AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

Internal Revenue

cumulative

bulletin

1999–2

July–December

Department of the Treasury
Internal Revenue Service

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The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of the 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 published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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 pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and 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 Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases.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.

The Cumulative Bulletin (C.B.) is composed of reprints of the weekly Internal Revenue Bulletins (I.R.B.s) issued during the year, bound together to form the C.B. Volume 1 contains I.R.B. issues 1 through 26 and Volume 2 contains I.R.B. issues 27 through 52. Public laws relating to taxes are published in Volume 3 of the C.B. If needed, additional volumes are published and labeled consecutively.

The C.B. also includes the following items.

- Numerical Finding List.
- Finding List of Current Actions on Previously Published Items.
- Code Sections Affected by Current Actions. This list is organized by code section and identifies the actions that impact the code section.
- Cumulative List of Actions on Decisions (if applicable).
- Cumulative Lists of Disbarments and Suspensions (if applicable).
- Cumulative Index.

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Cumulative List of Actions on Decisions

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. Nonacquiescence signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a nonacquiescence indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletins are consolidated semiannually in the Cumulative Bulletins.

The Commissioner ACQUIESCES in the following decisions:

James J. and Sandra A. Gales v. Commissioner,[1]
T.C. Memo 1999-27

Dubin v. Commissioner,[2]
99 T.C. 325 (1992)

William and Helen Woodral v. Commissioner,[3]
112 T.C. 19 (1999)

Internal Revenue Service v. Waldschmidt (In re Bradley),[4]
(M.D. Tenn. 1999)

Estate of Mellinger v. Commissioner,[5]
112 T.C. 4 (1999)

Hospital Corp. of America and Subsidiaries v. Commissioner,[6]
109 T.C. 21 (1997)

Boyd Gaming Corporation v. Commissioner,[7]
F.3d (9th Cir. 1999)

Conway v. Commissioner,[8]
111 T.C. 350 (1998)

The Commissioner NONACQUIESCES in the following decisions:

RJR Nabisco, Inc., et al., v. Commissioner,[9]
T.C. Memo 1998-252

Vulcan Materials Company and Subsidiaries v. Commissioner,[10]
96 T.C. 410 (1991)

St. Jude Medical, Inc. v. Commissioner,[11]
34 F.3d 1394 (8th Cir. 1994)

Hospital Corp. of America and Subsidiaries v. Commissioner,[12]
109 T.C. 21 (1997)

Mutual Assurance, Inc., v. United States,[13]
56 F.3d 1353 (11th Cir. 1995)

Duke Energy Natural Gas Corporation v. Commissioner,[14]
–F.3d–(10th Cir. 1999)

[1] Acquiescence in result only relating to whether advance commissions received on insurance written by taxpayer husband were income at the time paid or were loans such that income was reportable only as the commissions were subsequently earned.

[2] Acquiescence in result only relating to whether partnership items reported on a joint return convert to nonpartnership items with respect to both spouses when a TEFRA conversion event, pursuant to I.R.C. section 6231, occurs as to only one spouse.

[3] Acquiescence in result only as to whether the Tax Court lacks jurisdiction to review the Internal Revenue Service's denial of petitioner's claim for abatement of interest on employment taxes arising under I.R.C. section 6404(a), i.e., whether the Court's jurisdiction is limited to reviewing the denial of claims brought under section 6404(e).

[4] Acquiescence relating to whether gain on the sale of the debtor's residence is excluded from gross income of the bankruptcy estate to the extent provided by I.R.C. §121 and in accord with section 1398.

[5] Acquiescence relating to whether, for estate tax valuation purposes, a minority interest in a closely held corporation held in a Qualified Terminable Interest Property (QTIP) trust, which is includible in the gross estate under I.R.C. §2044, is aggregated with a minority interest in the same corporation that is includible in a decedent's gross estate under other provisions of the Code.

[6] Acquiescence relating to whether the tests developed under the investment tax credit (ITC) prior to the 1981 adoption of the cost recovery system are applicable in determining a structural component for the purposes of Accelerated Cost Recovery System (ACRS) and Modified Accelerated Cost Recovery System (MACRS).

[7] Acquiescence relating to whether a meal furnished by the taxpayer/employer on its business premises to an employee is furnished for "the convenience of the employer" within the meaning of that phrase in section 119 of the Internal Revenue Code.

[8] Acquiescence relating to whether a taxpayer's partial surrender of an annuity contract and direct transfer of the resulting proceeds for the purchase of a new annuity qualifies as a nontaxable exchange under I.R.C. section 1035.

[9] Nonacquiescence relating to whether graphic design and advertising campaign costs incurred by petitioner are currently deductible business expenses under I.R.C. section 162 or are properly treated as capital expenditures under I.R.C. section 263.

[10] Nonacquiescence relating to whether the term "accumulated profits" as used in the denominator of the section 902 deemed paid credit fraction before the Tax Reform Act of 1986 means all of a foreign corporation's accumulated profits for the taxable year. This revised action on decision clarifies the Service's position on this issue in cases appealable to the 11th Circuit.

[11] Nonacquiescence relating to whether section 1.861–8(e)(3) of the Income Tax Regulations is invalid as applied to DISC combined taxable income (CTI) calculations.

[12] Nonacquiescence relating to whether certain items treated as tangible personal property and depreciated over a 5-year recovery period were in fact structural components of the buildings to which they relate which must be depreciated over the same recovery period as the buildings, pursuant to I.R.C. §168.

[13] Nonacquiescence relating to whether a timely filed claim for refund that was allowed in full may be amended after the expiration of the statute of limitations for filing a claim for refund.

[14] Nonacquiescence relating to whether, for purposes of depreciation, a taxpayer engaged in the business of pipeline transmission of natural gas, who is not a producer of natural gas, must include gathering pipelines in assets class 46.0 Pipeline Transaction (15-year recovery period) or in class 13.2 Exploration for and Production of Petroleum Natural Gas Deposits (7-year recovery period).

Internal Revenue
bulletin

Bulletin No. 1999–27
July 6, 1999

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 99–29, page 3.
Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for July 1999.

EXEMPT ORGANIZATIONS

Announcement 99–64, page 7.
A list is given of organizations now classified as private foundations.

EMPLOYMENT TAX

T.D. 8822, page 5.
Final regulations under section 6302 of the Code adopt the rules of temporary regulations that change the *de minimis* deposit rule for quarterly and annual return periods from $500 to $1,000.

ADMINISTRATIVE

Announcement 99–65, page 9.
This document contains a correction to REG–208156–91, 1999–22 I.R.B. 11, proposed regulations relating to accounting for long-term contracts.

Announcement 99–66, page 9.
This document contains corrections to T.D. 8805, 1999–5 I.R.B. 14, final regulations relating to the application of section 904 of the Code to certain categories of income.

Finding Lists begin on page 11.
Index for January through June begins on page 14.

Department of the Treasury
Internal Revenue Service

Mission of the Service

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

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 published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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 pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and 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.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

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. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 807.—Rule for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for July 1999.

Rev. Rul. 99–29

This revenue ruling provides various prescribed rates for federal income tax purposes for July 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the blended annual rate for 1999 for purposes of section 7872.

REV. RUL. 99–29 TABLE 1

Applicable Federal Rates (AFR) for July 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	5.32%	5.25%	5.22%	5.19%
110% AFR	5.86%	5.78%	5.74%	5.71%
120% AFR	6.40%	6.30%	6.25%	6.22%
130% AFR	6.95%	6.83%	6.77%	6.73%
Mid-Term				
AFR	5.82%	5.74%	5.70%	5.67%
110% AFR	6.41%	6.31%	6.26%	6.23%
120% AFR	7.01%	6.89%	6.83%	6.79%
130% AFR	7.60%	7.46%	7.39%	7.35%
150% AFR	8.80%	8.61%	8.52%	8.46%
175% AFR	10.30%	10.05%	9.93%	9.85%
Long-Term				
AFR	6.10%	6.01%	5.97%	5.94%
110% AFR	6.72%	6.61%	6.56%	6.52%
120% AFR	7.34%	7.21%	7.15%	7.10%
130% AFR	7.96%	7.81%	7.74%	7.69%

REV. RUL. 99–29 TABLE 2

Adjusted AFR for July 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.48%	3.45%	3.44%	3.43%
Mid-term adjusted AFR	4.14%	4.10%	4.08%	4.07%
Long-term adjusted AFR	4.98%	4.92%	4.89%	4.87%

REV. RUL. 99–29 TABLE 3

Rates Under Section 382 for July 1999

Adjusted federal long-term rate for the current month	4.98%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.98%

REV. RUL. 99–29 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for July 1999

Appropriate percentage for the 70% present value low-income housing credit	8.40%
Appropriate percentage for the 30% present value low-income housing credit	3.60%

REV. RUL. 99–29 TABLE 5	
Rate Under Section 7520 for July 1999	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.0%

REV. RUL. 99–29 TABLE 6	
Blended Annual Rate for 1999	
Section 7872(e)(2) blended annual rate for 1999	4.94%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, page 3.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, page 3.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 1999. See Rev. Rul. 99–29, page 3.

Section 6302.—Mode or Time of Collection

26 CFR 31.6302–1: Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

T.D. 8822

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

Federal Employment Tax Deposits-*De Minimis* Rule

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the deposit of Federal employment taxes. The final regulations adopt the rules of temporary regulations that change the *de minimis* deposit rule for quarterly and annual return periods from $500 to $1,000. The regulations affect taxpayers required to make deposits of Federal employment taxes.

DATES: *Effective date:* These regulations are effective June 17, 1999.

Applicability date: For dates of applicability, see §31.6302–1(f)(4).

FOR FURTHER INFORMATION CONTACT: Vincent Surabian, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 31, Employment Taxes and Collection of Income Tax at Source. On June 16, 1998, temporary and final regulations (T.D. 8771, 1998–29 I.R.B. 6) relating to the deposit of Federal employment taxes under section 6302 of the Internal Revenue Code were published in the **Federal Register** (63 F.R. 32735). A notice of proposed rulemaking (REG–110403–98, 1998–29 I.R.B. 11) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (63 F.R. 32774). No comments were received from the public in response to the notice of proposed rulemaking.

Explanation of Provisions

These final regulations adopt the rules of the temporary regulations. Under these rules, a taxpayer that has accumulated Federal employment taxes of less than $1,000 for a return period (quarterly or annual, as the case may be) does not have to make deposits but may remit its full liability with a timely filed return for the return period. The regulations are effective with respect to quarterly return periods beginning on or after July 1, 1998, and annual return periods beginning on or after January 1, 1999.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Vincent Surabian, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel

from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 is amended by removing the entry for Section 31.6302–1T to read in part as follows:

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

Par. 2. In §31.6302–1, paragraph (f)(4) is revised to read as follows:

§31.6302–1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

* * * * *

(f) * * *

(4) *De Minimis rule.* For quarterly return periods beginning on or after July 1, 1998, and annual return periods beginning on or after January 1, 1999, if the total amount of accumulated employment taxes for the return period is less than $1,000 and the amount is fully deposited or remitted with a timely filed return for the return period, the amount deposited or remitted will be deemed to have been timely deposited.

* * * * *

§ 31.6302–1T [Removed]

Par. 3. Section 31.6302–1T is removed.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 9, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 16, 1999, 8:45 a.m., and published in the issue of the Federal Register for June 17, 1999, 64 F.R. 32408)

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 99–64

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Archangel Foundation, Inc., Silver Spring, MD
Bay View High School Education Foundation, Milwaukee, WI
The Block, Houston, TX
Chicago House of Recovery Inc., Alsip, IL
Citizens for Health Improvement of Nigeria, Dayton, OH
Conceptual International Agency, Anchorage, AK
COMBAC Family Center, Washington, DC
Educational Research and Development Foundation, Grove City, OH
Ernie's Museum of Black Arkansans Hall of Fame and Music Theater, Little Rock, AR
Gulf Coast Wetlands Preservation Foundation, Metairie, LA
Haitian Education & Revitalization Team-HEART, Naples FL.
Highland Terrace Housing Corp., New Castle, PA
Interventional Cardiology Research Fund, Inc., Metairie, LA
International Health Network, Tacoma, WA
International Museum Theatre Alliance, Inc., Boston, MA
Jasper Rotary Charitable Fund Inc., Big Canoe, GA
Jefferson Economic Development Inc., Louisville, KY
Joan Mitchell Foundation, Inc., Bronx, NY
Keewaydin Institute, Naples, FL
Lenape Enterprise, Inc., Winfield, TN
Michael J. Carmichael Family Foundation Inc., Ocala, FL
New Creek Foundation for Low Impact Therapy, Evaluation and Research, Alexandria, VA
New Road Community Development Group of Exmore, Exmore, VA
NIA Hope Inc., Philadelphia, PA
NNI Revitalization Corp., Stamford, CT
Organplan Foundation Inc., New York, NY
Providence Sickle Cell Research, Inc., Dalzell, SC
Southern Oklahoma Memorial Foundation Inc., Ardmore, OK
Spirit of America Research Foundation Inc., Lake Mary, FL
Togs for Tots Professional Child Care, Flint, MI
Tol Inc., Houston, TX
Toledo-Lucas Housing Fund Inc., Toledo, OH
Tomche Shabbos Fund Inc., Miami Beach, FL
Tomi Care Facility, Houston, TX
Tomorrows Vision Foundation, Charleston, SC
Tonopah Life Center, Tonopah, NV
Tony Casillas Foundation, Irving, TX
Tonya Potter Ministries Inc., Seminole, FL
Toppers Association Inc., Brooklyn, NY
Torah Vadanesh Inc., Forest Hills, NY
Tori Foundation, Houston, TX
Totally Tennis Inc., Washington, DC
Touch the Earth Inc., Bismarck, ND
Touch Together Our Unity Can Help, Baltimore, MD
Township of Washington Operation Playground Inc., Washington Township, NJ
Trade Support Institute Inc., Durham, NC
Traditional Indian Housing Inc., Shawnee, OK
Traffic Incident Services Inc., Sutton, MA
Transitional Housing Employing Islip Rehab Homes Inc., Islip, NY
Translating Assistance Program for Patients Inc., Kansas City, MO
Treasure Island Training Center Inc., Chicago, IL
Trees for Dubuque, Dubuque, IA
Trezza Foundation for the Arts Inc., Hollywood, FL
Tri-Agency Conference 95 Inc., Miami, FL
Tri-Community Development Inc., Cherry Creek, SD
Tri Counties Special Services Inc., Hopkinsville, KY
Tri-County Hospice Inc., Charleston, SC
Tri-County Problem Solving Services Inc., Sault Ste Marie, MI
Triangle Productions, Kirkland, WA
Triple R Speciality Ranch Inc., Portland, OR
Truckers for Kids Incorporated, Wichita, KS
True Alternative Inc., West Palm Beach, FL
Truth Program Services Inc., Bronx, NY
TSM Inc., Racine, WI
Tulsa Firefighters Educational Clowns Inc., Tulsa, OK
Tundra Club, Salt Lake City, UT
Turner Group Home, Tustin, CA
Turning Point Services, Houston, TX
Turtle River Nation Inc., Fair Acres, NM
TW Fastpitch, Inc., Naples, FL
Twelve Step House II Inc., Omaha, NE
Twenty-First Century Educational Computing Corp., Baltimore, MD
Twin Ports Boxing Club, Duluth, MN
Tyler Auto Christian Fellowship Inc., Tyler, TX
Tyler Family Ministries Inc., Little Rock, AR
U N L Medical School Foundation, San Antonio, TX
U P Outreach-93, Marquette, MI
U S A Verich Reps., Warren, OH
U S Shelter Corporation, Minneapolis, MN
UJC Community Advocacy Program Inc., River Edge, NJ
UMOJA Optimist Foundation, Detroit, MI
Uni-Rock Group Inc., New York, NY
Unicorn School of Acting, Pearland, TX
Unified Community Economic Development Association, Seattle, WA
Union County Foundation, Lewisburg, PA
Union of Baptists of the Ukraine, Louisville, KY

Union Station Alliance Inc., Worcester, MA
United African American Coalition, Philadelphia, PA
United Asian Community Center Inc., Milwaukee, WI
United Black Fund of Alabama Inc., Birmingham, AL
United Business Association of Woodlawn, Chicago, IL
United Caring Service, Sandusky, MI
United Charitable Foundation of America, Las Vegas, NV
United Charities of America, Clemmons, NC
United Chow Christian Mission, San Diego, CA
United Christian Charities-Georgia Inc., Norcross, GA
United Compassionate Artists Project, Bend, OR
United Day of San Antonio, San Antonio, TX
United Endeavors Inc., New York, NY
United Fellowship Foundation, Hoffman Estates, IL
United Fellowship Ministries Inc., Tampa, FL
United for the Community of Homeless Inc., Atlanta, GA
United Fundraisers Inc., Eugene, OR
United Parents for all Salinas, Salinas, CA
United Parents for Excellence in Education Inc., Atlanta, GA
United Park Drive Association, Statesville, NC
United Progressive Action League, Lakeview, NY
United States League for Freedom and Democracy Inc., East Orange, NJ
United States Marshals Posse, New Salem, ND
United States Precision Flying Association Inc., Longview, TX
United Veterans Council of Washington County, Forest Lake, MN
Unity House Inc., Phoenix, AZ
Unity Outreach Inc., Chicago, IL
Universal Book Program Inc., Yazoo City, MS
Universal Dynamics Inc., Chicago, IL
University of Pennsylvania Dade Alumni Foundation Incorporated, Miami, FL
Upper Room, Ortonville, MN
Upson Renewed Education and Adult Development Program, Thomaston, GA
Uptown 23 Development Association, Oklahoma City, OK
Urban and Suburban Properties, Blue Island, IL
Urban Art Retreat, Chicago, IL
Urban Artists Incorporated, Philadelphia, PA
Urban Computer Learning Corp., Minneapolis, MN
Urban Express Inc., Lake Dallas, TX
Urban Living Center, Denver, CO
Uriah Art Council, Uriah, AL
USA Basketball Camp Inc., Irving, TX
Utah Baroque Ensemble, Springville, UT
Utah Blues Society Inc., Salt Lake City, UT
Utah Gerontological Society, Salt Lake City, UT
Utah Music Festival, Logan, UT
Utah Society of Fund Raisers, Salt Lake City, UT
V F H & E Inc., Grand Rapids, MI
V IA Art Inc., New York, NY
Valley Arts Group Inc., Saint Albans, WV
Valley Green Resident Council Inc., Washington, DC
Valley Medical Clinic Inc., Julesburg, CO
Valley Youth Basketball Association, Perris, CA
Valorie Dancer & Patricia Gill Ptr., Houston, TX
Venture Abilities U S A Inc., Boston, MA
Vera Court Neighborhood Association Inc., Madison, WI
Verden Improvement Inc., Verden, OK
Vermont Aviation Advisory Council Inc., Montpelier, VT
Veterans Council for American Rights and Equality Redwood Empire, Nice, CA
Veterans Counseling Services Inc., Lawrence, MA
Veterans Emergency Transition Shelter Inc., Newport News, VA
Veterans Memorial Committee, Jupiter, FL
Veterans Resource Center Inc. of New England, Lawrence, MA
Veterans Services Association Inc., Phoenix, AZ
Vian Indian Community Organization Inc., Vian, OK
Victim Investigation Information Services, Tucson, AZ
Victory Ministries Flying Service, Albuquerque, NM
Victory Road Rehab Program Inc., Redding, CA
Video Vista of New York Ltd., New York, NY
Vincennes Cub League Inc., Vincennes, IN
Vinedresser Ministries Inc., Grand Rapids, MI
VINH Long-VINH BINH-SA DEC Fraternity, Houston, TX
Violence Free School Project, Duluth, MN
Virgin Valley Volunteer Services Incorporated, Mesquite, NV
Virginia Alliance for Safety Education, Richmond, VA
Virginia Nurserymens Association Horticulture Research Foundation, Christiansburg, VA
Virtual Reality Alliance of Students and Professionals Inc., Piscataway, NJ
Vision for the Nations Ministries Incorporated, Wills Point, TX
Visions, Pickett, WI
Visions of Hope Incorporated, Terre Haute, IN
Vista Initiative for the Visual Arts Inc., Carlsbad, CA
Visual Video Ministry, Houston, TX
VIVV Inc., Fort Worth, TX
Vocare Spiritual Awakening for Sexual Minorities, Monterey, CA
Voice of Calvary Family Health Center Inc., Jackson, MS
Voluntech, Minneapolis, MN
Volunteers With A Vision, Arlington, VA
VVES Inc., Vestal, NY
WRC Elderly Assisted Living Housing, Brookville, PA
Zezzo House Corporation, Hartford, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Accounting for Long-Term Contracts; Correction

Announcement 99–65

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains a correction to a notice of proposed rulemaking which was published in the **Federal Register** on Wednesday, May 5, 1999 (64 F.R. 24096). The notice of proposed rulemaking relates to accounting for long-term contracts.

FURTHER INFORMATION CONTACT: John M. Aramburu or Leo F. Nolan II (202) 622-4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking that is subject to this correction is under section 460 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking contains an error which may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–208156–91, 1999–22 I.R.B. 11), which is the subject of FR Doc. 99–10948 is corrected as follows:

§1.460–4 [Corrected]

On page 24109, column 2, §1.460–4(b)(3), line 9, the language "the treatment of post-completion costs," is corrected to read "the treatment of post-completion-year costs,".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

Application of Section 904 to Income Subject to Separate Limitations; Correction

Announcement 99–66

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final regulations that were published in the **Federal Register** on Monday, January 11, 1999 (64 F.R. 1505 [T.D. 8805, 1999–5 I.R.B. 14]) relating to the application of section 904 with respect to certain categories of income.

DATES: This correction is effective March 12, 1999.

FOR FURTHER INFORMATION CONTACT: Rebecca Rosenberg (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 904 of the Internal Revenue Code.

Need for correction

As published, the final regulations contain errors that may prove to be misleading and are in need of clarification.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Correction of Publication

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendment:

PART 1 – INCOME TAXES

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

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

§1.904–4 [Corrected]

Par. 2. Section 1.904–4 is amended as follows:

1. Paragraph (c)(1) is amended by adding the sentence "This paragraph (c)(1) is applicable for taxable years beginning after March 12, 1999." at the end of the paragraph.

2. Paragraph (c)(2)(i)(A) is amended by removing the last sentence of the paragraph and adding a new sentence "Paragraph (c)(2)(ii) of this section is applicable for taxable years beginning after March 12, 1999." in its place.

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

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 1986 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 valid 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 Contribution 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.—Statements of Procedral 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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Key to Abbreviations:

Ann	Announcement
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
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26 CFR 1.446–1, added; 1.471–12, added; 1.475(c)–1, revised; 1.475(c)–2, added; 1.475(e)–1, redesignated as 1.475(g)–1; 1.475(e)–1, added; 1.475(f)–1, –2, added; 1.475(g)–1, amended; mark-to-market accounting for dealers in commodities and traders in securities or commodities (REG–104924–98) 10, *47*
26 CFR 1.446–1, amended; 1.451–3, removed; 1.451–5, amended; 1.460–0, amended; 1.460–1 through 1.460–3, revised; 1.460–4, amended; 1.460–5, revised; 1.460–6, amended; 1.460–7 and 1.460–8, removed; accounting for long-term contracts (REG–208156–91) 22, *11*
26 CFR 1.453–12, added; capital gains, installment sales, unrecaptured section 1250 gain (REG–110524–98) 10, *55*
26 CFR 1.467–3(b)(1), revised; rental agreements involving payments of $2,000,000 or less (REG–103694–99) 24, *49*
26 CFR 1.468B–0, amended; 1.468B–1, amended; 1.468B–5, amended; 1.468B–6 thru 1.468B–9, and intermediary sections, added; 1.1031(k)–1, amended; escrow funds and other similar funds (REG–209619–93) 10, *28*

26 CFR 1.663(c)–1, amended; 1.663(c)–2, revised; 1.663(c)–3, amended; 1.663(c)–4, redesignated; 1.663(c)–4, added; 1.663(c)–5, amended; 1.663(c)–6, added; separate share rules applicable to estates (REG–114841–98) 11, *41*

26 CFR 1.861–8, amended; 1.865–1, added; 1.865–2, amended; allocation of loss with respect to stock and other personal property (REG–106905–98) 11, *39*

26 CFR 1.1291–8, withdrawn; mark-to-market elections for RICs (INTL–941–86) 24, *49*

26 CFR 1.1296(e)–1, added; passive foreign investment companies; definitions of marketable stocks (REG–113744–98), 10, *59;* correction (Ann. 35) 14, *22*

26 CFR 1.1362–3, amended; 1.1502–76, amended; acquisition of an S corporation by a member of a consolidated group (REG–106219–98) 9, *51*

26 CFR 1.1502–3, amended; 1.1502–9A, amended; new 1.1502–9, added; consolidated overall foreign losses and separate limitation losses (REG–106902–98) 8, *57*

26 CFR 1.1502–13, amended; intercompany transactions (REG–105964–98) 12, *22*

26 CFR 1.6041–3, effective 1/1/2000, amended; 1.6041–3, in effect as of 5/21/99, amended; 1.6045–5, added; reporting of payments to attorneys (REG–105312–98) 23, *14*

26 CFR 1.6049–7(g), removed; real estate mortgage investment conduits (REMICs); reporting requirements (REG–100905–97) 22, *10*

26 CFR 1.6302–4, revised; 20.6302–1, added; 25.6302–1, added; 31.6302–1, amended; 40.6302(a)–1, added; electronic funds transfers of federal deposits (REG–100729–98) 14, *9*

26 CFR 1.6695–1, amended; retention of income tax return preparer's signature (REG–106386–98) 12, *15*

26 CFR 1.6695–2, added; preparer due diligence requirements for determining earned income credit eligibility (REG–120168–97) 12, *16*

26 CFR 1.7701(l)–3, added; 1.1441–7, amended; recharacterizing financing arrangements involving fast-pay stock (REG–104072–97) 11, *12*; correction (Ann. 30) 13, *26*

26 CFR 54.4980B, amended; continuation coverage requirements of group health plans (REG–121865–98) 8, *63*

26 CFR 301.6103(j)(1)–1, amended; disclosure of return information to the Bureau of Census (REG–121806–97) 10, *46*

26 CFR 301.6103(k)(9)–1, added; 301.6311–1(a)(1)(i), amended; payment of tax by credit card or debit card (REG–111435–98) 7, *55*

26 CFR 301.6221–1, amended; 301.6223(c)–1, amended; 301.6224(c)–3, amended; 301.6229(b)–2, added; 301.6229(f)–1, added; 301.6231(a)(1)–1, amended; 301.6231(a)(6)–1, amended; 301.6231(a)(7)–1, amended; modifications and additions to the unified partnership audit procedures (REG–106564–98) 10, *53*

26 CFR 301.6320–1, added; notice and opportunity for hearing upon filing of notice of lien (REG–116824–98) 7, *57*

26 CFR 301.6330–1, added; notice and opportunity for hearing prior to levy (REG–117620–98) 7, *59*

26 CFR 301.7502–1, revised; 301.7502–2, added; Timely mailing treated as timely filing / electronic postmark (REG–115433–98) 9, *54*

26 CFR 801.0–1 thru 801.0–5, and intermediary sections, added; establishment of a balanced measurement system (REG–119192–98) 11, *45*

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26 CFR 1.61–8, revised; 1.451–1(g), added; 1.461–1, –4, amended; 1.467–0 through 1.467–9, added; treatment of rent and interest under certain agreements for the lease of tangible property (T.D. 8820) 24, *3*

26 CFR 1.79–1(d)(7), revised; 1.79–3, amended; group-term life insurance; uniform premiums (T.D. 8821) 25, *3*

26 CFR 1.170A–6, amended; 1.170A–12T, added; 1.642(c)–6, –6A, amended; 1.642(c)–6T, added; 1.664–4, –4A, amended; 1.664–4T, added; 1.7520–1, amended; 1.7520–1T, added; valuation of annuities, interests for life or term of years, and remainder or reversionary interests (T.D. 8819) 20, *5*

26 CFR 1.148–5(d)(6)(iii), revised; 1.148–5(e)(2)(iv), added; arbitrage restrictions on tax-exempt bond (T.D. 8801) 4, *5*

26 CFR 1.195–1, added; election to amortize start-up expenditures for active trades or businesses (T.D. 8797) 5, *5*

26 CFR 1.337(d)–4, added; certain asset transfers to a tax-exempt entity (T.D. 8802) 4, *10*

26 CFR 1.408A–0 through –9, and intermediary sections, added; Roth IRAs (T.D. 8816) 8, *4*

26 CFR 1.469–10, revised; 1.7704–3, added; certain investment income under the qualifying income provisions and the application of the passive activity loss rules to publicly traded partnerships (T.D. 8799) 6, 12

26 CFR 1.664–1(a)(7), (d)(1)(iii), (f)(4), added; 1.664–2(a)(1)(i), revised; 1.664–3, amended; 25.2702–1(c)(3), revised; charitable remainder trusts and special valuation rules for transfers of interests in trusts (T.D. 8791) 5, *7*

26 CFR 1.861–8, amended; 1.861–8T, amended; 1.865–1T, added; 1.865–2, added; 1.865–2T, added; 1.904–0, amended; 1.904–4, amended; allocation of loss with respect to stocks

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26 CFR 1.871–14, revised; rules relating to repeal of tax on interest of nonresident alien individuals and foreign corporations received from certain portfolio debt investments (T.D. 8804) 12, *5*; correction (Ann. 29) 13, *25*

26 CFR 1.881–3, corrected conduit arrangement regulations (Ann 14) 7, *60*

26 CFR 1.1441–1, –5, –6, –9, revised; 1.1441–4, amended; 1.1441–8, redesignated and amended; 1.1443–1, revised; requirements for the deduction and withholding of tax on payments to foreign persons (T.D. 8804) 12, *5*

26 CFR 1.1502–3T, –9(a), –9T(b)(1)(v) and (vi), amended; consolidated returns, limitation on recapture of overall foreign loss accounts (T.D. 8800) 4, *20*

26 CFR 1.6038B–1, amended; 1.6038B–2, added; notice of certain transfers to foreign partnerships and foreign corporations (T.D. 8817) 8, *51*

26 CFR 1.6042–3, amended; dividends subject to reporting; 1.6045–1, amended; returns of information of brokers and barter exchanges; 1.6049–5, amended; interest and original issue discount subject to reporting after December 31, 1982 (T.D. 8804) 12, *5*

26 CFR 1.6695–1, amended; 1.6695–1T, added; retention of income tax return preparer's signature (temporary) (T.D. 8803) 12, *15*

26 CFR 1.6695–2T, added; preparer due diligence requirements for determining earned income credit eligibility (temporary) (T.D. 8798) 12, *16*

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26 CFR 1.7702B–1, –2, added; qualified long-term care insurance contracts (T.D. 8792) 7, *36*

26 CFR 54.4980B–0 through –8, and intermediary sections, added; continuation coverage requirements of group health plans (T.D. 8812) 8, *19*

26 CFR 301.6103(j)(1)–1, amended; 301.6103(j)(1)–1T, added; disclosure of return information to the Bureau of Census (T.D. 8811) 10, *19*

26 CFR 301.6103(k)(9)–1T, –2T, added; payment of tax by credit card or debit card (T.D. 8793) 7, *15*

26 CFR 301.6221–1T, amended; 301.6223(c)–1T, amended; 301.6224(c)–3T, amended; 301.6229(b)–2T, added; 301–6229(f)–1T, added; 301.6231(a)(1)–1T, amended; 301.6231(a)(6)–1T, amended; 301.6231(a)(7)–1, amended; 301.6231(a)(7)–1, added; modifications and additions to the unified partnership audit procedures (T.D. 8808) 10, *21*

26 CFR 301.6320–1T, added; notice and opportunity for hearing upon filing of notice of lien (T.D. 8810) 7, *19*

26 CFR 301.6330–1T, added; notice and opportunity for hearing prior to levy (T.D. 8809) 7, *27*

26 CFR 301.6404–2, added; 301.6404–2T. removed; abatement of interest (T.D. 8789) 3, *5*

26 CFR 301.7502–1, amended; 301.7502–1T, added; timely mailing treated as timely filing / electronic postmark (T.D. 8807) 9, *33*

26 CFR 301.7701–5, amended; 301.7701–7, added; residence of trusts and estates (T.D. 8813) 9, *34*

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-in Losses Following Ownership Change

26 CFR 1.382–2: General rules for ownership change.

T.D. 8825

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Application of Section 382 in Short Taxable Years and With Respect to Controlled Groups

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final and temporary regulations

SUMMARY: This document contains final regulations relating to limitations on net operating loss carryovers and certain built-in losses following an ownership change of a corporation. The regulations implement the statutory authority under section 382(m) of the Internal Revenue Code to prescribe regulations concerning short taxable years and controlled groups of corporations. Additional rules are adopted relating principally to corporations that cease to exist following a merger (or similar transaction) or that have two or more ownership changes. These final regulations replace temporary regulations that provided guidance on these topics.

DATES: *Effective Dates:* These regulations are effective June 25, 1999.

Applicability Dates: For dates of application and special transition rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Lee A. Kelley at 202-622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1434. Responses to this collection of information are required to obtain a benefit relating to the value of a controlled group member.

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

The estimated annual burden per respondent is one quarter hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC, 20503.

Books and records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On February 4, 1991, the IRS and Treasury issued a notice of proposed rulemaking, CO–077–90 (56 F.R. 4183 [1991–1 C.B. 749]) (the 1991 controlled group proposed regulations), setting forth rules regarding the application of section 382 to controlled groups of corporations and to corporations that undergo a merger or similar transaction. The 1991 controlled group proposed regulations also related to the determination of the section 382 limitation following an ownership change in the case of short taxable year, and to the valuation of the stock of a loss corporation for purposes of determining the amount of the section 382 limitation. On the same day, the IRS and Treasury also issued proposed regulations relating to the application of section 382 to affiliated groups of corporations filing consolidated returns (CO–132–87, 56 F.R. 4194 [1991–1 C.B. 728]), and to the use of built-in deductions and net operating losses and capital losses, including the carryover and carryback of separate return year (SRLY) losses, of members of consolidated groups (CO–078–90, 56 F.R. 4228 [1991–1 C.B. 757]). A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the IRS and Treasury published temporary regulations (T.D. 8679, 61 F.R. 33313 [1996–2 C.B. 25]) (the 1996 controlled group temporary regulations) relating to section 382. Except for the addition of a provision relating to the effects of successive ownership changes, these regulations were substantially identical to the 1991 controlled group proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations was published in the Federal Register on the same day (CO–026–96, 61 F.R. 33391 [1996–2 C.B. 440]) (the 1996 controlled group proposed regulations), and the 1991 controlled group proposed regulations were withdrawn. No written comments were received on the 1996 controlled group proposed regulations and no public hearing was held. Also on June 27, 1996, the IRS and Treasury published temporary regulations relating to the application of section 382 to affiliated groups of corporations filing consolidated returns (T.D. 8678, 61 F.R. 33335 [1996–2 C.B. 134]) and the SRLY limitation (T.D. 8677, 61 F.R. 33321 [1996–2 C.B. 119]). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO–025–96, 61 F.R. 33395 [1996–2 C.B. 439] and CO–024–96, 61 F.R. 33393 [1996–2 C.B. 437]), and the corresponding proposed regulations published in 1991 were withdrawn.

The 1996 controlled group proposed regulations are adopted as revised by this Treasury decision and the corresponding temporary regulations are removed. The final regulations are substantially the same as the 1996 controlled group proposed regulations, with one significant change relating to built-in losses of a member of a controlled group of corporations. This change is discussed below.

Under section 382, if an ownership change occurs with respect to a loss corporation (as defined in section 382 and the regulations thereunder), the amount of the loss corporation's taxable income for a post-change year that may be offset by the net operating loss carryovers arising before the ownership change are subject to a limitation known as the section 382 limitation. The section 382 limitation for a post-change taxable year of the loss corporation generally equals the fair market value of the stock of the corporation immediately before the ownership change multiplied by the long-term tax exempt rate (a rate of return published periodically in the Internal Revenue Bulletin).

In addition to net operating loss carryovers, the recognized built-in losses of corporations that have a net unrealized built-in loss on the ownership change date are also subject to the section 382 limitation. In general, a corporation has a net unrealized built-in loss on its ownership change date if the adjusted basis of its assets exceeds their fair market value, and such excess is greater than the threshold amount under section 382(h)(3)(B). In general, recognized built-in losses are losses with respect to assets held on the change date that are recognized within the 5-year period beginning on the ownership change date. The recognized built-in loss on an asset, however, is limited to the lesser of the loss recognized on its disposition or the amount by which the adjusted basis of the asset exceeded its fair market value on the change date.

Consistent with the proposed regulations, the final regulations require appropriate adjustments to the value of a loss corporation that is a member of a controlled group of corporations so that the same value is not included more than once in computing the section 382 limitations for the loss corporations that are members of the controlled group. In general, adjustments are required only when corporations are members of the same controlled group both when a pre-change loss arises and on the date of the ownership change. Thus, adjustments are required if a loss corporation is a component member of the same controlled group as another member (i) on December 31 of the taxable year in which a pre-change loss arises (or the change date, if earlier) and (ii) on the date that the loss corporation has an ownership change. If a loss corporation has pre-change losses that arise in different taxable years, the component members of the controlled group with respect to losses arising in each taxable year may differ. Therefore, as in the 1996 controlled group proposed regulations, the final regulations are applied by determining a controlled group with respect to each year's pre-change loss of the corporation (a controlled group loss).

To avoid duplication of value in connection with a controlled group loss, the value of the stock of each corporation that is a component member of the controlled group with respect to a controlled group loss is reduced by the value of the stock of other component members that it directly owns immediately before the ownership change. A second adjustment (more fully explained in the preamble to the 1991 controlled group proposed regulations) permits a lower tier member to elect to restore some or all of the previously reduced value to a member that directly owns its stock.

In identifying controlled group losses, the determination of the taxable year to which a net operating loss carryover is attributable usually presents no difficulty. The determination of the taxable year in which a net unrealized built-in loss accrues, however, is more problematic. To address some concerns in this area, the final regulations include an irrebutable presumption that certain built-in losses are attributable to the period before a particular taxable year. The presumption applies to a loss corporation that had an ownership change prior to the first day of the taxable year in question, and whose net unrealized built-in losses became subject to a section 382 limitation as a result of that ownership change. Under the presumption, any built-in loss in such an asset is considered to be attributable to a period prior to the taxable year in question to the extent of the built-in loss in that asset on the previous change date.

