

(4) *Rate of addition and period of underpayment—Installments due for taxable years beginning after December 31, 1982.* (i) Except as provided in (ii) of this subparagraph, with respect to an amount of underpayment determined under subparagraph (3), the amount of the addition is determined at the annual rate referred to in the regulations under section 6621 upon the underpayment of any installment of estimated tax for the period of the underpayment.

(ii) In any case where there would be no underpayment if "80 percent" in subparagraph (3) were substituted for "90 percent" each place it appears, the addition to tax shall be 75 percent of the amount otherwise determined under section 6621 and subdivision (i).

(iii) The period of the underpayment of any installment shall run from the date the installment was required to be paid until the 15th day of the 3rd month following the close of the taxable year, or the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment, (A) the date prescribed for payment of any installment of estimated tax shall be determined without regard to any extension of time, and (B) a payment of estimated tax on any installment date, to the extent that it exceeds the amount of the installment determined under subparagraph (3)(i) of this paragraph for such date, shall be considered a payment of the previous underpayment, if any.

(5) *Definition of term "tax".* The term "tax" as used in subparagraph (1)(i) and (3)(i) of this paragraph means the excess of—

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Code, whichever is applicable, over

(ii) The sum of—

(A) The credits against tax provided by part IV of subchapter A of chapter 1 of the Code, plus

(B) [reserved].

(6) *Special rules for consolidated returns.* For special rules relating to the determination of the amount of the underpayment in the case of a corporation whose income is included in a consolidated return, see §1.1502-5(b).

(c) *Statement relating to underpayment.* If there has been an underpayment of estimated tax as of the installment date prescribed for its payment and the taxpayer believes that one or more of the exceptions described in §1.6655-2 or §1.6655-3 precludes the assertion of the addition to the tax under section 6655, it should attach to its income tax return for the taxable year a Form 2220 showing the applicability of any exception upon which the taxpayer relies.

(d) *Examples.* The method prescribed in paragraph (b)(3) and (4) of this section may be illustrated by the following examples:

Example (1). X, a corporation which reports on a calendar year basis, anticipates that its estimated tax for 1983 will be in the amount of $54,000. It makes payments of $13,500 each on April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983. On March 15, 1984, X files its income tax return showing a tax imposed of $70,000, with a total of $5,000 of allowable credits against tax. The addition to tax under section 6655(a) is computed as follows:

(1)	Tax as defined in (b)(5) of this section ($70,000 - $5,000)	$65,000
(2)	90% of item (1)	58,500
(3)	Amount of estimated tax required to be paid on each installment date (25% of $58,500)	14,625
(4)	Deduct amount paid on each installment date	13,500
(5)	Amount of underpayment for each installment date (item (3) minus item (4))	$1,125

(6) Addition to tax, assuming that none of the exceptions provided by section 6655(d) and (e) and §§1.6655-2 and 1.6655-3 are applicable, and assuming the addition is computed at the rate of 11 percent per annum applicable to periods of underpayment under section 6621:

(i)	First installment (period 4-15-83 to 3-15-84)	$113.27
(ii)	Second installment (period 6-15-83 to 3-15-84)	92.64
(iii)	Third installment (period 9-15-83 to 3-15-84)	61.54
(iv)	Fourth installment (period 12-15-83 to 3-15-84)	30.77
(v)	Total of items (i) through (iv)	$298.22

Since X Corporation paid at least 80% of the tax due in equal quarterly installments, the amount of the addition under section 6655(a)(2) is $223.67 (*i.e.*, .75 × $298.22).

Example (2). Y, a corporation which reports on a calendar year basis, anticipates that its estimated tax for 1983 will be in the amount of $70,000. It makes no payments on April 15, 1983, June 15, 1983, and September 15, 1983, but makes a payment of $63,000 on December 15, 1983. On March 15, 1984, Y files its income tax return showing a tax imposed of $70,000. The addition to tax under section 6655(a) is computed as follows:

(1)	Tax as defined in (b)(5) of this section		$70,000
(2)	90% of item (1)		63,000
		First, Second, And Third Installments	Fourth Installment
(3)	Amount of estimated tax required to be paid on each installment date (25% of $63,000)	$15,750	$15,750

(4)	Amount paid on each installment date 0	$63,000
(5)	Amount of underpayment for each date $15,750	0

(6) Addition to tax, assuming that none of the exceptions provided by section 6655(d) and (e) and §§1.6655-2 and 1.6655-3 are applicable, and assuming the addition is computed at the rate of 11 percent per annum applicable to periods of underpayment under section 6621:

(i)	First installment (period 4-15-83 to 12-15-83)	$1,158.16
(ii)	Second installment (period 6-15-83 to 12-15-83)	868.62
(iii)	Third installment (period 9-15-83 to 12-15-83)	431.94
(iv)	Fourth installment	0
(v)	Total of items (i) through (iv)	$2,458.72

Par. 6. Section 1.6655-2 is amended to read as follows:

§1.6655-2 Exceptions to imposition of the addition to the tax in the case of corporations.

(a) *In general.* The addition to the tax under section 6655 will not be imposed for any underpayment of any installment of estimated tax if, on or before the date prescribed for payment of the installment, the total amount of all payments of estimated tax made equals or exceeds the amount which would have been required to be paid on or before such date if the estimated tax were the least of the following amounts—

(1) The amount of tax shown on the return for the preceding taxable year, provided that the preceding taxable year was a year of 12 months and a return showing a liability for tax was filed for such year;

(2) An amount equal to a tax determined on the basis of the tax rates for the taxable year but otherwise on the basis of the facts shown on the return for the preceding taxable year and the law applicable to such year, in the case of a corporation required to file a return for such preceding taxable year; or

(3) An amount equal to 90 percent (80 percent in the case of a taxable year beginning on or before December 31, 1982) of the tax determined by placing on an annual basis the taxable income for—

(i) The first 3 months of the taxable year, in the case of the installment required to be paid in the 4th month,

(ii) Either the first 3 months or the first 5 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 6th month,

(iii) Either the first 6 months or the first 8 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 9th month, and

(iv) Either the first 9 months or the first 11 months of the taxable year (whichever results in no addition being imposed), in the case of the installment required to be paid in the 12th month.

The taxable income so determined shall be placed on an annual basis by first multiplying it by 12, and then dividing the resulting amount by the number of months in the taxable year for which the taxable income was so determined.

(b) *Special rules.* (1) In the case of a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with section 441(f), the rules prescribed by paragraph (b) of §1.441-2 shall be applicable in determining—

(i) Whether a taxable year was a year of 12 months for purposes of paragraph (a)(1) of this §1.6655-2, and

(ii) When the 3-month period, or the 3- or 5-month period, or the 6- or 8-month period, or the 9- or 11-month period (whichever is applicable) commences for purposes of paragraph (a)(3) of this §1.6655-2.

For example, if a taxable year begins on December 26, 1982, taxable income for the first 6 months of such year, for purposes of paragraph (a)(3) of this §1.6655-2, shall be taxable income for the period beginning on December 26, 1982, and ending on June 30, 1983, since such taxable year is deemed to commence on January 1, 1983, under section 441(f).

(2) If the end of any accounting period employed by the taxpayer (*e.g.*, any of either thirteen 4-week periods or four 13-week periods) does not correspond to the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period, taxable income for the applicable period shall equal—

$$(a + (b \times c + d)),$$

where

a = taxable income from the beginning of the taxable year to the close of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period,

b = number of days from the close of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period to the close of the applicable 3-month, or 3- or 5- month, or 6- or 8-month, or 9- or 11-month period,

c = taxable income from the beginning of the taxable year to the close of the accounting period within which the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period falls, minus a, and

d = number of days between the termination dates of the accounting period ending immediately before the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period and the accounting period within which the termination date of the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period falls.

Thus, for example, a taxpayer whose taxable year consists of 52 or 53 weeks in accordance with section 441(f) has a taxable year beginning on December 26, 1982, and thirteen 4-week accounting periods are employed in determining taxable income. Taxable income from December 26, 1982, to the close of the 4-week accounting period ending on June 11, 1983, is $200,000, and taxable income from December 26, 1982, to the close of the 4-week accounting period ending on July 9, 1983, is $228,000. Under the provisions of this paragraph (b)(2), taxable income for the 6-month period ending on June 30, 1983, is $219,000 (*i.e.*, ($200,000 + (19 x 28,000 + 28)).

(c) *Meaning of terms*—(1) *Meaning of term "tax"*. For the purpose of the exceptions described in paragraph (a) of this section, the term "tax" means the excess of—

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Code, whichever is applicable, over

(ii) The sum of—

(A) The credits against tax provided by part IV of subchapter A of chapter 1, plus

(B) [reserved].

For purposes of paragraph (a)(2) of this section, the amount of tax paid from recomputing a prior year's investment credit under section 47 is a fact shown on the return for the preceding taxable year and is included in computing the prior year's tax. For example, X Corporation timely filed its 1977 income tax return. The return showed no taxable income, but it included an amount of tax from recomputing a prior year's investment credit. For 1978, X had taxable income and a liability for income tax. X was required to pay its tax in installments under section 6154, but made no installment payments. X is subject to the addition to tax for underpayment of estimated tax imposed by section 6655(a), because X failed to pay, on or before the prescribed installment due dates, an amount equal to the tax resulting from the recomputation of the prior year's investment credit.

(2) *Credits against tax*. The credits against the tax allowed by part IV of subchapter A of chapter 1 are—

(i) In the case of the exception described in paragraph (a)(1) of this section, such credits shown on the return for the preceding taxable year,

(ii) In the case of the exception described in paragraph (a)(2) of this section, such credits shown on the return for the preceding taxable year, except that if the amount of any such credits would be affected by any change in rates, the credits shall be determined by reference to the rates applicable to the current taxable year, and

(iii) In the case of the exception described in paragraph (a)(3) of this section, such credits computed under the law and rates applicable to the current taxable year.