Effective Dates

Section 1.382–5 (relating to the section 382 limitation) generally applies to a loss corporation that has an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies. The rules in that section relating to successive ownership changes, however, apply to taxable years of a loss corporation beginning on or after January 1, 1997. Section 1.382–8 (relating to controlled groups of corporations) generally applies to a loss corporation that has an ownership change with respect to a controlled group loss on or after January 1, 1997. Transition rules are provided for members of controlled groups that have ownership changes before that date. The rules in §1.382–1(a)(iv) (relating to separate tracking of certain loss corporations) apply to testing dates on or after January 29, 1991. The rules in §1.382–2 (a) (4) and (a) (5) relating to successor or predecessor corporations in other than corporate reorganizations apply to testing dates on or after January 1, 1997.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It has also been determined that section 553 of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information in this regulation is a statement of election that it is estimated will take less than one hour to prepare. The statement will be filed by electing corporations that are members of a controlled group of corporations (determined by applying a 50% common control requirement) both (1) when a net operating loss carryover (or certain other tax attributes) arises and (2) a member of the controlled group has an ownership change under section 382 of the Internal Revenue Code with respect to that net operating loss carryover (or other attribute). (An affiliated group of corporations that files a consolidated return is treated as a single corporation for this purpose, which reduces the number of potential filers.) Because the election is only filed with respect to an ownership change, it is unlikely that a corporation will file the election frequently. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not

required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting information

The principal author of these regulations is Lee A. Kelley of the Office of Assistant Chief Counsel (Corporate). Other personnel from the IRS and Treasury participated in their development.

* * * * *

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing entries for sections 1.382–5T and 1.382–8T and by adding entries in numerical order to read in part as follows:

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

Section 1.382–5 also issued under 26 U.S.C. 382(m). * * *

Section 1.382–8 also issued under 26 U.S.C. 382(m). * * *

Par. 2. Section 382–1 is amended by:

1. Revising the entry for §1.382–2, paragraph (a)(1)(iv).

2. Adding an entry for §1.382–2, paragraph (a)(1)(v).

3. Adding entries for §1.382–2, paragraphs (a)(5) and (a)(6).

4. Removing the entries for §1.382–2T, paragraphs (f)(1)(i), (f)(1)(ii), and (f)(1)(iii).

5. The entry for §1.382–4 is amended as follows:

a. The entry for paragraph (b) is revised.

b. Entries for paragraphs (b)(1) and (b)(2) are added.

6. Removing the entry for §1.382–5.

7. Redesignating the entry for §1.382–5T as § 1.382–5 and revising the section heading.

8. Removing the entry for §1.382–8.

9. Redesignating the entry for §1.382–8T as §1.382–8, revising the section heading, and adding entries for paragraphs (b)(1) and (b)(2).

The revision and additions read as follows:

§1.382–1 Table of contents.

* * * * *

§1.382–2 General rules for ownership change.

(a) * * *

(1) * * *

(iv) End of separate accounting for losses and credits of distributor or transferor corporation.

(v) Application to other successor corporations.

* * * * *

(5) Successor corporation.

(6) Predecessor corporation.

* * * * *

§1.382–4 Constructive ownership of stock.

* * * * *

(b) Attribution from corporations, partnerships, estates and trusts.

(1) [Reserved].

(2) Limitation.

* * * * *

§1.382–5 Section 382 limitation.

* * * * *

§1.382–8 Controlled groups.

* * * * *

(b) * * *

(1) In general.

(2) Presumption regarding net unrealized built-in loss.

* * * * *

§1.382–2 [Amended]

Par. 2a. Section 1.382–2 is amended by removing paragraph (a)(1)(iv).

Par. 3. Section 1.382–2T is amended as follows:

1. In paragraph (e)(2)(iv) *Example (2)*(ii), remove the reference "paragraph (f)(1)(ii)" and add "§1.382–2(a)(1)(iv)" in its place.

2. Paragraph (f)(1)(ii) is redesignated as paragraph (a)(1)(iv) of §1.382–2.

3. Paragraph (f)(1) is revised.

4. Paragraphs (f)(4) and (f)(5) are redesignated as paragraphs (a)(5) and (a)(6) of §1.382–2, respectively.

5. New paragraphs (f)(4) and (f)(5) are added.

6. In paragraph (h)(2)(i)(A), remove the language "and solely for purposes of determining whether a loss corporation has an ownership change".

The revision and additions read as follows:

§1.382–2T Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

* * * * *

(f) *Definitions.* * * *

(1) *Loss corporation.* See section 382 and §1.382–2(a)(1) for the definition of a loss corporation.

* * * * *

(4) *Successor corporation.* See §1.382–2(a)(5) for the definition of successor corporation.

(5) *Predecessor corporation.* See §1.382–2(a)(6) for the definitions of predecessor corporation.

* * * * *

Par. 4. Section 1.382–2 is amended as follows:

1. In the first sentence of paragraph (a)(1)(iii), remove the reference "§1.382–2T(f)(1)(ii)" and add "paragraph (a)(1)-(iv) of this section" in its place.

2. In the first sentence of newly designated paragraph (a)(1)(iv), remove the reference "§1.382–2(a)(1)(iii)" and add "paragraph (a)(1)(iii) of this section" in its place.

3. In the first sentence of newly designated paragraph (a)(1)(iv), remove the reference "§1.382–2(a)(1)(ii)" and add "paragraph (a)(1)(ii) of this section" in its place.

4. In the last sentence of newly designated paragraph (a)(1)(iv), remove the reference "paragraph (f)(1)(ii)" and add "paragraph (a)(1)(iv)" in its place.

5. Paragraph (a)(1)(v) is added.

6. In the first sentence of paragraph (a)(3)(i), remove the reference "paragraph

(f)(18)" and add "paragraph (a)(3)(i) and §1.382–2T(f)(18)(ii) and (iii)" in its place.

7. In the last sentence of newly designated paragraph (a)(5), remove the reference "paragraph (f)(4)" and add "paragraph (a)(5)" in its place.

8. In the last sentence of newly designated paragraph (a)(6), remove the reference "paragraph (f)(5)" and add "paragraph (a)(6)" in its place.

The addition reads as follows:

§1.382–2 General rules for ownership change.

(a) * * *

(1) * * *

(v) *Application to other successor corporations.* This paragraph (a)(1) also applies, as the context may require, to successor corporations other than successors in section 381(a) transactions. For example, if a corporation receives assets from the loss corporation that have basis in excess of value, the recipient corporation's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the loss corporation's basis, and the amount by which basis exceeds value is material, the recipient corporation is a successor corporation subject to this paragraph (a)(1). This paragraph (a)(1)(v) applies to any testing date occurring on or after January 1, 1997.

* * * * *

Par. 5. Section 1.382–4 is amended by revising paragraph (b) to read as follows:

§1.382–4 Constructive ownership of stock.

* * * * *

(b) *Attribution from corporations, partnerships, estates and trusts.* (1) [Reserved].

(2) *Limitation.* Section 1.382–2T(h)-(2)(i)(A) applies solely for purposes of determining whether a loss corporation has an ownership change.

* * * * *

§1.382–5 [Removed]

Par. 6. Section 1.382–5 is removed.

Par. 7. Section 1.382–5T is redesignated as §1.382–5 and amended as follows:

1. The section heading is revised.

2. In paragraph (e), the reference "§1.382–8T" is removed and "§1.382–8" is added in its place.

The revision reads as follows:

§1.382–5 Section 382 limitation.

* * * * *

§1.382–8 [Removed]

Par. 8. Section 1.382–8 is removed.

Par. 9. Section 1.382–8T is redesignated as §1.382–8 and amended as follows:

1. The section heading is revised.

2. Redesignate paragraphs (b) introductory text, (b)(1) and (b)(2) as paragraphs (b)(1) introductory text, (b)(1)(i) and (b)(1)(ii), respectively.

3. A paragraph heading for newly designated paragraph (b)(1) is added.

4. Paragraph (b)(2) is added.

5. The first three sentences of paragraph (f) are revised.

6. The graphics of paragraph (g) *Example 1*(a) are revised.

7. The graphics of paragraph (g) *Example 2*(a) are revised.

8. Paragraph (g) *Example 4* is amended as follows:

a. In the last sentence of paragraph (a), remove the reference "§1.1502–92T(b)-(1)(i)" and add "§1.1502–92(b)(1(i)" in its place.

b. In paragraph (b)(2), remove the reference "§1.1502–91T(c)" and add "§1.1502–91(c)" in its place.

c. In paragraph (c), remove the reference "§1.1502–93T" and add "§1.1502–93" in its place.

9. In the fifth sentence of paragraph (h)(1), remove the reference "§1.382–8T" and add "§1.382–8" in its place.

10. Paragraph (i) is added.

The additions and revisions read as follows:

§1.382–8 Controlled groups.

* * * * *

(b) *Controlled group loss and controlled group with respect to a controlled group loss*–(1) *In general.* * * *

(2) *Presumption regarding net unrealized built-in loss.* For purposes of determining whether a net unrealized built-in loss of a loss corporation is attributable to a taxable year (the determination year) with respect to which the corporation is a component member of a controlled group, the built-in loss in a prior change date asset is deemed to be attributable to a period ending before the determination year. A prior change date asset is any asset held by the loss corporation at all times during the period beginning on the change date of its most recent ownership change after 1986 (the first change date), and ending on the first day of the determination year. The built-in loss in a prior change date asset is the amount by which the adjusted basis of the asset on the first change date exceeds the fair market value of the asset on that date. The principles of this paragraph (b)(2) also apply to items described in section 382(h)(6)(B).

* * * * *

(f) *Coordination between consolidated groups and controlled groups.* Some or all of the component members of a controlled group may also be members of a consolidated group, and a controlled group loss may be subject to a consolidated section 382 limitation or subgroup section 382 limitation determined under §1.1502–93. Except as otherwise provided in this paragraph (f) and §§1.1502–91 through 1.1502–99, §1.1502–93 applies instead of this section when both sections, by their terms, are otherwise applicable. This section is applicable and may require an adjustment to value if a member of a consolidated group, a loss group, or loss subgroup (as those terms are defined in §§1.1502–1(h) and 1.1502–91) is also a component member of a controlled group with respect to a controlled group loss. * * *

(g) ***

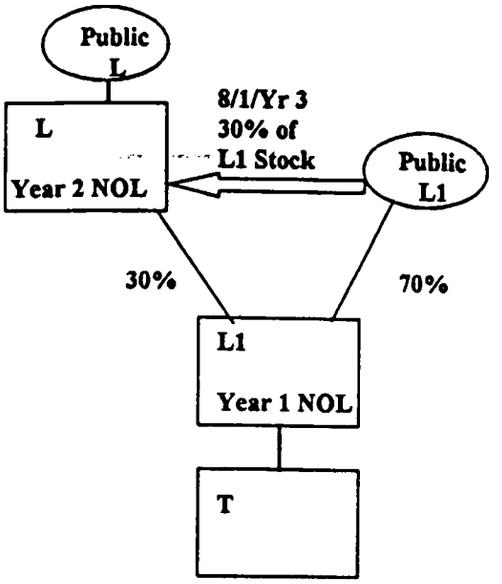
Example 1. * * *(a)* * *

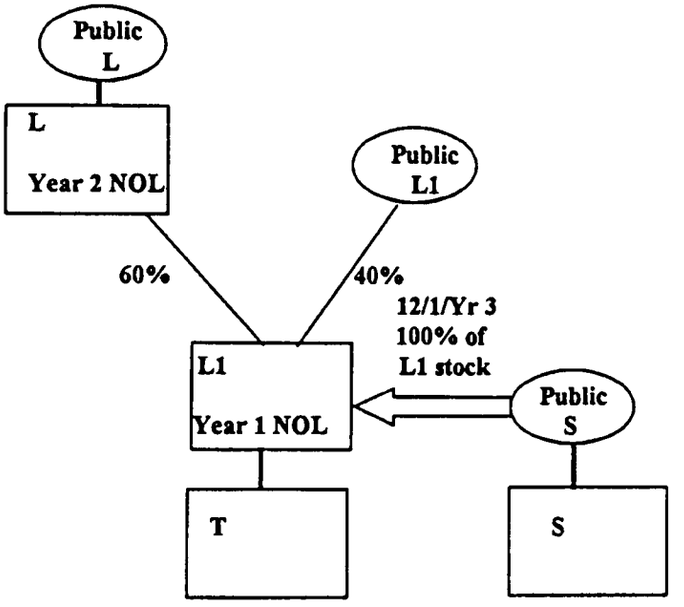
* * * * *

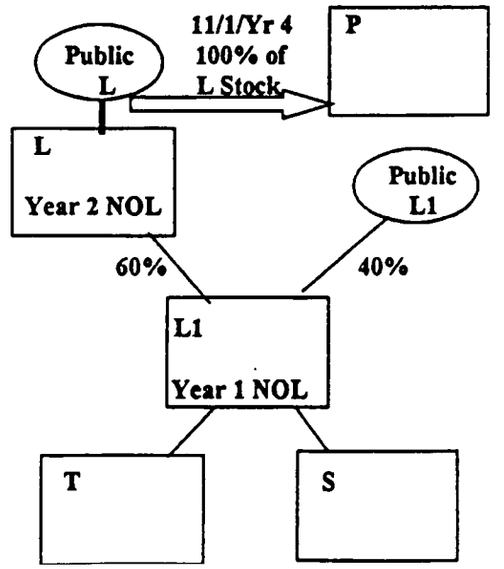
Example 2. * * *(a)* * *

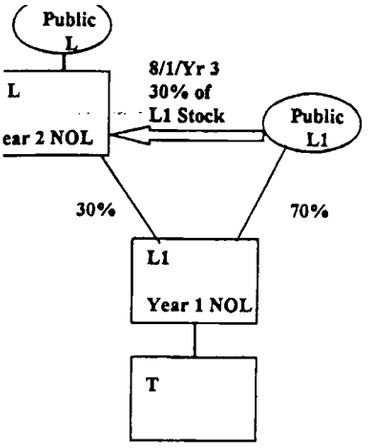
* * * * *

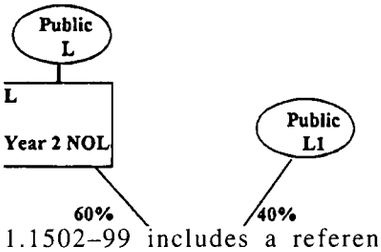
(i) *References to former temporary regulations.* As the context requires, a reference in this section to §1.382–8 includes a reference to §1.382–8T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised as of April 1, 1999, a reference to §§1.1502–91, 1.1502–92, 1.1502–3, and §§1.1502–91 through











1.1502–99 includes a reference to §§1.1502–91A, 1.1502–92A, 1.1502–93A and §§ 1.1502–91A through 1.1502–99A.

* * * * *

PART 602–OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 10. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 11. In § 602.101, paragraph (b) is amended in the table by removing the entry for 1.382–8T and adding an entry in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.382–8	1545–1434
* * * * *	

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved June 18, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 25, 1999, 1:27 p.m., and published in the issue of the Federal Register for July 2, 1999, 64 F.R. 36175)

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The May 1999 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 1999.

Rev. Rul. 99–30

The following Department Store Inventory Price Indexes for May 1999 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, 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, May 31, 1999.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	May 1998	May 1999	Percent Change from May 1998 to May 1999[1]
1. Piece Goods	534.6	547.0	2.3
2. Domestics and Draperies	637.0	631.1	–0.9
3. Women's and Children's Shoes	664.2	658.7	–0.8
4. Men's Shoes	907.9	885.6	–2.5
5. Infants' Wear	629.1	613.3	–2.5
6. Women's Underwear	576.1	570.0	–1.1
7. Women's Hosiery	306.1	323.1	5.6
8. Women's and Girls' Accessories	546.5	561.3	2.7
9. Women's Outerwear and Girls' Wear	425.4	406.4	–4.5
10. Men's Clothing	634.5	632.1	–0.4
11. Men's Furnishings	608.6	646.3	6.2
12. Boys' Clothing and Furnishings	497.9	491.5	–1.3
13. Jewelry	986.2	977.7	–0.9
14. Notions	786.5	743.6	–5.5
15. Toilet Articles and Drugs	951.0	957.9	0.7
16. Furniture and Bedding	682.1	686.8	0.7
17. Floor Coverings	602.7	602.4	0.0
18. Housewares	814.2	794.6	–2.4
19. Major Appliances	238.5	234.0	–1.9
20. Radio and Television	72.1	66.8	–7.4
21. Recreation and Education[2]	105.1	99.3	–5.5
22. Home Improvements[2]	134.3	128.1	–4.6
23. Auto Accessories[2]	106.6	106.8	0.2
Groups 1 – 15: Soft Goods	612.0	609.8	–0.4
Groups 16 – 20: Durable Goods	462.5	450.8	–2.5
Groups 21 – 23: Misc. Goods[2]	109.1	104.6	–4.1
Store Total[3]	557.9	551.0	–1.2

1 Absence of a minus sign before percentage change in this column signifies price increase.

2 Indexes on a January 1986=100 base.

3 The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Richard C. Farley, Jr. of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Farley on (202) 622-4970 (not a toll-free call).

Section 1397.—Other Definitions and Special Rules

1.1397–1T: Qualified zone academy bonds.

Guidance is provided for ascertaining the credit rate for qualified zone academy bonds. See Notice 99–35, page 26.

Part III. Administrative, Procedural, and Miscellaneous

Qualified Zone Academy Bond Credit Rate

Notice 99–35

Section 1397E(b)(2) of the Internal Revenue Code provides that the Secretary shall determine a credit rate that the Secretary estimates will permit the issuance of a qualified zone academy bond without discount and without interest cost to the issuer. Temporary regulations interpreting § 1397E(b)(2) were published on January 7, 1998, as T.D. 8755 (63 F.R. 671 [1998–10 I.R.B. 21]). The Treasury and IRS are issuing temporary regulations that revise T.D. 8755 to provide that guidance for ascertaining the credit rate will be set forth in procedures, notices, forms, and instructions as prescribed by the Commissioner.

The Secretary has determined that, until further notice, the credit rate for a qualified zone academy bond is the qualified zone academy bond credit rate published daily by the Bureau of Public Debt on its Internet site for State and Local Government Bonds at: http://www.publicdebt.treas.gov. The qualified zone academy bond credit rate shall be applied to a qualified zone academy bond on the first day on which there is a binding contract in writing for the sale or exchange of the bond. The credit rate will be determined by the Department of the Treasury based on its estimate of the yield on outstanding AA rated corporate bonds of a similar maturity for the business day immediately prior to the date on which there is a binding contract in writing for the sale or exchange of the bond.

The principal author of this notice is Timothy L. Jones of the Office of Financial Institutions and Products. For further information regarding this notice, call (202) 622-3980 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Definition of a Qualified Interest in a Grantor Retained Annuity Trust and a Grantor Retained Unitrust

REG-108287-98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the definition of a qualified interest. The proposed regulations apply to a grantor retained annuity trust (GRAT) and a grantor retained unitrust (GRUT) in determining whether a retained interest is a "qualified interest." The proposed regulations will affect individuals who have made a transfer in trust to a family member and have retained an interest in the trust. The proposed regulations clarify that a trust that uses a note, other debt instrument, option or similar financial arrangement to satisfy the annual payment obligation will not meet the requirements of section 2702(b) of the Internal Revenue Code. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by September 20, 1999. Outlines of topics to be discussed at the public hearing scheduled for October 20, 1999, at 10:00 a.m., must be received by September 29, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-108287-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-108287-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.gov/prod/tax regs/regslist.html. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, James F. Hogan, (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Sections 2701 through 2704 were added to the Internal Revenue Code in the Omnibus Budget and Reconciliation Act of 1990 (1990 Act), 1991-2 C.B. 481, 524. Section 2702 applies to a transfer in trust that benefits a family member where the transferor retains an interest in the property subject to the transfer. If section 2702 applies to a transfer, the transferor's retained interest will be valued at zero for gift tax purposes (and the transferor will be treated as making a gift of the entire value of the property), unless the interest is a "qualified interest." The term "qualified interest" is defined in section 2702(b) and includes a right to receive, annually, fixed payments (a qualified annuity interest) and a right to receive, annually, a fixed percentage of the trust corpus determined annually (a qualified unitrust interest).

Congress was particularly concerned about properly valuing gifts in trust with retained interests. The legislative history that accompanied the 1990 Act states:

> [T]he committee is concerned about the undervaluation of gifts valued pursuant to Treasury tables. Based on average rates of return and life expectancy, those tables are seldom accurate in a particular case, and therefore, may be the subject of adverse selection. Because the taxpayer decides what property to give, when to give it, and often controls the return on the property, use of Treasury tables undervalues the transferred interests in the aggregate, more often than not.
>
> Therefore, the committee determines that the valuation problems inherent in trusts and term interests in property are best addressed by valuing retained interests at zero unless they take an easily valued form—as an annuity or unitrust interest. By doing so, the bill draws upon present law rules valuing split interests in property for purposes of the charitable deduction.

136 Cong. Rec. S15681 (daily ed. Oct. 18, 1990) (Informal Senate Report on S. 3209).

The provisions of section 2702 and the regulations thereunder are intended to ensure that, when a donor transfers property and retains an interest in the property, the value of the retained interest is readily ascertainable. Thus, the value of the gift, that is, the value of the transferred property less the value of the retained interest, can be accurately determined. Section 25.2702-3(b)(1) of the Gift Tax Regulations implements this principle by requiring that for a qualified annuity interest: (1) the annuity must be a fixed amount; (2) the annuity must be payable at least annually; and (3) the yearly amount must be paid by a specified date each year, that is, the annuity payment may be paid after the close of the taxable year, but no later than the due date of the trust's income tax return. The annuity payment must be payable to (or for the benefit of) the holder of the annuity interest for each taxable year of the trust term. A right of withdrawal, whether or not cumulative, is not a qualified annuity interest. Section 25.2702-3(c) provides comparable rules applicable in the case of a qualified unitrust interest.

To avoid making a cash or an in-kind payment, some GRATs have issued notes to the transferor in satisfaction of the obligation to make the annual payment. In certain cases, the trust instrument specifically authorizes the trustee to satisfy the annual payment obligation with notes. The notes provide for actual payment at a date some time in the future.

Thus far, the transactions that have come to the Service's attention have involved the use of notes. However, the Service is also concerned about other financial arrangements that have the effect of delaying payment from the trust to the

grantor and thus may alter the value of the transferor's retained interest. These techniques include the grant of an option to purchase trust property in the future.

Issuing a note is not payment of a fixed amount not less frequently than annually, nor is it payment of a fixed percentage of the trust assets determined annually, as required by the statute and regulations. A note is merely a promise to pay in the future. Delaying payment by the use of a note to satisfy the annual payment obligation alters the true value of the transferor's retained interest, contrary to Congressional intent in requiring provisions ensuring an accurate valuation of the interest. This position is consistent with case law and rulings concluding that the use of a note to satisfy an obligation does not constitute payment of the obligation for tax purposes. *Don E. Williams Company v. Commissioner,* 429 U.S. 569 (1977); *Helvering v. Price,* 309 U.S. 409 (1940); *Eckert v. Burnet;* 283 U.S. 140 (1931); *Maddrix v. Commissioner,* 780 F.2d 946 (11th Cir. 1986); *Battelstein v. Internal Revenue Service,* 631 F.2d 1182 (5th Cir. 1980); Rev. Rul. 76–135, 1976–1 C.B. 114.

Furthermore, under §§25.2702–(3)(b)-(1)(i) and 25.2702–(3)(c)(1)(i), a right of withdrawal is not a qualified annuity or unitrust interest. A right of withdrawal allows the payee to determine, in the payee's discretion, when the payment will be made, and thus, neither the timing nor the amount of each payment is fixed and determinable under the trust instrument. For similar reasons, the use of notes, other debt instruments, options or other similar financial arrangements that place the amount and timing of each payment at the discretion of the payee should not satisfy the annual payment obligation.

Accordingly, these proposed regulations amend the regulations under section 2702 to provide that issuance of a note, other debt instrument, option or similar financial arrangement does not constitute payment for purposes of section 2702. A retained interest that can be satisfied with such instruments is not a qualified annuity interest or a qualified unitrust interest. In examining all of these transactions, the Service will apply the step transaction doctrine where more than one step is used to achieve similar results. In addition, a retained interest is not a qualified interest under section 2702, unless the trust instrument expressly prohibits the use of notes, other debt instruments, options or similar financial arrangements that effectively delay receipt by the grantor of the annual payment necessary to satisfy the annuity or unitrust interest amount. Under these provisions, in order to satisfy the annuity or unitrust payment obligation under section 2702(b), the annuity or unitrust payment must be made with either cash or other assets held by the trust.

The proposed regulations provide a transition rule for trusts created before September 20, 1999. If a trust created before September 20, 1999, does not prohibit a trustee from issuing a note, other debt instrument, option or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation, the interest will be treated as a qualified interest under section 2702(b) if notes, etc. are not used after September 20, 1999, to satisfy the obligation and any note or notes or other debt instruments issued on or prior to September 20, 1999, to satisfy the annual payment obligation are paid in full by December 31, 1999, and any option or similar financial arrangement is terminated by December 31, 1999, such that the grantor actually receives cash or other trust assets in satisfaction of the payment obligation. For purposes of this section, an option will be considered terminated if the grantor is paid the greater of the required annuity or unitrust payment plus interest computed under section 7520 of the Code, or the fair market value of the option.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the regulations will be submitted to the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 20, 1999, at 10:00 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments by September 20, 1999, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by September 29, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is James F. Hogan, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 25 is proposed to be amended as follows:

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 1. The authority citation for part 25 continues to read in part as follows:

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

Par. 2. Section 25.2702–3 is amended as follows:

1. Paragraph (b)(1)(i) is amended by adding a new sentence after the third sentence.

2. Paragraph (c)(1)(i) is amended by adding a new sentence after the fourth sentence.

3. A new paragraph (d)(5) is added.

The additions read as follows:

§25.2702–3 Qualified interests.

* * * * *

(b) * * *

(1) * * * (i) * * * Issuance of a note, other debt instrument, option or other similar financial arrangement in satisfaction of the annuity amount does not constitute payment of the annuity amount. * * *

* * * * *

(c) * * *

(1) * * * (i) * * * Issuance of a note, other debt instrument, option or other similar financial arrangement in satisfaction of the unitrust amount does not constitute payment of the unitrust amount. * * *

* * * * *

(d) * * *

(5) *Use of debt obligations to satisfy the annuity or unitrust payment obligation*—(i) *In general.* The trust instrument must prohibit the trustee from issuing a note, other debt instrument, option or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation.

(ii) *Special rule in the case of a trust created prior to September 20, 1999.* In the case of a trust created prior to September 20, 1999, the interest will be treated as a qualified interest under section 2702(b) if—

(A) Notes, other debt instruments, options or similar financial arrangements are not used after September 20, 1999, to satisfy the annuity or unitrust payment obligation; and

(B) Any note or notes or any other debt instruments issued to satisfy the annual payment obligation on or prior to September 20, 1999, are paid in full by December 31, 1999, and, any option or similar financial arrangement issued to satisfy the annual payment obligation is terminated by December 31, 1999, such that the grantor receives cash or other trust assets in satisfaction of the payment obligation. For purposes of the preceding sentence, an option will be considered terminated only

if the grantor receives cash or other trust assets equal in value to the greater of the required annuity or unitrust payment plus interest computed under section 7520 of the Code, or the fair market value of the option.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 21, 1999, 8:45 a.m., and published in the issue of the Federal Register for June 22, 1999, 64 F.R. 33235)

Use of Actuarial Tables in Valuing Annuities, Interests for Life or Terms of Years, and Remainder or Reversionary Interests; Correction

Announcement 99–47

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to T.D. 8819, 1999–20 I.R.B. 5, final regulations relating to the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests.

DATES: This correction is effective May 1, 1999.

FOR FURTHER INFORMATION CONTACT: William L. Blodgett (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 7520 and 2031 of the Internal Revenue Code.

Need for correction

As published, the final regulations contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 8819), that were the subject of F.R. Doc. 99–10533 is corrected as follows:

1. On page 23188, in the table entitled "CROSS REFERENCE TO REGULATION SECTIONS", in the column entitled "Interest rate", line 11, the language "§7520....." is corrected to read "§7520".

PART 1 — [CORRECTED]

§1.170A–12T [Corrected]

2. On page 23189, column 3, §1.170A–12T(b)(2), the formula is corrected to read as follows:

§1.170A–12T Valuation of a remainder interest in real property for contributions made after July 31, 1969 (temporary).

* * * * *

(b) (2) * * *

$$\left(1+\frac{i}{2}\right)\sum_{t=0}^{n-1} v^{(t+1)}\left[\left(1-\frac{l_{x+t+1}}{l_x}\right)-\left(1-\frac{l_{x+t}}{l_x}\right)\right]\left(1-\frac{1}{2n}-\frac{t}{n}\right)$$

* * * * *

§1.7520–1T [Corrected]

3. On page 23211, column 1, §1.7520–1T(c)(2) heading, line 3, the language *"interest rates between 2.2 and 26"* is corrected to read *"interest rates between 2.2 and 22"*.

4. On page 23211, column 1, §1.7520-1T(c)(2)(iii), line 5, the language "depreciation adjustment factors. See" is corrected to read "depreciation adjustment factors. See".

PART 20 — [CORRECTED]

§20.2031–7A [Corrected]

5. On page 23212, column 1, §20.2031–7A(e)(4), line 9, the language "paragraph (b)(4), and Table B, Table J," is corrected to read "paragraph (e)(4), and Table B, Table J,".

6. On page 23212, column 2, §20.2031–7T(c), the table at the end of the paragraph is corrected to read as follows:

§20.2031–7T Valuation of annuities, interests for life or term of years, and remainder or reversionary interests (temporary).

* * * * *

(c) * * *

Valuation Dates		Applicable Regulations
After	Before	
	01-01-52	20.2031-7A(a).
12-31-51	01-01-71	20.2031-7A(b).
12-31-70	12-01-83	20.2031-7A(c).
11-30-83	05-01-89	20.2031-7A(d).
04-30-89	05-01-99	20.2031-7A(e).

* * * * *

7. On page 23222, §20.2031-7T(d)(7), in the table entitled "TABLE 90 CM. LIFE TABLE APPLICABLE AFTER APRIL 30, 1999", the column headings are corrected to read as follows:

§20.2031–7T Valuation of annuities, interests for life or term of years, and remainder or reversionary interests (temporary).

* * * * *

(d) * * *

(7) * * *

TABLE 90 CM. LIFE TABLE APPLICABLE AFTER APRIL 30, 1999

Age x (1)	l (x) (2)		Age x (1)	l (x) (2)		Age x (1)	l (x) (2)

* * * * *

§20.7520–1T [Corrected]

8. On page 23223, column 2, §20.7520–1T(c)(2) heading, line 3, the language "interest rates between 2.2 and 26" is corrected to read "interest rates between 2.2 and 22".

PART 25 — [CORRECTED]

§25.7520–1T [Corrected]

9. On page 23227, column 3, §25.7520-1T(c)(2) heading, line 3, the language *"interest rates between 2.2 and 26"* is corrected to read *"interest rates between 2.2 and 22"*.

PARTS 1, 20, 25 — [CORRECTED]

10. On page 23228, in the table in amendatory instruction Par.32, the entry for 1.170A–6(c)(5), *Example* (2)(c) is added in numerical order; and the entries for 1.170A-6(c)(5), *Example* (2)(a), first sentence; 1.170A-6(c)(5), *Example* (3)(a), seventh and eighth sentences (the fifth entry from top of chart); 1.642(c)–A6(e)(2)(i); 20.2055–2 (f)(2)(iv), *Example* (3), second sentence; 20.2055–2(f)(2)(iv), *Example* (3), third sentence; 20.2056A–4(c)(4)(ii)(B), penultimate sentence; and 25.7520–1(c)(1), third sentence are corrected to read as follows:

Section	Remove	Add
* * * * *		
1.170A–6(c)(5), Example (2)(a), first sentence	1970,	
1.170A–6(c)(5), Example (2)(c)	for 1970	
* * * * *		
1.170A–6(c)(5), Example (3)(a), seventh, eighth,and ninth sentences	1972	1973.
* * * * *		
1.642(c)–6A(e)(2)(i)	§20.2031–7(d)(6)	§20.2031–7A(e)(4).
* * * * *		
20.2055–2(f)(2)(iv), Example (3), third sentence.	§20.2031–10(e)	§20.2031–7A(c).
20.2055–2(f)(2)(iv), Example (3), fourth sentence	§20.2031–10(f)	§20.2031–7A(d).
20.2056A–4(c)(4)(ii)(B), fifth sentence	Alpha Volume	Book Aleph.
* * * * *		
25.7520–1(c)(1), third sentence	Section 20.2031–7(d)(6) of this chapter (Estate Tax Regulations) contains.	Sections 20.2031–7(d)(6) and 20.2031–7A(e)(4) of this chapter contain.

Michael Slaughter,
Acting Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on June 21, 1999, 8:45 a.m., and published in the issue of the Federal Register for June 22, 1999, 64 F.R. 33194)

Information Reporting Seminar for 1999; Correction

Announcement 99–67

This announcement reflects information to be corrected in Announcement 99–59, 1999–24 I.R.B. 52, dated June 14, 1999.

1. The IRS/SSA seminar scheduled in Louisville, KY, on September 16, 1999, has been canceled.

2. The telephone number for the IRS/SSA seminar scheduled for Salt Lake City, UT, on September 2, 1999, has changed to 801-799-6876.

3. The telephone number for the IRS/SSA seminar scheduled for Tampa, FL, on September 23, 1999, has changed to 904-665-0520 and the fax number has changed to 904-665-1842.

Foundations Status of Certain Organizations

Announcement 99–68

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Smith-Cotton Alumni Association, Sedalia, MO
Smoketown Neighborhood Development Incorporated, Louisville, KY
Snohomish Valley Junior Football Association, Snohomish, WA
Snowmass-Capitol Creek Caucus, Snowmass, CO
Sober House, Port Angeles, WA
Sober Lifestyles Inc., Houston, TX
Social Work Association of the Veterans Administration, Woodside, CA
Society for Preservation of McGrew House Inc., Kingwood, WV
Society for the Construction of an Observatory for Public Education, Salt Lake City, UT
Society for the Cultural Preservation of Hist Jonesborough, Jonesborough, TN
Society of Arab Americans Inc., Houston, TX
Society of Arab Womens Welfare Aid, Chicago, IL
Society of Connecticut Sculptors, Windsor Locks, CT
Socorro ISD PTO-PTA Inc., El Paso, TX
Sojourners Athletic Club, Birmingham, AL
Solano County Visually Impaired Group, Fairfield, CA
Solid Believers Ministry Incorporated, Kansas City, KS
Solo Arts Group Inc., New York, NY
Solutions & Possibilities Inc., Columbus, OH
Solutions Business Center, Markham, IL

Solutions for the Homeless, Baltimore, MD
Solutions Group Inc., Sandpoint, ID
Somali Community of San Diego, San Diego, CA
Somerville Players Inc., Tewksbury, MA
Somnambulist Project, Chapel Hill, NC
Sonny Billie Foundation for Native Culture Studies Inc., Ft. Lauderdale, FL
Sonoma County Trails Council, Windsor, CA
Sons & Daughters of America Inc., Plantation, FL
SOS Community Foundation, Fairview, OK
Souderton Tourney Incorporated, Tylersport, PA
Soul in Motion Players Inc., Gaithersburg, MD
Souls of Wonder Inc., New York, NY
Sound Vision Radio Reading Service for the Blind Incorporated, Tulsa, OK
Soundbyte Incorporated, Baltimore, MD
South Asian Society on Atherosclerosis and Thrombosis Inc., Minneapolis, MN
South Bay Junior All American Football, Torrance, CA
South Bend Junior Chamber of Commerce Charitable Fund Inc., South Bend, IN
South Carolina Association of Prevention Professional and, Columbia, SC
South Central Community Development Committee Inc., Dallas, TX
South Central Kentucky Soccer Association Inc., Somerset, KY
South Central Shepherds Center of Wichita Inc., Wichita, KS
South Coast Storytellers Guild, Dana Point, CA
South County Resource Center Inc., Venice, FL
South Cumberland Regional Land Trust Inc., Sewanee, TN
South Dakota Council on Problem Gambling, Sioux Falls, SD
South East Atlanta Resource Center for Housing Inc., Atlanta, GA
South Florida Dance Theatre Inc., Boca Raton, FL
South Florida Reef Research Team, Hallandale, FL
South Georgia Baseball & Softball Umpires Association Inc., Waycross, GA
South Hills Terrace Tenants Organizations Inc., Brownsville, PA
South Little Rock Community Development Corporation, Little Rock, AR
South Mountain Manor Inc., Vauxhall, NJ
South Orange Athletic Association Inc., Orlando, FL
South Puget Environmental Education Clearinghouse, Olympia, WA
South Texas Chariot Wheelchair Basketball Association, Mission, TX
South Texas Informer Educational Foundation Inc., Corpus Christi, TX
South Village Neighborhood Association Inc., Indianapolis, IN
Southeast Durham Development Corporation, Durham, NC
Southeast Kirkwood Housing Corporation, Kirkwood, MO
Southeast Missouri Ballet Theatre, Cape Girardeau, MO
Southwest Arts in Action Inc., Sedona, AZ
Southwest Business & Economic Development Association Inc., Homestead, FL
Southwest Center for World Missions, El Paso, TX
Southwest Development Partnership Inc., Cleveland, OH
Southwest Fantasy Sports Foundation, Dallas, TX
Southwest Firefighting Explorer Post 790, MacDona, TX
Southwest Germantown Performing Arts Center, Philadelphia, PA
Southwest Iowa Humane Society, Clarinda, IA
Southwest Louisiana Economic Development Inc., Lake Charles, LA
Southwest Lynx System Inc., Midland, TX
Southwest Trailriders Association Inc., Houston, TX
Southwest Virginia Public Education Foundation Inc., Wise, VA
Southwest Wings Inc., Sierra Vista, AZ
Southwest Yonkers Planning Association, Yonkers, NY
Southwest Rural Vision Enterprises Foundation, Kindred, ND
Southeast Texas Trauma Regional Advisory Council, Houston, TX
Southeastern Animal Fiber Fair, Hillsborough, NC
Southeastern Climbers Coalition Inc., Chattanooga, TN
Southeastern Community Development Corporation, Rowland, NC
Southeastern Institute for Law & Commerce, Nashville, TN
Southeastern Pennsylvania Womens Ordination Conference, Blue Bell, PA
Southern Arizona Hospice Memorial Foundation, Tucson, AZ
Southern California Tradeswomen Network, Fontana, CA
Southern Colorado Coal Miners Memorial and Scholarship Fund, Trinidad, CO
Southern Equine Educational Foundation Inc., Hopkins, SC
Southern Maryland Association for Deaf Children, Bryans Rd., MD
Southern Minnesota Retrouvaille, Mankato, MN
Southern Onondaga Youth Football Association Inc., Lafayette, NY
Southern Regional Model United Nations Inc., N. Miami Beach, FL
Southern Union Gas Company Employee Directed Charity, Austin, TX
Southland Sheltie Rescue Inc., La Habra, CA
Southwestern Family Center Inc., Baltimore, MD
Sovereign God Ministries Inc., College Station, TX
Soweta Beat Street Theatre Inc., Marietta, GA
Space Information Laboratories Inc., Vandenberg AFB, CA
Spanish River Community High School Foundation Inc., Boca Raton, FL
Spearfish Youth Baseball Assoc. Inc., Spearfish, SD
Special Education Booster Club Inc., Austin, TX
Special Kids Equipment Association, San Diego, CA
Special People Accessing the Community Equally Inc., Cincinnati, OH
Spina Bifida Association of Akron Inc., Akron, OH
Splendora Football Association, Splendora, TX
Sports Foundation of Texas Inc., Houston, TX
Sports Pride of America Foundation Inc., Raleigh, NC
Spotlight Productions, Poquoson, VA
Spring Up O Well Inc., Benbrook, TX

Springfield Area Soccer Assoc., Springfield, IL
St. Anthonys Catholic School Endowment Fund Inc., Lakeland, FL
St. Clair County Housing Development Corporation, Fort Gratiot, MI
St. Francis Center at the Knolls Inc., Warwick, NY
St. James USA Inc., Ellington, CT
St. John Bosco Educational Society Desert Solitaire, Dolores, CO
St. John Institute of Culture Inc., Cruz Bay, VI
St.Joseph Fire Museum Inc., St. Joseph, MO
St. Jude Day Care Center Incorporated, Memphis, TN
St. Louis Firefighter Memorial Statue Inc., St. Louis, MO
St. Louis Knights Soccer Club, St. Louis, MO
St. Martin De Porres Center, San Diego, CA
St. Mary Crime Stoppers Inc., Morgan City, LA
St. Matthew Housing Corp., Milwaukee, WI
St. Peters Homes Inc., Charlotte, NC
St. Rose Center Support Board, Chicago, IL
St. Stephen Parent Teachers Organization, St. Stephen, MN
Stage Studio Inc., Largo, FL
Stagelights, Williamsburg, VA
Stan Ham Memorial Bull Ride and Bull Fight, Odessa, TX
Stana Foundation for Democracy, Chantilly, VA
Stand-Up Incorporated, Kansas City, MO
Star Flight Fund Inc., Austin, TX
Starfire Council of Greater Cincinnati Inc., Cincinnati, OH
Starke County Child Abuse Prevention Council Inc., Knox, IN
Starr Fine Arts Ranch, Wimberly, TX
Stat Team, San Antonio, TX
Stephen Girard Memorial Committee Inc., Philadelphia, PA
Stepping High Youth Club Inc., Clearwater, FL
Stop and Recover, Philadelphia, PA
Stow Munroe Falls Library Foundation Inc., Stow, OH
Straight & Narrow Inc., Lake Forest, IL
Strategic Arts Alliance Inc., Tinker AFB, OK
Strategies for the Disadvantaged & Indigent, Mitchellville, MD
Straughn Memorial Diabetes Ride, Mancelona, MI
Substance Abuse Management and Development Corporation, Cincinnati, OH
Substance Abuse Recovery Group Inc., Great Falls, MT
Suda for Ex-Offenders Inc., Adams Basin, NY
Suffolk Essential Needs for Seniors Effort Inc., Commack, NY
Sugar Land Select Soccer Club, Sugarland, TX
Summer Incentive Program Foundation, Cincinnati, OH
Summer Academy Alumni Association Incorporated, Lenexa, KS
Sunny Hills High School Athletic Fund, Fullerton, CA
Sunshine Emergency Shelter and Residential Home, Loma Linda, CA
Sunshine Health Foundation Inc., Pompano Beach, FL
Sunshine House Inc., Fresno, CA
Support Our Communities Kids Inc., Gainesville, FL
Support Services Network Inc., San Angelo, TX
Survivors of Suicide, Aurora, IL
Susquehanna River Arts Center Inc., Clearfield, PA
Sustainability Project Inc., Santa Fe, NM
Swap Inc., West Annapolis, MD
Sweetwater Crisis Pregnancy Center Inc., Sweetwater, TX
Swing Orchestra Institute of Chicago, Chicago, IL
Sylacauga Jaycees Childrens Fund Inc., Sylacauga, AL
Symphonic Fund Inc., Galesburg, IL
Synergy Research Consortium, Pittsburgh, PA
Syosset Baseball Association Inc., Syosset, NY

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Page Numbers in Internal Revenue Bulletins

Announcement 99–69

Beginning with Internal Revenue Bulletin (IRB) 1999–28, the page numbers will run consecutively from one IRB to the next. Since IRB 1999–27 ended on page 18, this IRB starts with page 19. Previously, each IRB started with page one.

This change is based on Announcement 99–36, 1999–16 IRB 10, which stated that reprints of weekly IRBs will be bound together to form the Cumulative Bulletin (CB). With this new numbering system, the page number for an item will be the same in the CB as it is in the IRB.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1502.—Regulations

26 CFR 1.1502–21: Net operating losses.

T.D. 8823

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 301, and 602

Consolidated Returns—Limitations on the Use of Certain Losses and Deductions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding certain deductions and losses, including built-in deductions and losses, of members who join a consolidated group. The regulations provide rules for computing the limitation with respect to separate return limitation year (SRLY) losses, and the carryover or carryback of losses to consolidated and separate return years. The regulations also eliminate the application of the SRLY rules in certain circumstances in which the rules of section 382 of the Internal Revenue Code also apply.

DATES: *Effective Dates:* These regulations are effective June 25, 1999.

Applicability Dates: For dates of applicability, see the "Dates of Applicability" portion of this preamble.

FOR FURTHER INFORMATION CONTACT: Jeffrey L. Vogel, or Marie Milnes-Vasquez at (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this final rule has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1237.

The collection of information in this regulation is in §1.1502–21(b)(3). This information is required to ensure that an election to relinquish a carryback period is properly documented, and will be used for that purpose. The collection of information is required to obtain a benefit (relating to the carryover of losses which would otherwise be carried back). The likely respondents are consolidated groups.

Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by August 31, 1999.

Comments are specifically requested concerning: Whether the collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total annual reporting burden: 2,000 hours.

Estimated average annual burden hours per respondent: 15 minutes. Estimated number of respondents: 8,000.

Estimated annual frequency of responses: On occasion.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On February 4, 1991, the Treasury and the IRS issued three notices of proposed rulemaking, CO–132–87 (56 F.R. 4194 [1991–1 C.B. 728]), CO–077–90 (56 F.R. 4183 [1991–1 C.B. 749]), and CO–078–90 (56 F.R. 4228 [1991–1 C.B. 757]), setting forth amendments to the rules regarding net operating losses, built-in deductions, and capital losses of consolidated groups. Those proposed regulations also included rules regarding the carryover and carryback of losses to consolidated return years and separate return years, and rules regarding the application of section 382 and 383 by consolidated groups and by controlled groups. A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the Treasury and the IRS published temporary regulations regarding the separate return limitation year (SRLY) limitation (T.D. 8677, 61 F.R. 33321 [1996–2 C.B. 119]). These regulations were substantially identical to the proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations, the 1996 proposed SRLY regulations, was published in the **Federal Register** on the same day (CO–024–96, 61 F.R. 33393 [1996–2 C.B. 437]), and the proposed regulations published in 1991 were withdrawn. The Treasury and the IRS also published temporary regulations (T.D. 8678, 61 F.R. 33335 [1996–2 C.B. 134]) setting forth rules regarding the application of section 382 to affiliated groups of corporations filing consolidated returns, and controlled group losses (T.D. 8679, 61 F.R. 33313 [1996–2 C.B. 25]). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO–026–96, 61 F.R. 33391 [1996–2 C.B. 440] and CO–025–96, 61 F.R. 33395 [1996–2 C.B. 439]), and the

earlier proposed regulations published in 1991 were withdrawn.

On August 10, 1998, the Treasury and the IRS issued Notice 98–38 (1998–32 I.R.B. 4). The Notice requested comments about the advisability of adopting rules that would replace the existing SRLY rules with an approach modeled on section 382.

As companions to this Treasury decision, which adopts the 1996 proposed SRLY regulations with certain revisions and modifications, the Treasury and the IRS are also issuing final regulations relating to the application of sections 382 and 383 by members of consolidated and controlled groups. See T.D. 8824 on page 62, and T.D. 8825, 1999–28 I.R.B. 3.

On January 12, 1998, the Treasury and IRS issued temporary and proposed regulations governing the use of tax credits of a consolidated group and its members (T.D. 8751, 63 F.R. 1740 [1998–10 I.R.B. 23]). The Treasury and IRS intend to finalize those regulations at a later date.

Operation of the Proposed and Temporary Regulations

The 1991 proposed regulations generally retained the approach of the prior SRLY regulations in limiting a consolidated group's use of attributes arising in or attributable to a SRLY, but altered the manner in which the limitation is computed. While the pre-1991 regulations determined the limitation separately for each member (fragmentation), and under a year-by-year approach, the proposed regulations introduced two new concepts: subgrouping and the cumulative register.

Subgrouping was added because fragmentation is in many ways inconsistent with the single entity approach to the use of losses under the consolidated return regulations. For example, if an entire consolidated group were acquired by another group, under the fragmentation approach, none of the losses of a former member of the target group could be used to offset income of another former member of the target group. However, had no acquisition occurred, those losses could have been used to offset income within the target group.

The 1991 proposed regulations also introduced the concept of a cumulative register to address certain issues resulting from the year-by-year approach. The prior SRLY regulations based the limitation on the SRLY member's annual contribution to the group's consolidated taxable income. The SRLY limitation was computed by taking the difference between the group's consolidated taxable income "with" the SRLY member and "without" the SRLY member. This resulted in certain anomalies. For example, if a SRLY member produced income in a tax year but the group as a whole did not have income, the SRLY loss could not be absorbed in that year. Because the member's contribution to income was not carried over to later years, the SRLY losses also could not be absorbed in a later year unless the member also contributed to the group's taxable income in that year.

The cumulative register, rather than looking to a member's contribution for the year, includes in the limitation computation a member's complete income history while it is a member of a consolidated group. The cumulative register is determined by aggregating a member's net contribution of income in excess of losses absorbed during the entire period the member was in the consolidated group. To the extent that the cumulative register for a member is positive, that member's SRLY net operating losses can be absorbed in a consolidated return year (provided the group otherwise has taxable income) even though the member might not have contributed to taxable income in that year. On the other hand, if the cumulative register is negative, the absorption of losses is precluded even though the member might have contributed to taxable income in that consolidated return year.

Much of the complexity of the SRLY rules results from the subgroup and cumulative register concepts. In fact, the preamble to the proposed SRLY regulations acknowledged that the subgrouping approach was more complex than the fragmentation approach and solicited comments about whether the benefits provided by subgrouping outweigh and justify the additional burdens required, and whether the fragmentation approach should be retained. 1991–1 C.B. 759. No comments received in response to this request advocated the elimination of subgrouping or the cumulative register, and it was ultimately decided that these principles would be retained.

Comments

Comments were received in response to the 1991 proposed regulations, the 1996 temporary regulations and Notice 98–38. Some comments addressed whether the SRLY rules should be retained. Other comments addressed issues about the technical operation of the proposed rules.

All of the comments were evaluated in finalizing these regulations. Several suggestions were adopted while others were not. This preamble describes some of the decisions that were made in finalizing the regulations.

Elimination or Retention of SRLY

The preliminary issue considered in finalizing these regulations was the extent, if any, to which the SRLY rules should be retained. The comments were divided about whether to retain or eliminate SRLY. Some commentators asserted that the amendment to section 382 in 1986 adequately addressed Congressional concerns regarding loss trafficking. Therefore, it was argued, the SRLY rules should be eliminated because they have become superfluous, add unwarranted complexity to the consolidated return system, and are easily avoided. Other commentators asserted that the SRLY rules should be retained because in their view, policing loss trafficking is incidental to SRLY's function of resolving a single entity/separate entity conflict in applying the consolidated return regulations. A third group suggested a middle position by urging the elimination of SRLY only in those circumstances in which the rules of section 382 also apply.

Arguments for Elimination of SRLY

Some commentators urged elimination of the SRLY rules (either in whole or in part) because, in their view, section 382 provides sufficient protection against loss trafficking transactions. They asserted that the rules of section 382 provide greater precision and predictability about the consequences of a transfer of tax losses, and that section 382 promotes neutrality between a buyer and seller of tax benefits in a more efficient and more equitable way than do the SRLY rules.

Section 382 and SRLY overlap to a large extent, and the rules applying sec-

tion 382 to consolidated groups are even more complex than the SRLY rules. Thus, these commentators asserted that requiring a taxpayer to run the SRLY gauntlet in addition to the section 382 gauntlet is unwarranted because any additional revenue that might be gained from retaining a dual limitation is outweighed by the added complexity of the SRLY rules.

These commentators argued that the complexity of the SRLY rules is unwarranted because the impact of the SRLY rules is easily avoided by various "self-help" techniques. For example, taxpayers can contribute income-producing assets or built-in gain assets to the SRLY member to minimize the effect of a SRLY limitation. They also argued that the SRLY rules impose a meaningful limitation only in those cases in which, for regulatory or other reasons, loss corporations cannot be combined with other profitable businesses. Some commentators also argued that the SRLY rules improperly discriminate between stock and asset acquisitions. Other arguments urging the elimination of SRLY asserted that section 382 supercedes the SRLY rules as a Congressionally mandated rule for policing loss trafficking and that the SRLY rules are inconsistent with treating the consolidated group as a single entity.

Arguments for Retention of SRLY

Notwithstanding the substantial area of overlap between section 382 and SRLY, section 382 does not always apply when SRLY does. In fact, most commentators expressed concern about loss trafficking through carryback transactions (to which section 382 does not apply) and acknowledged the need for a rule to police those transactions. Many urged retention of the existing SRLY rules at least for that purpose. Moreover, some commentators speculated that elimination of the SRLY rules would likely present new unforeseen opportunities for trafficking in tax benefits.

Those commentators supporting retention of SRLY argued that the objectives of section 382 and SRLY differ. Section 382, which seeks to prevent loss trafficking, is based on the notion that the rate of loss utilization following a change in ownership should be based on the expected income generated if all of the assets were converted to tax-exempt debt instruments. Accordingly, section 382 permits a fixed amount of income to be used each year to absorb a loss, regardless of the actual income contribution of the loss corporation. Moreover, under section 382 and in the absence of SRLY, the available loss can be used against any member's income. SRLY, on the other hand, makes actual income generation by the SRLY member the determinant of loss usage. Thus, SRLY assures that the loss attributes that arose outside of the consolidated group are not generally available to the other group members.

These commentators noted that the consolidated return system combines single and separate entity treatment. The ability to offset the income of one member with the losses of another member reflects single entity treatment of the consolidated group. But, when a corporation becomes a member of a consolidated group, it retains its separate existence and individual status, its own accounting methods, and its own separate attributes, including its losses that are carried from a separate return year to a consolidated return year. These aspects reflect treatment of each member of a consolidated group as a separate entity. The carryover of losses from separate return years reflects separate entity treatment, while the sharing of losses among the members of a consolidated group reflects single entity treatment. Thus, there is a conflict between single entity and separate entity treatment. Single entity treatment in computing consolidated taxable income is inconsistent with permitting a corporation's losses to straddle consolidated and separate return years when it enters or leaves a consolidated group. These commentators argued that the SRLY rules present a resolution of this conflict and protect the integrity of the consolidated return system by ensuring that attributes arising in a separate return year belong to, and remain with, the SRLY member, and attributes arising in a consolidated return year belong to the group.

Through these rules, according to these commentators, SRLY seeks to provide that the manner and extent to which a corporation's separate tax attributes are absorbed or utilized should not vary based on whether the corporation is inside or outside a consolidated group. Unlike in the case of section 382, the policy objectives underlying these rules do not hinge on whether the ownership of the corporation changes upon its entrance into or departure from the group.

Moreover, commentators urging the retention of SRLY pointed out that the rules of section 381 dictate the circumstances under which one corporation can use the tax attributes of another corporation. In certain reorganizations, section 381 allows the tax attributes of one corporation to be used by another corporation after an acquisition, but in those transactions generally stock basis is also lost. By contrast, in a taxable stock purchase where the stock takes a cost basis and the corporation retains its existence, including its underlying attributes, there is no policy reason for those attributes to be freely available to the purchaser. In essence, these commentators argued, the SRLY limitation prevents the benefits provided by section 381 in certain reorganization transactions from being extended to acquisitions and restructurings that do not involve the commingling of assets in one entity that section 381 transactions generally require. A consolidated group's acquisition of the stock of a corporation should not be treated the same way as an asset acquisition.

Notice 98–38

Notice 98–38 announced that the Treasury and the IRS were considering an approach that would model the SRLY limitation on the mechanism of section 382. One intended advantage of this approach was to reduce complexity in cases of overlap of the SRLY rules with section 382. In those cases, the SRLY limitation would be the same as the section 382 limitation, and consolidated groups would not need to make two computations to determine how much income could be used to absorb a loss. A second intended advantage was to address concerns that the impact of a SRLY limitation can be minimized by stuffing transactions (e.g., transferring income-producing assets to the loss corporation) which could not be used to affect the section 382 limitation.

Although many commentators favor the elimination of a separate SRLY limita-

tion in the case where section 382 also applies, commentators did not favor adoption of the section 382 mechanism in cases where section 382 does not otherwise apply. Commentators argued that imposing a limitation based on section 382 in a case where section 382 would not otherwise apply would be inordinately burdensome. Because (absent an ownership change) the owners of a loss corporation held outside a consolidated group could engage in a stuffing transaction in order to increase that corporation's loss absorption, commentators argued that a SRLY limitation that could not be increased through stuffing transactions would violate the objective of providing that the extent of a corporation's loss absorption should not vary based on whether it is inside or outside a consolidated group.

In light of these concerns, the Treasury and the IRS decided not to impose a SRLY limitation based on the mechanism of section 382.

The Overlap Rule

The Treasury and the IRS believe that limitations on the extent to which a consolidated group can use attributes arising in a separate return limitation year remain necessary. However, the Treasury and the IRS remain concerned about complexity in applying the current SRLY rules, particularly with respect to situations where both the SRLY rules and section 382 apply. As described above, the SRLY limitation is based on the member's (or subgroup's) actual contribution to consolidated taxable income. The section 382 limitation is based on the expected income generation of the member (or subgroup) determined with reference to its value on the change date. On balance, the Treasury and the IRS believe that the simultaneous or proximate imposition of a section 382 limitation reasonably approximates a corresponding SRLY limitation. Accordingly, these regulations generally eliminate the SRLY limitation in circumstances in which its application overlaps with that of section 382.

In the majority of cases, the date on which a corporation becomes a member of a consolidated group (and thus subject to the SRLY rules) is also a "change date" as defined in section 382(j), determined as a result of an ownership change as defined in section 382(g). In this situation, under the temporary regulations, taxpayers must calculate two separate limitations for loss carryovers — the SRLY limitation and the section 382 limitation. The final regulations provide an overlap rule which eliminates the application of the SRLY rules in this situation. As a result, the final regulations remove the burden of determining two limitations, and simplify the loss limitation rules applicable to consolidated groups in most instances in which both the SRLY and the section 382 limitations would otherwise arise.

To address situations in which not all of an acquisition occurs simultaneously, the overlap rule also applies if the acquisition results in a corporation joining the consolidated group on a date other than the "change date", provided the transactions are separated by no more than six months. Additional rules have been included to prevent the inappropriate operation of the overlap rule in certain cases involving the acquisition of multiple corporations.

Net Operating Losses

Generally, to qualify for the net operating loss overlap rule, a corporation must become a member of a consolidated group (a SRLY event) within six months of the change date of an ownership change that gives rise to a section 382(a) limitation with respect to that carryover (a section 382 event). For net operating losses, an overlap also will generally include situations in which a net operating loss arises in the maximum six month period after the section 382 event but before the SRLY event.

For example, if a section 382 event occurs on April 1 and a SRLY event occurs on September 1, any losses that arise between April 1 and September 1 would not be subject to a section 382 limitation because they would be allocable to the post-change period. However, in the absence of the overlap rule, those losses would be subject to a SRLY limitation. The overlap rule of the final regulations eliminates the application of SRLY to those post-change losses. In cases of an acquisition of a single corporation, the elimination of SRLY has been determined to be an appropriate result and is a trade-off to promote simplicity in the consolidated return regulations.

The final regulations provide special overlap rules for subgroups. In general, the overlap rule applies to the subgroup and not separately to the members of the subgroup. However, the overlap rule does not apply unless the SRLY subgroup is coextensive with the section 382 loss subgroup. This rule is necessary because a section 382 subgroup limitation that is computed with respect to the expected income generation of a group of corporations does not reasonably approximate a limitation that would be based on the actual contribution to consolidated taxable income by a smaller number of corporations. In the reverse case, where the SRLY subgroup is larger than any corresponding section 382 loss subgroup or single new loss member, and particularly with respect to built-in losses, it is unclear in certain circumstances how the overlap rule could be applied. To address such circumstances in which a SRLY subgroup would otherwise be larger than the corresponding section 382 subgroup or single new loss member, the accompanying final regulations relating to the application of sections 382 and 383 provide for an election effectively to expand a newly-formed section 382 subgroup to conform with a SRLY subgroup.

For example, assume that the S consolidated group (composed entirely of S and T) has a $200 consolidated net operating loss, of which $100 is attributable to S and $100 is attributable to T. If the M group acquires the S group, S and T compose both a SRLY subgroup as well as a section 382 loss subgroup. Because the subgroups are coextensive, the overlap rule applies to eliminate the application of SRLY in the M group for the $200 consolidated net operating loss.

The overlap rule will not apply, however, if all the corporations included in a section 382 loss subgroup are not also included in a SRLY subgroup. For example, in Year 1, T joins the S group with a net operating loss carryover in a transaction that is not subject to section 382, and T does not subsequently have an ownership change. Under §1.1502–96 (relating to the end of separate tracking), after five years, T's net operating loss becomes an attribute of the S group (also referred to as

a "fold-in") for section 382 purposes. If the P group later acquires S in a transaction to which section 382 applies, the section 382 loss subgroup with respect to the T loss would include S and T, but for SRLY purposes there would be no subgroup. In this situation, the overlap rule would not apply, and the limitations under both SRLY and section 382 would continue to apply.

To preserve the effect of the elimination of SRLY under the overlap rule as corporations move from group to group, the final regulations also provide a special rule expanding the definition of SRLY subgroups. Under this rule, a SRLY subgroup includes a member carrying over a loss that was subject to the overlap rule in a former group, and all members of that former group who become a member of the current group at the same time as the loss member. The effect of this rule is to increase the number of circumstances in which SRLY subgroups and section 382 subgroups will be coextensive as corporations move from group to group. However, SRLY and section 382 subgroups may not be coextensive with respect to losses that were carried into a former group in a transaction to which the overlap rule does not apply. Subgroups may not be coextensive, as demonstrated above, if for purposes of section 382, such losses "fold-in" to the former group by virtue of an ownership change occurring more than six months after the SRLY event or because the loss member remains a member of the former group for at least five years.

Operating Rules

If the section 382 event occurs on the same date as the SRLY event or precedes the SRLY event, the overlap rule, and therefore the elimination of SRLY, is applicable to the tax year that includes the SRLY event. If the SRLY event precedes the section 382 event, the elimination of SRLY is delayed until the first tax year that begins after the section 382 event. The delay is necessary to ensure that an adequate limitation is always in effect for a net operating loss carryover.

For example, for a calendar year consolidated group, if the SRLY event occurs December 1, Year 1, but the section 382 event occurs on April 1, Year 2, it is necessary to maintain the application of the SRLY rules between such dates because otherwise no limitation would be applicable and the separate attributes could be freely absorbed during that period.

Built-in Losses

The overlap rule for built-in losses is very similar to the overlap rule for net operating losses. Generally, to qualify for the built-in loss overlap rule, a SRLY event must occur within six months of the change date of an ownership change that gives rise to a section 382(a) limitation that would apply to recognized built-in losses (a section 382 event). However, the overlap rule does not apply (even with respect to assets held on the date of the section 382 event) if assets are transferred to a corporation after the section 382 event and before the SRLY event that exceed the de minimis threshold of section 382(h). In that case, both the SRLY rules and the section 382 rules will apply. Even after the application of the overlap rule, the SRLY rules for built-in losses apply to asset acquisitions by an acquired corporation that occur after the latter or the SRLY event or section 382 event.

Special Subgroup Rule for Built-in Losses

The temporary regulations provide that, for purposes of built-in losses, a SRLY subgroup consists of those members that have been continuously affiliated for the 60-month period ending immediately before they become members of the group in which the loss is recognized. Generally, the final regulations maintain the subgroup rule provided by the temporary regulations. The final regulations, however, modify the subgroup rules to take account of the overlap rule. These modifications, in effect, conform the SRLY subgroup rules to adopt principles contained in §§1.1502–91 through 1.1502–98 (regarding the application of section 382 to consolidated groups) where necessary to preserve the effect of an overlap transaction in a former group and to increase the number of SRLY and section 382 subgroups that are coextensive and eligible for future operation of the overlap rule as corporations move from group to group.

The final regulations provide that after a corporation joins a group in an overlap transaction, it is deemed to have been affiliated with the common parent of the acquiring group for 60 consecutive months. Those corporations that join the group in the same transaction, but that were not part of a subgroup eligible for the overlap rule, begin measuring the period of their affiliation immediately after joining the group, notwithstanding their actual affiliation history. This rule may prevent some corporations from subsequently qualifying as a SRLY subgroup, notwithstanding their actual affiliation history. For example, assume that after four years of affiliation, S and T join the P group without any net operating loss carryovers. S, which has a net unrealized built-in loss, and T, which has a net unrealized built-in gain, would not qualify as a SRLY subgroup with respect to their built-in items because they do not have the requisite affiliation history. Therefore, S and T are tested separately under section 382 and §1.1502–15. The acquisition results in S becoming subject to section 382 (but owing to the overlap rule, not to the limitation contained in §1.1502–15(a)). T is not subject to either. Because S joined the P group in a transaction subject to the overlap rule, it is deemed to have been affiliated with P for 60 consecutive months. T, however, is required to begin measuring its affiliation with P and S from the date it joined the group, notwithstanding its historic affiliation with S.

Other Substantive Changes

Predecessors and Successors
Material Difference Requirement

The temporary regulations provide that a reference to a corporation or member also includes, as the context may require, a reference to a successor or predecessor. See, §1.1502–15T(e) and §1.1502–21T(f). The definition of predecessor is provided in §1.1502–1(f)(4). In general, a predecessor is any transferor of assets in a section 381(a) transaction. A predecessor also includes any transferor of assets in a transaction in which the basis of assets to the transferee (successor) is determined by reference to the transferor's basis, but only if there is a "material difference" between the basis and the value of assets. Thus the application of the predecessor rule to a section 351 transaction is dependent upon the specific assets transferred, and consequently a transferor in a section 351 transaction might not

qualify as a predecessor. Also, in the case of such a section 351 transaction, the temporary regulations provided that there be a maximum of one predecessor to, or successor of, any member.

Commentators objected to the "material difference" requirement and suggested that a section 351 transferee should not be excluded from successor status solely because there was no material difference between the basis and value of the assets transferred. The final regulations eliminate both the material difference and the single predecessor-successor requirements.

CNOL Carrybacks

Section 1.1502–21T(b)(2)(B) of the temporary regulations provides an offspring rule which generally permits the common parent of a group to carryback a consolidated net operating loss (CNOL) attributable to a member that did not exist in the year to which the loss is carried, provided that the member has been a member of the group continuously since its organization. In that section, there is also a reference to the application of the predecessor and successor rule of §1.1502–21T(f), which states that a reference to a member also includes references to a predecessor of the member, as the context may require.

Commentators were concerned that the combination of the predecessor and successor rule would deny any carryback in the case of a merger under section 368(a)(1)(A) and (a)(2)(D). For example, assume that P, the common parent of a consolidated group, forms Newco in Year 2 for the sole purpose of acquiring T, in a merger with and into Newco. In Year 3, there is a CNOL all of which is attributable to Newco. Newco appears to be within the scope of the offspring rule, and therefore a carryback to P's Year 1 consolidated return, a year before Newco's existence, would be permitted. However, because the merger is a transaction to which section 381(a) applies, Newco is also a successor to T. Under this analysis, Newco would not be considered to have been a member of the P group continuously since its organization, so a carryback to the P group's consolidated return year would not be permitted. Moreover, Newco would not be permitted to carryback the loss to any year of T. Thus, no carryback of Newco's loss would be permitted.

The Treasury and the IRS believe that the denial of any carryback in this situation is inappropriate. In general, a newly-formed group member should be permitted to carry back its contribution to the consolidated net operating loss, whether or not it is a successor to a corporation that was acquired by the group. Moreover, the Treasury and the IRS believe that rules providing for a carryback within — rather than outside — the group would be more administrable than rules requiring taxpayers to trace the assets of a newly-formed member to determine whether such corporation's contribution to the consolidated net operating loss should be carried back to the pre-consolidation years of an acquired corporation or back within the group. The Treasury and the IRS also considered whether to provide that all consolidated net operating losses should be carried back within the group, even if attributable to a corporation that was itself acquired from outside the group. Whether or not such a rule is appropriate, it was determined that such a change should not be adopted in final regulations. Accordingly, the final regulations provide that the offspring rule applies regardless of whether the newly-formed member is a successor to any other corporation.

Successor's Income

Section 1.1502–21T(f)(2) of the temporary regulations provides, "Except as the Commissioner may otherwise determine, any increase in the taxable income of a SRLY subgroup that is attributable to a successor is disregarded unless the successor acquires substantially all of the assets and liabilities of its predecessor and the predecessor ceases to exist." The rule was intended to prevent the subgroup from inappropriately affecting the determination of its taxable income either by removing assets that would generate losses or by bringing into the subgroup income generated by members outside the subgroup.

Some commentators stated that they did not understand whether the rule was intended to require the subgroup to disregard all income of the successor, or only that income of the successor in excess of that generated by the transferred assets. In the event that all the successor's income is disregarded, commentators argued that the rule produced unduly harsh results. A particularly sympathetic case is a divisive section 351 transaction. For example, if T, a member of a SRLY subgroup, formed T1, by contributing to it one of its businesses, and T1 produced net operating losses, those losses would be included in determining the taxable income of the subgroup. On the other hand, if T1 produced taxable income, that income would not be included in the subgroup's taxable income. If no transfer to T1 had occurred, and the business had remained in T, all of its income or loss, as the case may be, would be included in determining the subgroup's taxable income.

The Treasury and the IRS have determined that a broad rule disregarding all income contributed by the successor is necessary to avoid an unadministrable requirement that the successor's income be traced to particular assets, but that the rule should only be applied in more limited circumstances. Thus, the final regulations provide that the net positive income attributable to the successor generally is disregarded, but provide four exceptions to this rule: (A) the successor acquires substantially all of the assets and liabilities of its predecessor, and the predecessor ceases to exist; (B) the successor became a member of the SRLY subgroup at the time the subgroup was formed (e.g., the successor was organized before it and its affiliates joined the current group and thus qualifies in its own right as a subgroup member); (C) 100 percent of the stock of the successor is owned directly by corporations that were members of the SRLY subgroup when the subgroup was formed; or (D) the Commissioner determines otherwise. The IRS might, for example, publish a revenue ruling or other guidance expanding the list of exceptions if it is later determined that other circumstances should be excluded from the general rule. It is also anticipated that through the letter ruling process, the IRS will evaluate individual cases upon request and determine whether income attributable to a successor will be included in determining the subgroup's taxable income. See also §1.1502–21(c)(2)(iv) of the regulations (an anti-abuse rule deny-

ing SRLY subgroup treatment in certain circumstances.)

Built-in Losses
Non-Corporate Transferors

Section 1.1502–15T(a) of the temporary regulations provides that solely for the purpose of determining the amount of, and the extent to which, a built-in loss is limited by the SRLY rules for the year in which it is recognized, a built-in loss is treated as a hypothetical net operating loss carryover or net capital loss arising in a SRLY, instead of as a deduction or loss in the year recognized.

Some commentators thought the rule was anomalous as applied to transfers of built-in loss assets by individuals. In their view, because a SRLY is defined only with respect to corporations (see §1.1502–1(f)), it would be inappropriate to view a corporate transferee as a successor to a non-corporate transferor. Other commentators asserted that because the built-in loss concept is a subset of the SRLY limitations, the built-in loss rules should not apply to transfers by an individual or other non-corporate transferor to a member of a consolidated group in a section 351 transaction.

The temporary regulation does not base the determination of whether a corporation has built-in losses on any application of the predecessor and successor rule. If an asset enters the group with a built-in loss, in general, the temporary regulation deems the built-in loss to have arisen in a SRLY without regard to whether the asset was owned by a corporation when the built-in loss arose. Moreover, §1.1502–15T(b)(2)(i) provides that in the case of an asset acquisition by a group, the assets and liabilities acquired directly from the same transferor pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the group on the date of the acquisition. That corporation would generally be subject to the SRLY built-in loss rules when it becomes a member of the consolidated group. The Treasury and the IRS continue to believe that a separate tax attribute arising outside the consolidated group should not be freely absorbed within the group, regardless of where that separate attribute arose. Accordingly, these final regulations reaffirm that a built-in loss asset transferred to a group by a non-corporate transferor is subject to the SRLY rules. An example explains that for purposes of applying the SRLY limitation to that built-in loss, all of the items contributed by the acquiring member (and not just items attributable to that asset) to consolidated taxable income are taken into account.

Lonely Parent

Under §1.1502–15T of the temporary regulations, the SRLY limitation on recognized built-in losses applies to a loss recognized by the group on an asset the common parent held prior to the formation of a group. In contrast, net operating loss carryovers of a corporation that becomes the common parent of a consolidated group are not subject to a SRLY limitation within the group under the so-called "lonely parent" rule (see §1.1502–1(f)(2)(i)).

The final regulations conform the built-in loss rules to the net operating loss rules as applied in conjunction with the lonely parent rule. Therefore, a loss recognized by any member of the group on an asset that was held by the corporation that becomes the common parent when the group is formed is not subject to the SRLY rules. However, a built-in loss asset acquired by the common parent after the formation of the group remains subject to the SRLY limitation. An anti-abuse rule is also provided to apply the SRLY limitation to built-in loss assets transferred to a corporation prior to and in anticipation of the corporation becoming the common parent of a group.

For example, in Year 1, P, a stand alone corporation holds Asset 1, a built-in loss asset. In Year 3, P forms S but retains Asset 1. In Year 4, P sells Asset 1, recognizing a loss. Section 1.1502–15(f) of the final regulations provides that the loss is not subject to the SRLY limitation. Similarly if P transferred Asset 1 with an unrealized built-in loss to S, the SRLY limitation on built-in losses would not apply if S sold Asset 1 and recognized the loss. However if, after the formation of the P/S group, P acquired an asset with an unrealized built-in loss and sold the asset, recognizing that loss during the recognition period, a SRLY limitation would apply with respect to that loss.

Split Election Rule

Section 1.1502–21T(b)(3)(i) of the temporary regulations permits a consolidated group to waive the entire carryback period provided by section 172. This irrevocable election is not available on a member by member basis, but rather requires that the common parent waive the carryback period for all members of the group.

Some commentators suggested that the election be permitted on a member-by-member basis. The commentators expressed concern that requiring the whole group to waive the carryback period makes it difficult for sellers and purchasers to negotiate who gets the benefit of a post-acquisition loss. Because section 172 generally requires a carryback to the earliest year, absent the purchaser's waiver of the carryback, a seller could be required to disclose confidential tax information to the purchaser relating to the ability to use the loss carryback. In situations where such disclosure is a concern, an election to waive the loss carryback, available on a member by member basis, could ensure the separation of a particular purchaser and seller without requiring the group to waive the remaining amount of the consolidated net operating loss carryback.

The final regulations permit taxpayers to waive, with respect to all consolidated net operating losses attributable to a member, the portion of the carryback period for which the corporation was a member of another group. If an election is made for any member, all members acquired from the same group, in the same transaction, are required to make the election. The election must be made on the timely filed original return for the year of the acquisition.

Absorption of Losses

Section 1.1502–21T(b)(1) provides general rules concerning the absorption of losses within a consolidated group. Although the rules refer to section 382(l)(2)(B), commentators stated that the absorption rules were ambiguous with respect to establishing the priority of absorption of multiple losses carried from the same taxable year if only a portion of the losses were subject to limitation under

section 382. The final regulations make clear that the rule of section 382(l)(2)(B) applies, and that losses limited by section 382 are absorbed before losses from the same taxable year that are not subject to a section 382 limitation, regardless of whether such losses are attributable to the same member.

A comment was also received requesting guidance on how to determine the amount of a subgroup member's net operating loss carryover that was absorbed so that it can determine how much of the loss it retains when it leaves the group. In response to this comment, the final regulations provide that within a subgroup, losses are absorbed on a pro rata basis. Thus, when a subgroup member leaves the group, its net operating loss carryover is treated as having been absorbed on a pro rata basis, determined by comparing its initial net operating loss carryover and the subgroup's initial net operating loss carryover.