The provisions of subparagraph (2)(ii) of this paragraph are illustrated by the following example:

Example. Assume that during a taxable year within which the graduated tax rates in section 11 are lowered, Corporation X has an underpayment of estimated tax. One-fourth of the taxable income of Corporation X for the taxable year preceding that in which such underpayment occurs was from sources within foreign country Y and the remainder of the taxable income was from sources within the United States. The return of Corporation X for such preceding year shows taxable income of $325,000 and a tax, without regard to any credits, of $163,500. For such preceding year, Corporation X paid more taxes to foreign country Y than may be allowed as a credit under section 33 by reason of the limitation of section 904. The credit allowed by section 33 on account of taxes paid to foreign country Y may not, under section 904, exceed one-fourth of the tax without regard to any credits, or $40,875. The tax for the preceding year, computed by using the rates applicable to the year during which the underpayment occurs, would be reduced to $147,250, and the limitation under section 904 on the credit allowed under section 33 for taxes paid to foreign country Y would be reduced to $36,812.50, for purposes of determining the applicability of the exception described in paragraph (a)(2) of this section. Therefore, the exception described in paragraph (a)(2) of this section will be applicable if, on or before the date prescribed for such payment, the total amount paid by Corporation X equals or exceeds the amount which would have been required to be paid by such date if the estimated tax were $110,437.50 ($147,250 less $36,812.50).

(3) *Definition of return for the preceding taxable year*. For the purpose of the exceptions described in paragraph (a)(1) and (2) of this section, the term "return for the preceding taxable year" means the income tax return for such year which is required by section 6012(a)(2). However, if an amended return has been timely filed, then the term "return for the preceding taxable year" means the income tax return as amended and as timely filed.

(d) *Examples*. The application of the exceptions to the imposition of the addition to tax is illustrated by examples employing the following statement of facts:

STATEMENT OF FACTS

Y, a corporation which reports on a calendar year basis, expected that it would have an estimated tax liability of $62,000 for its taxable year ending December 31, 1983. Y is not a "large corporation" (see section 6655(i) and §1.6655-4). Y paid four installments of estimated tax, each in the amount of $15,500 (25 percent of $62,000), on April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983, respectively. Y reported a tax liability of $88,900 on its return due March 15, 1984, with no credits against tax. There was an underpayment in the amount of $4,502.50 on each of the four installment dates, determined as follows:

(1)	Tax as defined in paragraph (c)(1) of this section	$88,900.00
(2)	90% of item (1)	$80,010.00
(3)	Amount of estimated tax required to be paid on each installment (25% of $80,010)	$20,002.50
(4)	Deduct amount paid on each installment date	$15,500.00
(5)	Amount of underpayment for each installment date	$4,502.50

The application of each exception described in paragraph (a) of this section is determined as follows:

(1) Assume Y reported a liability of $74,900 on its return for the taxable year ending December 31, 1982. If the exception described in paragraph (a)(1) of this section were to apply, the amount which would have been required to be paid on or before each of the four installment dates would be 25 percent of $74,900, or $18,725. Since this amount exceeds the amount actually paid on each installment date, $15,500, the exception does not apply.

(2) Assume that the facts shown on the return for the previous year (1982) showed Y to have a taxable income of $184,167 and no credits against tax. The amount of tax determined under paragraph (a)(2) of this section and the amounts required to be paid on or before each installment date are as follows: the tax liability on the basis of the 1983 rates but on the basis of the calendar year 1982 return is $64,467; the amount which would have been required to be paid on or before each of the four installment dates is 25 percent of $64,467, or $16,116.75. Since this amount exceeds the amount actually paid on each installment date, $15,500, the exception described in paragraph (a)(2) of this section does not apply.

(3) The total amount of all payments of estimated tax actually paid on or before the installment dates of April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983, are $15,500, $31,000, $46,500, and $62,000, respectively. Assume Y determined that its taxable income for the first 3, 5, 6, 8, 9, and 11 months was $45,000, $90,000, $105,000, $145,000, $160,000, and $195,000 respectively. The income for each period is annualized as follows:

$ 45,000 x 12 ÷ 3 = $180,000
$ 90,000 x 12 ÷ 5 = $216,000
$105,000 x 12 ÷ 6 = $210,000
$145,000 x 12 ÷ 8 = $217,500
$160,000 x 12 ÷ 9 = $213,333.33
$195,000 x 12 ÷ 11 = $212,727.27

(i) To determine whether the installment payment made on April 15, 1983, equals or exceeds the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for the 3-month period, the following computation is necessary:

		3 months
(1)	Annualized income	$180,000
(2)	Tax on item (1)	$ 62,550
(3)	90% of item (2)	$ 56,295
(4)	25% of item (3)	$ 14,073.75

Since the total amount of estimated tax actually paid on the first installment date (*i.e.*, $15,500) exceeds the amount required to be

paid on this date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 3-month period, the exception described in paragraph (a)(3) of this section applies, and no addition to tax will be imposed for the installment paid on April 15, 1983.

(ii) To determine whether the installment payments made on or before June 15, 1982, equal or exceed the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for either the 3- or 5-month period, the following computation is necessary:

		3 months	5 months
(1)	Annualized income	$180,000	$216,000
(2)	Tax on item (1)	$ 62,550	$ 79,110
(3)	90% of item (2)	$ 56,295	$ 71,199
(4)	50% of item (3)	$ 28,147.50	$ 35,599.50

Since the total amount of estimated tax actually paid on the second installment date (*i.e.*, $31,000) exceeds the amount required to be paid on such date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 3- or 5-month period for the taxable year, the exception described in paragraph (a)(3) of this section applies, and no addition to tax will be imposed for the installment paid on June 15, 1983.

(iii) To determine whether the installment payments made on or before September 15, 1983, equal or exceed the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for either the 6- or 8-month period, the following computation is necessary:

		6 months	8 months
(1)	Annualized income	$210,000	$217,500
(2)	Tax on item (1)	$ 76,350	$ 79,800
(3)	90% of item (2)	$ 68,715	$ 71,820
(4)	75% of item (3)	$ 51,536.25	$ 53,865

Since the total amount of estimated tax actually paid on or before the third installment date (*i.e.*, $46,500) does not equal or exceed the amount required to be paid on such date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 6- or 8-month period, the exception described in paragraph (a)(3) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 1983, installment unless another exception applies to this installment payment.

(iv) To determine whether the installment payments made on or before December 15, 1983, equal or exceed the amount which would have been required to have been paid if the estimated tax were equal to 90 percent of the tax computed on the annualized income for either the 9- or 11-month period, the following computation is necessary:

		9 months	11 months
(1)	Annualized income	$213,333.33	$212,727.27
(2)	Tax on item (1)	$ 77,883.33	$ 77,604.54
(3)	90% of item (2)	$ 70,095	$ 69,844.09
(4)	100% of item (3)	$ 70,095	$ 69,844.09

Since the total amount of estimated tax actually paid on or before the fourth installment date (*i.e.*, $62,000) does not equal or exceed the amount required to be paid on such date if the estimated tax were 90 percent of the tax determined by placing on an annualized basis the taxable income for the first 9- or 11-month period, the exception described in paragraph (a)(3) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 1983, installment unless another exception applies to this installment payment.

(e) *Determination of taxable income for portion of taxable year when using annualization exceptions*—(1) *In general.* In determining the applicability of the exception described in paragraph (a)(3) of this section (relating to the annualization of income) and the exception described in §1.6655-3 (relating to annualization of income for corporations with seasonal income), there must be a reasonably accurate determination of the items of income, gain, loss, deduction, and credit properly includible under the taxpayer's method of accounting for the appropriate period, that is, for the first 3, 5, 6, 8, 9, or 11 months of the taxable year. Generally, deductions which are not properly accruable during an applicable installment period because all the events which fix the fact of a liability have not yet occurred or because the amount of the deduction cannot be estimated with reasonable accuracy are not taken into account in that period for purposes of the annualization exception, even if such amounts are accruable by the end of the taxable year.

(2) *Exception for recurring expenditures.* (i) When a taxpayer has a history of incurring a specific category of expense, which, while attributable to income earned throughout the year, has not become a fixed liability until the end of the taxable year, the taxpayer may take into account for each installment period the amount of such expense properly allocable to such period provided—

(A) The amount so allocated to a particular installment period is determinable with reasonable accuracy, and

(B) The amount of the item so allocated is properly deductible by the taxpayer during the taxable year under the taxpayer's method of accounting.

(ii) The provisions of subparagraph (2)(i) may be illustrated by the following example:

Example. Corporation X, a calendar year taxpayer, uses the accrual method of accounting. X has historically adopted a program at the beginning of each taxable year which provides for the distribution of year-end cash bonuses to its employees. The aggregate amount of bonuses to be distributed is determined at the beginning of the taxable year. In accordance with this program, the amount of the bonus payable to each employee is to be determined by the management in December. Under the provisions of subparagraph (2)(i), X may allocate a portion of the total amount of such year-end bonus to each installment period since X can determine that amount with reasonable accuracy and the amount of the bonus is properly deductible during X's taxable year under its method of accounting.

(3) *Items that substantially impact taxable income but cannot be determined accurately by the installment due date.* In determining the applicability of the annualization exceptions described in paragraph (a)(3) of this section and §1.6655-3, reasonable estimates may be made from existing data for items that substantially impact income when the amount of such items cannot be determined accurately by the installment due date. Examples of these items are the LIFO index for taxpayers using the dollar-value LIFO inventory method, the deferred gross profit for taxpayers with revolving charge accounts, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes would be replaced at the end of the year. Thus, for example, reasonable estimates by a taxpayer using the dollar-value LIFO method of accounting would be made by interpolating from an available inflation index for the same months in the previous year to calculate the cost of goods sold in the present period of less than a full taxable year if no reliable inflation index for the

present period is available. See also §1.6654-2(d)(1) and (2).