Dates of Applicability

The final regulations generally are applicable for taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However, there are several special effective dates, including an effective date which addresses transitional issues relating to the adoption of the rule eliminating SRLY in the event of an overlap with section 382. Generally, if a particular attribute would not have been subject to a SRLY limitation as of June 25, 1999 if these final regulations had always been in effect, and the overlap transaction occurred after the effective date of section 382 as amended by the 1986 Tax Reform Act, then the existing SRLY limitation will not apply in taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999 (but will not be eliminated retroactively with respect to earlier taxable years).

If an existing SRLY limitation for which the cumulative register began in a taxable year prior to a taxable year for which the due date (without extensions) of the consolidated return is after June 25, 1999 would not be eliminated by the overlap rule, that SRLY limitation continues to be applied without regard to the changes applicable to the definition of SRLY subgroups (so that a member or SRLY subgroup is not forced to alter the application of a SRLY limitation in midstream). However, when corporations enter a group in a new SRLY event occurring in a taxable year for which the due date (without extensions) of the consolidated return is after June 25, 1999, the regulations apply (with respect to any overlap transactions occurring after the effective date of section 382 as amended by the 1986 Tax Reform Act) as if the final regulations had always been in effect.

Thus, for example, and assuming that all corporations are on a calendar taxable year, if a corporation S joins the P group in an overlap transaction in 1996, and the first year for which this final regulation is effective is 1999, then any losses carried by S into the P group are subject to a SRLY limitation in 1996, 1997 and 1998. However, the losses are no longer subject to a SRLY limitation within the P group starting in 1999.

If, in the above example, the M group had acquired both P and S on January 1, 1998 in a non-overlap transaction, and S carried into the M group its losses arising before it joined the P group, then, in 1998, under the temporary regulations as then in effect, those S losses would have been subject to a SRLY limitation computed with reference only to S's cumulative register. Under the special transition rule, the new regulations would not operate in 1999 or thereafter to cause S and P to constitute a SRLY subgroup in the M group with respect to those S losses, even though P and S would otherwise qualify as a SRLY subgroup with respect to those losses under the new rules. However, if the X group acquires both P and S from M in or after 1999, P and S would constitute a SRLY subgroup with respect to those S loss carryovers.

Need for Immediate Guidance

Because the temporary regulations are not applicable for taxable years ending after June 26, 1999, it is necessary to implement these final regulations without delay to ensure continuity of treatment of certain attributes and to ensure that there is no period within which the treatment of such attributes is inconsistent with the temporary regulations and these final regulations. See section 7805(e)(2). Accordingly, it is impracticable and contrary to the public interest to issue this Treasury decision subject to the effective date limitation of section 553(d) of title 5 of the United States Code (if applicable).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated federal income tax returns that have carryover or carryback of certain losses from separate return limitation years. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have loss carryovers or carrybacks that are subject to the separate return limitation year rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was sent to the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Jeffrey L. Vogel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the Treasury and the IRS participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for sections 1.1502–15T, 1.1502–21T, 1.1502–22T, and 1.1502–23T and adding entries in numerical order to read in part as follows:

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

Section 1.1502–12 also issued under 26 U.S.C. 1502.* * *

Section 1.1502–15 also issued under 26 U.S.C. 1502.* * *
Section 1.1502–22 also issued under 26 U.S.C. 1502.
Section 1.1502–23 also issued under 26 U.S.C. 1502.* * *

Par. 2. In the list below, for each section indicated in the left column, remove the wording indicated in the middle column, and add the wording indicated in the right column.

Affected Section	*Remove*	*Add*
1.469–1(h)(2)	1.1502–21T (net operating losses (temporary)), and 1.1502–22T (consolidated net capital gain and loss (temporary))	1.1502–21 (net operating losses), and 1.1502–22 (consolidated net capital gain and loss)
1.597–2(c)(5), first sentence	1.1502–15T, 1.1502–21T, and 1.1502–22T	1.1502–15, 1.1502–21, and 1.1502–22
1.597–2(c)(5), second sentence	1.1502–15T, 1.1502–21T or 1.1502–22T	1.1502–15, 1.1502–21 or 1.1502–22
1.597–4(g)(3), fifth sentence	1.1502–15T, 1.1502–21T and 1.1502–22T	1.1502–15, 1.1502–21 and 1.1502–22
1.597–4(g)(3), sixth sentence	1.1502–15T, 1.1502–21T, or 1.1502–22T	1.1502–15, 1.1502–21, or 1.1502–22
1.904(f)–3(a), first sentence	(or §1.1502–21T(b)	(or §1.1502–21(b)
1.904(f)–3(b), first sentence	(or §1.1502–22T(b)	(or §1.1502–22(b)
1.1502–2(h)	1.1502–22T)(or, for consolidated return years to which §1.1502–22T	1.1502–22)(or, for consolidated return years to which §1.1502–22
1.1502–3T(c)(2)(iii), first sentence	1.1502–21T(c)(2)	1.1502–21(c)(2)
1.1502–3T(c)(2)(iii), second sentence	1.1502–21T(f)	1.1502–21(f)
1.1502–9(a), seventh sentence	§1.1502–21T(b)(2)	1.1502–21(b)(2)
1.1502–9(a), eighth sentence	1.1502–21T(b)(1)	1.1502–21(b)(1)
1.1502–11(a)(2)	§1.1502–21T	1.1502–21
1.1502–11(a)(3)	§1.1502–22T	1.1502–22
1.1502–11(a)(4)	§1.1502–23T	1.1502–23
1.1502–11(b)(2)(iii) *Example 1*(c), last sentence	1.1502–21T	1.1502–21
1.1502–11(b)(2)(iii) *Example 2*(d), last sentence	1.1502–21T and 1.1502–22T	1.1502–21 and 1.1502–22
1.1502–12(b)	1.1502–15T	1.1502–15
1.1502–13(c)(7)(ii) *Example 10*(d), first and second sentences	S's net operating loss carryovers are subject to the separate return limitation year (SRLY) rules. See §1.1502–21T(c)	P's acquisition of S is not subject to the overlap rule of §1.1502–21(g), and S's net operating loss carryovers are subject to the separate return limitation year (SRLY) rules. See §1.1502–21(c)
1.1502–13(g)(5) *Example 4*(b), fourth sentence	1.1502–15T (or §1.1502–15A, as appropriate) (limitations on the absorption of built in losses)	1.1502–15 (as appropriate)

1.1502–13(h)(2) *Example 1*(a), second sentence	1.1502–21T(c)	1.1502–21(c)
1.1502–13(h)(2) *Example 1*(b), first sentence	1.1502–21T(c)	1.1502–21(c)
1.1502–13(h)(2) *Example 2*(a), last sentence	1.1502–15T	1.1502–15
1.1502–13(h)(2) *Example 2*(b), second sentence	1.1502–22T	1.1502–22
1.1502–20(c)(4) *Example 7*(iii), first sentence	1.1502–21T	1.1502–21
1.1502–20(g)(3) *Example 1*(i), second sentence	1.1502–21T	1.1502–21
1.1502–20(g)(3) *Example 2*(i), third sentence	§1.1502–21A or 1.1502–21T	1.1502–21A or 1.1502–21
1.1502–23A(a), third sentence	1.1502–21T(c) and 1.1502–22T(c), as provided in 1.1502–15T(a)	(1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999 and 1.1502–22T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as provided in 1.1502–15T(a) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999) or (1.1502–21(c) and 1.1502–22(c), as provided in 1.1502–15(a), as applicable))
1.1502–23A(b), first sentence	1.1502–21T(g)	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–23A(b), second sentence	1.1502–21T(g) for effective dates of that section	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable for effective dates of these sections
1.1502–26(a)(1) concluding text	1.1502–21T(e)	1.1502–21(e)
1.1502–32(b)(5)(ii) *Example 2*(b), third sentence	1.1502–21T(b)	1.1502–21(b)
1.1502–41A(c), first sentence	1.1502–21T(g)	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–41A(c), second sentence	1.1502–21T(g) for effective dates of that section	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable for effective dates of these sections

1.1502–42(f)(4)(i)(A)	1.1502–21T(b)	1.1502–21(b)
1.1502–43(b)(2)(iv)	1.1502–21T(a)	1.1502–21(a)
1.1502–43(b)(2)(v)	1.1502–22T(a)	1.1502–22(a)
1.1502–43(b)(2)(vi)(A)	1.1502–22T(a)	1.1502–22(a)
1.1502–43(b)(2)(vii)	1.1502–22T(b)	1.1502–22(b)
1.1502–43(b)(2)(viii)	1.1502–15T) and 1.1502–15T (SRLY limitation on built–in losses (temporary))	1.1502–15) and 1.1502–15
1.1502–44(b)(2)	§1.1502–21T	1.1502–21
1.1502–44(b)(3)	§1.1502–22T	1.1502–22
1.1502–47(h)(2)(i)	1.1502–21T	1.1502–21
1.1502–47(h)(2)(ii)	1.1502–21T(e)	1.1502–21(e)
1.1502–47(h)(2)(iii),first sentence	1.1502–21T	1.1502–21
1.1502–47(h)(2)(iv), first sentence	1.1502–21T	1.1502–21
1.1502–47(h)(3)(iii)	1.1502–21T(c)	1.1502–21(c)
1.1502–47(h)(4)(i), first sentence	1.1502–22T	1.1502–22
1.1502–47(h)(4)(i), second sentence	1.1502–22T	1.1502–22
1.1502–47(h)(4)(ii), first sentence	1.1502–22T	1.1502–22
1.1502–47(h)(4)(ii), first sentence	1.1502–21T	1.1502–21
1.1502–47(h)(4)(iii)	1.1502–22T(b)	1.1502–22(b)
1.1502–47(k)(5) introductory text	1.1502–22T	1.1502–22
1.1502–47(l)(3)(i), second sentence	1.1502–21T	1.1502–21
1.1502–47(m)(2)(ii), first sentence	1.1502–21T	1.1502–21
1.1502–47(m)(2)(ii), first sentence	1.1502–22T	1.1502–22
1.1502–47(m)(3)(i), first sentence	1.1502–21T and 1.1502–22T	1.1502–21 and 1.1502–22
1.1502–47(m)(3)(vi)(A), second sentence	1.1502–21T(b) or 1.1502–79A(a)(3) (as appropriate)	1.1502–21(b))
1.1502–47(m)(3)(vi)(A), second sentence	§1.1502–21T(b) or 1.1502–79A(a)(3) (as appropriate)	1.1502–21(b)
1.1502–47(m)(3)(vii)(A)	1.1502–21A(b)(3)(ii)	1.1502–21A(b)(3)(ii) or 1.1502–21(b)
1.1502–47(m)(3)(ix), last sentence	1.1502–15T	1.1502–15
1.1502–47(q), last sentence	1.1502–21T	1.1502–21
1.1502–55T(h)(4)(iii) (B)(*4*), first sentence	1.1502–21T(c)(2)	1.1502–21(c)(2)

1.1502–55T(h)(4)(iii) (B)(*4*), second sentence	1.1502–21T(f)	1.1502–21(f)
1.1502–78(a), first sentence	1.1502–21T(b), 1.1502–22T(b)	1.1502–21(b), 1.1502–22(b)
1.1502–79(a), second sentence	1.1502–21T(b)	1.1502–21(b)
1.1502–79(b), second sentence	1.1502–22T(b)	1.1502–22(b)
1.1502–79(c)(1)	1.1502–21T(b)	1.1502–21(b)
1.1502–79(d)(1)	1.1502–21T(b)	1.1502–21(b)
1.1502–79(e)(1)	1.1502–21T(b)	1.1502–21(b)
1.1502–91T(a)(2), last sentence	1.1502–21T(a)	1.1502–21(a) or 1.1502–21T(a) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(c)(3) *Example* (b), first sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(d)(1)(iii)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(d)(6) *Example 1*(a), fourth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(d)(6) *Example 2*(a), fourth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(f)(2) *Example* (a), last sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–92T(b)(2) *Example 3*(a), fourth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–93T(e)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–94T(a)(1)(i)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable

1.1502–94T(b)(4) *Example 1*(c), last sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–95T(b)(1)(i)	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–95T(b)(4) *Example 1*(a), sixth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–95T(c)(7) *Example 1*(a), fifth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(a)(1) introductory text sixth sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(a)(2), first sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(a)(5), first sentence	1.1502–15T and 1.1502–21T	1.1502–15 and 1.1502–21 (or §1.1502–15T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999 and 1.1502–21T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable)
1.1502–96T(b)(2)(ii)(A)	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(b)(2)(ii)(B)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–99T(c)(2)(i), fourth sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–99T(c)(2)(ii)	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–100(c)(2)	§§1.1502–21A or 1.1502–21T	§1.1502–21A or 1.1502–21

1.1503–2(d)(2)(i), last sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(d)(2)(ii), last sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(d)(4) *Example 1* (iv), last sentence	1.1502–22T(c)	1.1502–22(c)
1.1503–2(g)(2)(vii)(B)(*1*), second sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(g)(2)(vii)(B)(*2*), first sentence	§1.1502–21A(c) or 1.1502-21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(g)(2)(vii)(G) *Example 1*, ninth sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(g)(2)(vii)(G) *Example 2*, last sentence	§§1.1502–21A(c) or 1.1502–21T(c)	§1.1502–21A(c) or 1.1502–21(c)
1.1503–2(h)(3), second sentence	§§1.1502–21A(c) or 1.1502–21T(c))	(§1.1502–21A(c) or 1.1502–21(c)
1.1503–2A(f)(1)(i) introductory text	1.1502–21T(b)	1.1502–79A(a)(3)
1.1503–2A(f)(1)(i)(C)	1.1502–22T(b)	1.1502–22
1.1503–2A(f)(2)(i), fourth sentence	1.1502–21T(c)	1.1502–21(c)
1.1503–2A(f)(2)(ii), last sentence	1.1502–21T(c)	1.1502–21(c)
301.6402–7(g)(2)(iii), first sentence	§1.1502–21T(b)	1.1502–21(b)
301.6402–7(g)(3) *Example 2*, second sentence	1.1502–21T	1.1502–21
301.6402–7(g)(3) *Example 2*, third sentence	1.1502–21T(c)	1.1502–21(c)
301.6402–7(h)(1)(ii) *Example* (b), first sentence	1.1502–21T(b) and 1.1502–22T(b)	1.1502–21(b) and 1.1502–22(b)

Par. 3. Section 1.1502–1 is amended by revising paragraph (f)(4) to read as follows:

§1.1502–1 Definitions.

* * * * *

(f) * * *

(4) *Predecessor and successors.* The term *predecessor* means a transferor or distributor of assets to a member (the successor) in a transaction-

(i) To which section 381(a) applies; or

(ii) That occurs on or after January 1, 1997, in which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but in the case of a transaction that occurs before June 25, 1999, only if the amount by which basis differs from value, in the aggregate, is material. For a transaction that occurs before June 25, 1999, only one member may be considered a predecessor to or a successor of one other member.

* * * * *

Par. 4. Section 1.1502–15 is added to read as follows:

§1.1502–15 SRLY limitation on built-in losses.

(a) *SRLY limitation.* Except as provided in paragraph (f) of this section (relating to built-in losses of the common parent) and paragraph (g) of this section (relating to an overlap with section 382), built-in losses are subject to the SRLY limitation under §§1.1502–21(c) and 1.1502–22(c) (including applicable subgroup principles). Built-in losses are treated as deductions or losses in the year recognized, except for the purpose of determining the amount of, and the extent to which the built-in loss is limited by, the SRLY limitation for the year in which it is recognized. Solely for such purpose, a built-in loss is treated as a hypothetical net operating loss carryover or net capital loss carryover arising in a SRLY, instead of as a deduction or loss in the year recognized. To the extent that a built-in loss is allowed as a deduction under this section in the year it is recognized, it offsets any consolidated taxable income for the year before

any loss carryovers or carrybacks are allowed as a deduction. To the extent not so allowed, it is treated as a separate net operating loss or net capital loss carryover or carryback arising in the year of recognition and, under §1.1502–21(c) or 1.1502–22(c), the year of recognition is treated as a SRLY.

(b) *Built-in losses*—(1) *Defined.* If a corporation has a net unrealized built-in loss under section 382(h)(3) (as modified by this section) on the day it becomes a member of the group (whether or not the group is a consolidated group), its deductions and losses are built-in losses under this section to the extent they are treated as recognized built-in losses under section 382(h)(2)(B) (as modified by this section). This paragraph (b) generally applies separately with respect to each member, but see paragraph (c) of this section for circumstances in which it is applied on a subgroup basis.

(2) *Operating rules.* Solely for purposes of applying paragraph (b)(1) of this section, the principles of §1.1502–94(c) apply with appropriate adjustments, including the following:

(i) *Stock acquisition.* A corporation is treated as having an ownership change under section 382(g) on the day the corporation becomes a member of a group, and no other events (e.g., a subsequent ownership change under section 382(g) while it is a member) are treated as causing an ownership change.

(ii) *Asset acquisition.* In the case of an asset acquisition by a group, the assets and liabilities acquired directly from the same transferor (whether corporate or non-corporate, foreign or domestic) pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the group (and has an ownership change) on the date of the acquisition.

(iii) *Recognized built-in gain or loss.* A loss that is included in the determination of net unrealized built-in gain or loss and that is recognized but disallowed or deferred (e.g., under §1.1502–20 or section 267) is not treated as a built-in loss unless and until the loss would be allowed during the recognition period without regard to the application of this section. Section 382(h)(1)(B)(ii) does not apply to the extent it limits the amount of recognized built-in loss that may be treated as a pre-change loss to the amount of the net unrealized built-in loss.

(c) *Built-in losses of subgroups*—(1) *In general.* In the case of a subgroup, the principles of paragraph (b) of this section apply to the subgroup, and not separately to its members. Thus, the net unrealized built-in loss and recognized built-in loss for purposes of paragraph (b) of this section are based on the aggregate amounts for each member of the subgroup.

(2) *Members of subgroups.* A subgroup is composed of those members that have been continuously affiliated with each other for the 60 consecutive month period ending immediately before they become members of the group in which the loss is recognized. A member remains a member of the subgroup until it ceases to be affiliated with the loss member. For this purpose, the principles of §1.1502–21(c)(2)-(iv) through (vi) apply with appropriate adjustments.

(3) *Coordination of 60 month affiliation requirement with the overlap rule.* If one or more corporations become members of a group and are included in the determination of a net unrealized built-in loss that is subject to the overlap rule described in paragraph (g)(1) of this section, then for purposes of paragraph (c)(2) of this section, such corporations that become members of the group are treated as having been affiliated for 60 consecutive months with the common parent of the group and are also treated as having been affiliated with any other members who have been affiliated or are treated as having been affiliated with the common parent at such time. The corporations are treated as having been affiliated with such other members for the same period of time that those members have been affiliated or are treated as having been affiliated with the common parent. If two or more corporations become members of the group at the same time, but this paragraph (c)(3) does not apply to every such corporation, then immediately after the corporations become members of the group, and solely for purposes of paragraph (c)(2) of this section, the corporations to which this paragraph (c)(3) applies are treated as having not been previously affiliated with the corporations to which this paragraph (c)(3) does not apply. If the common parent has become the common parent of an existing group within the previous five year period in a transaction described in §1.1502–75(d)-(2)(ii) or (3), the principles of §§1.1502–91(g)(6) and 1.1502–96(a)(2)(iii) shall apply.

(4) *Built-in amounts.* Solely for purposes of determining whether the subgroup has a net unrealized built-in loss or whether it has a recognized built-in loss, the principles of §1.1502–91(g) and (h) apply with appropriate adjustments.

(d) *Examples.* For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this section are illustrated by the following examples:

Example 1. Determination of recognized built-in loss. (i) Individual A owns all of the stock of P and T. T has two depreciable assets. Asset 1 has an unrealized loss of $55 (basis $75, value $20), and asset 2 has an unrealized gain of $20 (basis $30, value $50). P acquires all the stock of T from Individual A during Year 1, and T becomes a member of the P group. P's acquisition of T is not an ownership change as defined by section 382(g). Paragraph (g) of this section does not apply because there is not an overlap of the application of the rules contained in paragraph (a) of this section and section 382.

(ii) Under paragraph (b)(2)(i) of this section, and solely for purposes of applying paragraph (b)(1) of this section, T is treated as having an ownership change under section 382(g) on becoming a member of the P group. Under paragraph (b)(1) of this section, none of T's $55 of unrealized loss is treated as a built-in loss unless T has a net unrealized built-in loss under section 382(h)(3) on becoming a member of the P group.

(iii) Under section 382(h)(3)(A), T has a $35 net unrealized built-in loss on becoming a member of the P group (($55) + $20 = ($35)). Assume that this amount exceeds the threshold requirement in section 382(h)(3)(B). Under section 382(h)(2)(B), the entire amount of T's $55 unrealized loss is treated as a built-in loss to the extent it is recognized during the 5-year recognition period described in section 382(h)(7). Under paragraph (b)(2)(iii) of this section, the restriction under section 382(h)(1)(B)(ii), which limits the amount of recognized built-in loss that is treated as pre-change loss to the amount of the net unrealized built-in loss, is inapplicable for this purpose. Consequently, the entire $55 of unrealized loss (not just the $35 net unrealized loss) is treated under paragraph (b)(1) of this section as a built-in loss to the extent it is recognized within 5 years of T's becoming a member of the P group. Under paragraph (a) of this section, a built-in loss is

subject to the SRLY limitation under §1.1502–21(c)(1).

(iv) Under paragraph (b)(2)(ii) of this section, the built-in loss would similarly be subject to a SRLY limitation under §1.1502–21(c)(1) if T transferred all of its assets and liabilities to a subsidiary of the P group in a single transaction described in section 351. To the extent the built-in loss is recognized within 5 years of T's transfer, all of the items contributed by the acquiring subsidiary to consolidated taxable income (and not just the items attributable to the assets and liabilities transferred by T) are included for purposes of determining the SRLY limitation under §1.1502–21(c)(1).

Example 2. Actual application of section 382 not relevant. (i) Individual A owns all of the stock of P, and Individual B owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized loss of $25 (basis $75, value $50), and asset 2 has an unrealized gain of $20 (basis $30, value $50). P buys 55 percent of the stock of T in January of Year 1, resulting in an ownership change of T under section 382(g). During March of Year 2, P buys the 45 percent balance of the T stock, and T becomes a member of the P group.

(ii) Although T has an ownership change for purposes of section 382 in Year 1 and not Year 2, T's joining the P group in Year 2 is treated as an ownership change under section 382(g) solely for purposes of this section. Consequently, for purposes of this section, whether T has a net unrealized built-in loss under section 382(h)(3) is determined as if the day T joined the P group were a change date.

Example 3. Determination of a recognized built-in loss of a subgroup. (i) Individual A owns all of the stock of P, S, and M. P and M are each common parents of a consolidated group. During Year 1, P acquires all of the stock of S from Individual A, and S becomes a member of the P group. P's acquisition of S is not an ownership change as defined by section 382(g). At the beginning of Year 7, M acquires all of the stock of P from Individual A, and P and S become members of the M group. M's acquisitions of P and S are also not ownership changes as defined by section 382(g). At the time of M's acquisition of the P stock, P has (disregarding the stock of S) a $10 net unrealized built-in gain (two depreciable assets, asset 1 with a basis of $35 and a value of $55, and asset 2 with a basis of $55 and a value of $45), and S has a $75 net unrealized built-in loss (two depreciable assets, asset 3 with a basis of $95 and a value of $10, and asset 4 with a basis of $10 and a value of $20).

(ii) Under paragraph (c) of this section, P and S compose a subgroup on becoming members of the M group because P and S were continuously affiliated for the 60 month period ending immediately before they became members of the M group. Consequently, paragraph (b) of this section does not apply to P and S separately. Instead, their separately computed unrealized gains and losses are aggregated for purposes of determining whether, and the extent to which, any unrealized loss is treated as built-in loss under this section and is subject to the SRLY limitation under §1.1502–21(c).

(iii) Under paragraph (c) of this section, the P subgroup has a net unrealized built-in loss on the day P and S become members of the M group, determined by treating the day they become members as a change date. The net unrealized built-in loss is the aggregate of P's net unrealized built-in gain of $10 and S's net unrealized built-in loss of $75, or an aggregate net unrealized built-in loss of $65. (The stock of S owned by P is disregarded for purposes of determining the net unrealized built-in loss. However, any loss allowed on the sale of the stock within the recognition period is taken into account in determining recognized loss.) Assume that the $65 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B).

(iv) Under paragraphs (b)(1), (b)(2)(iii), and (c) of this section, a loss recognized during the 5-year recognition period on an asset of P or S held on the day that P and S became members of the M group is a built-in loss except to the extent the group establishes that such loss exceeds the amount by which the adjusted basis of such asset on the day the member became a member exceeded the fair market value of such asset on that same day. If P sells asset 2 for $45 in Year 7 and recognizes a $10 loss, the entire $10 loss is treated as a built-in loss under paragraphs (b)(2)(iii) and (c) of this section. If S sells asset 3 for $10 in Year 7 and recognizes an $85 loss, the entire $85 loss is treated as a built-in loss under paragraphs (b)(2)(iii) and (c) of this section (not just the $55 balance of the P subgroup's $65 net unrealized built-in loss).

(v) The determination of whether P and S constitute a SRLY subgroup for purposes of loss carryovers and carrybacks, and the extent to which built-in losses are not allowed under the SRLY limitation, is made under §1.1502–21(c).

Example 4. Computation of SRLY limitation. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. During Year 1, Individual A forms T by contributing $300 and T sustains a $100 net operating loss. During Year 2, T's assets decline in value to $100. At the beginning of Year 3, P acquires all the stock of T from Individual A, and T becomes a member of the P group with a net unrealized built-in loss of $100. P's acquisition of T is not an ownership change as defined by section 382(g). Assume that $100 exceeds the threshold requirements of section 382(h)(3)(B). During Year 3, T recognizes its unrealized built-in loss as a $100 ordinary loss. The members of the P group contribute the following net income to the consolidated taxable income of the P group (disregarding T's recognized built-in loss and any consolidated net operating loss deduction under §1.1502–21) for Years 3 and 4:

	Year 3	Year 4	Total
P group (without T)	$100	$100	$200
T	$60	$40	$100
CT	$160	$140	$300

(ii) Under paragraph (b) of this section, T's $100 ordinary loss in Year 3 (not taken into account in the consolidated taxable income computations above) is a built-in loss. Under paragraph (a) of this section, the built-in loss is treated as a net operating loss carryover for purposes of determining the SRLY limitation under §1.1502–21(c).

(iii) For Year 3, §1.1502–21(c) limits T's $100 built-in loss and $100 net operating loss carryover from Year 1 to the aggregate of the P group's consolidated taxable income through Year 3, determined by reference to only T's items. For this purpose, consolidated taxable income is determined without regard to any consolidated net operating loss deductions under §1.1502–21(a).

(iv) The P group's consolidated taxable income through Year 3 is $60 when determined by reference to only T's items. Under §1.1502–21(c), the SRLY limitation for Year 3 is therefore $60.

(v) Under paragraph (a) of this section, the $100 built-in loss is treated as a current deduction for all purposes other than determination of the SRLY limitation under §1.1502–21(c). Consequently, a deduction for the built-in loss is allowed in Year 3 before T's loss carryover from Year 1 is allowed, but only to the extent of the $60 SRLY limitation. None of T's Year 1 loss carryover is allowed because the built-in loss ($100) exceeds the SRLY limitation for Year 3.

(vi) The $40 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation is treated as a $40 net operating loss arising in Year 3 that is carried to other years in accordance with the rules of §1.1502–21(b). The $40 net operating loss is treated under paragraph (a) of this section and §1.1502–21(c)(1)(ii) as a loss carryover or carryback from Year 3 that arises in a SRLY, and is subject to the rules of §1.1502–21 (including §1.1502–21(c)) rather than this section. See also §1.1502–21(c)(1)(iii) *Example 4.*

(vii) The facts are the same as in paragraphs (i) through (vi) of this *Example 4*, except that T has an additional built-in loss when it joins the P group which is recognized in Year 4. For purposes of determining the SRLY limitation for these additional losses in Year 4 (or any subsequent year), the $60 of built-in loss allowed as a deduction in Year 3 is treated under paragraph (a) of this section as a deduction in Year 3 that reduces the P group's consolidated taxable income when determined by reference to only T's items.

Example 5. Built-in loss exceeding consolidated taxable income in the year recognized. (i) Individual A owns all of the stock of P and T. During Year 1, P acquires all the stock of T from Individual A, and T becomes a member of the P group. P's acquisition of T was not an ownership change as defined by section 382(g). At the time of acquisition, T has a non-capital asset with an unrealized loss of $45 (basis $100, value $55), which exceeds the threshold requirements of section 382(h)(3)(B). During Year 2, T sells its asset for $55 and recognizes the unrealized built-in loss. The P group has $10 of consolidated taxable income in Year 2, computed by disregarding T's recognition of the $45 built-in loss and the consolidated net operating loss deduction, while the consolidated taxable income would be $25 if determined by reference to only T's items (other than the $45 loss).

(ii) T's $45 loss is recognized in Year 2 and, under paragraph (b) of this section, constitutes a built-in loss. Under paragraph (a) of this section and §1.1502–21(c)(1)(ii), the loss is treated as a net operating loss carryover to Year 2 for purposes of applying the SRLY limitation under §1.1502–21(c).

(iii) For Year 2, T's SRLY limitation is the aggregate of the P group's consolidated taxable income through Year 2 determined by reference to only T's items. For this purpose, consolidated taxable income is determined by disregarding any built-in loss that is treated as a net operating loss carryover, and any consolidated net operating loss deductions under

§1.1502–21(a). Consolidated taxable income so determined is $25.

(iv) Under §1.1502–21(c), $25 of the $45 built-in loss could be deducted in Year 2. Because the P group has only $10 of consolidated taxable income (determined without regard to the $45), the $25 loss creates a consolidated net operating loss of $15. This loss is carried back or forward under the rules of §1.1502–21(b) and absorbed under the rules of §1.1502–21(a). This loss is not treated as arising in a SRLY (see §1.1502–21(c)(1)(ii)) and therefore is not subject to the SRLY limitation under §1.1502–21(c) in any consolidated return year of the group to which it is carried. The remaining $20 is treated as a loss carryover arising in a SRLY and is subject to the limitation of §1.1502–21(c) in the year to which it is carried.

(e) *Predecessors and successors.* For purposes of this section, any reference to a corporation or member includes, as the context may require, a reference to a successor or predecessor, as defined in §1.1502–1(f)(4).

(f) *Built-in losses recognized by common parent of group*—(1) *General rule.* Paragraph (a) of this section does not apply to any loss recognized by the group on an asset held by the common parent on the date the group is formed. Following an acquisition described in §1.1502–75(d)(2) or (3), references to the common parent are to the corporation that was the common parent immediately before the acquisition.

(2) *Anti-avoidance rule.* If a corporation that becomes a common parent of a group acquires assets with a net unrealized built-in loss in excess of the threshold requirement of section 382(h)(3)(B) (and thereby increases its net unrealized built-in loss or decreases its net unrealized built-in gain) prior to, and in anticipation of, the formation of the group, paragraph (f)(1) of this section does not apply.

(g) *Overlap with section 382*—(1) *General rule.* The limitations provided in §§1.1502-21(c) and 1.1502–22(c) do not apply to recognized built-in losses or to loss carryovers or carrybacks attributable to recognized built-in losses when the application of paragraph (a) of this section results in an overlap with the application of section 382.

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in section 382, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap*—(A) An overlap of the application of paragraph (a) of this section and the application of section 382 with respect to built-in losses occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382(a) limitation that would apply with respect to the corporation's recognized built-in losses (the section 382 event). Except as provided in paragraph (g)(3) of this section, application of the overlap rule does not require that the size and composition of the corporation's net unrealized built-in loss is the same on the date of the section 382 event and the SRLY event.

(B) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(2) with respect to built-in losses, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 382 event before SRLY event.* If a SRLY event occurs on the same date as a section 382 event or within the six month period beginning on the date of the section 382 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event. Paragraph (g)(1) of this section does not apply, however, if a corporation that would otherwise be subject to the overlap rule acquires assets from a person other than a member of the group with a net unrealized built-in loss in excess of the threshold requirement of section 382(h)(3)(B) (and thereby increases its net unrealized built-in loss) after the section 382 event, and before the SRLY event.

(ii) *SRLY event before section 382 event.* If a section 382 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 382 event. However, paragraph (g)(1) of this section does not apply at any time if a corporation that otherwise would be subject to paragraph (g)(1) of this section transfers assets with an unrealized built-in loss to another member of the group after the SRLY event, but before the section 382 event, unless the corporation recognizes the built-in loss upon the transfer.

(4) *Subgroup rules.* In general, in the case of built-in losses for which there is a SRLY subgroup and the corporations joining the group at the time of the SRLY event also constitute a loss subgroup (as defined in §1.1502–91(d)(2)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies with respect to built-in losses only if—

(i) all members of the SRLY subgroup with respect to those built-in losses are also included in a loss subgroup; and

(ii) all members of a loss subgroup are also members of a SRLY subgroup with respect to those built-in losses.

(5) *Asset acquisitions.* Notwithstanding the application of this paragraph (g), paragraph (a) of this section applies to asset acquisitions by the corporation that occurs after the latter of the SRLY event and the section 382 event. See, paragraph (b)(2)(ii) of this section.

(6) *Examples.* The principles of this paragraph (g) are illustrated by the following examples:

Example 1. Determination of subgroup. (i) Individual A owns all of the stock of P, P1, and S. In Year 1, P acquires all of the stock of P1, and they file a consolidated return. In Year 3, P acquires all of the stock of S, and S joins the P group. Individual B, unrelated to Individual A, owns all of the stock of M and K, each the common parent of a consolidated group. Individual C, unrelated to either Individual A or Individual B, owns all of the stock of T.

(ii) At the beginning of Year 7, M acquires all of the stock of P from Individual A, and, as a result, P, P1, and S become members of the M group. At the time of M's acquisition of the P stock, P has a $15 net unrealized built-in loss (disregarding the stock of P1), P1 has a net unrealized built-in gain of $10, and S has a net unrealized built-in gain of $5.

(iii) During Year 8, M acquires all of the stock of T, and T joins the M group. At the time of M's acquisition of the T stock, T had an unrealized built-in loss of $15. At the beginning of Year 9, K acquires all of the stock of M from Individual B, and the members of the M consolidated group including P, P1, S, and T become members of the K group. At the time of K's acquisition of the M stock, M has (disregarding the stock of P and T) a $15 net unrealized built-in loss, P has a $20 net unrealized built-in loss (disregarding the stock of P1), P1 has a net unrealized built-in gain of $5, S has a net unrealized built-in loss of $35, and T has a $15 net unrealized built-in loss.

(iv) M's acquisition of P in Year 7 results in P, P1, and S becoming members of the M group (the SRLY event). Under paragraph (c) of this section, P and P1 compose a SRLY built-in loss subgroup because they have been affiliated for the 60 consecutive

month period immediately preceding joining the M group. S is not a member of the subgroup because on becoming a member of the M group it had not been continuously affiliated with P and P1 for the 60 month period ending immediately before it became a member of the M group. Consequently, §1.1502–15 applies to S separately from the P and P1 subgroup.

(v) Assuming that the $5 net unrealized built-in loss of the P/P1 subgroup exceeds the threshold requirement under section 382(h)(3)(B), M's acquisition of P resulted in an ownership change of P and P1 within the meaning of section 382(g) that subjects P and P1 to a limitation under section 382(a) (the section 382 event). Because, with respect to P and P1, the SRLY event and the change date of the section 382 event occur on the same date and because the loss subgroup and SRLY subgroup are coextensive, there is an overlap of the application of the SRLY rules and the application of the section 382.

(vi) S was not a loss corporation because it did not have a net operating loss carryover, or a net unrealized built-in loss, and therefore, M's acquisition of P did not result in an ownership change of S within the meaning of section 382(g). S, therefore is not subject to the overlap rule of paragraph (g) of this section.

(vii) M's acquisition of T resulted in T becoming a member of the M group (the SRLY event). Assuming that T's $15 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B), M's acquisition of T also resulted in an ownership change of T within the meaning of section 382(g) that subjects T to a limitation under section 382(a) (the section 382 event). Because, with respect to T, the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section.

(viii) K's acquisition of M results in the members of the M consolidated group, including T, P, P1, and S, becoming members of the K group (the SRLY event). Because T, P, and P1 were each included in the determination of a net unrealized built-in loss that was subject to the overlap rule described in paragraph (g)(1) of this section when they each became members of the M group, they are deemed under paragraph (c)(3) of this section to have been continuously affiliated with M for the 60 month period ending immediately before becoming a member of the M group, notwithstanding their actual affiliation history. As a result, M, T, P, and P1 compose a SRLY built-in loss subgroup under paragraph (c)(2) of this section. K's acquisition of M is not subject to paragraph (g) of this section because it does not result in a section 382 event.

(ix) S, however, is not a member of the subgroup under paragraph (c)(2) of this section. Because S was not included in the determination of a net unrealized built-in loss that was subject to the overlap rule described in paragraph (g)(1) of this section when it joined the M group, S is treated as becoming an affiliate of M on the date it joined the M group. Furthermore, under paragraph (c)(3) of this section, S is deemed to have begun its affiliation with P and P1 on the date it joined the M group. Consequently, §1.1502–15 applies to S separately to the extent its built-in loss is recognized with the recognition period.

Example 2. Post-overlap acquisition of assets. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized built-in loss of $25 (basis $75, value $50), and asset 2 has an unrealized built-in gain of $20 (basis $30, value $50). During Year 3, P buys all of the stock of T from Individual B. On January 1, Year 4, P contributes $80 cash and Individual A contributes asset 3, a depreciable asset, with a net unrealized built-in loss of $45 (basis $65, value $20), in exchange for T stock in a transaction that is described in section 351.

(ii) P's acquisition of T results in T becoming a member of the P group (the SRLY event) and also results in an ownership change of T, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event).

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382. Consequently, under paragraph (g) of this section, the limitation under paragraph (a) of this section does not apply to T's net unrealized built-in loss when it joined the P group.

(iv) Individual A's Year 4 contribution of a depreciable asset occurred after T was a member of the P group. Assuming that the amount of the net unrealized built-in loss exceeds the threshold requirement of section 382(h)(3)(B), the sale of asset 3 within the recognition period is subject to the SRLY limitation of paragraphs (a) and (b)(2)(ii) of this section.

Example 3. Overlap rule. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized loss of $55 (basis $75, value $20), and asset 2 has an unrealized gain of $30 (basis $30, value $60). On February 28 of Year 2, P purchases 55% of T from Individual B. On June 30, of Year 2, P purchases an additional 35% of T from Individual B.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T that gives rise to a section 382(a) limitation. The June 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382, and paragraph (a) of this section does not apply. Therefore, the SRLY limitation does not apply to any of the $55 loss in asset 1 recognized by T after T joined the P group. See §1.1502–94 for rules relating to the application of section 382 with respect to T's $25 unrealized built-in loss.

Example 4. Overlap rule-Fluctuation in value. (i) The facts are the same as in *Example 3*, except that by June 30, of Year 2, asset 1 had declined in value by a further $10. Thus asset 1 had an unrealized loss of $65 (basis $75, value $10), and asset 2 had an unrealized gain of $30 (basis $30, value $60).

(ii) Because paragraph (a) of this section does not apply, the further decrease in asset 1's value is disregarded. Consequently, the results are the same as in *Example 3*.

(h) *Effective date*—(1) *In general.* This section generally applies to built-in losses recognized in taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraphs (f)(1) and (g)(1) of this section do not apply to a particular built-in loss in the current group, then solely for purposes of applying paragraph (a) of this section to determine a limitation with respect to that built-in loss and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's (or subgroup's) items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), paragraph (c)(3) of this section shall not apply; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 382(a) as amended by the Tax Reform Act of 1986 applies shall constitute a section 382 event.

(2) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–15T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

§1.1502–15T [Removed]

Par. 5. Section 1.1502–15T is removed.

Par. 6. Section 1.1502–21 is added to read as follows:

§1.1502–21 Net operating losses.

(a) *Consolidated net operating loss deduction.* The consolidated net operating loss deduction (or CNOL deduction) for any consolidated return year is the aggregate of the net operating loss carryovers and carrybacks to the year. The net operating loss carryovers and carrybacks consist of—

(1) Any CNOLs (as defined in paragraph (e) of this section) of the consolidated group; and

(2) Any net operating losses of the members arising in separate return years.

(b) *Net operating loss carryovers and carrybacks to consolidated return and separate return years.* Net operating losses of members arising during a consolidated return year are taken into account in determining the group's CNOL

under paragraph (e) of this section for that year. Losses taken into account in determining the CNOL may be carried to other taxable years (whether consolidated or separate) only under this paragraph (b).

(1) *Carryovers and carrybacks generally.* The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of section 172 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. Additional rules provided under the Internal Revenue Code or regulations also apply. See, e.g., section 382(l)(2)(B) (if losses are carried from the same taxable year, losses subject to limitation under section 382 are absorbed before losses that are not subject to limitation under section 382). See *Example 2* of paragraph (c)(1)(iii) of this section for an illustration of pro rata absorption of losses subject to a SRLY limitation.

(2) *Carryovers and carrybacks of CNOLs to separate return years*—(i) *In general.* If any CNOL that is attributable to a member may be carried to a separate return year of the member, the amount of the CNOL that is attributable to the member is apportioned to the member (apportioned loss) and carried to the separate return year. If carried back to a separate return year, the apportioned loss may not be carried back to an equivalent, or earlier, consolidated return year of the group; if carried over to a separate return year, the apportioned loss may not be carried over to an equivalent, or later, consolidated return year of the group. For rules permitting the reattribution of losses of a subsidiary to the common parent when loss is disallowed on the disposition of subsidiary stock, see §1.1502–20(g).

(ii) *Special rules*—(A) *Year of departure from group.* If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, and only the amount so attributable that is not absorbed by the group in that year is carried to the corporation's first separate return year. For rules concerning a member departing a subgroup, see paragraph (c)(2)-(vii) of this section.

(B) *Offspring rule.* In the case of a member that has been a member continuously since its organization (determined without regard to whether the member is a successor to any other corporation), the CNOL attributable to the member is included in the carrybacks to consolidated return years before the member's existence. If the group did not file a consolidated return for a carryback year, the loss may be carried back to a separate return year of the common parent under paragraph (b)(2)(i) of this section, but only if the common parent was not a member of a different consolidated group or of an affiliated group filing separate returns for the year to which the loss is carried or any subsequent year in the carryback period. Following an acquisition described in §1.1502–75(d)(2) or (3), references to the common parent are to the corporation that was the common parent immediately before the acquisition.

(iii) *Equivalent years.* Taxable years are equivalent if they bear the same numerical relationship to the consolidated return year in which a CNOL arises, counting forward or backward from the year of the loss. For example, in the case of a member's third taxable year (which was a separate return year) that preceded the consolidated return year in which the loss arose, the equivalent year is the third consolidated return year preceding the consolidated return year in which the loss arose. See paragraph (b)(3)(iii) of this section for certain short taxable years that are disregarded in making this determination.

(iv) *Amount of CNOL attributable to a member.* The amount of a CNOL that is attributable to a member is determined by a fraction the numerator of which is the separate net operating loss of the member for the year of the loss and the denominator of which is the sum of the separate net operating losses for that year of all members having such losses. For this purpose, the separate net operating loss of a member is determined by computing the CNOL by reference to only the member's items of income, gain, deduction, and loss, including the member's losses and deductions actually absorbed by the group in the taxable year (whether or not absorbed by the member).

(v) *Examples.* For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this paragraph (b)(2) are illustrated by the following examples:

Example 1. Offspring rule. (i) During Year 1, Individual A forms P and T, and they each file a separate return. P forms S on March 15 of Year 2, and P and S file a consolidated return. P acquires all the stock of T from Individual A at the beginning of Year 3, and T becomes a member of the P group. P's acquisition of T is not an ownership change within the meaning of section 382. P, S, and T sustain a $1,100 CNOL in Year 3 and, under paragraph (b)(2)(iv) of this section, the loss is attributable $200 to P, $300 to S, and $600 to T.

(ii) Of the $1,100 CNOL in Year 3, the $500 amount of the CNOL that is attributable to P and S ($200 + $300) may be carried to P's separate return in Year 1. Even though S was not in existence in Year 1, the $300 amount of the CNOL attributable to S may be carried back to P's separate return in Year 1 because S (unlike T) has been a member of the P group since its organization and P is a qualified parent under paragraph (b)(2)(ii)(B) of this section. To the extent not absorbed in that year, the loss may then be carried to the P group's return in Year 2. The $600 amount of the CNOL attributable to T is a net operating loss carryback to T's separate return in Year 1, and if not absorbed in Year 1, then to Year 2.

Example 2. Departing members. (i) The facts are the same as in *Example 1.* In addition, on June 15 of Year 4, P sells all the stock of T. The P group's consolidated return for Year 4 includes the income of T through June 15. T files a separate return for the period from June 16 through December 31.

(ii) $600 of the Year 3 CNOL attributable to T is apportioned to T and is carried back to its separate return in Year 1. To the extent the $600 is not absorbed in T's separate return in Year 1 or Year 2, it is carried to the consolidated return in Year 4 before being carried to T's separate return in Year 4. Any portion of the loss not absorbed in T's Year 1 or Year 2 or in the P group's Year 4 is then carried to T's separate return in Year 4.

Example 3. Offspring rule following acquisition. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. In Year 1, B, an individual unrelated to Individual A, forms T. P acquires all of the stock of T at the beginning of Year 3, and T becomes a member of the P group. The P group has $200 of consolidated taxable income in Year 2, and $300 of consolidated taxable income in Year 3 (computed without regard to the CNOL deduction). At the beginning of Year 4, T forms a subsidiary, Y, in a transaction described in section 351. The P group has a $300 consolidated net operating

loss in Year 4, and under paragraph (b)(2)(iv) of this section, the loss is attributable entirely to Y.

(ii) Even though Y was not in existence in Year 2, $300, the amount of the consolidated net operating loss attributable to Y, may be carried back to the P group's Year 2 consolidated return under paragraph (b)(2)(ii)(B) of this section because Y has been a member of the P group since its organization. To the extent not absorbed in that year, the loss may then be carried to the P group's consolidated return in Year 3

(3) *Special rules*—(i) *Election to relinquish carryback.* A group may make an irrevocable election under section 172(b)(3) to relinquish the entire carryback period with respect to a CNOL for any consolidated return year. Except as provided in paragraph (b)(3)(ii)(B) of this section, the election may not be made separately for any member (whether or not it remains a member), and must be made in a separate statement entitled "THIS IS AN ELECTION UNDER SECTION 1.1502–21(b)(3)(i) TO WAIVE THE ENTIRE CARRYBACK PERIOD PURSUANT TO SECTION 172(b)(3) FOR THE [insert consolidated return year] CNOLs OF THE CONSOLIDATED GROUP OF WHICH [insert name and employer identification number of common parent] IS THE COMMON PARENT." The statement must be signed by the common parent and filed with the group's income tax return for the consolidated return year in which the loss arises.

(ii) *Special elections*—(A) *Groups that include insolvent financial institutions.* For rules applicable to relinquishing the entire carryback period with respect to losses attributable to insolvent financial institutions, see §301.6402–7 of this chapter.

(B) *Acquisition of member from another consolidated group.* If one or more members of a consolidated group becomes a member of another consolidated group, the acquiring group may make an irrevocable election to relinquish, with respect to all consolidated net operating losses attributable to the member, the portion of the carryback period for which the corporation was a member of another group, provided that any other corporation joining the acquiring group that was affiliated with the member immediately before it joined the acquiring group is also included in the waiver. This election is not a yearly election and applies to all losses that would otherwise be subject to a carryback to a former group under section 172. The election must be made in a separate statement entitled "THIS IS AN ELECTION UNDER SECTION 1.1502–21(b)(3)(ii)(B) TO WAIVE THE PRE-[insert first taxable year for which the member (or members) was not a member of another group] CARRYBACK PERIOD FOR THE CNOLs attributable to [insert names and employer identification number of members]." The statement must be filed with the acquiring consolidated group's original income tax return for the year the corporation (or corporations) became a member, and it must be signed by the common parent and each of the members to which it applies.

(iii) *Short years in connection with transactions to which section 381(a) applies.* If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net operating loss may be carried.

(iv) *Special status losses.* [Reserved]

(c) *Limitations on net operating loss carryovers and carrybacks from separate return limitation years*—(1) *SRLY limitation*—(i) *General rule.* Except as provided in paragraph (g) of this section (relating to an overlap with section 382), the aggregate of the net operating loss carryovers and carrybacks of a member arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate consolidated taxable income for all consolidated return years of the group determined by reference to only the member's items of income, gain, deduction, and loss. For this purpose—

(A) Consolidated taxable income is computed without regard to CNOL deductions;

(B) Consolidated taxable income takes into account the member's losses and deductions (including capital losses) actually absorbed by the group in consolidated return years (whether or not absorbed by the member);

(C) In computing consolidated taxable income, the consolidated return years of the group include only those years, including the year to which the loss is carried, that the member has been continuously included in the group's consolidated return, but exclude—

(*1*) For carryovers, any years ending after the year to which the loss is carried; and

(*2*) For carrybacks, any years ending after the year in which the loss arose; and

(D) The treatment under §1.1502–15 of a built-in loss as a hypothetical net operating loss carryover in the year recognized is solely for purposes of determining the limitation under this paragraph (c) with respect to the loss in that year and not for any other purpose. Thus, for purposes of determining consolidated taxable income for any other losses, a built-in loss allowed under this section in the year it arises is taken into account.

(ii) *Losses treated as arising in SRLYs.* If a net operating loss carryover or carryback did not arise in a SRLY but is attributable to a built-in loss (as defined under §1.1502–15), the carryover or carryback is treated for purposes of this paragraph (c) as arising in a SRLY if the built-in loss was not allowed, after application of the SRLY limitation, in the year it arose. For an illustration, see §1.1502–15(d), *Example 5.* But see §1.1502–15(g)(1).

(iii) *Examples.* The principles of this paragraph (c)(1) are illustrated by the following examples:

Example 1. Determination of SRLY limitation. (i) Individual A owns P. In Year 1, Individual A forms T, and T sustains a $100 net operating loss that is carried forward. P acquires all the stock of T at the beginning of Year 2, and T becomes a member of the P group. The P group has $300 of consolidated taxable income in Year 2 (computed without regard to the CNOL deduction). Such consolidated taxable income would be $70 if determined by reference to only T's items.

(ii) T's $100 net operating loss carryover from Year 1 arose in a SRLY. See §1.1502–1(f)(2)(iii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, the $100 net operating loss carryover is subject to the SRLY limitation in paragraph (c)(1) of this section. The SRLY limitation for Year 2 is consolidated taxable income determined by reference to only T's items, or $70. Thus, $70 of the loss is included under paragraph (a) of this section in the P group's CNOL deduction for Year 2.

(iii) The facts are the same as in paragraph (i) of this *Example 1*, except that such consolidated taxable income (computed without regard to the CNOL deduction and by reference to only T's items) for Year 2 is a loss (a CNOL) of $370. Because the SRLY limitation may not exceed the consolidated

taxable income determined by reference to only T's items, and such items aggregate to a CNOL, T's $ 100 net operating loss carryover from Year 1 is not allowed under the SRLY limitation in Year 2. Moreover, if consolidated taxable income (computed without regard to the CNOL deduction and by reference to only T's items) did not exceed $370 in Year 3, the carryover would still be restricted under paragraph (c) of this section in Year 3, because the aggregate consolidated taxable income for all consolidated return years of the group computed by reference to only T's items would not be a positive amount.

Example 2. Net operating loss carryovers. (i) In Year 1, Individual A forms P, and P sustains a $40 net operating loss that is carried forward. P has no income in Year 2. Individual A also owns T which sustains a net operating loss of $50 in Year 2 that is carried forward. P acquires the stock of T from Individual A during Year 3, but T is not a member of the P group for each day of the year. P and T file separate returns and sustain net operating losses of $120 and $60, respectively, for Year 3. The P group files consolidated returns beginning in Year 4. During Year 4, the P group has $160 of consolidated taxable income (computed without regard to the CNOL deduction). Such consolidated taxable income would be $70 if determined by reference to only T's items. These results are summarized as follows:

	Separate Year 1	Separate Year 2	Separate/ Affiliated Year 3	Consolidated Year 4
P	$(40)	$0	$(120)	$90
T	0	(50)	(60)	70
CTI				160

(ii) P's Year 1, Year 2, and Year 3 are not SRLYs with respect to the P group. See §1.1502–1(f)(2)(i). Thus, P's $ 40 net operating loss arising in Year 1 and $120 net operating loss arising in Year 3 are not subject to the SRLY limitation under paragraph (c) of this section. Under the principles of section 172, paragraph (b) of this section requires that the loss arising in Year 1 be the first loss absorbed by the P group in Year 4. Absorption of this loss leaves $120 of the group's consolidated taxable income available for offset by other loss carryovers.

(iii) T's Year 2 and Year 3 are SRLYs with respect to the P group. See §1.1502–1(f)(2)(ii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, T's $50 net operating loss arising in Year 2 and $60 net operating loss arising in Year 3 are subject to the SRLY limitation. Under paragraph (c)(1) of this section, the SRLY limitation for Year 4 is $70, and under paragraph (b) of this section, T's $50 loss from Year 2 must be included under paragraph (a) of this section in the P group's CNOL deduction for Year 4. The absorption of this loss leaves $70 of the group's consolidated taxable income available for offset by other loss carryovers.

(iv) P and T each carry over net operating losses to Year 4 from a taxable year ending on the same date (Year 3). The losses carried over from Year 3 total $180. Under paragraph (b) of this section, the losses carried over from Year 3 are absorbed on a pro rata basis, even though one arises in a SRLY and the other does not. However, the group cannot absorb more than $20 of T's $60 net operating loss arising in Year 3 because its $70 SRLY limitation for Year 4 is reduced by T's $50 Year 2 SRLY loss already included in the CNOL deduction for Year 4. Thus, the absorption of Year 3 losses is as follows:

Amount of P's Year 3 losses absorbed = $120/($120 + $20) × $70 = $60.

Amount of T's Year 3 losses absorbed = $20/($120 + $20) × $70 = $10.

(v) The absorption of $10 of T's Year 3 loss further reduces T's SRLY limitation to $10 ($70 of initial SRLY limitation, reduced by the $60 net operating loss already included in the CNOL deductions for Year 4 under paragraph (a) of this section).

(vi) P carries its remaining $60 Year 3 net operating loss and T carries its remaining $50 Year 3 net operating loss over to Year 5. Assume that, in Year 5, the P group has $90 of consolidated taxable income (computed without regard to the CNOL deduction). The group's CTI determined by reference to only T's items is a CNOL of $4. For Year 5, the CNOL deduction is $66, which includes $60 of P's Year 3 loss and $6 of T's Year 3 loss (the aggregate consolidated taxable income for Years 4 and 5 determined by reference to T's items, or $66, reduced by T's SRLY losses actually absorbed by the group in Year 4, or $60).

Example 3. Net operating loss carrybacks. (i) P owns all of the stock of S and T. The members of the P group contribute the following to the consolidated taxable income of the P group for Years 1, 2, and 3:

	Year 1	Year 2	Year 3	Total
P	$100	$60	$80	$240
S	20	20	30	70
T	30	10	(50)	(10)
CTI	150	90	60	300

(ii) P sells all of the stock of T to Individual A at the beginning of Year 4. For its Year 4 separate return year, T has a net operating loss of $30.

(iii) T's Year 4 is a SRLY with respect to the P group. See §1.1502–1(f)(1). T's $30 net operating loss carryback to the P group from Year 4 is not allowed under paragraph (c) of this section to be included in the CNOL deduction under paragraph (a) of this section for Year 1, 2, or 3, because the P group's consolidated taxable income would not be a positive amount if determined by reference to only T's items for all consolidated return years through Year 4 (without regard to the $30 net operating loss). The $30 loss is carried forward to T's Year 5 and succeeding taxable years as provided under the Internal Revenue Code.

Example 4. Computation of SRLY limitation for built-in losses treated as net operating loss carryovers. (i) Individual A owns P. In Year 1, Individual A forms T by contributing $300 and T sustains a $100 net operating loss. During Year 2, T's assets decline in value by $100. At the beginning of Year 3, P acquires all the stock of T from Individual A, and T becomes a member of the P group in a transaction that does not result in an ownership change under section 382(g). At the time of the acquisition, T has a $100 net unrealized built-in loss, which exceeds the threshold requirements of section 382(h)(3)(B). During Year 3, T recognizes its unrealized loss as a $100 ordinary loss. The members of the P group contribute the following to the consolidated taxable income of the P group for Years 3 and 4 (computed without regard to T's recognition of its unrealized loss and any CNOL deduction under this section):

	Year 3	Year 4	Total
P group (without T)	$100	$100	$200
T	60	40	100
CTI	160	140	300

(ii) Under §1.1502–15(a), T's $100 of ordinary loss in Year 3 constitutes a built-in loss that is subject to the SRLY limitation under paragraph (c) of this section. The amount of the limitation is determined by treating the deduction as a net operating loss carryover from a SRLY. The built-in loss is therefore subject to a $60 SRLY limitation for Year 3. The built-in loss is treated as a net operating loss carryover solely for purposes of determining the extent to which the loss is not allowed by reason of the SRLY limitation, and for all other purposes the loss remains a loss arising in Year 3. Consequently, under paragraph (b) of this section, the $60 allowed under the SRLY limitation is absorbed by the P group before T's $100 net operating loss carryover from Year 1 is allowed.

(iii) Under §1.1502–15(a), the $40 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation is treated as a $40 net operating loss arising in Year 3 that is subject to the SRLY limitation because, under paragraph (c)(1)(ii) of this section, Year 3 is treated as a SRLY, and is carried to other years in accordance with the rules of paragraph (b) of this section. The SRLY limitation for Year 4 is the P group's consolidated taxable income for Year 3 and Year 4 determined by reference to only T's items and without regard to the group's CNOL deductions ($60 + $40), reduced by T's loss actually absorbed by the group in Year 3 ($60). The SRLY limitation for Year 4 is $40.

(iv) Under paragraph (c) of this section and the principles of section 172(b), $40 of T's $100 net operating loss carryover from Year 1 is included in the CNOL deduction under paragraph (a) of this section in Year 4.

Example 5. Dual SRLY registers and accounting for SRLY losses actually absorbed. (i) In Year 1, T sustains a $ 100 net operating loss and a $50 net capital loss. At the beginning of Year 2, T becomes a member of the P group in a transaction that does not result in an ownership change under section 382(g). Both of T's carryovers from Year 1 are subject to SRLY limits under this paragraph (c) and §1.1502–22(c). The members of the P group contribute the following to the consolidated taxable income for Years 2 and 3 (computed without regard to T's CNOL deduction under this section or net capital loss carryover under §1.1502–22):

	P	T
Year 1 (SRLY)		
Ordinary		(100)
Capital		(50)
Year 2		
Ordinary	30	60
Capital	0	(20)
Year 3		
Ordinary	10	40
Capital	0	30

(ii) For Year 2, the group computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group determines its ability to use its capital loss carryover before it determines its ability

to use its ordinary loss carryover. Under section 1212, because the group has no Year 2 capital gain, it cannot absorb any capital losses in Year 2. T's Year 1 net capital loss and the group's Year 2 consolidated net capital loss (all of which is attributable to T) are carried over to Year 3.

(iii) Under this section, the aggregate amount of T's $100 net operating loss carryover from Year 1 that may be included in the CNOL deduction of the group for Year 2 may not exceed $60 — the amount of the consolidated taxable income computed by reference only to T's items, including losses and deductions to the extent actually absorbed (i.e., $60 of T's ordinary income for Year 2). Thus, the group may include $60 of T's ordinary loss carryover from Year 1 in its Year 2 CNOL deduction. T carries over its remaining $40 of its Year 1 loss to Year 3.

(iv) For Year 3, the group again computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group has consolidated net capital gain (without taking into account a net capital loss carryover deduction) of $30. Under §1.1502–22(c), the aggregate amount of T's $50 capital loss carryover from Year 1 that may be included in computing the group's consolidated net capital gain for all years of the group (here Years 2 and 3) may not exceed $30 (the aggregate consolidated net capital gain computed by reference only to T's items, including losses and deductions actually absorbed (i.e., $30 of capital gain in Year 3)). Thus, the group may include $30 of T's Year 1 capital loss carryover in its computation of consolidated net capital gain for Year 3, which offsets the group's capital gains for Year 3. T carries over its remaining $20 of its Year 1 loss to Year 4. The group carries over the Year 2 consolidated net capital loss to Year 4.

(v) Under this section, the aggregate amount of T's net operating loss carryover from Year 1 that may be included in the CNOL deduction of the group for Years 2 and 3 may not exceed $100, which is the amount of the aggregate consolidated taxable income for Years 2 and 3 determined by reference only to T's items, including losses and deductions actually absorbed (i.e., $60 of ordinary income in Year 2 plus $40 of ordinary income, $30 of capital gain, and $30 of SRLY capital losses actually absorbed in Year 3). The group included $60 of T's ordinary loss carryover in its Year 2 CNOL deduction. It may include the remaining $40 of the carryover in its Year 3 CNOL deduction.

(2) *SRLY subgroup limitation.* In the case of a net operating loss carryover or carryback for which there is a SRLY subgroup, the principles of paragraph (c)(1) of this section apply to the SRLY subgroup, and not separately to its members. Thus, the contribution to consolidated taxable income and the net operating loss carryovers and carrybacks arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section are based on the aggregate amounts of income, gain, deduction, and loss of the members of the SRLY subgroup for the relevant consolidated return years (as provided in paragraph (c)(1)(i)(C) of this section). For an illustration of aggregate amounts during the relevant consolidated return years following the year in which a member of a SRLY subgroup ceases to be a member of the group, see paragraph (c)(2)(viii) *Example 4* of this section. A SRLY subgroup may exist only for a carryover or carryback arising in a year that is not a SRLY (and is not treated as a SRLY under paragraph (c)(1)(ii) of this section) with respect to another group (the former group), or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group). A separate SRLY subgroup is determined for each such carryover or carryback. A consolidated group may include more than one SRLY subgroup and a member may be a member of more than one SRLY subgroup. Solely for purposes of determining the members of a SRLY subgroup with respect to a loss:

(i) *Carryovers.* In the case of a carryover, the SRLY subgroup is composed of the member carrying over the loss (the loss member) and each other member that was a member of the former group that becomes a member of the group at the same time as the loss member. A member remains a member of the SRLY subgroup until it ceases to be affiliated with the loss member. The aggregate determination described in paragraph (c)(1) of this section and this paragraph (c)(2) includes the amounts of income, gain, deduction, and loss of each member of the SRLY subgroup for the consolidated return years during which it remains a member of the SRLY subgroup. For an illustration of the aggregate determination of a SRLY subgroup, see paragraph (c)(2)(viii) *Example 2* of this section.

(ii) *Carrybacks.* In the case of a carryback, the SRLY subgroup is composed of the member carrying back the loss (the loss member) and each other member of the group from which the loss is carried back that has been continuously affiliated with the loss member from the year to which the loss is carried through the year in which the loss arises.

(iii) *Built-in losses.* In the case of a built-in loss, the SRLY subgroup is composed of the member recognizing the loss (the loss member) and each other member that was part of the subgroup with respect to the loss determined under §1.1502–15(c)(2) immediately before the members became members of the group. The principles of paragraphs (c)(2)(i) and (ii) of this section apply to determine the SRLY subgroup for the built-in loss that is, under paragraph (c)(1)(ii) of this section, treated as arising in a SRLY with respect to the group in which the loss is recognized. For this purpose and as the context requires, a reference in paragraphs (c)(2)(i) and (ii) of this section to a group or former group is a reference to the subgroup determined under §1.1502–15(c)(2).

(iv) *Principal purpose of avoiding or increasing a SRLY limitation.* The members composing a SRLY subgroup are not treated as a SRLY subgroup if any of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, this paragraph (c). Any member excluded from a SRLY subgroup, if excluded with a principal purpose of so avoiding or increasing any SRLY limitation, is treated as included in the SRLY subgroup.

(v) *Coordination with other limitations.* This paragraph (c)(2) does not allow a net operating loss to offset income to the extent inconsistent with other limitations or restrictions on the use of losses, such as a limitation based on the nature or activities of members. For example, any dual consolidated loss may not reduce the taxable income to an extent greater than that allowed under section 1503(d) and §1.1503–2. See also §1.1502–47(q) (relating to preemption of rules for life-nonlife groups).

(vi) *Anti-duplication.* If the same item of income or deduction could be taken into account more than once in determining a limitation under this paragraph (c), or in a manner inconsistent with any other provision of the Internal Revenue Code or regulations incorporating this paragraph (c), the item of income or deduction is taken into account only once and in such manner that losses are absorbed in accordance with the ordering rules in paragraph (b) of this section and the underlying purposes of this section.

(vii) *Corporations that leave a SRLY subgroup.* If a loss member ceases to be affiliated with a SRLY subgroup, the

amount of the member's remaining SRLY loss from a specific year is determined by multiplying the aggregate of the unabsorbed net operating loss carryovers of the SRLY subgroup from that year by a fraction, the numerator of which is the net operating loss carryover for that year that the member leaving the subgroup had when it became a member of the group, and the denominator of which is the aggregate of the net operating loss carryovers of the members of the SRLY subgroup for that year when they joined the group. The unabsorbed net operating loss carryovers of the SRLY subgroup are those carryovers that have not been absorbed by the group as of the end of the taxable year in which the loss member leaves the group.

(viii) *Examples.* The principles of this paragraph (c)(2) are illustrated by the following examples:

Example 1. Members of SRLY subgroups. (i) Individual A owns all of the stock of P, S, T and M. P and M are each common parents of a consolidated group. During Year 1, P sustains a $50 net operating loss. At the beginning of Year 2, P acquires all the stock of S at a time when the aggregate basis of S's assets exceeds their aggregate value by $70 and S becomes a member of the P group. At the beginning of Year 3, P acquires all the stock of T, T has a $60 net operating loss carryover at the time of the acquisition, and T becomes a member of the P group. During Year 4, S forms S1 and T forms T1, each by contributing assets with built-in gains which are, in the aggregate, material. S1 and T1 become members of the P group. During Year 7, M acquires all of the stock of P, and the members of the P group become members of the M group for the balance of Year 7. The $50 and $60 loss carryovers of P and T are carried to Year 7 of the M group, and the value and basis of S's assets did not change after it became a member of the former P group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) Under paragraph (c)(2) of this section, a separate SRLY subgroup is determined for each loss carryover and built-in loss. In the P group, P's $50 loss carryover is not treated as arising in a SRLY. See §1.1502–1(f). Consequently, the carryover is not subject to limitation under paragraph (c) of this section in the P group.

(iii) In the M group, P's $50 loss carryover is treated as arising in a SRLY and is subject to the limitation under paragraph (c) of this section. A SRLY subgroup with respect to that loss is composed of members which were members of the P group, the group as to which the loss was not a SRLY. The SRLY subgroup is composed of P, the member carrying over the loss, and each other member of the P group that became a member of the M group at the same time as P. A member of the SRLY subgroup remains a member until it ceases to be affiliated with P. For Year 7, the SRLY subgroup is composed of P, S, T, S1, and T1.

(iv) In the P group, S's $70 unrealized loss, if recognized within the 5-year recognition period after S becomes a member of the P group, is subject to limitation under paragraph (c) of this section. See §1.1502–15 and paragraph (c)(1)(ii) of this section. Because S was not continuously affiliated with P, T, or T1 for 60 consecutive months prior to joining the P group, these corporations cannot be included in a SRLY subgroup with respect to S's unrealized loss in the P group. See paragraph (c)(2)(iii) of this section. As a successor to S, S1 is included in a subgroup with S in the P group, and because 100 percent of S1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the P group, its net positive income is not excluded from the consolidated taxable income of the P group that may be offset by the built-in loss. See paragraph (f) of this section.

(v) In the M group, S's $70 unrealized loss, if recognized within the 5-year recognition period after S becomes a member of the M group, is subject to limitation under paragraph (c) of this section. Prior to becoming a member of the M group, S had been continuously affiliated with P (but not T or T1) for 60 consecutive months and S1 is a successor that has remained continuously affiliated with S. Those members had a net unrealized built-in loss immediately before they became members of the group under §1.1502–15(c). Consequently, in Year 7, S, S1, and P compose a subgroup in the M group with respect to S's unrealized loss. Because S1 was a member of the SRLY subgroup when it became a member of the M group and also because 100 percent of S1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the M group its net positive income is not excluded from the consolidated taxable income of the M group that may be offset by the recognized built-in loss. See paragraph (f) of this section.

(vi) In the P group, T's $60 loss carryover arose in a SRLY and is subject to limitation under paragraph (c) of this section. P, S, and S1 were not members of the group in which T's loss arose and T's loss carryover was not subject to the overlap rule described in paragraph (g) of this section with respect to the P group (the former group). Thus, P, S, and S1 are not members of a SRLY subgroup with respect to the T carryover in the P group. See paragraph (c)(2)(i) of this section. As a successor to T, T1 is included in a SRLY subgroup with T in the P group; and, because 100 percent of T1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the P group, its net positive income is not excluded from the consolidated taxable income of the P group that may be offset by the carryover. See paragraph (f) of this section.

(vii) In the M group, T's $60 loss carryover arose in a SRLY and is subject to limitation under paragraph (c) of this section. T and T1 remain the only members of a SRLY subgroup with respect to the carryover. Because T1 was a member of the SRLY subgroup when it became a member of the M group and also because 100 percent of T1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the M group, its net positive income is not excluded from the consolidated taxable income of the M group that may be offset by the carryover. See paragraph (f) of this section.

Example 2. Computation of SRLY subgroup limitation. (i) Individual A owns all of the stock of S, T, P and M. P and M are each common parents of a consolidated group. In Year 2, P acquires all the stock of S and T from Individual A, and S and T become members of the P group. For Year 3, the P group has a $45 CNOL, which is attributable to P, and which P carries forward. M is the common parent of another group. At the beginning of Year 4, M acquires all of the stock of P and the former members of the P group become members of the M group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) P's year to which the loss is attributable, Year 3, is a SRLY with respect to the M group. See §1.1502–1(f)(1). However, P, S, and T compose a SRLY subgroup with respect to the Year 3 loss under paragraph (c)(2)(i) of this section because Year 3 is not a SRLY (and is not treated as a SRLY) with respect to the P group. P's loss is carried over to the M group's Year 4 and is therefore subject to the SRLY subgroup limitation in paragraph (c)(2) of this section.

(iii) In Year 4, the M group has $10 of consolidated taxable income (computed without regard to the CNOL deduction for Year 4). Such consolidated taxable income would be $45 if determined by reference to only the items of P, S, and T, the members included in the SRLY subgroup with respect to P's loss carryover. Therefore, the SRLY subgroup limitation under paragraph (c)(2) of this section for P's net operating loss carryover from Year 3 is $45. Because the M group has only $10 of consolidated taxable income in Year 4, however, only $10 of P's net operating loss carryover is included in the CNOL deduction under paragraph (a) of this section in Year 4.

(iv) In Year 5, the M group has $100 of consolidated taxable income (computed without regard to the CNOL deduction for Year 5). Neither P, S, nor T has any items of income, gain, deduction, or loss in Year 5. Although the members of the SRLY subgroup do not contribute to the $100 of consolidated taxable income in Year 5, the SRLY subgroup limitation for Year 5 is $35 (the sum of SRLY subgroup consolidated taxable income of $45 in Year 4 and $0 in Year 5, less the $10 net operating loss carryover actually absorbed by the M group in Year 4). Therefore, $35 of P's net operating loss carryover is included in the CNOL deduction under paragraph (a) of this section in Year 5.

Example 3. Inclusion in more than one SRLY subgroup. (i) Individual A owns all of the stock of S, T, P and M. S, P and M are each common parents of a consolidated group. At the beginning of Year 1, S acquires all the stock of T from Individual A, and T becomes a member of the S group. For Year 1, the S group has a CNOL of $10, all of which is attributable to S and is carried over to Year 2. At the beginning of Year 2, P acquires all the stock of S, and S and T become members of the P group. For Year 2, the P group has a CNOL of $35, all of which is attributable to P and is carried over to Year 3. At the beginning of Year 3, M acquires all of the stock of P and the former members of the P group become members of the M group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) P's and S's net operating losses arising in SRLYs with respect to the M group are subject to limitation under paragraph (c) of this section. P, S, and T compose a SRLY subgroup for purposes of determining the limitation for P's $35 net operating loss carryover arising in Year 2 because, under paragraph (c)(2)(i) of this section, Year 2 is not a SRLY with respect to the P group. Similarly, S and T compose a SRLY subgroup for purposes of determining the limitation for S's $10 net operating loss carryover arising in Year 1 because Year 1 is not a SRLY with respect to the S group.

(iii) S and T are members of both the SRLY subgroup with respect to P's losses and the SRLY subgroup with respect to S's losses. Under paragraph (c)(2) of this section, S's and T's items cannot be included in the determination of the SRLY subgroup limitation for both SRLY subgroups for the same consolidated return year; paragraph (c)(2)(vi) of this section requires the M group to consider the items of S and T only once so that the losses are absorbed in the order of the taxable years in which they were sustained. Because S's loss was incurred in Year 1, while P's loss was incurred in Year 2, the items will be added in the determination of the consolidated taxable income of the S and T SRLY subgroup to enable S's loss to be absorbed first. The taxable income of the P, S, and T SRLY subgroup is then computed by including the consolidated taxable income for the S and T SRLY subgroup less the amount of any net operating loss carryover of S that is absorbed after applying this section to the S subgroup for the year.

Example 4. Corporation ceases to be affiliated with a SRLY subgroup. (i) Individual A owns all of the stock of P and M. P and S are members of the P group and the P group has a CNOL of $30 in Year 1, all of which is attributable to P and carried over to Year 2. At the beginning of Year 2, M acquires all of the stock of P, and P and S become members of the M group. P and S compose a SRLY subgroup with respect to P's net operating loss carryover. For Year 2, consolidated taxable income of the M group determined by reference to only the items of P (and without regard to the CNOL deduction for Year 2) is $40. However, such consolidated taxable income of the M group determined by reference to the items of both P and S is a loss of $20. Thus, the SRLY subgroup limitation under paragraph (c)(2) of this section prevents the M group from including any of P's net operating loss carryover in the CNOL deduction under paragraph (a) of this section in Year 2, and P carries the Year 1 loss to Year 3.

(ii) At the end of Year 2, P sells all of the S stock and S ceases to be a member of the M group and the P subgroup. For Year 3, consolidated taxable income of the M group is $50 (determined without regard to the CNOL deduction for Year 3), and such consolidated taxable income would be $10 if determined by reference to only items of P. However, the limitation under paragraph (c) of this section for Year 3 for P's net operating loss carryover still prevents the M group from including any of P's loss in the CNOL deduction under paragraph (a) of this section. The limitation results from the inclusion of S's items for Year 2 in the determination of the SRLY subgroup limitation for Year 3 even though S ceased to be a member of the M group (and the P subgroup) at the end of Year 2. Thus, the M group's consolidated taxable income determined by reference to only the SRLY subgroup members' items for all consolidated return years of the group through Year 3 (determined without regard to the CNOL deduction) is not a positive amount.

(ix) *Application to other than loss carryovers.* Paragraph (g) of this section and the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502-15(g) with respect to another group (the former group)" in paragraph (c)(2) of this section apply only to net operating loss carryovers and net capital loss carryovers, and not with respect to other tax attributes, such as credits. Accordingly, as the context may require, if another regulation references this section and such other regulation does not concern net operating loss carryovers or net capital loss carryovers, then such reference does not include a reference to such paragraph or phrase.

(d) *Coordination with consolidated return change of ownership limitation and transactions subject to old section 382*—(1) *Consolidated return changes of ownership.* If a consolidated return change of ownership occurred before January 1, 1997, the principles of §1.1502–21A(d) apply to determine the amount of the aggregate of the net operating losses attributable to old members of the group that may be included in the consolidated net operating loss deduction under paragraph (a) of this section. For this purpose, §1.1502–1(g) is applied by treating that date as the end of the year of change.