(4) *Events arising after installment due date which were not reasonably foreseeable.* Events arising subsequent to the installment due date which cause the taxpayer's computation of its taxable income for the short period to be understated will not result in a recomputation of its taxable income for the short period. The preceding sentence applies only if at the time the installment payment is made, based on all the facts and circumstances, it was not reasonably foreseeable that these subsequent events would occur. Thus, for example, assume that Congress enacts retroactively effective legislation which causes the taxable income for the applicable 3-month, or 3- or 5-month, or 6- or 8-month, or 9- or 11-month period to be understated. This event, which occurred after the applicable installment due date, will not result in a recomputation of a corporation's taxable income for the applicable installment period because such an event was unforeseeable.

Par. 7. Section 1.6655-3 is revised to read as follows:

§1.6655-3 Additional exception for corporation with recurring seasonal income.

(a) *In general*—(1) *Additional exception for corporations with recurring seasonal income.* Except as provided in paragraph (b)(4) of this section, for taxable years beginning after December 31, 1982, notwithstanding section 6655(b) (relating to the general rule for amount of underpayment of estimated tax) and section 6655(d) (relating to the exceptions to the underpayment of estimated tax), the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installment equals or exceeds 90 percent of the applicable amount determined under subparagraph (2) of this paragraph.

(2) *Applicable amount.* To determine the applicable amount—

(i) Total the taxable income for all months during the taxable year preceding the filing month (as defined in paragraph (b)(3)),

(ii) Divide the amount in subdivision (i) by the base period percentage (as defined in paragraph (b)(1)) for all months during the taxable year preceding the filing month,

(iii) Determine the tax (as defined in §1.6655-2(c)(1)) on the amount determined in subdivision (ii),

(iv) Multiply the amount determined in subdivision (iii) by the base period percentage for the filing month and all months during the taxable year preceding the filing month.

(b) *Definition and limitation on application of exception*—(1) *Base period percentage.* The base period percentage for any period of months shall be the average of the three percentages calculated by dividing—

(i) The taxable income for the corresponding months in each of the 3 preceding taxable years, by

(ii) The taxable income for each of the 3 preceding taxable years.

(2) *Determination of base period percentage in a year in which there occurs a transaction to which section 381 applies.* (i) In a year in which there occurs a transaction to which section 381 applies, the acquiring corporation's taxable income shall be the sum of—

(A) The taxable income of the acquiring corporation for its taxable year, plus

(B) The taxable income of the distributor or transferor corporation (or corporations) for that portion of the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)-1(b)).

(ii) The corresponding monthly taxable income of the acquiring corporation in a year in which there occurs a transaction to which section 381 applies shall be the sum of—

(A) The corresponding monthly taxable income of the acquiring corporation, plus

(B) The corresponding monthly taxable income of the distributor or transferor corporation (or corporations) for those months of the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)-1(b)).

(3) *Filing month.* The term "filing month" means the month in which the installment is required to be paid. A corporation must make estimated tax payments in installments in accordance with the provisions of section 6154(b). Thus, for example, a corporation which, before the 1st day of the 4th month of its taxable year, reasonably expects its estimated tax for such taxable year to be $40 or more, must make quarterly installments of estimated tax on or before the 15th day of the 4th, 6th, 9th, and 12th months of its taxable year.

(4) *Limitation on use of exception for corporations with recurring seasonal income.* This section shall apply only if the base period percentage (as defined in subparagraph (1)) for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent.

(c) *Illustration.* The provisions of this section may be illustrated by the following example:

Example. (a) Y, a corporation which reports on a calendar year basis, expected that it would have an estimated tax liability of $1,380,000 for its taxable year ending December 31, 1983. Y therefore paid four installments of estimated tax, each in the amount of $345,000 (25 percent of $1,380,000), on April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983, respectively. Y reported a tax liability of $1,539,150 on its return due March 15, 1984, with no credits against tax. Under the general provision of section 6655(b), there was an underpayment in the amount of $1,308.75 on each of the four installment dates, determined as follows:

(1)	Tax as defined in section 6655(f)	$1,539,150.00
(2)	90% of item (1)	1,385,235.00
(3)	Amount of estimated tax required to be paid on each installment (25% of $1,385,235.00)	346,308.75
(4)	Deduct amount paid on each installment date under general rule of section 6655(b)	345,000.00
(5)	Amount of underpayment for each installment date under general rule of section 6655(b)	$1,308.75

(b) Y corporation wants to determine if it qualifies under the exception of this section. Y Corporation determines that its monthly taxable income for the preceding 3 taxable years and for the current taxable year 1983 is as follows:

	January	February	March	April	May	June
1980	$100,000	$ 90,000	$ 80,000	$ 70,000	$ 60,000	$ 20,000
1981	$200,000	$170,000	$170,000	$130,000	$125,000	$ 45,000
1982	$410,000	$350,000	$330,000	$270,000	$240,000	$ 80,000
1983	$600,000	$680,000	$650,000	$560,000	$460,000	$170,000

	July	August	September	October	November	December
1980	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 10,000	$ 10,000
1981	$ 21,000	$ 19,000	$ 20,000	$ 20,000	$ 20,000	$ 20,000
1982	$ 40,000	$ 40,000	$ 40,000	$ 40,000	$ 40,000	$ 40,000
1983	$ 70,000	$ 60,000	$ 50,000	$ 40,000	$ 30,000	$ 20,000

Y Corporation must initially determine if its base period percentage for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent (*see* section 6655(e)(3)(C) and §1.6655-3(b)(4)). By using its taxable income for the first 6 months of 1980, 1981, and 1982, Y qualifies since its base period percentage is 87.5 percent (which exceeds 70 percent) computed as follows:

(1)	Taxable income for first 6 months of 1980	$420,000
(2)	Total taxable income for 1980	$480,000
(3)	Divide item (1) by item (2)	$.875
(4)	Taxable income for first 6 months of 1981	$840,000
(5)	Total taxable income for 1981	$960,000
(6)	Divide item (4) by item (5)	.875
(7)	Taxable income for first 6 months of 1982	$1,680,000
(8)	Total taxable income for 1982	$1,920,000
(9)	Divide item (7) by item (8)	.875
(10)	Add items (3), (6), and (9)	2.625
(11)	Divide item (10) by 3	.875

(c) To determine whether the installment payment made on April 15, 1983, equals or exceeds 90 percent of the applicable amount (computed under the rules of section 6655(e)(2) and §1.6655-3(a)(2)) for the 3-month period, the following computation is necessary:

(1)	Taxable income for first 3 months of 1983	$1,930,000
(2)	Taxable income for first 3 months of 1980 ($270,000) divided by total taxable income for 1980 ($480,000)	.5625
(3)	Taxable income for first 3 months of 1981 ($540,000) divided by total taxable income for 1981 ($960,000)	.5625
(4)	Taxable income for first 3 months of 1982 ($1,090,000) divided by total taxable income for 1982 ($1,920,000)	.5677
(5)	Add items (2), (3), and (4) and divide by 3	.5642
(6)	Divide item (1) by item (5)	$3,420,772.78
(7)	Determine the tax on item (6)	$1,553,305.48
(8)	Taxable income for first 4 months of 1980 ($340,000) divided by total taxable income for 1980 ($480,000)	.7083
(9)	Taxable income for first 4 months of 1981 ($670,000) divided by total taxable income for 1981 ($960,000)	.6979
(10)	Taxable income for first 4 months of 1982 ($1,360,000) divided by total taxable income for 1982 ($1,920,000)	.7083
(11)	Add items (8), (9), and (10) and divide by 3	.7048
(12)	Multiply item (7) by item (11)	$1,094,769.70
(13)	90% of item (12)	$985,292.73

(d) To determine whether the installment payment made on or before June 15, 1983, equals or exceeds 90 percent of the applicable amount (computed under the rules of section 6655(e)(2) and §1.6655-3(a)(2)) for the 5-month period, the following computation is necessary:

(1)	Taxable income for first 5 months of 1983	$2,950,000
(2)	Taxable income for first 5 months of 1980 ($400,000) divided by total taxable income for 1980 ($480,000)	.8333
(3)	Taxable income for first 5 months of 1981 ($795,000) divided by total taxable income for 1981 ($960,000)	.8281
(4)	Taxable income for first 5 months of 1982 ($1,600,000) divided by total taxable income for 1982 ($1,920,000)	.8333
(5)	Add items (2), (3), and (4) and divide by 3	.8316
(6)	Divide item (1) by item (5)	$3,547,378.55
(7)	Determine the tax on item (6)	$1,611,544.13
(8)	Taxable income for first 6 months of 1980 ($420,000) divided by total taxable income for 1980 ($480,000)	.875
(9)	Taxable income for first 6 months of 1981 ($840,000) divided by total taxable income for 1981 ($960,000)	.875
(10)	Taxable income for first 6 months of 1982 ($1,680,000) divided by total income for 1982 ($1,920,000)	.875
(11)	Add items (8), (9), and (10) and divide by 3	.875
(12)	Multiply item (7) by item (11)	$1,410,101.11
(13)	90% of item (12)	$1,269,091.00

(e) To determine whether the installment payment made on or before September 15, 1983, equals or exceeds 90 percent of the applicable amount (computed under the rules of section 6655(e)(2) and §1.6655-3(a)(2)) for the 8-month period, the following computation is necessary:

(1)	Taxable income for first 8 months of 1983	$3,250,000
(2)	Taxable income for first 8 months of 1980 ($440,000) divided by total taxable income for 1980 ($480,000)	.9167
(3)	Taxable income for first 8 months of 1981 ($880,000) divided by total taxable income for 1981 ($960,000)	.9167
(4)	Taxable income for first 8 months of 1982 ($1,760,000) divided by total taxable income for 1982 ($1,920,000)	.9167
(5)	Add items (2), (3), and (4) and divide by 3	.9167
(6)	Divide item (1) by item (5)	$3,545,325.62
(7)	Determine the tax on item (6)	$1,610,599.79
(8)	Taxable income for first 9 months of 1980 ($450,000) divided by total taxable income for 1980 ($480,000)	.9375
(9)	Taxable income for first 9 months of 1981 ($900,000) divided by total taxable income for 1981 ($960,000)	.9375
(10)	Taxable income for first 9 months of 1982 ($1,800,000) divided by total taxable income for 1982 ($1,920,000)	.9375
(11)	Add items (8), (9), and (10) and divide by 3	.9375
(12)	Multiply item (7) by item (11)	$1,509,937.30
(13)	90% of item (12)	$1,358,943.57

(f) To determine whether the installment payment made on or before December 15, 1983, equals or exceeds 90 percent of the applicable amount (computed under the rules of section 6655(e)(2) and §1.6655-3(a)(2)) for the 11-month period, the following computation is necessary:

(1)	Taxable income for first 11 months of 1983	$3,370,000
(2)	Taxable income for first 11 months of 1980 ($470,000) divided by total taxable income for 1980 ($480,000)	.9792
(3)	Taxable income for first 11 months of 1981 ($940,000) divided by total taxable income for 1981 ($960,000)	.9792
(4)	Taxable income for first 11 months of 1982 ($1,880,000) divided by total taxable income for 1982 ($1,920,000)	.9792
(5)	Add items (2), (3), and	

	(4) and divide by 3	.9792
(6)	Divide item (1) by item (5)	$3,441,584.97
(7)	Determine the tax on item (6).....	$1,562,879.09
(8)	90% of item (7)	$1,406,591.18

The total amounts of all payments of estimated tax actually paid on or before the installment dates of April 15, 1983, June 15, 1983, September 15, 1983, and December 15, 1983, are $345,000, $690,000, $1,035,000, and $1,380,000, respectively. Since the total amounts of estimated tax actually paid on the first, second, third, and fourth installment dates does not equal or exceed the amounts required to be paid on such dates if the estimated tax were 90 percent of the applicable amount (computed under the rules of section 6655(e)(2) and §1.6655-3(a)(2)) for the first 3-month period, first 5-month period, first 8-month period, and first 11-month period of the taxable year, the exception described in section 6655(e) and this section does not apply, and the addition to the tax with respect to the underpayment for all installments will be imposed unless another exception (*see* §6655(d)) applies with respect to these installments.

Par. 8. A new §1.6655-4 is added immediately following §1.6655-3 to read as follows:

§1.6655-4 Estimated tax payments in the case of large corporations.

(a) *Elimination of certain exceptions to underpayment penalty for large corporations.* For taxable years beginning after December 31, 1983, section 6655(d)(1) and (2) and §1.6655-2(a)(1) and (2)(relating to exceptions to underpayment of estimated tax) shall not apply to large corporations (as defined in paragraph (e) of this section). However, the exception relating to the annualization of income (*see* section 6655(d)(3) and §1.6655-2(a)(3)) remains available to large corporations for taxable years beginning after such date. For taxable years beginning after December 31, 1982, the additional exception for corporations with recurring seasonal income is available to large corporations (*see* section 6655(e) and §1.6655-3).

(b) *Transitional rule; minimum percentage requirement.* For taxable years beginning before January 1, 1984, in the case of large corporations, the amount treated as estimated tax for the taxable year under section 6655(d)(1) and (2) shall in no event be less than the minimum estimated tax (as defined in paragraph (c)). Payment by a large corporation of less than the minimum estimated tax is an underpayment of estimated tax to which the addition to tax provided under section 6655(a) applies unless an exception provided under section 6655(d)(3) and §1.6655-2(a)(3) and section 6655(e) and §1.6655-3 (for taxable years beginning after 1982) applies.

(c) *Minimum estimated tax defined.* For purposes of this section, the term "minimum estimated tax" means—

(1) For taxable years beginning after December 31, 1980, and before January 1, 1982, an amount which is not less than 60 percent of the tax shown on its income tax return for such year or, if no return was filed for such year, 60 percent of the tax for such year;

(2) For taxable years beginning after December 31, 1981, and before January 1, 1983, an amount which is not less than 65 percent of the tax shown on its income tax return for such year or, if no return was filed for such year, 65 percent of the tax for such year; and

(3) For taxable years beginning after December 31, 1982, and before January 1, 1984, an amount which is not less than 75 percent of the tax shown on its income tax return for such year or, if no return was filed for such year, 75 percent of the tax for such year.

(d) *Payment in installments.* Every large corporation required to make payments of minimum estimated tax for a taxable year must make payments in installments in accordance with the provisions of section 6154(b). Thus, for example, a large corporation which, before the 1st day of the 4th month of the taxable year, reasonably expects its estimated tax for such taxable year to be $40 or more, shall make quarterly installments of its minimum estimated tax on or before the 15th day of the 4th, 6th, 9th, and 12th month of its taxable year.

(e) *Large corporation*—(1) *In general.* For purposes of this section, a corporation is a large corporation if the corporation (or a predecessor corporation) had taxable income of at least $1 million for any of the 3 taxable years immediately preceding the taxable year involved ("testing period"). For purposes of this section, a predecessor corporation is the distributor or transferor corporation in a transaction to which section 381 (relating to carryovers in certain corporate acquisitions) applies.

(2) *Short taxable year.* In the case of a corporation (or predecessor corporation) which had a short taxable year for any of the 3 taxable years immediately preceding the taxable year involved, for purposes of determining whether the $1 million amount referred to in subparagraph (1) is equaled or exceeded, the "taxable income" for the short taxable year shall be computed by—

(i) Multiplying by 12 the taxable income for the short taxable year, and

(ii) Dividing the resulting amount by the number of months in the short taxable year.

(3) *Component members of controlled group.* (i) For purposes of applying subparagraph (1) of this paragraph to any of the 3 taxable years immediately preceding the taxable year involved with respect to corporations that are component members of a controlled group of corporations (as defined in section 1563(a)) for such taxable year, the $1 million amount shall be divided equally among the component members of such group unless all of such component members consent to an apportionment plan providing for an unequal allocation of such amount. The procedure for making and filing this plan shall be the same as the procedure used for making and filing an apportionment plan under section 1561. See section 1561 and the regulations thereunder. The provisions of section 6655(i) and this section shall not apply to component members of a controlled group for any taxable year in which the aggregate taxable income of the component members of the controlled group is less than $1 million.

(ii) In the case of any corporation which was a component member of a controlled group of corporations at any time during the 3 preceding taxable years but is not a member of such group during its current taxable year, taxable income for the 3 preceding taxable years shall be determined

as if such corporation were not a member of a group at any time during those years. With respect to the controlled group, the taxable income of its former member shall not be taken into account in determining such group's taxable income for any of the 3 preceding taxable years in making a determination whether such group is a "large corporation" for the current taxable year.

(4) *Computation of taxable income in year where there occurs a transaction to which section 381 applies.* (i) For purposes of determining whether an acquiring corporation had taxable income of $1 million or more for a year in which there occurs a transaction to which section 381 applies, its taxable income shall be the sum of—

(A) The taxable income of the acquiring corporation for its taxable year, plus

(B) The taxable income of the distributor or transferor for that portion of the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)-1(b)).

(ii) For purposes of determining whether a transferor or distributor corporation had taxable income of $1 million or more for a year in which there occurs a transaction to which section 381 applies, its taxable income shall be reduced by the amount of its taxable income for that portion of its taxable year corresponding to the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)-1(b)).

(5) *Consolidated returns.* [reserved].

(6) *Illustration.* The provisions of subparagraphs (1) and (4) of this paragraph (e) may be illustrated by the following example:

Example. X Corporation and Y Corporation are calendar year taxpayers. In 1983 Y Corporation acquires all of the assets of X Corporation in a transaction to which section 381 applies. Y Corporation's taxable income for both 1981 and 1982 was less than $1 million. X Corporation's taxable income for 1983 is determined under subparagraph (4) to be $300,000 for that portion of the acquiring corporation's taxable year up to and including the date of transfer. Y Corporation's taxable income for 1983 is $800,000. Under the provisions of subparagraph (4), Y Corporation's 1983 taxable income for purposes of determining whether it is a large corporation for taxable year 1984 is $1,100,000 (*i.e.*, $800,000 + $300,000). If Y Corporation's 1983 taxable income as determined under subparagraph (4) had been less than $1 million but X Corporation's taxable income in 1981 or 1982 had been $1 million or more, then Y Corporation would be a large corporation for taxable year 1984 since X Corporation is a predecessor corporation.

(7) *Effect on a corporation's taxable income of items which may be carried back to a prior taxable year.* (i) In determining whether a corporation (or predecessor corporation) is a "large corporation" for its present taxable year, that is, whether it had taxable income of $1 million or more during any of the 3 taxable years preceding its present taxable year ("testing period"), items which could be carried back under other Code provisions (*e.g.*, those described in sections 172 and 1212) from one of the years in the testing period to another year in the testing period shall be taken into account. Additionally, if a corporation's taxable income for a year during the testing period is redetermined during that testing period, by reason of an examination by the Internal Revenue Service or otherwise, such redetermination shall be taken into account in determining whether the corporation is a large corporation for its present taxable year. Any items which are carried forward under other Code provisions shall be taken into account in determining a corporation's taxable income.

(ii) The provisions of subparagraph (7)(i) may be illustrated by the following example:

Example. X Corporation's taxable income for taxable years 1981 and 1982 was $1 million. Therefore, X was a large corporation for 1982 and 1983. X incurred a net operating loss in 1983 which was carried back under section 172 to taxable years 1981 and 1982. This carryback reduced X's taxable income for both 1981 and 1982 to below $1 million. For taxable year 1984, X is not a large corporationi since the net operating loss sustained during one of the years in the 3-year testing period may be carried back to the other years in the 3-year testing period. However, this net operating loss which is carried back does not affect X's large corporation status for taxable years 1982 and 1983 because the 1983 net operating loss was not sustained during the respective 3-year testing periods for 1982 and 1983.

Par. 9. Section 1.6655-5 is redesignated as §1.6655-6, and a new §1.6655-5 is added to read as follows:

§1.6655-5 Short taxable years in the case of corporations.