(2) *Old section 382.* The principles of §1.1502–21A(e) apply to disallow or reduce the amount of a net operating loss carryover of a member as a result of a transaction subject to old section 382.

(e) *Consolidated net operating loss.* Any excess of deductions over gross income, as determined under §1.1502–11(a) (without regard to any consolidated net operating loss deduction), is also referred to as the consolidated net operating loss (or CNOL).

(f) *Predecessors and successors*—(1) *In general.* For purposes of this section, any reference to a corporation, member, common parent, or subsidiary, includes, as the context may require, a reference to a successor or predecessor, as defined in §1.1502–1(f)(4).

(2) *Limitation on SRLY subgroups*—(i) *General rule.* Except as provided in paragraph (f)(2)(ii) of this section, if a successor's items of income and gain exceed the successor's items of deduction and loss (net positive income), then the net positive income attributable to the successor is excluded from the computation of the consolidated taxable income of a SRLY subgroup.

(ii) *Exceptions.* A successor's net positive income is not excluded from the consolidated taxable income of a SRLY subgroup if—

(A) The successor acquires substantially all the assets and liabilities of its predecessor and the predecessor ceases to exist;

(B) The successor was a member of the SRLY subgroup when the SRLY subgroup members became members of the group;

(C) 100 percent of the stock of the successor is owned directly by corporations that were members of the SRLY subgroup when the SRLY subgroup members became members of the group; or

(D) The Commissioner so determines.

(g) *Overlap with section 382*—(1) *General rule.* The limitation provided in paragraph (c) of this section does not apply to net operating loss carryovers (other than a hypothetical carryover described in paragraph (c)(1)(i)(D) of this section and a carryover described in paragraph (c)(1)(ii) of this section) when the application of paragraph (c) of this section results in an overlap with the application of section 382. For a similar rule applying in the case of net operating loss carryovers described in paragraphs (c)(1)(i)(D) and (c)(1)(ii) of this section, see §1.1502–15(g).

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in section 382, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap*—(A) An overlap of the application of paragraph (c) of this section and the application of section 382 with respect to a net operating loss carryover occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382(a) limitation with respect to that carryover (the section 382 event).

(B) If an overlap described in paragraph (g)(2)(ii)(A) of this section occurs

with respect to net operating loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 382 event, then an overlap is treated as also occurring with respect to that corporation's net operating loss carryover that arises within the period beginning with the section 382 event and ending with the SRLY event.

(C) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(1) with respect to a carryover, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 382 event before SRLY event.* If a SRLY event occurs on the same date as a section 382 event or within the six month period beginning on the date of the section 382 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event.

(ii) *SRLY event before section 382 event.* If a section 382 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 382 event.

(4) *Subgroup rules.* In general, in the case of a net operating loss carryover for which there is a SRLY subgroup and a loss subgroup (as defined in §1.1502–91(d)(1)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies—

(i) With respect to a carryover described in paragraph (g)(2)(ii)(A) of this section only if—

(A) All members of the SRLY subgroup with respect to that carryover are also included in a loss subgroup with respect to that carryover; and

(B) All members of a loss subgroup with respect to that carryover are also members of a SRLY subgroup with respect to that carryover; and

(ii) With respect to a carryover described in paragraph (g)(2)(ii)(B) of this section only if all members of the SRLY subgroup for that carryover are also members of a SRLY subgroup that has net operating loss carryovers described in paragraph (g)(2)(ii)(A) of this section that are subject to the overlap rule of paragraph (g)(1) of this section.

(5) *Examples.* The principles of this paragraph (g) are illustrated by the following examples:

Example 1. Overlap—Simultaneous Acquisition. (i) Individual A owns all of the stock of P, which in turn owns all of the stock of S. P and S file a consolidated return. In Year 2, B, an individual unrelated to Individual A, forms T which incurs a $100 net operating loss for that year. At the beginning of Year 3, S acquires T.

(ii) S's acquisition of T results in T becoming a member of the P group (the SRLY event) and also results in an ownership change of T, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event) with respect to the T carryover.

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382.

(iv) Consequently, under this paragraph (g), in Year 3 the SRLY limitation does not apply to the Year 2 $100 net operating loss.

Example 2. Overlap—Section 382 event before SRLY event. (i) Individual A owns all of the stock of P, which in turn owns all of the stock of S. P and S file a consolidated return. In Year 1, B, an individual unrelated to Individual A, forms T which incurs a $100 net operating loss for that year. On February 28 of Year 2, S purchases 55% of T from Individual B. On June 30, of Year 2, S purchases an additional 35% of T from Individual B.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover. The June 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382.

(iv) Consequently, under paragraph (g) of this section, in Year 2 the SRLY limitation does not apply to the Year 1 $100 net operating loss.

Example 3. No overlap—Section 382 event before SRLY event. (i) The facts are the same as in *Example 2* except that Individual B does not sell the additional 35% of T to S until September 30, Year 2.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover. The September 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event did not occur within six months of the change date of the section 382 event, there is no overlap of the application of the SRLY rules and the application of section 382. Consequently, the Year 1 net operating loss is subject to a SRLY limitation and a section 382 limitation.

Example 4. Overlap—SRLY event before section 382 event. (i) P and S file a consolidated return. S has owned 40% of T for 6 years. For Year 6, T has an net operating loss of $500 that is carried forward. On March 31, Year 7, S acquires an additional 40% of T, and on August 31, Year 7, S acquires the remaining 20% of T.

(ii) The March 31 purchase of 40% of T results in T becoming a member of the P group and is therefore a SRLY event. The August 31 purchase of 20% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of this paragraph (g).

(iv) Under this paragraph (g), the SRLY rules of paragraph (c) of this section will apply to the Year 7 tax year. Beginning in Year 8 (the year after the section 382 event), any unabsorbed portion of the Year 6 net operating loss will not be subject to a SRLY limitation.

Example 5. Overlap—Coextensive subgroups. (i) Individual A owns all of the stock of S, which in turn owns all of the stock of T. S and T file a consolidated return beginning in Year 1. B, an individual unrelated to A, owns all of the stock of P, the common parent of a consolidated group. In Year 2, the S group has a $200 consolidated net operating loss which is carried forward, of which $100 is attributable to S, and $100 is attributable to T. At the beginning of Year 3, the P group acquires all of the stock of S from Individual A.

(ii) P's acquisition of S results in S and T becoming members of the P group (the SRLY event). With respect to the Year 2 net operating loss carryover, S and T compose a SRLY subgroup under paragraph (c)(2) of this section.

(iii) S and T also compose a loss subgroup under §1.1502-91(d)(1) with respect to the Year 2 net operating loss carryover. P's acquisition also results in an ownership change of S, the subgroup parent, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event) with respect to the Year 2 carryover.

(iv) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section. Because the SRLY subgroup and the loss subgroup are coextensive, under paragraph (g) of this section, the SRLY limitation does not apply to the Year 2 $200 net operating loss.

Example 6. No Overlap—Different subgroups. (i) Individual B owns all of the stock of P, the common parent of a consolidated group. P owns all of the stock of S and all of the stock of T. Individual A owns all of the stock of X, the common parent of another consolidated group. In Year 1, the P group has a $200 consolidated net operating loss, of which $100 is attributable to S and $100 is attributable to T. At the beginning of Year 3, the X group acquires all of the stock of S and T from P and does not make an election under §1.1502–91(d)(4) (concerning an election to treat the loss subgroup parent requirement as having been satisfied).

(ii) X's acquisition of S and T results in S and T becoming members of the X group (the SRLY event). With respect to the Year 1 net operating loss,

S and T compose a SRLY subgroup under paragraph (c)(2) of this section.

(iii) S and T do not bear (and are not treated as bearing) a section 1504(a)(1) relationship. Therefore S and T do not qualify as a loss subgroup under §1.1502–91(d)(1). X's acquisition of S and T results in separate ownership changes of S and T, that give rise to separate limitations under section 382(a) (the section 382 events) with respect to each of S and T's Year 1 net operating loss carryovers. See §1.1502–94.

(iv) The SRLY event and the change dates of the section 382 events occur on the same date. However, paragraph (g)(1) of this section does not apply because the SRLY subgroup (composed of S and T) is not coextensive with a loss subgroup with respect to the Year 1 carryovers. Consequently, the Year 1 net operating loss is subject to both a SRLY subgroup limitation and also separate section 382 limitations for each of S and T.

Example 7. No Overlap—Different subgroups. (i) Individual A owns all of the stock of T and all of the stock of S, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of P, the common parent of another consolidated group. In Year 1, T has a net operating loss of $100 that is carried forward. At the end of Year 2, S acquires all of the stock of T from Individual A. In Year 3, the S group sustains a $200 consolidated net operating loss that is carried forward. In Year 8, the P group acquires all of the stock of S from Individual A.

(ii) S's acquisition of T in Year 1 results in T becoming a member of the S group. The acquisition, however, did not result in an ownership change under section 382(g). As a result, T's Year 1 net operating loss is subject to SRLY within the S group. At the end of Year 7, §1.1502–96(a) treats T's Year 1 net operating loss as not having arisen in a SRLY with respect to the S group. Section 1.1502–96(a), however, applies only for purposes of §§1.1502–91 through 1.1502–96 and §1.1502–98 but not for purposes of this section. See §1.1502–96(a)(5).

(iii) P's acquisition of S in Year 8 results in S and T becoming members of the P group (the SRLY event). With respect to the Year 1 net operating loss, S and T do not compose a SRLY subgroup under paragraph (c)(2) of this section.

(iv) S and T compose a loss subgroup under §1.1502–91(d)(1) with respect to the Year 1 net operating loss carryover. P's acquisition of S results in an ownership change of the loss subgroup, within the meaning of section 382(g), that gives rise to a subgroup limitation under section 382(a) (the section 382 event) with respect to that carryover.

(v) The SRLY event and the change date of the section 382 event occur on the same date. However, under paragraph (g)(4) of this section, because the SRLY subgroup and the loss subgroup are not coextensive, T's Year 1 net operating loss carryover is subject to a SRLY limitation.

(vi) With respect to the Year 3 net operating loss carryover, S and T compose both a SRLY subgroup and a loss subgroup under §1.1502–91(d)(1). Thus, paragraph (g)(1) of this section applies and the S group's Year 3 net operating loss carryover is not subject to a SRLY limitation.

Example 8. SRLY after overlap. (i) Individual A owns all of the stock of R and M, each the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of D. In Year 1, D incurs a $100 net operating loss that is carried forward. At the beginning of Year 3, R acquires all of the stock of D. In Year 5, M acquires all of the stock of R in a transaction that did not result in an ownership change of R.

(ii) R's Year 3 acquisition of D results in D becoming a member of the R group (the SRLY event) and also results in an ownership change of D, that gives rise to a limitation under section 382(a) (the section 382 event) with respect to D's net operating loss carryover.

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of paragraph (c) of this section and section 382 with respect to D's net operating loss. Consequently, under this paragraph (g), D's Year 1 $100 net operating loss is not subject to a SRLY limitation in the R group.

(iv) M's Year 5 acquisition of R results in R and D becoming members of the M group (the SRLY event), but does not result in an ownership change of R or D that gives rise to a limitation under section 382(a). Because there is no section 382 event, the application of the SRLY rules and section 382 do not overlap. Consequently, D's Year 1 $100 net operating loss is subject to a SRLY limitation in the M group.

(v) Because D's Year 1 net operating loss carryover was subject to the overlap rule of paragraph (g) of this section when it joined the R group, under §1.1502-21(c)(2) the SRLY subgroup with respect to that carryover includes all of the members of the R group that joined the M group at the same time as D.

Example 9. Overlap—Interim losses. (i) Individual A owns all of the stock of P and S, each the common parent of a consolidated group. S owns all of the stock of T, its only subsidiary. B, an individual unrelated to Individual A, owns all of the stock of M, the common parent of a consolidated group. In Year 1, the S group has a $100 consolidated net operating loss. On January 1 of Year 2, P acquires all of the stock of S from Individual A. On January 1 of Year 3, M acquires 51% of the stock of P from Individual A. On May 31 of Year 3, M acquires the remaining 49% of the stock of P from Individual A. The P group, for the Year 3 period prior to June 1 had a $50 consolidated net operating loss, and under paragraph (b)(2)(iv) of this section, the loss is attributable entirely to S. Other than the losses described above, the P group does not have any other consolidated net operating losses.

(ii) In the P group, S's $100 loss carryover is treated as arising in a SRLY and is subject to the limitation under paragraph (c) of this section. A SRLY subgroup with respect to that loss is composed of S and T, the members which were members of the S group as to which the loss was not a SRLY.

(iii) M's January 1 purchase of 51% of P is a section 382 event because it results in an ownership change of S and T that gives rise to a section 382(a) limitation (the section 382 event) with respect to the Year 1 net operating loss carryover. The purchase, however, does not result in an ownership change of P because it is not a loss corporation under section 382(k)(1). M's May 31 purchase of 49% of P results in P, S, and T becoming members of the M group and is therefore a SRLY event.

(iv) With respect to the Year 1 net operating loss, S and T compose a SRLY subgroup under paragraph (c)(2) of this section and a loss subgroup under §1.1502–91(d)(1). The loss subgroup does not include P because the only loss at the time of the section 382 event was subject to SRLY with respect to the P group. See §1.1502–91(d)(1).

(v) Because the SRLY event and the change date of the section 382 event occur on the same date and the SRLY subgroup and loss subgroup are coextensive with respect to the Year 1 net operating loss carryover, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section. Thus, the SRLY limitation does not apply to that carryover.

(vi) The Year 3 net operating loss, which arose between the section 382 event and the SRLY event, is a net operating loss described in paragraph (g)(2)(ii)(B) of this section because it is the net operating loss of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 382 event.

(vii) With respect to the Year 3 net operating loss, P, S, and T compose a SRLY subgroup under paragraph (c)(2) of this section. Because P, a member of the SRLY subgroup for the Year 3 carryover, is not also a member of a SRLY subgroup that has net operating loss carryovers described in paragraph (g)(2)(ii)(A) of this section (the Year 1 net operating loss), the Year 3 carryover is subject to a SRLY limitation in the M group. See paragraph (g)(4)(ii) of this section.

(h) *Effective date*—(1) *In general.* This section generally applies to taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraph (g)(1) of this section does not apply to a particular net operating loss carryover in the current group, then solely for purposes of applying paragraph (c) of this section to determine a limitation with respect to that carryover and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's or subgroup's items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), paragraph (c)(2) of this section shall be applied without regard to the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group)"; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies shall constitute a section 382 event.

(2) *SRLY limitation.* Except in the case of those members (including members of a SRLY subgroup) described in paragraph (h)(3) of this section, a group does not

take into account a consolidated taxable year beginning before January 1, 1997, in determining the aggregate of the consolidated taxable income under paragraph (c)(1) of this section (including for purposes of §1.1502–15 and §1.1502–22(c)) for the members (or SRLY subgroups).

(3) *Prior retroactive election.* A consolidated group that applied the rules of §1.1502–21T(g)(3) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, to all consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997, does not take into account a consolidated taxable year beginning before January 29, 1991, in determining the aggregate of the consolidated taxable income under paragraph (c)(1) of this section (including for purposes of §1.1502–15 and §1.1502–22(c)) for the members (or SRLY subgroups).

(4) *Offspring rule.* Paragraph (b)(2)(ii)-(B) of this section applies to net operating losses arising in taxable years ending on or after June 25, 1999.

(5) *Waiver of carrybacks.* Paragraph (b)(3)(ii)(B) of this section (relating to the waiver of carrybacks for acquired members) applies to acquisitions occurring after August 24, 1999.

(6) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–21T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

§1.1502–21T [Removed]

Par. 7. Section 1.1502–21T is removed.

Par. 8. Section 1.1502–22 is added to read as follows:

§1.1502–22 Consolidated capital gain and loss.

(a) *Capital gain.* The determinations under section 1222, including capital gain net income, net long-term capital gain, and net capital gain, with respect to members during consolidated return years are not made separately. Instead, consolidated amounts are determined for the group as a whole. The consolidated capital gain net income for any consolidated return year is determined by reference to—

(1) The aggregate gains and losses of members from sales or exchanges of capital assets for the year (other than gains and losses to which section 1231 applies);

(2) The consolidated net section 1231 gain for the year (determined under §1.1502–23); and

(3) The net capital loss carryovers or carrybacks to the year.

(b) *Net capital loss carryovers and carrybacks*—(1) *In general.* The determinations under section 1222, including net capital loss and net short-term capital loss, with respect to members during consolidated return years are not made separately. Instead, consolidated amounts are determined for the group as a whole. Losses included in the consolidated net capital loss may be carried to consolidated return years, and, after apportionment, may be carried to separate return years. The net capital loss carryovers and carrybacks consist of—

(i) Any consolidated net capital losses of the group; and

(ii) Any net capital losses of the members arising in separate return years.

(2) *Carryovers and carrybacks generally.* The net capital loss carryovers and carrybacks to a taxable year are determined under the principles of section 1212 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they were sustained, and losses carried from taxable years ending on the same date, and which are available to offset consolidated capital gain net income, generally are absorbed on a pro rata basis. Additional rules provided under the Internal Revenue Code or regulations also apply, as well as the SRLY limitation under paragraph (c) of this section. See, e.g., section 382(l)(2)(B).

(3) *Carryovers and carrybacks of consolidated net capital losses to separate return years.* If any consolidated net capital loss that is attributable to a member may be carried to a separate return year under the principles of §1.1502–21(b)(2), the amount of the consolidated net capital loss that is attributable to the member is apportioned and carried to the separate return year (apportioned loss).

(4) *Special rules*—(i) *Short years in connection with transactions to which section 381(a) applies.* If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net capital loss may be carried.

(ii) *Special status losses.* [Reserved]

(c) *Limitations on net capital loss carryovers and carrybacks from separate return limitation years.* The aggregate of the net capital losses of a member arising (or treated as arising) in SRLYs that are included in the determination of consolidated capital gain net income for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate of the consolidated capital gain net income for all consolidated return years of the group determined by reference to only the member's items of gain and loss from capital assets as defined in section 1221 and trade or business assets defined in section 1231(b), including the member's losses actually absorbed by the group in the taxable year (whether or not absorbed by the member). The principles of §1.1502–21(c) (including the SRLY subgroup principles under §1.1502–21(c)(2)) apply with appropriate adjustments for purposes of applying this paragraph (c).

(d) *Coordination with respect to consolidated return change of ownership limitation occurring in consolidated return years beginning before January 1, 1997.* If a consolidated return change of ownership occurred before January 1, 1997, the principles of §1.1502–22A(d) apply to determine the amount of the aggregate of the net capital loss attributable to old members of the group (as those terms are defined in §1.1502–1(g)), that may be included in the net capital loss carryover under paragraph (b) of this section. For this purpose, §1.1502–1(g) is applied by treating that date as the end of the year of change.

(e) *Consolidated net capital loss.* Any excess of losses over gains, as determined under paragraph (a) of this section (without regard to any carryovers or carrybacks), is also referred to as the consolidated net capital loss.

(f) *Predecessors and successors.* For purposes of this section, the principles of §1.1502–21(f) apply with appropriate adjustments.

(g) *Overlap with section 383*—(1) *General rule.* The limitation provided in paragraph (c) of this section does not apply to net capital loss carryovers ((other than a hypothetical carryover like those described in §1.1502–21(c)(1)(i)(D) and a carryover like those described in §1.1502–21(c)(1)(ii)) when the application of paragraph (c) of this section results in an overlap with the application of section 383. For a similar rule applying in the case of net capital loss carryovers like those described in §§1.1502–21(c)(1)(i)-(D) and (c)(1)(ii), see §1.1502–15(g).

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in sections 382 and 383, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap.* (A) An overlap of the application of paragraph (c) of this section and the application of section 383 with respect to a net capital loss carryover occurs if a corporation becomes a member of the consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382 limitation with respect to that carryover (the section 383 event).

(B) If an overlap described in paragraph (g)(2)(ii)(A) of this section occurs with respect to net capital loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 383 event, then an overlap is treated as also occurring with respect to that corporation's net capital loss carryover that arises within the period beginning with the section 383 event and ending with the SRLY event.

(C) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(1) with respect to a carryover, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 383 event before SRLY event.* If a SRLY event occurs on the same date as a section 383 event or within the six month period beginning on the date of the section 383 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event.

(ii) *SRLY event before section 383 event.* If a section 383 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 383 event.

(4) *Subgroup rules.* In general, in the case of a net capital loss carryover for which there is a SRLY subgroup and a loss subgroup (as defined in §1.1502–91(d)(1)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies—

(i) With respect to a carryover described in paragraph (g)(2)(ii)(A) of this section only if—

(A) All members of the SRLY subgroup with respect to that carryover are also included in a loss subgroup with respect to that carryover; and

(B) All members of a loss subgroup with respect to that carryover are also members of a SRLY subgroup with respect to that carryover; and

(ii) With respect to a carryover described in paragraph (g)(2)(ii)(B) of this section only if all members of the SRLY subgroup for that carryover are also members of a SRLY subgroup that has net capital loss carryovers described in paragraph (g)(2)(ii)(A) of this section that are subject to the overlap rule of paragraph (g)(1) of this section.

(h) *Effective date*—(1) *In general.* This section generally applies to taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraph (g)(1) of this section does not apply to a particular net capital loss carryover in the current group, then solely for purposes of applying paragraph (c) of this section to determine a limitation with respect to that carryover and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's or subgroup's items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), the principles of §1.1502–21(c)(2) shall be applied without regard to the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group)"; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 383, as amended by the Tax Reform Act of 1986, applies and which results in a section 382 limitation shall constitute a section 383 event.

(2) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–22T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

§1.1502–22T [Removed]

Par. 9. Section 1.1502–22T is removed.

Par. 10. Section 1.1502–23 is added to read as follows:

§1.1502–23 Consolidated net section 1231 gain or loss.

(a) *In general.* Net section 1231 gains and losses of members arising during consolidated return years are not determined separately. Instead, the consolidated net section 1231 gain or loss is determined under this section for the group as a whole.

(b) *Example.* The following example illustrates the provisions of this section:

Example. Use of SRLY registers with net gains and net losses under section 1231. (i) In Year 1, T sustains a $20 net capital loss. At the beginning of Year 2, T becomes a member of the P group. T's capital loss carryover from Year 1 is subject to SRLY limits under §1.1502–22(c). The members of the P group contribute the following to the consolidated taxable income for Year 2 (computed without regard to T's net capital loss carryover under §1.1502–22):

	P	T
	Year 1 (SRLY)	
Ordinary		
Capital		(20)
	Year 2	
Ordinary	10	20
Capital	70	0
§1231	(60)	30

(ii) Under section 1231, if the section 1231 losses for any taxable year exceed the section 1231 gains for such taxable year, such gains and losses are treated as ordinary gains or losses. Because the P group's section 1231 losses, $(60), exceed the section 1231 gains, $30, the P group's net loss is treated as an ordinary loss. T's net section 1231 gain has the same character as the P group's consolidated net section 1231 loss, so T's $30 of section 1231 income is treated as ordinary income for purposes of applying §1.1502–22(c). Under §1.1502–22(c), the group's consolidated net capital gain determined by reference only to T's items is $0. None of T's capital loss carryover from Year 1 may be taken into account in Year 2.

(c) *Recapture of ordinary loss.* [Reserved]

(d) *Effective date*—(1) *In general.* This section applies to gains and losses arising in the determination of consolidated net section 1231 gain or loss for taxable years for which the due date (without extensions) of the consolidated return is taxable years is after June 25, 1999.

(2) *Application to prior periods.* See §1.1502–21(h)(3) for rules applicable to groups that applied the rules of this section to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997.

§1.1502–23T [Removed]

Par. 11. Section 1.1502–23T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. In §602.101, paragraph (b) is amended by removing the entry for §1.1502–21T from the table and adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–21	1545–1237
* * * * *	

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved June 18, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 25, 1999, 1:27 p.m., and published in the issue of the Federal Register for July 2, 1999, 64 F.R. 36091)

26 CFR 1.1502–91A: Application of Section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.

T.D. 8824

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Regulations Under Section 1502 of the Internal Revenue Code of 1986; Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses and Credits Following an Ownership Change of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding the operation of sections 382 and 383 of the Internal Revenue Code of 1986 (relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change) with respect to consolidated groups. The regulations include rules for determining whether a loss group or a loss subgroup has an ownership change, for computing a consolidated section 382 limitation or subgroup section 382 limitation, and for applying sections 382 and 383 to corporations that join or leave a group. The rules are necessary to provide guidance to such groups on the use of certain of their tax attributes.

DATES: *Effective Dates:* These regulations are effective June 25, 1999.

Applicability Dates: For dates of application and special effective date rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Lee A. Kelley at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1218.

The collections of information in this regulation are in §§1.1502–20(g)(4), 1.1502–95(e)(8), 1.1502–95(f), and 1.1502–96(e). This information is required to assure that a section 382 limitation is properly determined and applied in cases of corporations that become or cease to be members of a consolidated group. The collection of information in §1.1502–98(e)(8) is mandatory. The other collections of information are required to obtain a benefit. The likely respondents are business or other for-profit institutions.

Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by August 31, 1999. Comments are specifically requested concerning:

Whether the collection[s] of information is necessary for the proper performance of the functions of the **Internal Revenue Service,** including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection[s] of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total annual reporting burden: 662 hours.

The estimated annual burden per respondent varies from 15 to 25 minutes, depending on individual circumstances, with an estimated average of 20 minutes.

Estimated number of respondents: 12,054

Estimated annual frequency of responses: On occasion

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On February 4, 1991, the IRS and Treasury issued three notices of proposed rulemaking, CO–132–87 (56 F.R. 4194 [1991–1 C.B. 728]), CO– 077–90 (56 F.R. 4183 [1991–1 C.B. 749]), and CO–078–90 (56 F.R. 4228 [1991–1 C.B. 757]), setting forth rules regarding the application of sections 382 and 383 by consolidated groups and by controlled groups, and regarding the use of built-in deductions and net operating losses and capital losses, including the carryover and carryback of separate return limitation year (SRLY) losses of members of consolidated groups. A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the IRS and Treasury published temporary regulations (T.D. 8678, 61 F.R. 33335 [1996–2 C.B. 134]) setting forth rules regarding the application of section 382 to affiliated groups of corporations filing consolidated returns. These regulations were substantially identical to the proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations was published in the **Federal Register** on the same day (CO–026–96, 61 F.R. 33391 [1996–2 C.B. 440]) and the proposed regulations published in 1991 were withdrawn. The IRS and Treasury also published temporary regulations regarding the SRLY limitation (T.D. 8677, 61 F.R. 33321 [1996–2 C.B. 119]), and controlled group losses (T.D. 8679, 61 F.R. 33313 [1996–2 C.B. 25]). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO–025–96, 61 F.R. 33395 [1996–2 C.B. 439] and CO–024–96, 61 F.R. 33393 [1996–2 C.B. 437]) and the proposed regulations published in 1991 were withdrawn.

This Treasury decision adopts the 1996 proposed regulations regarding the application of section 382 to affiliated groups of corporations filing consolidated returns. The principal changes to those proposed regulations are described below.

As companions to this Treasury decision, the IRS and Treasury also are issuing final regulations relating to the application of sections 382 and 383 by members of controlled groups, and relating to the SRLY limitation. See T.D. 8823 on page 34 and T.D. 8825, 1999–28 I.R.B. 19.

Explanation of Provisions

A. Overview

1. Sections 382 and 383

Under section 382, if an ownership change occurs with respect to a loss corporation (as defined in section 382 and the regulations thereunder), the amount of the loss corporation's taxable income for a post-change year that may be offset by the net operating losses of the loss corporation arising before the ownership change is limited by an amount known as the section 382 limitation. The section 382 limitation for a taxable year of a loss corporation after an ownership change generally is equal to the fair market value of the corporation's stock immediately before the ownership change multiplied by the long-term tax exempt rate (a rate of return published periodically in the Internal Revenue Bulletin). See generally sections 382(b), (e), and (f). This limitation for a taxable year may be increased by certain items, such as an unused limitation from a prior taxable year and certain built-in gains recognized during the taxable year. See section 382(b)(2) and (h).

In general, an ownership change involves an increase of more than 50 percentage points in stock ownership by 5-percent shareholders during the testing period (usually the 3-year period ending on the date on which a loss corporation must make a determination whether it has had an ownership change). In determining whether an ownership change has occurred, all transactions occurring during the testing period that affect the stock ownership of any 5-percent shareholder whose percentage of stock ownership has increased as of the close of the testing date are taken into account. The determination of the percentage ownership interest of any shareholder is made on the basis of the ratio of the fair market value of the loss corporation stock owned by the shareholder to the total fair market value of the loss corporation's outstanding stock. Ordinarily, all stock of the loss corporation, except certain preferred stock described in section 1504(a)(4), is taken into account. These rules are contained in §§1.382–2 and 1.382–2T and relate to ownership changes of corporations without regard to whether the corporations file a separate return or join in filing a consolidated return.

2. General Description of Final Regulations

This document contains two sets of rules. The first set of rules, set forth in §§1.1502–91 through 1.1502–93, provide the tax treatment for net operating losses that arise in (and net unrealized built-in losses with respect to) years that are not separate return limitation years with respect to a consolidated group. (A separate return limitation year, or SRLY, generally is a taxable year of a subsidiary in which the subsidiary was not a member of the group). In general, these rules adopt a single entity approach to determine ownership changes and the section 382 limitations with respect to such losses.

These final regulations also extend the single entity approach to loss subgroups within consolidated groups. A loss subgroup generally consists of two or more corporations that continue to be affiliated with each other after leaving one group and joining another where at least one of the corporations carries over losses from the first group to the second group. Thus, the single entity approach under the final regulations can apply, for example, to a consolidated group's acquisition of another consolidated group or of a chain of subsidiaries from another group.

The second set of rules, set forth in §§1.1502–94 and 1.1502–95, applies to corporations that join or leave a consolidated group with respect to certain attributes (e.g., attributes other than those arising in a consolidated return year). In general, section 382 is applied separately with respect to those attributes because the attributes cannot be used by other members. Section 1.1502–96 contains miscellaneous rules.

In general, §1.1502–98 provides that the rules contained in §§1.1502–91

through 1.1502–96 also apply for purposes of section 383, with adjustments to reflect that section 383 applies to credits and net capital losses.

B. *Amendments to the Proposed Regulations*

1. Definition of a Loss Subgroup, §1.1502–91(d)

Under the proposed regulations, a loss subgroup is composed of members of one group (the former group) that become members of another consolidated group. In the case of a net operating loss carryover, the members of a group compose a loss subgroup if (i) they were affiliated with each other in another group, (ii) they bear a relationship to each other described in section 1504(a)(1) immediately after they become members of the group (the subgroup parent requirement), and (iii) at least one of the members carries over a net operating loss arising in a year that is not a SRLY (and is not treated as a SRLY under proposed §1.1502–21(c)) with respect to the former group. In the case of a net unrealized built-in loss (NUBIL), the members of a group compose a loss subgroup if they (i) have been continuously affiliated with each other for the 5 consecutive year period ending immediately before they become members of the group (the five-year affiliation requirement), (ii) meet the subgroup parent requirement, and (iii) have, in the aggregate, a NUBIL. A member ceases to be included in a loss subgroup when it files a separate return, or when a member breaks the relationship described in section 1504(a)(1) to the loss subgroup parent, regardless of whether that member leaves the current group or remains in the consolidated group.

Retention of the subgroup parent requirement in general

Commentators suggested that the final regulations should eliminate the subgroup parent requirement in order to provide a single subgroup definition for the SRLY limitation and for the section 382 limitation. Other commentators recommended eliminating the requirement following an ownership change of the loss subgroup.

Like a loss group, a loss subgroup has an ownership change if the loss subgroup parent has an ownership change (the parent change method). The parent change method, adopted for its administrative simplicity, looks only to ownership shifts of the parent corporation in determining whether the consolidated group (or loss subgroup) has an ownership change. Owner shifts of minority stock of subsidiary members are not taken into account. Application of the parent change method to loss subgroups eliminates the administrative burdens associated with a rule that would mandate separate tracking of the minority stock of each subgroup member for determining whether an ownership change of the loss subgroup has occurred.

The IRS and the Treasury have determined that, in circumstances where owner shifts of a loss subgroup must continue to be tracked, the parent change method should continue to apply for determining whether a subgroup has an ownership change. Accordingly, in general, these final regulations retain the subgroup parent requirement. Also, these final regulations retain the general rule that a member ceases to be a member of the loss subgroup on the first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent. The final regulations, however, provide an election to treat the subgroup parent requirement as satisfied, and provide certain exceptions for ceasing to be a member of a loss subgroup when a member breaks the relationship described in section 1504(a)(1) to the loss subgroup parent, but remains within the current consolidated group.

Election to treat subgroup parent requirement as satisfied

The subgroup parent requirement may preclude subgroup treatment in instances where single entity principles make such treatment conceptually appropriate. For example, brother-sister corporations with net operating loss carryovers that are not SRLY losses with respect to the former group are not a loss subgroup even if the same acquirer acquires both corporations at the same time. However, single entity principles support treating the brother-sister corporations as a subgroup because they were affiliated with each other in the former group and remain affiliated in the current group.

To extend single entity treatment in such cases would require a mechanism other than the parent change method to track owner shifts of the loss subgroup. Some commentators suggested permitting the parent of the current group to designate the subgroup parent. Under this approach, such designation would be respected unless the designation is made with a principal purpose of avoiding an ownership change.

The IRS and the Treasury believe that the ability to designate the subgroup parent presents opportunities for avoiding or lessening the impact of section 382. Also, a principal purpose standard is not an effective mechanism for preventing inappropriate designations because the *only* purpose of such designation is to apply the ownership change rules of section 382.

The IRS and Treasury recognize, however, that it is appropriate to extend subgroup treatment to the extent that single entity principles support such treatment, and to the extent that subgroup treatment does not compromise the determination whether a subgroup has an ownership change. Also, the IRS and Treasury recognize that, in certain circumstances, taxpayers may prefer more stringent ownership change rules if they can obtain the benefit of subgroup treatment. Finally, the IRS and Treasury recognize that the ability of brother-sister corporations to constitute a section 382 subgroup may be necessary in order for section 382 subgroups to conform with SRLY subgroups, thus permitting application of the rule that eliminates a separate SRLY limitation where the application of SRLY and section 382 overlap. See §§1.1502–15(g), 1.1502–21(g) and 1.1502–22(g).

Accordingly, these final regulations provide that two or more corporations that become members of a consolidated group at the same time and that were affiliated with each other immediately before becoming members of the group are deemed to meet the subgroup parent requirement immediately after they become members of the group if the common parent of the acquiring group makes an election under §1.1502–91(d)(4) with respect to those members. An election includes all corporations that become members of the current group at the same time and that were affiliated with each other immediately before they become members of the current

group. The election applies solely for purposes of satisfying the subgroup parent requirement, and does not apply in determining whether members meet the other requirements for inclusion in a loss subgroup. Although the election applies solely for purposes of §§1.1502–91 through 1.1502–96 and §1.1502–98, the election may affect whether a SRLY limitation overlaps with application of section 382.

If the common parent makes an election under §1.1502–91(d)(4), each of the members with respect to which the election is made (and that is included in the loss subgroup) is treated as the loss subgroup parent for purposes of determining if the loss subgroup has an ownership change on, or after, becoming members of the current group. If, however, a member with respect to which the election is made has an ownership change upon (or after) ceasing to be a member of the current group, that ownership change does not cause an ownership change of a loss subgroup comprised of one or more of its members that remain members of the current group.

Exceptions for ceasing to be a member of a loss subgroup when a member breaks the section 1504(a)(1) relationship with the loss subgroup parent, §1.1502–95(d)(1)

In general, under §1.1502–95(d)(1)(ii), these final regulations provide that a member ceases to be a member of the loss subgroup on the first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent. Continued affiliation through a loss subgroup parent is central to the operation of the parent change method to loss subgroups.

Under certain circumstances, however, separate tracking of the loss subgroup parent terminates, eliminating the need for members to maintain a section 1504(a)(1) relationship through a loss subgroup parent. Section 1.1502–96(a) provides, in part, that ownership shifts of a loss subgroup cease to be separately tracked if there is an ownership change of the loss subgroup within six months before, on, or after becoming members of the group, or if a period of five years elapses after becoming members of group during which time the loss subgroup does not have an ownership change (a fold-in event).

Also, an election under §1.1502–91(d)(4) obviates the need for a section 1504(a)(1) relationship through a loss subgroup common parent because each member is separately tracked as if it were the loss subgroup parent.

In circumstances where the necessity of a section 1504(a)(1) relationship through a loss subgroup parent is eliminated, the IRS and the Treasury believe that a subgroup member should not cease to be a member of the subgroup solely because it ceases to bear such a relationship. Accordingly, these final regulations provide two exceptions to the general rule of §1.1502–95(d)(1)(ii). The first exception applies to the members of the loss subgroup if an election under §1.1502–91(d)(4) applies to them. The second exception applies to loss subgroup members following a fold-in event.

Members excluded or included from a subgroup with a principal purpose of avoiding a limitation, §1.1502–91(d)(5)

Proposed §1.1502–91(d)(5) provides that corporations do not compose a loss subgroup if any one of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, section 382. This rule does not apply solely because, in connection with becoming members of the group, the members of a group are rearranged to satisfy the subgroup parent requirement. The final regulations retain these provisions, and, in conformity with the anti-abuse rule for SRLY subgroups, provide that any member excluded from a loss subgroup, if excluded with a principal purpose of avoiding or increasing a section 382 limitation, is treated as included in the loss subgroup. This rule does not apply solely because a group does not rearrange members of a group to satisfy the subgroup parent requirement.

2. Definition of Loss Subgroup with a NUBIL, §1.1502–91(d)(2)

Commentators criticized the five-year affiliation requirement for adding complexity to the regulations. For instance, the five-year affiliation requirement can cause application of section 382 and SRLY on a single entity basis with respect to members of a loss subgroup with a net operating loss carryover that arose within the former group (because an NOL loss subgroup does not require five years of affiliation), but on a separate entity basis for those same members with respect to built-in losses.

The IRS and Treasury have determined, however, that the five-year affiliation requirement is a necessary feature of the NUBIL subgroup rules. Just as the NOL subgroup rules apply only to loss carryovers that arise in (or have folded into) the former group, so should the NUBIL subgroup rules apply only to built-in losses that accrue within (or have folded into) the former group. Because an accurate method of determining economic accrual *(e.g.,* tracing) would present significant problems for tax administration and for compliance by taxpayers, the IRS and Treasury believe that the five-year affiliation requirement is the best available proxy for determining when built-in attributes arise.

Absent a five-year affiliation requirement, taxpayers could effectively traffic in net unrealized built-in losses without being subject to any limitation (other than one imposed under an applicable "principal purpose" anti-abuse rule). A selling group could acquire a new member with a NUBIG and sell both that recently-acquired NUBIG member and the member containing the desired NUBIL to the prospective buyer. To the extent that the NUBIG offset the NUBIL and the corporations were structured to satisfy the requirements for subgroup treatment, recognized built-in losses would escape any limitation and could be freely absorbed by the acquiring group.

Furthermore, the absence of a five-year affiliation requirement could be used to circumvent a SRLY limitation applicable to a NUBIL if built-in losses are recognized. For instance, if a member comes into a group with a NUBIL and without an ownership change, recognition of that NUBIL would be subject to a SRLY limitation during the following five years and the loss could not be freely absorbed by the income of the other members of the group. However, if all the members of the group were included in a NUBIL subgroup upon being acquired by a second group two years into that five-year period,

that member's recognized built-in losses immediately thereafter would be subject either to a SRLY or section 382 limitation computed with respect to all the members of the former group (thus increasing the rate at which such losses can be utilized) or, in the event that the acquired corporations have an aggregate NUBIG, to no limitation whatsoever.

Some commentators contended that the five-year affiliation requirement (and the time period required for a fold-in event under §1.1502–96(a)) should be reduced to three years, based on the duration of the testing period for an ownership change under section 382.

However, a five-year (rather than a three-year) affiliation requirement is necessary to ensure that taxpayers cannot shorten the five-year recognition period for the SRLY limitation, as described above. Also, the IRS and Treasury believe that the five-year recognition period for the SRLY limitation should be maintained because it mirrors the statutorily-mandated five-year recognition period of section 382(h)(7). In general, Treasury and the IRS believe that it is important to conform the application of section 382 and the SRLY rules where possible, particularly in the light of the rule eliminating application of SRLY where its application overlaps with that of section 382.

Moreover, the five-year affiliation requirement is consistent with Congress' indication in section 384(a) of the point at which it is appropriate for built-in attributes of a member to be treated as attributes of the group. Under certain circumstances, section 384(a) prevents the recognized built-in gain of one corporation from offsetting preacquisition losses of another corporation, if such gain is recognized within a five-year period following the acquisition date. Similarly, section 384(b) provides that section 384(a) does not apply to prevent the recognized built-in gain of one corporation from offsetting the preacquisition losses of another corporation if the gain corporation and the loss corporation were members of the same controlled group (as defined in section 384(b)(2)) for the five-year period ending on the acquisition date.

For these reasons, the final regulations do not reduce the duration of the affiliation requirement from five years to three years.

Commentators requested clarification that an acquiring group takes into account application of the fold-in rules of §1.1502–96(a) in the former group in determining which members are included in a loss subgroup. A new example under §1.1502–96(a)(3), and a cross-reference in a new §1.1502–91(g)(3) to the fold-in rules, clarifies this treatment. Thus, a corporation whose NUBIL folded in to a former group is deemed to have a five-year affiliation with the common parent of that group (and is deemed to have affiliation histories with other group members). A special rule provides that the corporation is not deemed to have been previously affiliated with another corporation that joined the former group at the same time, but was not taken into account in determining a NUBIL limitation, even if in fact the two corporations were previously affiliated.

3. Members Included—Determination Whether a Consolidated Group Has a NUBIL, §1.1502–91(g)(2)(ii)

Proposed §1.1502–91(g)(2)(i) provides, in part, that the members included in the determination whether a consolidated group has a NUBIG or NUBIL are all members of the group on the day the determination is made, other than a new loss member with a NUBIL, and members included in a NUBIL subgroup.

The IRS and Treasury have determined that the reasons for applying a five-year affiliation requirement to subgroups are equally relevant to groups. Accordingly, these final regulations provide that the members included in the determination whether a consolidated group has a NUBIL are the common parent and all other members that have been affiliated with the common parent for the five consecutive year period ending on the day that the determination is made.

In certain cases, a member (or loss subgroup) can join a consolidated group with a NUBIG, but have a NUBIL on the date the consolidated group determines whether it has a NUBIL. The IRS and Treasury have determined that, in such cases, it is appropriate for the built-in attribute of the member to be included in the group's determination because it is clear that such NUBIL arose when it was a group member. Accordingly, the final regulations include in the determination whether a group has a NUBIL any member that has a NUBIL on the date the determination is made, and that is neither a new loss member with a NUBIL nor a member of a NUBIL loss subgroup. The final regulations also include members in the group's determination whether the group has a NUBIL if such member(s) joined the consolidated group with a NUBIL, and, in the aggregate, have a NUBIG on the day that such determination is made.

4. Included—Determination Whether a Consolidated Group (or Loss Subgroup) with a Net Operating Loss Has a NUBIG, §1.1502–91(g)(2)(i)

Proposed §1.1502–93(c) provides that if a loss group (or loss subgroup) has a NUBIG, *any* recognized built-in gain of the loss group (or loss subgroup) is taken into account under section 382(h) in determining the consolidated section 382 limitation (or subgroup section 382 limitation)(emphasis added).

Commentators suggested that this provision, considered together with the five-year affiliation requirement, makes it unclear whether an NOL loss subgroup with members that do not satisfy the five-year affiliation requirement can use a NUBIG, if recognized, to increase the loss subgroup's section 382 limitation.

The IRS and Treasury have determined that the concerns forming the basis of the five-year affiliation requirement for determining whether a loss subgroup has a NUBIL do not extend to the determination whether a net operating loss carryover group (or loss subgroup) has a NUBIG. For example, unlike a NUBIL that can be eliminated by a NUBIG without an immediate tax cost, recognized built-in gains exact such a cost and, therefore, do not present the same planning opportunities. Accordingly, these final regulations provide that the members included in the determination whether an NOL loss group (or loss subgroup) has a NUBIG are all members of the group (or loss subgroup) on the day that the determination is made.

Section 1.1502–91(g)(2)(v) provides, in part, that in determining whether an NOL loss group has a NUBIG which, if recognized, increases the consolidated

section 382 limitation, the group includes all of its members on the day the determination is made. However, for purposes of determining whether a group has a net unrealized built-in loss, not all members of the consolidated group may be included. Thus, a consolidated group may have recognized built-in gains that increase the amount of consolidated taxable income that may be offset by its pre-change net operating loss carryovers that did not arise (and are not treated as arising) in a SRLY, and also may have recognized built-in losses the absorption of which is limited. Similar results may obtain for loss subgroups. In such cases, §1.1502–93(c)(2) prohibits the use of recognized built-in gains to increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

5. Recognized Built-in Gain or Loss on the Disposition of an Intercompany Obligation of a Member, §1.1502–91(h)(2)

Proposed §1.1502–91(h)(2) provides that gain or loss recognized by a member on the disposition of stock of another member or of an intercompany obligation is treated as recognized built-in gain or loss under section 382(h)(2)(unless disallowed under §1.1502–20 or otherwise), even though gain or loss on such stock or obligation is not included in the determination of the group's NUBIG or NUBIL immediately before the ownership change. The IRS and Treasury have determined that such treatment may lead to inappropriate results. For instance, if a bad debt deduction is treated as a recognized built-in loss, application of a section 382 limitation to that loss may prevent the proper offset of cancellation of indebtedness income against the bad debt deduction. Accordingly, §1.1502–91(h)-(2) of the final regulations treats gain or loss recognized on the disposition of an intercompany obligation as recognized built-in gain or loss only to the extent that the transaction gives rise to aggregate income or loss within the consolidated group.

6. Ownership Change Determination—The Parent Change Method, §1.1502–92

Proposed §1.1502–92 provides rules for determining an ownership change of a loss group (or a loss subgroup). A loss group (or loss subgroup) has an ownership change only if the common parent has an ownership change under the parent change method. Out of concern that taxpayers could exploit the parent change method's failure to account for minority shifts of stock, the proposed regulations adopted a supplemental change method that does take into account minority shifts of stock under certain circumstances.

Under the proposed regulations, the supplemental method applies if a person who is a 5-percent shareholder of the common parent (including any person acting pursuant to a plan or arrangement with such 5-percent shareholder) increases its percentage ownership both in the common parent and in any subsidiary of the group within the same testing period. In that event, the loss group (or loss subgroup) must also determine whether it had an ownership change under the rules for the parent change method by treating the common parent as though it had issued to the person who acquires (or is deemed to acquire) the subsidiary stock an amount of its own stock (by value) that equals the value of the subsidiary stock represented by the percentage increase in that person's ownership of the subsidiary (determined on a separate entity basis).

Section 1.1502–92(c), *Example 2* of the proposed regulations illustrates application of the supplemental change method. In *Example 2*, A owns all the stock of L, a loss group parent, and L owns all of the stock of L1. As part of a plan, A sells 49 percent of the L stock to B on October 7, Year 2, and L1 issues new stock representing a 20 percent ownership interest in L1 to the public on November 6, Year 2. The example concludes that "because the issuance of L1 stock to the public occurs in connection with B's acquisition of L stock pursuant to a plan," the supplemental change method applies to the public offering of L1 stock.

Commentators suggest that the "plan or arrangement" language sweeps too broadly, and that only plans to avoid section 382 should be subject to this rule. Commentators also contend that *Example 2* is beyond the scope of the operative rule because the facts do not demonstrate a plan or arrangement with a 5-percent shareholder.

The IRS and Treasury believe that it is appropriate to apply the supplemental change method to certain acquisitions of a loss group in which the plan is not between the 5-percent shareholder of the loss group parent and another person to increase their interests in the loss group. For example, if an individual buys 50 percent or less of the stock of a loss group parent, and as part of the same plan, causes a public offering out of a subsidiary, the supplemental change method should apply to that offering. (Conversely, the supplemental change method should not apply unless the 5-percent shareholder's increase in the stock of parent or subsidiary is related to the increase by another person because those increases are pursuant to the same plan.)

Accordingly, these final regulations provide that a 5-percent shareholder of the common parent (or loss subgroup parent) is treated as increasing its ownership interest in the stock of a subsidiary to the extent, if any, that the percentage ownership interest of another person or persons in the stock of the subsidiary is increased pursuant to a plan or arrangement under which the 5-percent shareholder increases its percentage ownership interest in the common parent (or loss subgroup parent).

To alleviate concerns that the supplemental change method is overly broad, the final regulations limit the scope of the supplemental change method through application of the rules of §1.382–2T(k). The final regulations provide that the supplemental change method will apply if the common parent (or loss subgroup parent) has actual knowledge of the increase in the 5-percent shareholder's ownership interest in the stock of the subsidiary (or has actual knowledge of the plan or arrangement) before the date that the group's income tax return is filed for the taxable year that includes the date of that increase or, if, at any time during the testing period, the 5-percent shareholder of the common parent is also a 5-percent shareholder of the subsidiary (determined without regard to a deemed acquisition of subsidiary stock under the plan or arrangement rule) whose percentage increase in the ownership of the stock of the subsidiary would be taken into account in determining if the subsidiary has an ownership change. For purposes of determining the 5-percent shareholders of the sub-

sidiary, the principles of §1.382–2T(k), including the duty to inquire, apply to the common parent (or loss subgroup parent).

Several additional changes to the supplemental change method were made in response to comments. Section 1.1502–92(c)(4)(iii) clarifies that stock treated as issued under the supplemental change method is not treated as issued in testing periods that do not include the testing date on which the parent stock is deemed to be issued. Section 1.1502–92(c)(4)(ii) provides that stock is not treated as issued if a deemed issuance of parent stock would not cause the loss group (or loss subgroup) to have an ownership change before the day on which the subsidiary leaves the loss group (or loss subgroup).

To avoid retroactive changes in ownership, §1.1502–92(c)(4)(v) provides that if the supplemental change method applies to an acquisition of subsidiary stock before the first date that the 5-percent shareholder increases its percentage ownership interest in the stock of the common parent (or loss subgroup parent), then the deemed issuance of stock is treated as occurring on the first such date. However, the value of the subsidiary stock is the value of such stock on the date it was acquired. In addition, §1.1502–92(c)(4)(vi) provides that if two or more 5-percent shareholders are treated as increasing their percentage ownership interests pursuant to a single plan or arrangement described above, appropriate adjustments must be made so that the amount of stock treated as issued is not taken into account more than one time.

Commentators also requested that the supplemental change method apply only if the acquisitions of parent stock and subsidiary stock are with a principal purpose of avoiding or lessening the impact of section 382. The IRS and Treasury believe that if the same 5-percent shareholder increases in the stock of both a subsidiary and the common parent within the same testing period, the supplemental change method should apply without further evidence of an avoidance purpose. Similarly, a plan or arrangement under which a 5-percent shareholder and another person both increase their interests in the loss group is sufficient proof of an avoidance purpose that the supplemental change method properly applies without further inquiry.

7. Consolidated Section 382 Limitation, §1.1502–93

Proposed §1.1502–93 provides rules for computing the consolidated section 382 limitation following an ownership change of a loss group. The value of the loss group is the value, immediately before the ownership change, of the stock (including stock described in section 1504(a)(4)) of each member of the loss group, other than stock that is owned directly or indirectly by a member. Section 1.1502–93(b)(2) provides that this value is adjusted under any rule in section 382 (such as section 382(l)(1), relating to certain capital contributions) requiring an adjustment to value for purposes of computing the section 382 limitation. The section 382 limitation, as so determined, is further adjusted as required by section 382 and the regulations thereunder (such as section 382(m)(2), relating to a short taxable year). Similar rules apply in determining the section 382 limitation for a loss subgroup.

In response to comments, the final regulations make several clarifications with respect to circumstances that require an adjustment to the value of a loss group or loss subgroup.

Section 1.1502–93(b)(2)(i) provides that, for purposes of section 382(e)(2), redemptions and corporate contractions that do not effect a transfer of value outside of the loss group (or loss subgroup) are disregarded. For purposes of section 382(l)(1), capital contributions between members of the loss group (or loss subgroup)(or a contribution of stock to a member made solely to satisfy the loss subgroup parent requirement of §§1.1502–91(d)(1)(ii) or 1.1502–91(d)-(2)(ii)), are not taken into account. Also, the substantial nonbusiness asset test of section 382(l)(4) is applied on a group (or subgroup) basis, and is not applied separately to its members.

Section 1.1502–93(b)(2)(ii) provides rules that apply to prevent duplication of value of the group (or loss subgroup) and to prevent duplication of the section 382 limitation. This section provides that appropriate adjustments must be made to the extent necessary to prevent any duplication of the value of the stock of a member, even though corporations that do not file consolidated returns may not be required to make such an adjustment. In making these adjustments, the group (or loss subgroup) may apply the principles of §1.382–8 (relating to controlled groups of corporations) in determining the value of a loss group (or loss subgroup) even if that section would not apply if separate returns were filed. Also, the principles of §1.382–5(d)(relating to successive ownership changes and absorption of a section 382 limitation) may apply to adjust the consolidated section 382 limitation (or subgroup section 382 limitation) of a loss group (or loss subgroup) to avoid a duplication of value if there are simultaneous (rather than successive) ownership changes.

One commentator suggested that contributions of assets by the selling group to a departing member or loss subgroup generally should not be subject to section 382(l)(1). The IRS and Treasury have determined that, unlike transfers of stock or assets that do not effect a transfer of value into a loss subgroup, capital contributions that constitute a transfer of value into a loss group or to a departing member should continue to be subject to section 382(l)(1).

A new §1.1502–93(c)(2) provides that appropriate adjustments must be made so that any recognized built-in gain of a member that increases more than one section 382 limitation (whether consolidated, subgroup, or separate) does not effect a duplication in the amount of consolidated taxable income that can be offset by prechange net operating losses. In addition, recognized built-in gains may not increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

8. Ceasing to Be a Member of a Consolidated Group (or Loss Subgroup), §1.1502–95

Elective apportionment of NUBIG

In general, the common parent of a consolidated group may elect to apportion all or part of each element (the value element and the adjustment element) of a consolidated section 382 limitation to a former member or loss subgroup. The proposed regulations do not provide that the common parent may elect to apportion all or part of a loss group's NUBIG.

Under section 382(h)(1)(A), if a consolidated group has a NUBIG immediately before an ownership change, the

section 382 limitation for any recognition period taxable year is increased by the recognized built-in gain for such taxable year. This increase cannot exceed the NUBIG, reduced by recognized built-in gains for prior years ending in the recognition period.

Commentators suggest that, like the value element and the adjustment element of the consolidated section 382 limitation, the common parent should be able to apportion any part or all of the group's NUBIG to a departing member (or loss subgroup). The final regulations adopt this recommendation.

In general, §1.1502–95(c)(2)(ii) provides that the amount of the loss group's NUBIG that may be apportioned to one or more former members that cease to be members during the same consolidated return year cannot exceed the loss group's excess, immediately after the close of that year, of net unrealized built-in gain over recognized built-in gain, determined under section 382(h)(1)(A)(ii) (relating to a limitation on recognized built-in gain). In general, NUBIG apportioned to a former member reduces the amount of NUBIG that the group can avail itself of in subsequent taxable years.

For purposes of determining the extent to which the former member's section 382 limitation can be increased by recognized built-in gains, the amount of NUBIG apportioned is treated as if it were an amount determined under section 382(h) with respect to the former member. The former member's five-year recognition period begins on the group's (or loss subgroup's) change date.

Default apportionment of zero section 382 limitation and NUBIG when a member ceases to be a member of a group (or loss subgroup), §1.1502–95(c)(2)(ii)

Section 1.1502–95(c)(1) provides that the common parent may elect to apportion all or any part of a consolidated section 382 limitation to a former member (or a loss subgroup) when the member or loss subgroup leaves the group. If the common parent does not make an apportionment of the applicable section 382 limitation(s) or of a NUBIG that the member recognizes during the recognition period, the former member or loss subgroup has a consolidated section 382 limitation of zero with respect to pre-change attributes (the zero default rule).

Commentators suggested that the zero default rule may be a trap for the unwary. For instance, under the proposed regulations, a subgroup member that ceases to bear a section 1504(a)(1) to the subgroup parent is subject to the zero default rule, even if that member remains within the current consolidated group.

The IRS and Treasury recognize that any default rule will benefit some taxpayers while operating to the detriment of others. For example, a default apportionment of a section 382 limitation or NUBIG based on the departing member's contribution to the group's net operating loss carryover could cause some apportioned limitation to go unused if that member becomes subject to a new section 382 limitation upon departing the group. By contrast, a rule providing that the default limitation is capped by the amount of any subsequent section 382 limitation, would be difficult to administer. Because the consequences of applying any default rule depend on the particular facts of a transaction, including the relative income generation of the departing and remaining members, the IRS and Treasury believe that the simplicity of the zero default rule makes the rule preferable to other alternatives.

Also, the IRS and the Treasury believe that the new exceptions to ceasing to be a member of a loss subgroup substantially reduce the likelihood that the zero default rule will yield unexpected results. For example, an acquisition of a loss subgroup typically will cause an ownership change of the loss subgroup. Following that ownership change, a member that remains within the current group now can break the section 1504(a)(1) relationship to the loss subgroup parent without ceasing to be a member of the loss subgroup. Accordingly, these final regulations retain the zero default rule when a member ceases to be a member of a group (or loss subgroup). The zero default rule also applies to a NUBIG.

Mandatory apportionment of a group's NUBIL to a departing member, §1.1502–95(e)

In general, a group has a NUBIL if the adjusted bases of the assets of members included in such determination under §1.1502–91(g) exceed their fair market value immediately before the change date. Similar rules apply to loss subgroups. Subject to the limitations of section 382(h)(2)(B), NUBILs recognized within the five year period beginning on the change date are subject to the consolidated section 382 limitation. The proposed regulations do not provide rules for apportioning a group's NUBIL to a former member (or loss subgroup). The IRS and Treasury believe that a mandatory apportionment of the group's NUBIL is necessary to ensure that the group's NUBIL, if recognized by the former member (or loss subgroup) during the recognition period, remains subject to the consolidated section 382 limitation. One commentator suggests that a former member (or loss group) should be apportioned a group's NUBIL only if and when a former member that had a separately computed NUBIL that contributed to the group's NUBIL departs the group, and the contributed built-in loss has not fully been recognized. Adjustments would reflect intragroup transfers of assets occurring between the change date and the date that the former member departs.

The IRS and Treasury believe that the suggested approach overemphasizes the location of assets with a NUBIG. For example, if a former member has a NUBIG determined on a separate entity basis, a recognized built-in loss of that member will not be limited, even if the former member is the first corporation to dispose of a built-in loss asset. The IRS and Treasury believe that subjecting the sale of built-in loss assets to the consolidated section 382 limitation, regardless of the location of built-in gain assets, more accurately reflects the NUBIL as a group attribute. Similarly, consistent with treatment of the NUBIL as a group attribute, the approach permits built-in gain to be sheltered by built-in loss only after the excess of built-in losses over built-in gains has been recognized. Accordingly, these final regulations adopt a model that apportions NUBIL based on the gross amount of built-in loss that the departing member contributed to the determination of the group's NUBIL.

In general, §1.1502–95(f) provides that a departing member is allocated a portion of the group's (or loss subgroup's)

NUBIL if, immediately after the close of the consolidated return year in which the departing member ceases to be a member, the amount of the loss group's (or loss subgroup's) excess of net unrealized built-in loss over recognized built-in loss (the remaining NUBIL balance) is greater than zero. In general, NUBIL apportioned to former members in prior taxable years is treated as recognized built-in loss in those years.

The amount of NUBIL allocated to a departing member is equal to the remaining NUBIL balance multiplied by a fraction. The numerator of the fraction is the amount of the built-in loss, taken into account on the change date, in the assets held by the departing member immediately after the member ceases to be a member of the loss group (or loss subgroup). The denominator of the fraction is the sum of the numerator, plus the amount of the built-in loss, taken into account on the change date, in the assets held by the group immediately after the close of the taxable year in which the departing member ceases to be a member. (Fluctuations in value of the assets between the change date and the date that the member ceases to be a member of the group (or loss subgroup), or the close of the taxable year in which the member ceases to be a member of the loss group, are disregarded.) In general, adjustments are made for gain or loss that has been recognized during the recognition period, and for assets that are transferred basis property. The amount of the NUBIL allocated to a former member generally is treated as previously recognized built-in loss for purposes of applying the limitation of section 382(h)(1)(B)(ii) to a loss group's taxable years beginning after the year in which the former member ceases to be a member.

For purposes of determining the amount of the former member's recognized built-in losses in any taxable year beginning after the former member ceases to be a member, the amount of the loss group's (or loss subgroup's) net unrealized built-in loss that is apportioned to the former member is treated as if it were an amount of net unrealized built-in loss determined under section 382(h)(1)(B)(i) with respect to such member, and that amount is not reduced under section 382(h)(1)(B)(ii) by the loss group's (or loss subgroup's) recognized built-in losses.

Subgroup principles apply to the allocation of a NUBIL. For example, if two or more members leave a loss group, and are members of a consolidated group, any allocation of the loss group's NUBIL is made on a subgroup basis. In general, the common parent may apportion all or any part of a consolidated section 382 limitation (or subgroup section 382 limitation) under §1.1502–95(c) to a former member to which the group's NUBIL is allocated (or to a loss subgroup that includes that member).

9. Miscellaneous Rules, §1.1502–96

Fold-in rules do not apply to NUBIGs, §1.1502–96(a)

Proposed §1.1502–96(a)(2) provides in part that, following a fold-in event described in §1.1502–96(a)(1), the member's separately computed NUBIG or NUBIL is included in the determination whether the group has a NUBIG or NUBIL.

The IRS and Treasury believe that the "fold-in" of a member's NUBIG can lead to inappropriate results. For example, a consolidated group that acquires a corporation with a small net operating loss carryover and a large NUBIG can immediately offset the group's NUBIL with the NUBIG, if the member is acquired with an ownership change. Accordingly, the fold-in rules of §1.1502–96(a) do not apply to include a member's separately computed NUBIG in determining whether a group has a NUBIL. A member's NUBIG is only included in such determination if the member is included under §1.1502–91(g)(2).

Net operating loss carryovers reattributed under §1.1502–20(g)

Section 1.1502–20 of the regulations disallows a deduction for certain losses on the disposition of stock of a subsidiary. In general, under §1.1502–20(g), the common parent can reattribute to itself net operating loss carryovers or capital loss carryovers attributable to the subsidiary in an amount not to exceed the disallowed loss. Section 1.1502–20(g) further provides that the common parent succeeds to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). Also, any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3)) in connection with the disposition is not taken into account under section 382 with respect to the reattributed losses. (§1.1502–20(g)(1)). The preamble to T.D. 8364 (56 F.R. 47379, September 19, 1991)(which added §1.1502–20), states that clarification regarding the application of section 382 to reattributed losses would be provided in connection with finalizing §§1.1502–91 through 1.1502–99. The preamble states that, for example, it is anticipated that proposed §1.1502–95 would be modified to permit the common parent to elect to retain all or part of a section 382 limitation that applies to reattributed SRLY losses.

A new §1.1502–96(d) provides rules relating to reattributed losses. This section generally provides that §§1.1502–91 through 1.1502–96 and §1.1502–98 apply to reattributed losses consistent with the provision of §1.1502–20(g) that treats the common parent as succeeding to the losses in a transaction to which section 381(a) applies. For example, if the reattributed loss is a pre-change attribute subject to a section 382 limitation, it remains subject to that limitation following the reattribution. Section 1.1502–96(d)(4) provides rules that allow the common parent to elect to apportion to itself all or part of any separate section 382 limitation or subgroup section 382 limitation to which the reattributed loss is subject. The apportionment is made under the principles of the rules of §1.1502–95(c), relating to the apportionment of a consolidated section 382 limitation to a member that leaves the group. In certain cases, the section 382 limitation applicable to the reattributed loss is zero unless an apportionment of such limitation is made to the common parent. The election to apportion a section 382 limitation is made as part of the election to reapportion the loss. See §1.1502–20(g)(4), as amended by this document.

As previously set forth in §1.1502–20(g), §1.1502–96(d) adopts the general rule that any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3))in connection with the disposition of the subsidiary's stock) is not taken

into account under section 382 with respect to the reattributed losses. The final regulations, however, modify the general rule to provide that any owner shift with respect to the successor corporation that is treated as continuing in existence under §1.382–2(a)(1)(ii) must be taken into account for such purpose if such owner shift is effected by the reattribution and any owner shift of the stock of the subsidiary not held directly or indirectly by the common parent would have been taken into account if such shift had occurred immediately before the reattribution. Such an owner shift may occur if the subsidiary has minority shareholders that, under §1.382–2(a)(1)(ii), are treated as decreasing their ownership in the reattributed loss, while the shareholders of the common parent increase their ownership interests in that loss.

The final regulations provide that, in general, the value of the stock of the common parent is used to establish a section 382 limitation for the reattributed loss with respect to an ownership change upon, or after, the reattribution. These rules coordinate the determination of the value of that stock with the capital contribution rules of section 382(l)(1), and also require appropriate adjustments so that value is not improperly omitted or duplicated as a result of the reattribution.

Effective Dates

Sections 1.1502–91 through 1.1502–96 and 1.1502–98

Except as set forth below, §§1.1502–91 through 1.1502–96 and 1.1502–98 apply to testing dates that occur on or after June 25, 1999. Sections 1.1502–94 through 1.1502–96 also apply on any date on or after June 25, 1999 on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup).

A transition rule for net unrealized built-in loss provides that a consolidated group may apply §1.1502–91A(g) for the period ending on the day before June 25, 1999 to determine the earliest date that its testing period begins (treating the day before June 25, 1999 as the end of a taxable year.)

The election under §1.1502–91(d)(4) to treat the subgroup parent requirement as satisfied is effective for corporations that become members of a consolidated group in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999. Section 1.1502–95(d)(2)(ii)(relating to exceptions to ceasing to be a member of loss subgroup) applies to corporations that cease to bear a section 1504(a)(1) relationship to a loss subgroup parent in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999.

The third sentence of §1.1502–91(d)-(5)(relating to members excluded from a loss subgroup) applies to corporations that become members of a consolidated group on or after June 25, 1999.

In the case of corporations that cease to be members of a loss group (or loss subgroup) before June 25, 1999, in a taxable year for which the due date of the income tax return (without extensions) is after June 25, 1999, §§1.1502–95(a), (b), (c) and (f) apply to those corporations if the common parent makes the election described in the second sentence of (c)(1) of that section in the time and manner prescribed in paragraph (f) of that section.

Section 1.1502–96(d) applies to reattributions of net operating losses or net capital losses in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999; except that the election under §1.1502– 96(d)(5) (relating to an election to reattribute section 382 limitation) can be made with any election under §1.1502–20(g)(4) to reattribute to the common parent a net operating loss or net capital loss that is timely filed on or after June 25, 1999.

Sections 1.1502–91A through 1.1502–96A and 1.1502–98A apply to any testing date on or after January 1, 1997, and before June 25, 1999. Sections 1.1502–94A through 1.1502–96A also apply on any date on or after January 1, 1997, and before June 25, 1999, on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup). For periods before January 1, 1997, the transition rules in §1.1502–99A(c) continue to apply.

The transition rules in §1.1502–99A for periods ending before January 1, 1997 also are clarified to provide that a member that ceases to be a member of a group does not have a zero section 382 limitation with respect to pre-change net operating losses allocated to that member.

Need For Immediate Guidance

Because the temporary regulations are not applicable for taxable years ending after June 26, 1999, it is necessary to implement these final regulations without delay to ensure continuity of treatment of certain attributes and to ensure that there is no period within which the treatment of such attributes is inconsistent with the temporary regulations and these final regulations. See section 7805(e)(2). Accordingly, it is impracticable and contrary to the public interest to issue this Treasury decision subject to the effective date limitation of section 553(d) of title 5 of the United States Code (if applicable).

SPECIAL ANALYSIS

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated federal income tax returns that have net operating losses or other attributes that are subject to section 382. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have net operating losses or other attributes subject to section 382. Moreover, many of these corporations will not have ownership changes. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was sent to the Small Business Administration for comment on its impact on small business.

DRAFTING INFORMATION

The principal author of the final regulations is Lee A. Kelley of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the IRS and Treasury participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for sections 1.1502–91T, 1.1502–92T, 1.1502–93T, 1.1502–94T, 1.1502–95T, 1.1502–96T, 1.1502–98T, and 1.1502–99T, and adding entries in numerical order to read in part as follows:

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

Section 1.1502–91 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–92 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–93 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–94 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–95 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–96 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–98 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–99 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502. * * *

Section 1.1502–91A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–92A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–93A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–94A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–95A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–96A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–98A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–99A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

* * *

Par. 2. In the list below, for each section indicated in the left column, remove the wording indicated in the middle column, and add the wording indicated in the right column.

Affected Section	*Remove*	*Add*
1.1502–91T(a)(1), first sentence	§§ 1.1502–92T and 1.1502–93T	§§ 1.1502–92A and 1.1502–93A
1.1502–91T(a)(1), third sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–91T(a)(1), third sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–91T(a)(3)	§§ 1.1502–94T and 1.1502–95T	§§ 1.1502–94A and 1.1502–95A
1.1502–91T(b) introductory text	§§ 1.1502–92T through 1.1502–99T	§§ 1.1502–92A through 1.1502–99A
1.1502–91T(b)(1)	§§ 1.1502–92T through 1.1502–99T	§§ 1.1502–92A through 1.1502–99A
1.1502–91T(c)(2), second sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(c)(3), Example(b), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–91T(d)(4), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–91T(d)(5), first sentence	§ 1.1502–95T(d)	§ 1.1502–95A(d)
1.1502–91T(d)(5), second sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(e)(2), Example(b), third sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–91T(f)(2), Example(b)(2), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(f)(2), Example(b)(2), third sentence	§ 1.1502–92T(a)(2)	§ 1.1502–92A(a)(2)
1.1502–91T(f)(2), Example(b)(2), fourth sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–91T(f)(2), Example(c), second sentence	§ 1.1502–96T(c)	§ 1.1502–96A(c)
1.1502–91T(g)(1), last sentence	§1.1502–94T(c)	§ 1.1502–94A(c)
1.1502–91T(g)(1), last sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(g)(2)(i)(A)	§ 1.1502–94T(a)(1)(ii)	§ 1.1502–94A(a)(1)(ii)
1.1502–91T(g)(2)(i)(B)	§ 1.1502–91T(d)(2)	§ 1.1502–91A(d)(2)
1.1502–91T(j), first sentence	§§ 1.1502–92T through 1.1502–99T	§§ 1.1502–92A through 1.1502–99A

1.1502–92T(a), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–92T(a), second sentence	§1.1502–96T(b)	§ 1.1502–96A(b)
1.1502–92T(b)(1)(i)(A)	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–92T(b)(1)(i)(B)	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–92T(b)(1)(ii), second sentence	§ 1.1502–95T(b)	§ 1.1502–95A(b)
1.1502–92T(b)(1)(ii)(A)	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–92T(b)(1)(ii)(C)	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–92T(b)(2) Example 1(a), sixth sentence	§ 1.1502–91T(c)(1)	§ 1.1502–91A(c)(1)
1.1502–92T(b)(2) Example 3(b), first sentence	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–92T(b)(2) Example 4(b), first sentence	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–92T(b)(3)(iii) Example 2(d), fourth sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–92T(b)(3)(iii) Example 3(a), seventh sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–92T(b)(4), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–92T(b)(4), first sentence	§ 1.1502–96T(a)(2)	§ 1.1502–96A(a)(2)
1.1502–92T(b)(4), first sentence	§ 1.1502–96T(b)	§ 1.1502–96A(b)
1.1502–92T(b)(4), second sentence	§ 1.1502–96T(a) applies, see § 1.1502–96T(c)	§1.1502–96A(a) applies, see § 1.1502–96A(c)
1.1502–92T(e)(1)(ii)	§ 1.1502–96T(b)	§ 1.1502–96A(b)
1.1502–92T(e)(2), fifth sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–92T(e)(2), fifth sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–93T(a)(2)	§ 1.1502–95T(c)	§ 1.1502–95A(c)
1.1502–93T(b)(2), last sentence	§ 1.382–8T	§ 1.382-8
1.1502–93T(b)(2), fourth sentence	§ 1.1502–91T(g)(2)	§ 1.1502–91A(g)(2)
1.1502–94T(a)(1)(i)	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–94T(a)(1)(ii)	§ 1.1502–91T(d)(2)	§ 1.1502–91A(d)(2)
1.1502–94T(a)(3)	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–94T(a)(3)	§§ 1.1502–92T and 1.1502–93T	§§ 1.1502–92A and 1.1502–93A
1.1502–94T(a)(4), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–94T(a)(4), first sentence	§, 1.1502–96T(a)(2)	§1.1502–96A(a)(2)
1.1502–94T(a)(4), first sentence	§ 1.1502–92T(b)(1)(i)	§1.1502–92A(b)(1)(i)
1.1502–94T(a)(4), first sentence	§1.1502–96T(b)	§§1.1502–96A(b)
1.1502–94T(a)(4), second sentence	§ 1.1502–96T(a) applies, see § 1.1502–96T(c)	§ 1.1502–96A(a) applies, see § 1.1502–96A(c)
1.1502–94T(a)(5)	§ 1.1502–96T(c)	§ 1.1502–96A(c)
1.1502–94T(b)(4) Example 1(b), first sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)

1.1502–94T(b)(4) Example 2(b),	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–94T(b)(4) Example 2(d), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–94T(b)(4) Example 2(d), third sentence	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–94T(b)(4) Example 3(b), first sentence	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–94T(b)(4) Example 3(c), second sentence	§§ 1.1502–96T(a) and 1.1502–91T(c)(2)	§§ 1.1502–96A(a) and 1.1502–91A(c)(2)
1.1502–94T(c), first sentence	§§ 1.1502–91T(g) and (h)	§§ 1.1502–91A(g) and (h) and 1.1502–93A(c)
1.1502–94T(c), second sentence	§ 1.1502–91T(g)(3)	§ 1.1502–91A(g)(3)
1.1502–94T(d), fifth sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–94T(d),sixth sentence	§ 1.1502–92T(e)(1)	§ 1.1502–92A(e)(1)
1.1502–95T(a)(3), paragraph heading	*§§ 1.1502–91T through 1.1502–93T*	*§§ 1.1502–91A through 1.1502–93A*
1.1502–95T(a)(3)	§§ 1.1502–91T through 1.1502–93T	§§ 1.1502–91A through 1.1502–93A
1.1502–95T(b)(1) introductory text, first sentence	§§ 1.1502–91T through 1.1502–93T	§§ 1.1502–91A through 1.1502–93A
1.1502–95T(b)(2) introductory text	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(b)(4) Example(2)(a), second sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(c)(2) introductory text	§ 1.1502–93T	§ 1.1502–93A
1.1502–95T(c)(7) Example(1)(a), third sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(d)(2) Example(1)(a), fifth sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(d)(2) Example(3)(a), fourth sentence	§ 1.1502–92T(b)(1)(ii)	§ 1.1502– 92A(b)(1)(ii)
1.1502–95T(e)(1) introductory text	§ 1.1502–95T	§ 1.1502–95A
1.1502–96T(a)(2) introductory text, first sentence	§ 1.1502–91T(c)(1)(i)	§ 1.1502–91A(c)(1)(i)
1.1502–96T(a)(2)(ii)	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–96T(a)(3), second sentence	§ 1.1502–91T(f)(2)	§ 1.1502–91A(f)(2)
1.1502–96T(a)(5), first sentence	§§ 1.1502–91T through 1.1502–95T	§§ 1.1502–91A through 1.1502–95A
1.1502–96T(a)(5) introductory text, first sentence	§ 1.1502–98T	§ 1.1502–98A
1.1502–96T(b)(1) introductory text, first sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–96T(b)(1) introductory text, first sentence	§ 1.1502–91T(c)(1)	§ 1.1502–91A(c)(1)
1.1502–96T(b)(1) introductory text, first sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–96T(b)(1) introductory text, second sentence	§ 1.1502–95T(b)	§ 1.1502–95A(b)

1.1502–96T(b)(3), paragraph heading	*§§ 1.1502–91T, 1.1502–92T, and 1.1502–94T*	*§§1.1502–91A, 1.1502–92A, and 1.1502–94A*
1.1502–96T(b)(3), first sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–96T(b)(3), first sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–96T(b)(3), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–96(c), last sentence	§ 1.382–5T(d)	§ 1.382–5(d)
1.1502–98T, first sentence	§§ 1.1502–91T through 1.1502–96T	§§ 1.1502–91A through 1.1502–96A
1.1502–98T, second sentence	§§ 1.1502–91T through 1.1502–96T	§§ 1.1502–91A through 1.1502–96A
1.1502–98T, third sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–98T, third sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–99T(a), first sentence	Sections 1.1502–91T through 1.1502–96T and 1.1502–98T	Sections 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(a), second sentence	Sections 1.1502–94T through 1.1502–96T	Sections 1.1502–94A through 1.1502–96A
1.1502–99T(b), first sentence	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(b), second sentence	§ 1.1502–92T(b)(1)(i)	§ 1.1502–92A(b)(1)(i)
1.1502–99T(b), third sentence	§ 1.1502–92T(b)(1)	§ 1.1502–92A(b)(1)
1.1502–99T(c)(1)(ii)	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(c)(1)(iii), first sentence	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(c)(1)(iii), second sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–99T(c)(2)(i), first sentence	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(c)(2)(i), first sentence	§ 1.1502–95T(c)	§ 1.1502–95A(c)
1.1502–99T(c)(2)(i), fifth sentence	§ 1.1502–91T(d)(2)(i)	§ 1.1502–91A(d)(2)(i)
1.1502–99T(c)(2)(ii)	§ 1.382–8T	§ 1.382–8
1.1502–99T(c)(2)(ii)	§ 1.382–8T(h)	§ 1.382–8(h)
1.1502–99T(d)(1)	§ 1.1502–92T	§ 1.1502–92A
1.1502–99T(d)(3)	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A

Par. 3. Section 1.1502–20 is amended as follows:

1. Adding a sentence to the end of paragraph (g)(1).

2. Redesignating paragraph (g)(5) as paragraph (g)(4).

3. Paragraph (g)(4)(i)(A) is amended by removing ", and" and adding ";" in its place.

4. Paragraph (g)(4)(i)(B) is amended by removing the period at the end of the paragraph and adding "; and" in its place.

5. Adding a new paragraph (g)(4)(i)(C) immediately after paragraph (g)(4)(i)(B) and before paragraph (g)(4)(i) concluding text.