(a) *In general.* The provisions of section 6655, with one exception described in paragraph (b) of this section and with certain modifications relating to the application of subsection (d) and (e) thereof which are explained in paragraphs (c) and (d) of this section, are applicable in the case of a short taxable year for which a payment of estimated tax is required to be made.

(b) *Exception to payment of estimated tax.* In the case of a short taxable year, no payment of estimated tax is required if the short taxable year is either—

(1) A period of less than 4 months, or

(2) A period of 4 or more months but less than 12 months and the requirements of section 6154(a) are not met before the 1st day of the last month in the short taxable year.

For purposes of this section a taxable year of 52 or 53 weeks shall be deemed a period of 12 months in the case of a corporation which computes its taxable income in accordance with the election permitted by section 441(f).

(c) *Rules as to application of section 6655(d).* In any case in which the taxable year for which an underpayment of estimated tax exists is a short taxable year due to a change in annual accounting periods, in determining the tax—

(1) Shown on the return for the preceding taxable year (for purposes of section 6655(d)(1));

(2) Based on the current year's rates but otherwise on the basis of the facts shown on the return for the preceding taxable year and the law applicable to such year (for purposes of section 6655(d)(2)); or

(3) Computed by placing taxable income for a portion of the current year on an annual basis under section 6655(d)(3);

the tax will be reduced by multiplying it by the number of months in the short taxable year and dividing the resulting amount by 12. The application of the exception provided in section 6655(d)(3) shall be determined as if the estimated tax were 90 percent of the tax so reduced (80 percent of the tax so reduced for taxable years be-

ginning before January 1, 1983).

(d) *Rules as to application of section 6655(e).* In any case in which the taxable year for which an underpayment of estimated tax exists is a short taxable year due to a change in annual accounting periods, in determining the applicable amount under section 6655(e)(2), this amount will be reduced by multiplying it by the number of months in the short taxable year and dividing the resulting number by 12. The application of the exception provided in section 6655(e) shall be determined as if the estimated tax were 90 percent of the applicable amount so reduced.

(e) *Preceding taxable year a short taxable year.* If "the preceding taxable year" referred to in section 6655(d)(2) was a short taxable year, the tax computed on the basis of the facts shown on the return for such preceding year, for purposes of determining the applicability of the exception described in section 6655(d)(2), shall be the tax computed on the annual basis in the manner described in section 443(b)(1)(prior to its reduction in the manner described in the last sentence thereof). If the tax rates for the taxable year with respect to which the underpayment occurs differ from the rates applicable to the preceding taxable year, the tax determined in accordance with the preceding sentence shall be recomputed using the rates applicable to the year with respect to which the underpayment occurs.

Par. 10. Paragraph (a)(1) of §1.6655-6 as redesignated is amended by removing "Section 6655(g)" and adding "Section 6655(h)" in lieu thereof. Paragraph (a)(6) of §1.6655-6 as redesignated is amended by removing "§1.6655-1 through §1.6655-3" and adding "§1.6655-1 through §1.6655-5" in lieu thereof.

PART 301—REGULATIONS ON PROCEDURE AND ADMINISTRATION

Par. 11. Section 301.6655-1 is amended to read as follows:

§301.6655-1 Failure by corporation to pay estimated income tax.

For regulations under section 6655, see §§1.6655-1 to 1.6655-6, inclusive of this chapter (Income Tax Regulations).

These amendments are proposed to be issued under the authority contained in section 7805 of the Internal Revenue Code (68A Stat. 917, 26 U.S.C. 7805).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 25, 1948, 8:45 a.m., and published in the issue of the Federal Register for March 26, 1984, 49 F.R. 11186)

Notice of Proposed Rulemaking

Tax Return Preparers

LR-290-82

SUMMARY: This document contains proposed amendments to the Income Tax Regulations under sections 6107(b) and the Regulations on Procedure and Administration under section 7216(b) of the Internal Revenue Code of 1954. The amendment under section 6107(b) relates to the retention of records of income tax returns prepared by a corporation or a partnership as an income tax return preparer. The amendment under section 7216(b) relates to disclosure to grand juries of income tax return information by the preparers of the returns.

EFFECTIVE DATES: The amendments are proposed to be effective [Date which is 30 days after publication of the amendment by Treasury Decision]. Written comments and requests for a public hearing must be delivered or mailed by January 16, 1984.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T [290-82], Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Mary Frances Pearson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3289, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 6107(b) and the Regulations on Procedure and Administration under section 7216(b) (26 CFR Part 301). The proposed amendment to section 6107(b) designates the person required to retain records of income tax returns when the income tax return preparer is a corporation or partnership which has been dissolved. The proposed amendment to regulations under section 7216(b) clarifies that disclosure of tax return information by an income tax return preparer to a grand jury does not trigger the penalty provision of section 7216(a). These amendments are to be issued under the authority contained in sections 7216(b)(3) (85 Stat. 529, 26 U.S.C. 7216) and 7805 (68A Stat. 917, 26 U.S.C. 7805) of the Internal Revenue Code of 1954.

DISCUSSION

Section 6107(b) provides that an income tax return preparer must retain a copy of each income tax return prepared, or a list of the taxpayers for whom such returns were prepared, available for inspection upon request for a specified 3-year period. When the preparer is a corporation or a partnership which is dissolved before completion of the 3-year period, the question has arisen as to who must retain the above described records for inspection until the 3-year period is completed. This amendment to the regulation would place that duty upon all persons under state law who are responsible for winding up the affairs of the corporation or partnership. If no persons are designated under state law, then the proposed regulations provide that, collectively, the directors of the corporation or the general partners of the partnership shall be required to retain the records for the requisite 3-year period.

Section 7216(b) provides that the

penalty provision of section 7216(a) will not apply to the disclosure or use of information by preparers of returns if the disclosure is made pursuant to provisions of the Code or pursuant to an order of a court. Section 7216(b)(3) gives the Secretary regulatory authority to prescribe other exceptions to section 7216(a). This amendment to the regulation would clarify that disclosure of tax return information by an income tax return preparer to a grand jury does not trigger the penalty provision of section 7216(a).

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting as final regulations these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

REGULATORY FLEXIBILITY ACT OF 1980 AND EXECUTIVE ORDER 12291

The Secretary of the Treasury has certified that this proposed amendment to the regulations would not have a significant impact on a substantial number of small entities. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act of 1980 (5 U.S.C. chapter 6). The Commissioner of Internal Revenue has determined that this proposed rule is not a major regulation subject to Executive Order 12291.

DRAFTING INFORMATION

The principal author of these regulations is Mary Frances Pearson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

* * * * *

Proposed amendments of the regulations

Accordingly, the proposed amendments to 26 CFR Parts 1 and 301 are as follows:

INCOME TAX REGULATIONS

Paragraph 1. Section 1.6107-1(b) is amended by adding at the end thereof the following:

§1.6107-1 Income tax return preparer must furnish copy of return to taxpayer and must retain a copy or record

* * * * *

(b) *Copy or record to be retained.* ***

If the person subject to the record retention requirements of this paragraph (b) is a corporation or a partnership which is dissolved before completion of the 3-year period, then all persons who under state law are responsible for the winding up of the affairs of the corporation or partnership shall be subject, on behalf of the corporation or partnership, to these record retention requirements until completion of the 3-year period. If state law does not specify any person or persons as responsible for winding up, then, collectively, the directors or general partners shall be subject, on behalf of the corporation or partnership, to the record retention requirements of this paragraph (b). For purposes of the penalty imposed by section 6695(d), such designated persons shall be deemed to be the income tax return preparer and will be jointly and severally liable for each failure.

REGULATIONS ON PROCEDURE AND ADMINISTRATION

Par. 2. Section 301.7216-2 is amended as follows:

(1) Paragraph (c)(2) is redesignated as (c)(3) and a new paragraph (c)(2) is added as set forth below:

(2) Paragraph (d) is amended by removing the period at the end thereof and adding ", or before any grand jury which may be convened by the court."

§301.7216-2 Disclosure or use without formal consent of taxpayer.

* * * * *

(c) *Disclosure pursuant to an order of a court of a Federal or State agency.* ***

(2) A subpoena issued by a grand jury, Federal or State, or

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 15, 1983, 8:45 a.m., and published in the issue of the Federal Register for November 16, 1983, 48 F.R. 52087)

Notice of Proposed Rulemaking

Elections and Miscellaneous Procedural Matters Under Section 338 of The Internal Revenue Code

LR-26-83

SUMMARY: *** [T]he Internal Revenue Service is issuing amendments to temporary income tax regulations relating in part to elections and miscellaneous procedural matters under section 338 of the Internal Revenue Code of 1954. The text of §5f.338-1 of the temporary regulations as amended also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by April 9, 1984. The regulations are proposed to be effective, generally, for stock acquisitions made after August 31, 1982.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-26-83) Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Duane H. Pellervo of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Atten-

tion: CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations *** [page 93, this Bulletin] revise §§5f.338.1 and 5f.338-2 of the Temporary Income Tax Regulations under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) [Pub. L. 97-248, 1982-2 C.B. 462], as published in the FEDERAL REGISTER on November 22, 1982 (47 F.R. 52433), [T.D. 7855, 1982-2 C.B. 79], and add new §5f.338-3. The final regulations that are proposed to be based on §5f.338-1, as revised by these temporary regulations, would be added to Part 1 of Title 26 of the Code of Federal Regulations to provide rules for making elections under section 338(g) (other than elections subject to section 224(d)(2) of TEFRA [Pub. L. 97-248, 1982-2 C.B. 462,504], as amended by section 306 of the Technical Corrections Act of 1982 [Pub. L. 97-448, 1983-1 C.B. 451,470]) and to provide guidance relating to miscellaneous procedural matters. For the text of the temporary regulations, see T.D. 7942, ***[page 93, of this Bulletin]. The preamble to the temporary regulations explains the addition to the regulations.

REGULATORY FLEXIBILITY ACT AND EXECUTIVE ORDER 12291

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER. The collection of information requirements contained herein have been submitted for OMB review under the Paperwork Reduction Act, and comments on them should be sent to the Office of Information and Regulatory Affairs of OMB, ATTN: Desk Officer for Internal Revenue Service, New Executive Office Bldg, Washington, D.C. 20503. The Internal Revenue Service requests persons submitting comments to OMB to also send copies of the comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Duane H. Pellervo of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

* * * * *

These amendments are necessary because of the addition of section 338 to the Code by Pub. L. 97-248 (96 Stat. 324). These regulations are proposed to be issued under the authority contained in sections 338 and 7805 of the Internal Revenue Code of 1954 (96 Stat. 324, 26 U.S.C. 338; 68A Stat. 917, 26 U.S.C. 7805, respectively).

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 7, 1984, 8:45 a.m., and published in the issue of the Federal Register for February 8, 1984, 49 F.R. 4789)

Notice of Proposed Rulemaking

Information Returns of Brokers

LR-201-83

SUMMARY: This document contains proposed amendments to the regulations relating to information returns of brokers. The proposed regulations would clarify the information reporting requirements applicable to sales (including short sales) of commodities and permit the Secretary to exempt from the broker reporting requirements, by notice published in the FEDERAL REGISTER, a minimum gross proceeds amount on sales of commodities. The proposed regulations would affect brokers effecting sales (including short sales) of commodities.

DATES: Written comments and request to speak at the public hearing must be delivered by March 5, 1984. A notice of public hearing on this proposed rule is published simultaneously with this notice in the FEDERAL REGISTER. The amendments are proposed to be effective on the date they are published in the FEDERAL REGISTER as final regulations. In general, the proposed amendments would apply to sales made on or after July 1, 1983, but no report would be required with respect to sales of a commodity (other than lead, palm oil, rapeseed, tea, or tin) that is not deliverable in satisfaction of a regulated futures contract by reason of its form or quality if the sale occurs before the date the amendments are published in the FEDERAL REGISTER as final regulations. The deadline to apply for an undue hardship exemption from magnetic media reporting for a broker or barter exchange in existence on or before July 1, 1983, is extended to February 6, 1984. Application for exemption from magnetic media reporting should be sent to the Internal Revenue Service Center with which the taxpayer normally files a return; no

such application will be processed through the National Office in Washington, D.C.

ADDRESS: Send comments and request to speak at the public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-201-83), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Bruce H. Jurist of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3238, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 6045 of the Internal Revenue Code of 1954, relating to information returns of brokers. These proposed amendments clarify information reporting requirements for brokers effecting sales (including short sales) of commodities. The amendments are to be issued under the authority of sections 6045 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 747, 917; 26 U.S.C. 6045, 7805).

EXPLANATION OF PROVISIONS

The current regulations under section 6045 generally require brokers to make returns of information on sales (including short sales) of commodities effected for customers. It is unclear under these regulations whether certain forms of personal property are commodities. The proposed regulations provide rules for determining whether personal property (including gold and silver) is a commodity. In general, the term "commodity" is defined as personal property that is deliverable in satisfaction of a regulated futures contract, certain specified personal property, personal property that the Secretary determines is to be treated as a commodity, or any form or quality of or any interest in such personal property. The term "commodity" does not include a security, regulated futures contract, forward contract, or a form of tangible personal property if the gross proceeds from its sale exceed by more than 15 percent its value as a commodity. It should be noted that this rule and the alternative methods of tangible personal property valuation set out in the proposed regulations (the "exact" and "approximate" methods) represent the Service's preliminary attempt to distinguish commodities from other property. The Service encourages public comment on the proposed approach and is particularly interested in suggestions for more precise distinctions between commodities and other property.

The proposed regulations also permit the Secretary to exempt sales of small amounts of a commodity from the broker reporting requirements. The Secretary would permit the exemption by prescribing a minimum gross proceeds reporting amount in a rule-related notice published in the FEDERAL REGISTER.

Under these proposed regulations, no report would be required with respect to a sale of a commodity (other than lead, palm oil, rapeseed, tea, or tin) that is not deliverable in satisfaction of a regulated futures contract by reason of its form or quality if the sale occurs before the date the amendments are published in the FEDERAL REGISTER as final regulations.

CFTC APPROVED COMMODITIES

Personal property is deliverable in satisfaction of a regulated futures contract if such property is deliverable in satisfaction of a futures contract that has been approved for trading by the Commodities Futures Trading Commission (CFTC). The CFTC has approved the trading of futures contracts in the following types of property:

Barley
Belgian francs
British pounds
Butter
Canadian dollars
Cattle
Certificates of deposit
Cocoa
Coconut oil
Coffee
Commercial paper
Copper
Corn
Cotton
Crude oil
Deutschmarks
Dutch guilders
Eggs
Flaxseed
French francs
Frozen boneless beef
Frozen pork bellies
Gasoline
Gold
Grain sorghums
Heating oil
Hogs
Iced broilers
Idaho potatoes
Industrial fuel oil
Italian lira
Japanese yen
Liquefied propane
Live hogs
Lumber
Maine potatoes
Mexican pesos
Mortgages
Natural rubber
Oats
Orange juice
Palladium
Palm oil
Platinum
Plywood
Rice
Rubber
Rye
Silver
Skinned hams
Soybean meal
Soybean oil
Soybeans
Stock index
Stud lumber
Sugar
Sunflower seeds
Swiss francs
Turkeys
U.S. silver coins
U.S. Treasury bills
U.S. Treasury bonds
Wheat
Wool

COMMENTS AND NOTICE OF A PUBLIC HEARING

Before adopting these proposed regulations consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A notice of public hearing on this proposed rule is being published simultaneously in the FEDERAL REGISTER with this notice.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required.

Although this document is a notice of proposed rulemaking that solicits public comment, the Internal Revenue Service has concluded that the notice and public procedure requirements of 5 U.S.C. 553 do not apply because the rules proposed are interpretative and provide an exemption. Accordingly, a Regulatory Flexibility Analysis is not required.

DRAFTING INFORMATION

The principal author of these proposed regulations is Bruce H. Jurist of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Proposed amendments to the regulations

The proposed amendments to 26 CFR Part 1 are as follows:

Paragraph. Section 1.6045-1 is amended by revising paragraph (a)(5), revising Example (5) of paragraph (b), adding Examples (9) through (17) to paragraph (b), redesignating paragraphs (c)(3)(v)(*a*), (*b*), and (*c*) as (c)(3)(v)(A), (B), and (C), respectively, revising paragraph (c)(3)(vii), adding paragraph (c)(3)(x), adding Examples (4) and (5) to paragraph (c)(4), and revising paragraph (l)(2)(ii). The revised and added provisions read as follows:

§1.6045-1 Returns of information of brokers and barter exchanges.

(a) *Meanings of terms.* ***

(5)(i) Except as otherwise provided in paragraph (a)(5)(ii) of this section, the term "commodity" means—

(A) Any form or quality of personal property that is deliverable (whether or not subject to price adjustment for form or quality) in satisfaction of a regulated futures contract that has been approved for trading by the Commodity Futures Trading Commission (whether or not the regulated futures contract is actually traded);

(B) Any form or quality of lead, palm oil, rapeseed, tea, or tin;

(C) Any form or quality of personal property that the Secretary determines is to be treated as a "commodity" under this section, from and after the date specified in a rule-related notice of such determination published in the FEDERAL REGISTER;

(D) Any form or quality of personal property a form or quality of which is described in paragraph (a)(5)(i)(A) of this section; or

(E) Any interest in personal property that is described in paragraph (a)(5)(i)(A), (B), (C), or (D) of this section.

(ii) The term "commodity" does not include—

(A) A security as defined in paragraph (a)(3) of this section;

(B) A regulated futures contract as defined in paragraph (a)(6) of this section;

(C) A forward contract as defined in paragraph (a)(7) of this section;

(D) A form of tangible personal property, or an interest therein, gross proceeds from the sale of which exceed by more than 15 percent the value on the date of sale of the underlying personal property determined, at the election of the broker, by either exact valuation or approximate valuation (as defined in paragraph (a)(5)(iii) of this section); or

(E) A form or quality of tangible personal property or an interest therein if no single type of tangible personal property described in paragraph (a)(5)(i) of this section comprises at least 30 percent of the weight or volume of the underlying personal property and the gross proceeds from the sale of such property are less than three thousand dollars ($3,000).

(iii) For purposes of paragraph (a)(5)(ii)(D) of this section—

(A) The term "exact valuation" means to determine the value of the underlying personal property—

(*1*) By separately determining the value of each type of tangible personal property described in paragraph (a)(5)(i) of this section of which the underlying personal property is composed at the price at which each such type of tangible personal property is bought and sold in the ordinary course of the buyer's business, or a similarly situated business if such price cannot be determined for the buyer's business; and

(2) Aggregating all such separately determined values; and

(B) The term "approximate valuation" means to determine the value of the underlying personal property—

(*1*) Solely with reference to its weight or volume;

(*2*) As if such weight or volume were composed entirely of a single type of tangible personal property described in paragraph (a)(5)(i) of this section identical in kind and quality to the most valuable type of tangible personal property described in paragraph (a)(5)(i) of this section that comprises at least 30 percent of such weight or volume (or if no type of tangible personal property described in paragraph (a)(5)(i) of this section comprises at least 30% of such weight or volume, the most valuable type of tangible personal property described in paragraph (a)(5)(i) of this section that comprises any portion of the underlying personal property);

(*3*) At the price at which the tangible personal property treated as composing the entire weight or volume is bought and sold in the ordinary course of the buyer's business, or a similarly situated business if such price cannot be determined for the buyer's business.

(iv) For purposes of paragraph (a)(5)(ii)(E) and (iii) of this section,

"type of tangible personal property" means any tangible personal property described in paragraph (a)(5)(i)(A), (B), or (C) of this section and any other tangible personal property that cannot be commercially reduced into two or more elements.

(b) *Examples.* ***

Example (5). A warehouse receipt is an interest in personal property for purposes of paragraph (a) of this section. Consequently, a warehouse receipt for a quantity of lead is a commodity under paragraph (a)(5)(i)(E) of this section. Similarly, an executory contract that requires delivery of a warehouse receipt for a quantity of lead is a forward contract under paragraph (a)(7)(i) of this section.

* * * * *

Example (9). If the gross proceeds from the sale of a gold coin (such as a Krugerrand, Maple Leaf, 50 Peso coin, or 100 Crown coil) do not exceed by more than 15 percent the bullion value of the gold in the coin, the coin is a commodity under paragraph (a)(5)(i)(D) of this section and is not excluded by paragraph (a)(5)(ii)(D) of this section.

Example (10). U.S. silver dimes, quarters, and half dollars minted before 1965 are personal property deliverable in satisfaction of a regulated futures contract approved by the Commodity Futures Trading Commission. The coins are a commodity under paragraph (a)(5)(i)(A) of this section. If, however, the gross proceeds from the sale of an individual coin exceed by more than 15 percent the bullion value of the silver in the coin, the coin is not a commodity under paragraph (a)(5)(ii)(D) of this section. If the gross proceeds from the sale of coins as a unit do not exceed by more than 15 percent the bullion value of the silver in the entire unit, all the coins in the unit are a commodity under paragraph (a)(5)(i)(A) of this section notwithstanding the possibility that the gross proceeds from the sale of one or more individual coins in the unit might exceed by more than 15 percent the bullion value of the silver in such individual coins.

Example (11). If the gross proceeds from the sale of a U.S. silver dollar minted before 1970 do not exceed by more than 15 percent the bullion value of the silver in the coin, the coin is a commodity under paragraph (a)(5)(i)(D) of this section and not excluded by paragraph (a)(5)(ii)(D) of this section.

Example (12). Customer E sells to jewelry store S, a broker, a gold necklace. The gross proceeds from the sale of the necklace do not exceed by more than 15 percent the value of the gold as bullion. Consequently, the gold necklace is a commodity under paragraph (a)(5)(i)(D) of this section and not excluded under paragraph (a)(5)(ii)(D) of this section.

Example (13). Customer F sells to jewelry store T, a broker, a diamond ring. The diamond ring (composed of a gold band and gem) weighs 0.5 troy ounces. The gold in the ring comprises more than 30 percent of the total weight of the ring, and the gross proceeds from the sale of the diamond ring exceed by more than 15 percent the value of 0.5 troy ounces of gold as bullion. Consequently, the diamond ring is not a commodity under paragraph (a)(5)(i)(D) of this section because of its exclusion under paragraph (a)(5)(ii)(D) of this section.

Example (14). Customer G sells to smelter U, a broker, a gold and silver goblet. More than 30 percent of the weight or volume of the goblet is gold. Assume that the broker chooses to use the "approximate valuation" method described in paragraph (a)(5)(iii)(B) of this section and that the goblet weighs 10 troy ounces. If the gross proceeds from the sale of the goblet do not exceed by more than 15 percent the value of 10 troy ounces of gold as bullion, the goblet is a commodity under paragraph (a)(5)(i)(D) of this section and not excluded under paragraph (a)(5)(ii)(D) of this section.

Example (15). V, a jeweler, generally purchases inventory (that is a commodity under paragraph (a)(5) of this section) from wholesalers and purchases inventory from the general public only when sufficient inventory cannot be secured from wholesalers. V does not accept offers for sale, but seeks out sellers when inventory is needed. Since V does not stand ready to effect sales to be made by others, V is not a broker.

Example (16). W, a coin dealer, regularly advertises that it will purchase gold items for their bullion value. Since W stands ready to effect sales to be made by others, W is a broker.

Example (17). X, a coin dealer, regularly buys gold items when they are offered for sale and this is known to sellers of such items. Since X stands ready to effect sales to be made by others, X is a broker whether or not it advertises.

(c) *Reporting by brokers—****

(3) *Exceptions.* ***

(vii) *Foreign currency.* No return of information is required with respect to a sale of foreign currency unless—

(A) Such sale is pursuant to a regulated futures contract or forward contract that requires or permits delivery of foreign currency; or

(B) Such foreign currency is a form or quality of or interest in gold or silver not described in paragraph (a)(5)(ii)(D) of this section.

* * * * *

(x) *Minimum gross proceeds.* No return of information is required with respect to a sale of a commodity effected by a broker for a customer if the aggregate gross proceeds from all sales of commodities effected by the broker for the customer on the date of such sale are less than the minimum gross proceeds reporting amount applicable on such date. For this purpose, the minimum gross proceeds reporting amount is the amount prescribed as such by the Secretary in a rule-related notice published in the FEDERAL REGISTER.

(4) *Examples.* The following examples illustrate the application of the reporting requirements.

* * * * *

Example (4). X, an individual, exchanges at bank N British pounds, in paper currency form, for U.S. dollars. Even though the exchange is a sale of a commodity under paragraph (a)(5)(i)(A) of this section, such sale is exempt from reporting under paragraph (c)(3)(vii) of this section.

Example (5). Y, an individual, sells goods to Company P, a British corporation. In payment for those goods Company P tenders to Y a check in the amount of 1000 pounds sterling. Y cashes the check at bank M and receives U.S. dollars. Even though the transaction is a sale of a commodity under paragraph (a)(5)(i)(E) of this section, such sale is exempt from reporting under paragraph (c)(3)(vii) of this section.

* * * * *

(1) *Use of magnetic media.* ***

(2) *Exception for undue hardship.* ***

(ii) In the case of a person who is a broker or barter exchange on July 1, 1983, an application to file returns of information on Form 1099 must be filed on or before February 6, 1984. In the case of a person who becomes a broker or barter exchange after July 1, 1983, such application must be filed by the later of February 6, 1984 or the end of the second month following the month in which such person becomes a broker or barter exchange.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 30, 1983, 4:23 p.m., and published in the issue of the Federal Register for January 5, 1984, 49 F.R. 646)

Notice of Proposed Rulemaking

Indian Tribal Governments Treated as States for Certain Purposes

LR-221-83

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: *** [T]he Internal Revenue Service is issuing temporary regulations that relate to the treatment of Indian tribal governments as States for certain purposes. The text of those temporary regulations also serves as the comment document for this proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered by July 6, 1984. The amendments are proposed to be effective generally for taxable years beginning

after December 31, 1982, and before January 1, 1985.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-221-83), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Linda M. Kroening, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3288) (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations *** [page 276, this Bulletin] add Part 305 to Title 26 of the Code of Federal Regulations. The final regulations, which this document proposes to base on those temporary regulations, would amend Part 301 of Title 26 of the Code of Federal Regulations.

The regulations provide guidance with respect to the treatment of Indian tribal governments as States for certain purposes under sections 7701(a)(40) and 7871 of the Internal Revenue Code of 1954, as added to the Code by sections 202 and 203 of the Indian Tribal Governmental Tax Status Act of 1982 (Pub. L. 97-473, 96 Stat. 2608, 2611). The regulations are to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805). For the text of the temporary regulations, see FR Doc. 84-12119 (T.D. 7952) *** [page 276, this Bulletin]. The preamble to the temporary regulations provides a discussion of the rules.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

Although this document is a notice of proposed rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis is required by Chapter 6 of Title 5, United States Code.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, D.C. 20503. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

DRAFTING INFORMATION

The principal author of these proposed regulations is Linda M. Kroening of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 4, 1984, 8:45 a.m., and published in the issue of the Federal Register for May 7, 1984, 49 F.R. 19329)

Notice of Proposed Rulemaking

Classification of Investment Arrangements with Multiple Classes of Ownership

LR-68-84

SUMMARY: This document contains proposed regulations relating to the classification for federal tax purposes of investment arrangements with multiple classes of ownership. The proposed regulations are designed to clarify the meaning of the term "fixed investment trust" and the application of the classification rules to investment arrangements with multiple classes of ownership. The regulations would provide guidance to taxpayers and Internal Revenue Service personnel.

DATES:

PROPOSED EFFECTIVE DATE

The amendments to the regulations are proposed to apply with respect to arrangements, any interest in which are initially issued after April 27, 1984.

DATE FOR COMMENTS

Written comments must be delivered or mailed by July 2, 1984.

DATE FOR PUBLIC HEARING

A public hearing on the proposed regulations will be held on July 31, 1984; for further information, see the notice of public hearing published elsewhere in this issue of the FEDERAL REGISTER.

ADDRESS: Send comments to Commissioner of Internal Revenue Attention: CC:LR:T [LR-68-84], Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Cynthia Grigsby of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3935).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7701 of the Internal Revenue Code of 1954. The proposed amendments relate to the definition of the term "trust" for federal tax purposes. These amendments to the regulations are proposed to be issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

EXPLANATION OF AMENDMENTS

Existing §301.7701-4(c) of the Regulations on Procedure and Administration provides guidance as to the classification for federal tax purposes of certain "investment" trusts. Under that regulation an entity of the type "commonly known as a fixed investment trust" is classified as a trust or an association (taxable as a corporation), depending upon the existence of a power under the agreement to vary the investment of the certificate holders. The question has been raised whether the rules for fixed investment trusts apply to an investment arrangement under which investors may choose among different classes of ownership with varying investment attributes.

The entities commonly known as fixed investment trusts at the time that the existing regulations were first promulgated in 1945 had only one class of certificates, with each certificate representing an undivided interest in trust property. "The investor [in a fixed trust]. . .has a beneficial undivided interest in specific deposited securities or property. . . .In the fixed trust. . .only one class of security is issued—the certificate of beneficial interest which is, in form, a receipt issued by the trustee for the deposited property." [Investment Trusts and Investment Companies, H.R. Doc. No. 567, 76th Cong., 3d Sess. 8-9 (1940) (footnote omitted).] The purpose of a fixed investment trust was to provide a convenient vehicle to enable investors to acquire undivided beneficial interests in a diversified investment portfolio. Thus, entities with multiple classes of ownership were not commonly known as fixed investment trusts at the time that the regulations were promulgated. *Consequently, the "fixed investment trust" rules were not intended to apply to such entities. In contrast, at the time the regulations were issued, multiple classes of ownership, such as preferred and common stock, often were associated with "management companies." H.R. Doc. No. 567 at 8-9. A "management trust", which is one type of management company, is classified for tax purposes as an association taxable as a corporation. Treas. Reg. §301.7701-4(c).

In recent months new arrangements have been created that are claimed to be fixed investment trusts. In one such arrangement, a mortgage pool was formed to allow various groups of investors with different investment objectives to join together in a financial arrangement in which different rights and risks associated with a pool of mortgages are allocated among three classes of certificates. The first class of certificates provides for a priority in distributions from the pool and represents a short term interest while the second and third classes of certificates represent interests with longer maturities. The owner of a certificate in any of the three classes is not entitled to distributions of principal and interest on any specific mortgage or mortgages, but merely the right to certain distributions from the pool. Because there are multiple classes of ownership, this arrangement is not a fixed investment trust. Moreover, a significant objective of the arrangement is to shift to the first class of certificate holders the risk that mortgages in the pool will be prepaid, so that the holders of the second and third classes of certificates will have "call protection" (freedom from premature termination of their interests on account of prepayments). This arrangement was not intended to protect and conserve property for the beneficiaries. Rather, the certificate holders, through this arrangement, associated together to fulfill their diverse profit-making objectives. The certificate holder must be viewed, therefore, as associates in a joint enterprise for the conduct of business for profit, and the arrangement is classified as an association or a partnership under §301.7701-2 of the regulations.

A second new type of arrangement provides a vehicle for investors to divide the income and appreciation elements inherent in a share of common stock. In this arrangement, a custodian accepts shares of stock in a single corporation and issues to the depositor one certificate for each share deposited. The certificate is perforated and can be separated by the depositor into two parts, with one part representing the right to receive an amount referable to the current value of the share of stock and the right to dividends from the stock, and the other part representing the right to the future appreciation on the share above the amount allocated to holders of the first part. The purpose of the arrangement is to allow investors to separate the certificate, retain the portion that suits their objectives and sell the other portion in the market. Buying one of the two parts enables investors to fulfill their specific profit-making objectives. Although only one type or class of certificate is issued by the custodian, the effect of the arrangement is to create two classes of interests. Thus, the arrangement is not a fixed investment trust. Moreover, as with the type of arrangement described above, the investors have associated together to divide the burdens and benefits inherent in the contributed shares and

*In *Commissioner v. Chase National Bank*, 122 F.2d 540 (2d Cir. 1941), the court held that a trust having certificates with detachable coupons evidencing the bearer's rights to receive semi-annual distributions from the trust paid out of dividends and other income from stocks held by the trust was a fixed investment trust. The court found, however, that the purpose underlying the arrangement was to enable investors to acquire undivided beneficial interests in the stocks held in the arrangement. 122 F.2d at 541. The detachable coupons were a convenience to facilitate distributions and there was no apparent intention for the coupons to be detached and actively traded prior to their maturity. Thus, there was no intention to create a second class of ownership.

must be viewed as associates with an objective to carry on a business and divide the gains therefrom. Thus, this arrangement is also classified as an association or a partnership under §301.7701-2 of the regulations.

In a third type of arrangement, a custodian holds one or more issues of bonds and issues certificates representing the right to specific interest or principal payments on the bonds. Although this arrangement is similar to that described above, it is distinguishable in that the division of the property is only between the bonds and specific interest coupons thereon. In section 1232B of the Code, Congress has provided a method for taxing transactions involving such "stripped bonds" and "stripped coupons." Thus, it would be inconsistent with section 1232B to treat typical "coupon stripping" arrangements in which bonds are held by a custodian and interests in specifically identifiable stripped coupons or bonds are sold as either associations or partnerships.

The proposed amendments to the regulations clarify the meaning of "fixed investment trust" under the regulations. The existing regulations, in focusing on the power of the trustee to vary the investment of the certificate holders, reflect the issue that was of primary concern at the time the regulations were drafted. With the development of multiple-class investment arrangements, however, there is a need for further elaboration on the definition of the term "fixed investment trust" and the essential elements of this type of entity. In providing this definition, the proposed amendments impose a limitation not expressly stated in the existing regulations, and thus it was decided that the amendments should be prospective from April 27, 1984. The proposed rules for classification will apply to investment arrangements, any interests in which are initially issued after April 27, 1984.

SPECIAL ANALYSES

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

Although this document is a notice of proposed rulemaking that solicits public comments, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis is required by chapter 6 of title 5, United States Code.

COMMENTS AND PUBLIC HEARING

Before adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying.

A public hearing on the proposed regulations will be held on July 31, 1984. For further information about the public hearing, see the notice of hearing that appears elsewhere in this issue of the FEDERAL REGISTER.

DRAFTING INFORMATION

The principal author of these proposed regulations is Paul A. Francis of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

* * * * *

Proposed amendments to the regulations

Accordingly, it is proposed to amend 26 CFR Part 301 as follows: Paragraph (c) of §301.7701-4 is revised to read as follows:

§301.7701-4 Trusts.

* * * * *

(c) *Certain investment trusts*—(1) An "investment" trust of the type commonly known as a management trust is an association, and a trust of the type commonly known as a fixed investment trust is an association if there is power under the trust agreement to vary the investment of the certificate holders. See *Commissioner v. North American Bond Trust*, 122 F.2d 545 (2d Cir. 1941), *cert. denied* 314 U.S. 701 (1942). However, if there is no power under the trust agreement to vary the investment of the certificate holders, such fixed investment trust shall be classified as a trust.

(2) A trust commonly known as a fixed investment trust is an arrangement in which legal title to property is conveyed to a trustee for the benefit of a group of investors. Each investor in such a trust has an undivided beneficial interest in the property held in trust, typically represented by certificates of beneficial interest issued to the investor; there is only one class of ownership interest. An arrangement having more than one class of ownership interest is not a fixed investment trust because an investor, rather than having an undivided beneficial interest in each asset of the trust, has a participating interest that differs from the interest held by an investor of another class. Because an arrangement with multiple classes of ownership enables investors to fulfill varying profit-making objectives through the division of rights, and the sharing of risks, in certain assets, the arrangement is considered to have associates and an objective to carry on business and divide the gains therefrom. Such an arrangement, therefore, is classified as an association or a partnership under §301.7701-2.

(3) The requirement that a fixed investment trust have only one class of undivided interests has no application to mere custodial arrangements formed to allow investors to own specifically identifiable stripped coupons or stripped bonds within the meaning of section 1232B.

(4) The provisions of paragraph (c)(2) of this section may be illustrated by the following examples:

Example (1). A corporation purchases a portfolio of residential mortgages (or participations in residential mortgages) and transfers the mortgages to a bank under a custody agreement. At the same time, the bank as custodian delivers to the corporation certificates evidencing rights to payments from the pooled mortgages; the corporation sells the certificates to the public. The custodian holds legal title to the mortgages in the pool for the benefit of the certificate holders but has no power to reinvest

proceeds attributable to the mortgages in the pool or to vary investments in the pool in any other manner. There are two classes of certificates. Holders of class A certificates are entitled to all payments of mortgage principal, both scheduled and prepaid, until their certificates are retired; holders of class B certificates receive payments of principal only after all class A certificates have been retired. This arrangement has two classes of ownerhsip and is, therefore, not a fixed investment trust. Such as arrangement is considered to have associates and an objective to carry on business for profit and divide the gains therefrom. Therefore, it is classified as an association or a partnership under §301.7701-2.

Example (2). A promoter formed a trust in which shareholders of a publicly traded corporation could deposit their stock. For each share of stock deposited with the trust, the participant receives a certificate that can be separated into two parts. One part represents the right to dividends and the value of the underlying stock up to a specified amount, the other part represents the right to appreciation above the specified amount. The two parts are traded separately on the open market. There are two classes of ownership in this arrangement and it is, therefore, not a fixed investment trust. Such an arrangement is considered to have associates and an objective to carry on business for profit and divide the gains therefrom. Therefore, it is classified as an association or a partnership under §301.7701-2.

* * * * *

ROSCOE L. EGGER, JR.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 27, 1984, 4:57 p.m., and published in the issue of the Federal Register for May 2, 1984, 49 F.R. 18741)

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will continue to appear in the weekly Bulletin for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the administrative law judge, the following individual has been suspended from further practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John B. Jackson	Concord, CA	Certified Public Accountant	30 days effective January 8, 1984

After due notice and hearing before the administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Peter Privitera	Buffalo, NY	Certified Public Accountant	December 14, 1983
Larry L. Eubanks	Winston-Salem, NC	Attorney	December 9, 1983
Joseph W. Poole	Lanham, MD	Certified Public Accountant	January 10, 1984

After due notice and opportunity for hearing, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Term of Disbarment
Benjamin A. Totten, III	Valparaiso, FL	Enrolled Agent	February 20, 1984
Steven S. Glick	Encino, CA	Certified Public Accountant	April 19, 1984

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practi-

tioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletin for five consecutive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Paul K. Kavanaugh	Berea, OH	Attorney	60 days effective December 15, 1983
Ralph J. Torraco	Jersey City, NJ	Certified Public Accountant	Indefinite effective January 13, 1984
Michael A. Cicero	Tempe, AZ	Enrolled Agent	Indefinite effective February 21, 1984
Ferdinand R. Goglio	Mineola, NY	Attorney	March 7, 1984 Indefinite
James R. Morrison	Fayette, AL	Certified Public Accountant	March 27, 1984 Indefinite
Susan K. Sirmons	Grove City, FL	Enrolled Agent	March 26, 1984 Indefinite
John A. Stiver	Pittsburgh, PA	Certified Public Accountant	18 months effective April 17, 1984

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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