6. Redesignating paragraph (g)(4)(ii) as paragraph (g)(4)(iii).

7. Adding a new paragraph (g)(4)(ii).

The revisions and additions read as follows:

§1.1502–20 Disposition or deconsolidation of subsidiary stock.

* * * * *

(g) * * *

(1) * * * See §1.1502–96(d) for rules relating to section 382 and the reattribution of losses under this paragraph (g).

* * * * *

(4)

(i) * * *

(C) If the common parent is reattributing to itself all or any part of a section 382 limitation pursuant to §1.1502–96(d)(5), the information required by paragraph (g)(4)(ii) of this section.

* * * * *

(ii) *Reattribution of section 382 limitation.* The information required by this paragraph (g)(4)(ii) is a separate list for each subsidiary (or a separate list for two or more subsidiaries that are members of a loss subgroup whose pre-change sub-

group losses are being reattributed) with respect to which an apportionment of a separate section 382 limitation or subgroup section 382 limitation is being made, setting forth—

(A) The name and E.I.N. of the subsidiary (or subsidiaries that were members of a loss subgroup);

(B) A statement entitled "THIS IS AN ELECTION UNDER §1.1502–96(d)(5) TO APPORTION ALL OR PART OF [insert A SEPARATE or A SUBGROUP or BOTH A SEPARATE AND A SUBGROUP] SECTION 382 LIMITATION TO [insert name and E.I.N. of the common parent]";

(C) The date of the ownership change giving rise to the separate section 382 limitation or subgroup section 382 limitation that is being apportioned;

(D) The amount of the separate (or subgroup) section 382 limitation for the taxable year in which the reattribution occurs (determined without reference to any apportionment under this section or §1.1502–95(c));

(E) The amount of each net operating loss carryover or capital loss carryover, and the year in which it arose, of the subsidiary (or subsidiaries) that is subject to the separate section 382 limitation or subgroup section 382 limitation that is being apportioned to the common parent, and the amount of the value element and adjustment element of that limitation that is apportioned to the common parent.

* * * * *

Par. 3a. Immediately following §1.1502–79A, an undesignated centerheading is added to read as follows:

REGULATIONS APPLYING SECTION 382 WITH RESPECT TO TESTING DATES (AND CORPORATIONS JOINING OR LEAVING CONSOLIDATED GROUPS) BEFORE June 25, 1999.

Par. 4. Section §1.1502–90T is amended as follows:

1. Redesignating §1.1502–90T as §1.1502–90A [newly redesignated §1.1502–90A will appear after the centerheading added in Par. 3a.]

2. Revising the section heading and the introductory text of newly designated §1.1502–90A.

3. Redesignating the entries for §1.1502–91T through §1.1502–99T as §1.1502–91A through §1.1502–99A and revising the section headings.

4. Revising the entries for paragraph (a) of newly designated §1.1502–99A.

The revisions read as follows:

§1.1502–90A Table of contents.

The following list contains the major headings in §§1.1502–91A through 1.1502–99A:

§1.1502–91A Application of section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–92A Ownership change of a loss group or a loss subgroup generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–93A Consolidated section 382 limitation (or subgroup section 382 limitation) generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–94A Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group generally applicable for corporations becoming members of a group before June 25, 1999.

* * * * *

§1.1502–95A Rules on ceasing to be a member of a consolidated group (or loss subgroup) generally applicable for corporations ceasing to be members before June 25, 1999.

* * * * *

§1.1502–96A Miscellaneous rules generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–97A Special rules under section 382 for members under the jursidiction of a court in a title 11 or similar case. [Reserved].

§1.1502–98A Coordination with section 383 generally applicable for testing dates (or members joining or leaving a group) before June 25, 1999.

§1.1502–99A Effective dates.

(a) Effective date.

(1) In general.

(2) Anti-duplication rules for recognized built-in gain.

* * * * *

Par. 5. Section 1.1502–91T is amended as follows:

1. Redesignating §1.1502–91T as §1.1502–91A.

2. Revising the section heading of newly designated §1.1502–91A.

3. Amending paragraph (h)(2) by removing the words "or an intercompany obligation" and replacing them with "(or an intercompany obligation disposed of before June 25, 1999)".

The revision reads as follows:

§1.1502–91A Application of section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.

* * * * *

Par. 6. Section 1.1502–92T is revised as §1.1502–92A, and the section heading is amended to read as follows:

§1.1502–92A Ownership change of a loss group or a loss subgroup generally applicable for testing dates before June 25, 1999.

* * * * *

Par 6a. Section 1.1502–93T is amended as follows:

1. Redesignating §1.1502–93T as §1.1502–93A.

2. Revising the section heading of newly redesignated §1.1502–93A.

3. Adding a sentence at the end of paragraph (c).

The additions and revisions read as follows:

§1.1502–93A Consolidated section 382 limitation (or subgroup section 382 limitation)generally applicable for testing dates before June 25, 1999.

* * * * *

(c)* * * See §1.1502–99A(a)(2) for a special rule relating to the application of

§1.502–93(c)(2) to consolidated return years for which the due date of the return is after June 25, 1999.

* * * * *

Par. 7. Section 1.1502–94T is amended as follows:

1. Redesignating §1.1502–94T as §1.1502–94A.

2. Revising the section heading of newly redesignated §1.1502–94A.

3. Revising the last sentence of paragraph (b)(4), Example 3(b).

The revision reads as follows:

§1.1502–94A Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group) generally applicable for corporations becoming members of a group before June 25, 1999.

* * * * *

(b) * * *

(4) * * *

Example 3. * * *

(b) * * * See also §1.1502–21T in effect prior to June 25, 1999, contained in 26 CFR Part 1, revised April 1, 1999, or §1.1502–21, as applicable.

* * * * *

Par. 8. Redesignate §1.1502–95T as §1.1502–95A and revise the section heading to read as follows:

§1.1502–95A Rules on ceasing to be a member of a consolidated group generally applicable for corporations ceasing to be members before June 25, 1999.

* * * * *

Par. 9. Redesignate §1.1502–96T as §1.1502–96A and revise the section heading to read as follows:

§1.1502–96A. Miscellaneous rules generally applicable for testing dates before June 25, 1999.

* * * * *

Par. 10. Redesignate §1.1502–97T as §1.1502–97A and revise the section heading to read as follows:

§1.1502–97A Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case. [Reserved].

* * * * *

Par. 11. Redesignate §1.1502–98T as §1.1502–98A and revise the section heading to read as follows:

§1.1502–98A Coordination with section 383 generally applicable for testing dates (or members joining or leaving a group) before June 25, 1999.

* * * * *

Par. 12. Section 1.1502–99T is amended as follows:

1. Redesignating §1.1502–99T as §1.1502–99A.

2. Revising the section heading.

3. Revising paragraph (a).

4. Amending paragraph (c)(2)(i) by removing the language "(relating to the apportionment" in the first sentence and adding "and (b)(2)(ii)(relating to the apportionment".

The revisions read as follows:

§1.1502–99A Effective dates.

(a) *Effective date*—(1) *In general.* Except as provided in §1.1502–99(b), §§1.1502–91A through 1.1502–96A and 1.1502–98A apply to any testing date on or after January 1, 1997, and before June 25, 1999. Sections 1.1502–94A through 1.1502–96A also apply on any date on or after January 1, 1997, and before June 25, 1999, on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup).

(2) *Anti-duplication rules for recognized built-in gain.* Section 1.1502–93(c)(2)(relating to recognized built-in gain of a loss group or loss subgroup) applies to taxable years for which the due date for income tax returns (without extensions) is after June 25, 1999.

* * * * *

Par. 13. Sections 1.1502–90 through 1.1502–99 are added to read as follows:

§1.1502–90 Table of contents.

The following list contains the major headings in §§1.1502–91 through 1.1502–99:

§1.1502–91 Application of section 382 with respect to a consolidated group.

a. Determination and effect of an ownership change.
(1) In general.
(2) Special rule for post-change year that includes the change date.
(3) Cross-reference.
(b) Definitions and nomenclature.
(c) Loss group.
(1) Defined.
(2) Coordination with rule that ends separate tracking.
(3) Example.
(d) Loss subgroup.
(1) Net operating loss carryovers.
(2) Net unrealized built-in loss.
(3) Loss subgroup parent.
(4) Election to treat loss subgroup parent requirement as satisfied.
(5) Principal purpose of avoiding a limitation.
(6) Special rules.
(7) Examples.
(e) Pre-change consolidated attribute.
(1) Defined.
(2) Example.
(f) Pre-change subgroup attribute.
(1) Defined.
(2) Example.
(g) Net unrealized built-in gain and loss.
(1) In general.
(2) Members included.
(i) Consolidated group with a net operating loss.
(ii) Determination whether a consolidated group has a net unrealized built-in loss.
(iii) Loss subgroup with net operating loss carryovers.
(iv) Determination whether subgroup has a net unrealized built-in loss.
(v) Separate determination of section 382 limitation for recognized built-in losses and net operating losses.
(3) Coordination with rule that ends separate tracking.
(4) Acquisitions of built-in gain or loss assets.

(5) Indirect ownership.
2. Common parent not common parent for five years.
(h) Recognized built-in gain or loss.
(1) In general. [Reserved]
(2) Disposition of stock or an intercompany obligation of a member.
(3) Intercompany transactions.
(4) Exchanged basis property.
(i) [Reserved]
(j) Predecessor and successor corporations.

§1.1502–92 Ownership change of a loss group or a loss subgroup.

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§1.1502–93 Consolidated section 382 limitation (or subgroup section 382 limitation).

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(i) Consolidated section 382 limitation.
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(e) Time and manner of making election under §1.1502–91(d)(4).
(1) In general.
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§1.1502–97 Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case.[Reserved].

§1.1502–98 Coordination with section 383.

§1.1502–99 Effective dates.

(a) Effective date.
(b) Special rules.
(1) Election to treat subgroup parent requirement as satisfied.
4. Principal purpose of avoiding a limitation.
(3) Ceasing to be a member of a loss subgroup.
(i) Ownership change of a loss subgroup.
(ii) Expiration of 5-year period.
(4) Reattribution of net operating loss carryovers under §1.1502–20(g).
(5) Election to apportion net unrealized built-in gain.
(c) Testing period may include a period beginning before June 25, 1999.
(1) In general.
(2) Transition rule for net unrealized built-in losses.

§1.1502–91 Application of section 382 with respect to a consolidated group.

(a) *Determination and effect of an ownership change*—(1) *In general.* This section and §§1.1502–92 and 1.1502–93 set forth the rules for determining an ownership change under section 382 for members of consolidated groups and the section 382 limitations with respect to attributes described in paragraphs (e) and (f) of this section. These rules generally provide that an ownership change and the section 382 limitation are determined with respect to these attributes for the group (or loss subgroup) on a single entity basis and not for its members separately. Following an ownership change of a loss group (or a loss subgroup) under §1.1502–92, the amount of consolidated taxable income for any post-change year which may be offset by pre-change consolidated attributes (or pre-change subgroup attributes) shall not exceed the consolidated section 382 limitation (or subgroup section 382 limitation) for such year as determined under §1.1502–93.

(2) *Special rule for post-change year that includes the change date.* If the post-change year includes the change date, section 382(b)(3)(A) is applied so that the consolidated section 382 limitation (or subgroup section 382 limitation) does not apply to the portion of consolidated taxable income that is allocable to the period in the year on or before the change date. See generally §1.382–6 (relating to the allocation of income and loss). The allocation of consolidated taxable income for the post-change year that includes the change date must be made before taking into account any consolidated net operating loss deduction (as defined in §1.1502–21(a)).

(3) *Cross-reference.* See §§1.1502–94 and 1.1502–95 for rules that apply section 382 to a corporation that becomes or ceases to be a member of a group or loss subgroup.

(b) *Definitions and nomenclature.* For purposes of this section and §§1.1502–92 through 1.1502–99, unless otherwise stated:

(1) The definitions and nomenclature contained in section 382 and the regulations thereunder (including the nomenclature and assumptions relating to the examples in §1.382-2T(b)) and this section and §§1.1502–92 through 1.1502–99 apply.

(2) In all examples, all groups file consolidated returns, all corporations file their income tax returns on a calendar year basis, the only 5-percent shareholder of a corporation is a public group, the facts set forth the only owner shifts during the testing period, no election is made under paragraph (d)(4) of this section, and each asset of a corporation has a value equal to its adjusted basis.

(3) As the context requires, references to §§1.1502–91 through 1.1502–96 include references to corresponding provisions of §§1.1502–91A through 1.1502–96A. For example, a reference to an ownership change under §1.1502–92 in §1.1502–95(b) can include a reference to an ownership change under §1.1502–92A.

(c) *Loss group*—(1) *Defined.* A loss group is a consolidated group that—

(i) Is entitled to use a net operating loss carryover to the taxable year that did not arise (and is not treated under §1.1502–21(c) as arising) in a SRLY;

(ii) Has a consolidated net operating loss for the taxable year in which a testing date of the common parent occurs (determined by treating the common parent as a loss corporation); or

(iii) Has a net unrealized built-in loss (determined under paragraph (g) of this section by treating the date on which the determination is made as though it were a change date).

(2) *Coordination with rule that ends separate tracking.* A consolidated group may be a loss group because a member's losses that arose in (or are treated as arising in) a SRLY are treated as described in paragraph (c)(1)(i) of this section. See §1.1502–96(a).

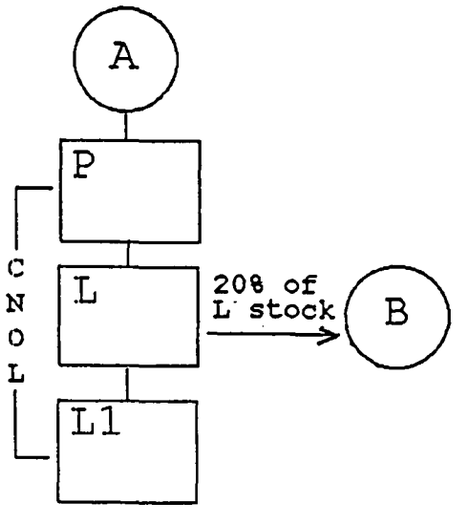
(3) *Example.* The following example illustrates the principles of this paragraph (c):

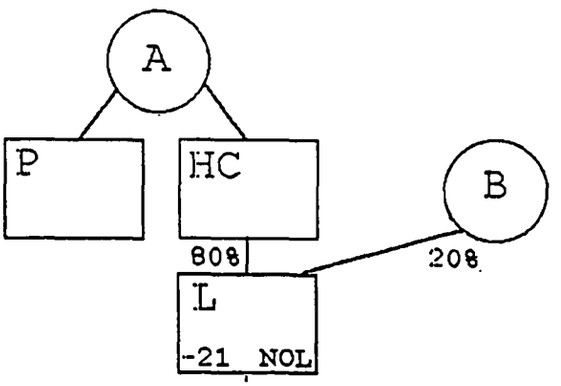
Example. Loss group. (i) L and L1 file separate returns and each has a net operating loss carryover arising in Year 1 that is carried over to Year 2. A owns 40 shares and L owns 60 shares of the 100 outstanding shares of L1 stock. At the close of Year 1, L buys the 40 shares of L1 stock from A. For Year 2, L and L1 file a consolidated return. The following is a graphic illustration of these facts:

(ii) L and L1 become a loss group at the beginning of Year 2 because the group is entitled to use the Year 1 net operating loss carryover of L, the common parent, which did not arise (and is not treated under §1.1502–21(c) as arising) in a SRLY. See §1.1502–94 for rules relating to the application of section 382 with respect to L1's net operating loss carryover from Year 1 which did arise in a SRLY.

(d) *Loss subgroup*—(1) *Net operating loss carryovers.* Two or more corporations that become members of a consolidated group (the current group) compose a loss subgroup if—

(i) They were affiliated with each other in another group (the former group), whether or not the group was a consolidated group;





(ii) They bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the current group (or are deemed to bear that relationship as a result of an election described in paragraph (d)(4) of this section); and

(iii) At least one of the members carries over a net operating loss that did not arise (and is not treated under §1.1502–21(c) as arising) in a SRLY with respect to the former group.

(2) *Net unrealized built-in loss.* Two or more corporations that become members of a consolidated group compose a loss subgroup if they—

(i) Have been continuously affiliated with each other for the 5 consecutive year period ending immediately before they become members of the group;

(ii) Bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the current group (or are deemed to bear that relationship as a result of an election described in paragraph (d)(4) of this section); and

(iii) Have a net unrealized built-in loss (determined under paragraph (g) of this section on the day they become members of the group by treating that day as though it were a change date).

(3) *Loss subgroup parent.* A loss subgroup parent is the corporation that bears the same relationship to the other members of the loss subgroup as a common parent bears to the members of a group.

(4) *Election to treat loss subgroup parent requirement as satisfied*—(i) *In general.* Solely for purposes of paragraphs (d)(1)(i) and (2)(ii) of this section, two or more corporations that become members of a consolidated group at the same time and that were affiliated with each other immediately before becoming members of the group are deemed to bear a section 1504(a)(1) relationship to each other immediately after they become members of the group if the common parent of that group makes an election under this paragraph (d)(4) with respect to those members. See §1.1502–96(e) for the time and manner of making the election.

(ii) *Members included.* An election under this paragraph (d)(4) includes all corporations that become members of the

current group at the same time and that were affiliated with each other immediately before they become members of the current group.

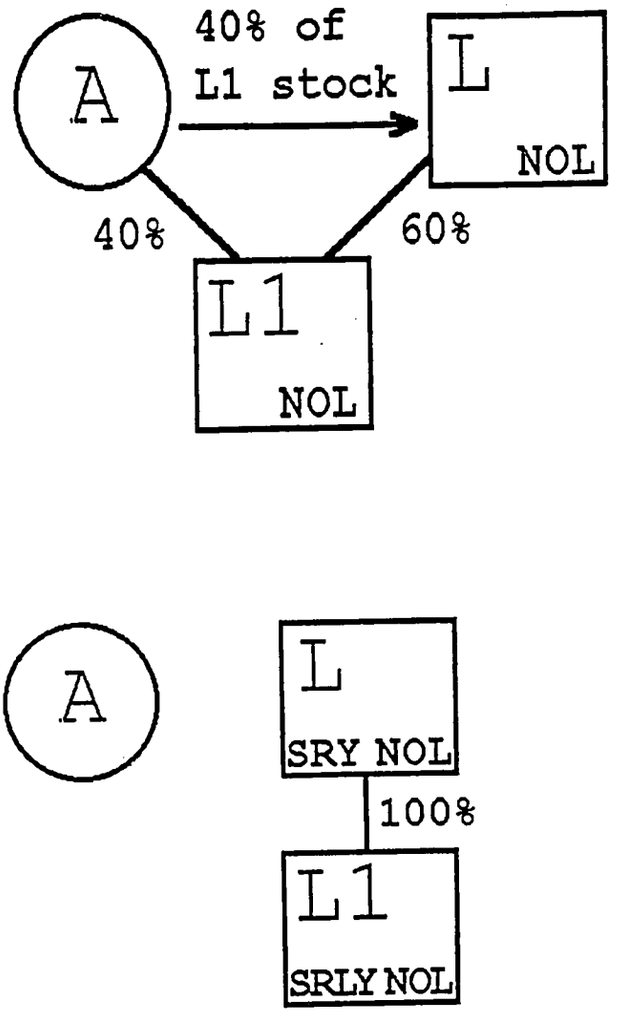
(iii) *Each member included treated as loss subgroup parent.* If the members to which this election applies are a loss subgroup described in paragraph (d)(1) or (2) of this section, then each member is treated as a loss subgroup parent. See §1.1502–92(b)(1)(iii) for special rules relating to an ownership change of a loss subgroup if the election under this paragraph (d)(4) is made.

(5) *Principal purpose of avoiding a limitation.* The corporations described in paragraphs (d)(1) or (2) of this section do not compose a loss subgroup if any one of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, section 382. Instead, §1.1502–94 applies with respect to the attributes of each such corporation. Any member excluded from a loss subgroup, if excluded with a principal purpose of so avoiding or increasing any section 382 limitation, is treated as included in the loss subgroup. This paragraph (d)(5) does not apply solely because, in connection with becoming members of the group, the members of a group (or loss subgroup) are rearranged (or, in the case of the preceding sentence, are not rearranged) to bear a relationship to the other members described in section 1504(a)(1).

(6) *Special rules.* See §1.1502–95(d) for rules concerning when a corporation ceases to be a member of a loss subgroup, and for certain exceptions that may apply if a member does not continue to satisfy the loss subgroup parent requirement within the current group. See also §1.1502–96(a) for a special rule regarding the end of separate tracking of SRLY losses of a member that has an ownership change or that has been a member of a group for at least 5 consecutive years.

(7) *Examples.* The following examples illustrate the principles of this paragraph (d):

Example 1. Loss subgroup. (i) P owns all the L stock and L owns all the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried to Year 2. On May 2, Year 2, P sells all the stock of L to A, and L and L1 thereafter file consolidated returns. A portion of the Year 1 consolidated net operating loss is apportioned under §1.1502–21(b) to each of L and L1, which they carry over to Year 2. The following is a graphic illustration of these facts:



(ii) (a) L and L1 compose a loss subgroup within the meaning of paragraph (d)(1) of this section because—

(A) They were affiliated with each other in the P group (the former group);

(B) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they became members of the L group; and

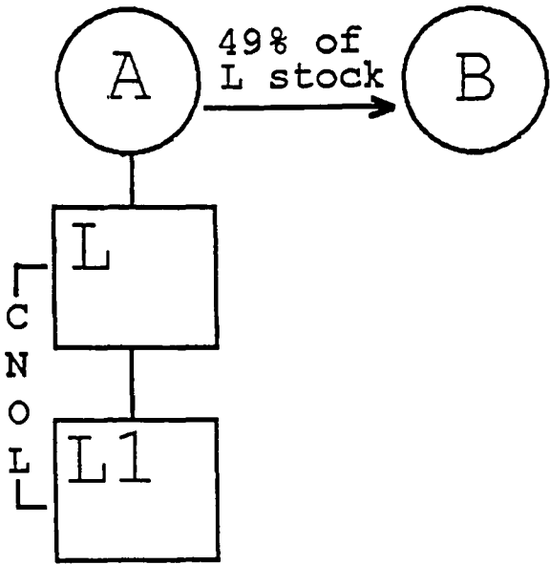
(C) At least one of the members (here, both L and L1) carries over a net operating loss to the L group (the current group) that did not arise in a SRLY with respect to the P group.

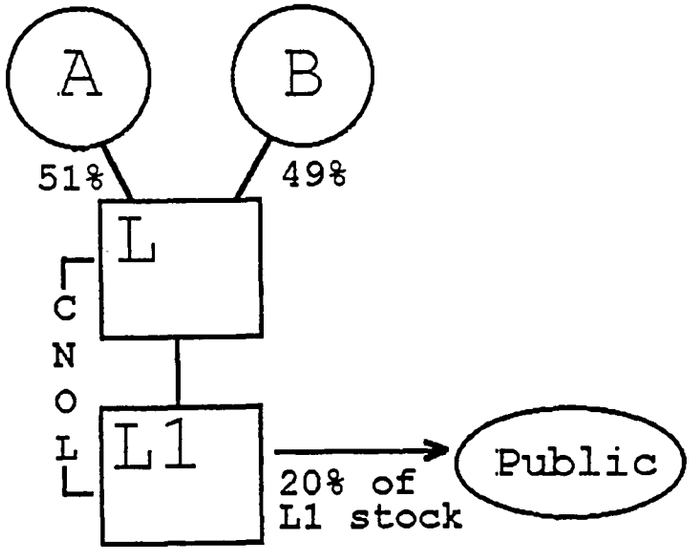
(b) Under paragraph (d)(3) of this section, L is the loss subgroup parent of the L loss subgroup.

Example 2. Loss subgroup—section 1504(a)(1) relationship. (i) P owns all the stock of L and L1. L owns all the stock of L2. L1 and L2 own 40 percent and 60 percent of the stock of L3, respectively. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On May 22, Year 2, P sells all the stock of L and L1 to P1, the common parent of another consolidated group. The Year 1 consolidated net operating loss is apportioned under §1.1502–21(b), and each of L, L1, L2, and L3 carries over a portion of such loss to the first consolidated return year of the P1 group ending after the acquisition. The following is a graphic illustration of these facts:

(ii) L and L2 compose a loss subgroup within the meaning of paragraph (d)(1) of this section. Neither L1 nor L3 is included in a loss subgroup because neither bears a relationship described in section 1504(a)(1) through a loss subgroup parent to any other member of the former group immediately after becoming members of the P1 group.

Example 3. Loss subgroup—section 1504(a)(1) relationship. The facts are the same as in *Example 2*, except that the stock of L1 is transferred to L in





connection with the sale of the L stock to P1. L, L1, L2, and L3 compose a loss subgroup within the meaning of paragraph (d)(1) of this section because—

(i) They were affiliated with each other in the P group (the former group);

(ii) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they become members of the P1 group; and

(iii) At least one of the members (here, each of L, L1, L2, and L3) carries over a net operating loss to the P1 group (the current group).

Example 4. Loss subgroup—elective section 1504(a)(1) relationship. The facts are the same as in Example 2, except that P1 makes the election under paragraph (d)(4) of this section. The election includes L, L1, L2, and L3 (even though L and L2 would compose a loss subgroup without regard to the election) because they become members of the current group (the P1 group) at the same time and were affiliated with each other in the P group immediately before they became members of the P1 group. As a result of the election, L, L1, L2, and L3 are treated as satisfying the requirement that they bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the P1 group. L, L1, L2, and L3 compose a loss subgroup within the meaning of paragraph (d)(1) of this section.

(e) *Pre-change consolidated attribute*—(1) *Defined.* A pre-change consolidated attribute of a loss group is—

(i) Any loss described in paragraph (c)(1)(i) or (ii) of this section (relating to the definition of loss group) that is allocable to the period ending on or before the change date; and

(ii) Any recognized built-in loss of the loss group.

(2) *Example.* The following example illustrates the principle of this paragraph (e):

Example. Pre-change consolidated attribute. (i) The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. The L loss group has an ownership change at the beginning of Year 2.

(ii) The net operating loss carryover of the L loss group from Year 1 is a pre-change consolidated attribute because the L group was entitled to use the loss in Year 2 and therefore the loss was described in paragraph (c)(1)(i) of this section. Under paragraph (a)(2)(i) of this section, the amount of consolidated taxable income of the L group for Year 2 that may be offset by this loss carryover may not exceed the consolidated section 382 limitation of the L group for that year. See §1.1502–93 for rules relating to the computation of the consolidated section 382 limitation.

(f) *Pre-change subgroup attribute*—(1) *Defined.* A pre- change subgroup attribute of a loss subgroup is—

(i) Any net operating loss carryover described in paragraph (d)(1)(iii) of this section (relating to the definition of loss subgroup); and

(ii) Any recognized built-in loss of the loss subgroup.

(2) *Example.* The following example illustrates the principle of this paragraph (f):

Pre-change subgroup attribute. (i) P is the common parent of a consolidated group. P owns all the stock of L, and L owns all the stock of L1. L2 is not a member of an affiliated group, and has a net operating loss arising in Year 1 that is carried over to Year 2. On December 11, Year 2, L1 acquires all the stock of L2, causing an ownership change of L2. During Year 2, the P group has a consolidated net operating loss that is carried over to Year 3. On November 2, Year 3, M acquires all the L stock from P. M, L, L1, and L2 thereafter file consolidated returns. All of the P group Year 2 consolidated net operating loss is apportioned under §1.1502–21(b) to L and L2, which they carry over to the M group.

(ii)(a) L, L1, and L2 compose a loss subgroup because—

(1) They were affiliated with each other in the P group (the former group);

(2) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they became members of the L group; and

(3) At least one of the members (here, both L and L2) carries over a net operating loss to the M group (the current group) that is described in paragraph (d)(1)(iii) of this section.

(b) For this purpose, L2's loss from Year 1 that was a SRLY loss with respect to the P group (the former group) is described in paragraph (d)(1)(iii) of this section because L2 had an ownership change on becoming a member of the P group (see §1.1502–96(a)) on December 11, Year 2. Starting on December 12, Year 2, the P group no longer separately tracked owner shifts of the stock of L1 with respect to the Year 1 loss. M's acquisition results in an ownership change of L, and therefore the L loss subgroup under §1.1502–92(a)(2). See §1.1502–93

for rules governing the computation of the subgroup section 382 limitation.

(iii) In the M group, L2's Year 1 loss continues to be subject to a section 382 limitation resulting from the ownership change that occurred on December 11, Year 2. See §1.1502–96(c).

(g) *Net unrealized built-in gain and loss*—(1) *In general.* The determination whether a consolidated group (or loss subgroup) has a net unrealized built-in gain or loss under section 382(h)(3) is based on the aggregate amount of the separately computed net unrealized built-in gains or losses of each member that is included in the group (or loss subgroup) under paragraph (g)(2) of this section, including items of built-in income and deduction described in section 382(h)(6). Thus, for example, amounts deferred under section 267, or under §1.1502–13 (other than amounts deferred with respect to the stock of a member (or an intercompany obligation) included in the group (or loss subgroup) under paragraph (g)(2) of this section) are built-in items. The threshold requirement under section 382(h)(3)(B) applies on an aggregate basis and not on a member-by-member basis. The separately computed amount of a member included in a group or loss subgroup does not include any unrealized built-in gain or loss on stock (including stock described in section 1504(a)(4) and §1.382–2T(f)(18)(ii) and (iii)) of another member included in the group or loss subgroup (or an intercompany obligation). However, a member of a group or loss subgroup includes in its separately computed amount the unrealized built-in gain or loss on stock (but not on an intercompany obligation) of another member not included in the group or loss subgroup. If a member is not included in the determination whether a group (or subgroup) has a net unrealized built-in loss under paragraph (g)(2)(ii) or (iv) of this section, that member is not included in the loss group or loss subgroup. See §1.1502–94(c) (relating to built-in gain or loss of a new loss member) and §1.1502–96(a) (relating to the end of separate tracking of certain losses).

(2) *Members included*—(i) *Consolidated group with a net operating loss.* The members included in the determination whether a consolidated group described in paragraph (c)(1)(i) or (ii) of this section (relating to loss groups with net operating losses) has a net unrealized built-in gain are all members of the consolidated group on the day that the determination is made.

(ii) *Determination whether a consolidated group has a net unrealized built-in loss.* The members included in the determination whether a consolidated group is a loss group described in paragraph (c)(1)(iii) of this section are—

(A) The common parent and all other members that have been affiliated with the common parent for the 5 consecutive year period ending on the day that the determination is made;

(B) Any other member that has a net unrealized built-in loss determined under paragraph (g)(1) of this section on the date that the determination is made, and that is neither a new loss member described in §1.1502–94(a)(1)(ii) nor a member of a loss subgroup described in paragraph (d)(2) of this section;

(C) Any new loss member described in §1.1502–94(a)(1)(ii) that has a net unrealized built-in gain determined under paragraph (g)(1) of this section on the day that the determination is made; and

(D) The members of a loss subgroup described in paragraph (d)(2) of this section if the members of the subgroup have, in the aggregate, a net unrealized built-in gain on the day that the determination is made.

(iii) *Loss subgroup with net operating loss carryovers.* The members included in the determination whether a loss subgroup described in paragraph (d)(1) of this section (relating to loss subgroups with net operating loss carryovers) has a net unrealized built-in gain are all members of the loss subgroup on the day that the determination is made.

(iv) *Determination whether subgroup has a net unrealized built-in loss.* The members included in the determination whether a subgroup has a net unrealized built-in loss are those members described in paragraphs (d)(2)(i) and (ii) of this section.

(v) *Separate determination of section 382 limitation for recognized built-in losses and net operating losses.* In determining whether a loss group described in paragraph (c)(1)(i) or (ii) of this section (relating to loss groups that have net operating loss carryovers) has a net unrealized built-in gain which, if recognized, increases the consolidated section 382 limitation, the group includes, under paragraph (g)(2)(i) of this section, all of its members on the day the determination is made. Under paragraph (g)(2)(ii) of this section, however, for purposes of determining whether a group has a net unrealized built-in loss described in paragraph (c)(1)(iii) of this section, not all members of the consolidated group may be included. Thus, a consolidated group may have recognized built-in gains that increase the amount of consolidated taxable income that may be offset by its pre-change net operating loss carryovers that did not arise (and are not treated as arising) in a SRLY, and also may have recognized built-in losses the absorption of which is limited. Similar results may obtain for loss subgroups under paragraphs (g)(2)(iii) and (iv) of this section. See §1.1502–93(c)(2) for rules prohibiting the use of recognized built-in gains to increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

(3) *Coordination with rule that ends separate tracking.* See §1.1502–96(a) for special rules relating to members (or loss subgroups) that have an ownership change within six months before, on, or after becoming a member of the group.

(4) *Acquisitions of built-in gain or loss assets.* A member of a consolidated group (or loss subgroup) may not, in determining its separately computed net unrealized built-in gain or loss, include any gain or loss with respect to assets acquired with a principal purpose to affect the amount of its net unrealized built-in gain or loss. A group (or loss subgroup) may not, in determining its net unrealized built-in gain or loss, include any gain or loss of a member acquired with a principal purpose to affect the amount of its net unrealized built-in gain or loss.

(5) *Indirect ownership.* A member's separately computed net unrealized built-in gain or loss is adjusted to the extent necessary to prevent any duplication of unrealized gain or loss attributable to the member's indirect ownership interest in another member through a nonmember if the member has a 5-percent or greater ownership interest in the nonmember.

(6) *Common parent not common parent for five years.* If the common parent has become the common parent of an existing

group within the previous 5 year period in a transaction described in §1.1502–75(d)(2)(ii) or (3), appropriate adjustments must be made in applying paragraph (g)(2)(ii)(A) of this section so that corporations that have not been members of the group for five years are not included. In such a case, references to the common parent in paragraph (g)(2)(ii)(A) of this section are to the former common parent. Thus, members of the group remaining in existence (including the new common parent) that have not been affiliated with the former common parent (or that have not been members of that group) for the five consecutive year period ending on the day that the determination is made are not included under paragraph (g)(2)(ii)(A) of this section. See, however, §1.1502–96(a)(2) for special rules relating to members (or loss subgroups) that have an ownership change within six months before, on, or after the time that the member becomes a member of the group.

(h) *Recognized built-in gain or loss*—(1) *In general.* [Reserved].

(2) *Disposition of stock or an intercompany obligation of a member.* Gain or loss recognized by a member on the disposition of stock (including stock described in section 1504(a)(4) and §1.382–2T(f)(18)(ii) and (iii)) of another member is treated as a recognized gain or loss for purposes of section 382(h)(2) (unless disallowed under §1.1502–20 or otherwise), even though gain or loss on such stock was not included in the determination of a net unrealized built-in gain or loss under paragraph (g)(1) of this section. Gain or loss recognized by a member with respect to an intercompany obligation is treated as recognized gain or loss only to the extent (if any) the transaction gives rise to aggregate income or loss within the consolidated group.

(3) *Intercompany transactions.* Gain or loss that is deferred under provisions such as section 267 and §1.1502–13 is treated as recognized built-in gain or loss only to the extent taken into account by the group during the recognition period. See also §1.1502–13(c)(7) *Example 10.*

(4) *Exchanged basis property.* If the adjusted basis of any asset is determined, directly or indirectly, in whole or in part, by reference to the adjusted basis of another asset held by the member at the beginning of the recognition period, the asset is treated, with appropriate adjustments, as held by the member at the beginning of the recognition period.

(i) [Reserved]

(j) *Predecessor and successor corporations.* A reference in this section and §§1.1502–92 through 1.1502–99 to a corporation, member, common parent, loss subgroup parent, or subsidiary includes, as the context may require, a reference to a predecessor or successor corporation as defined in §1.1502–1(f)(4). For example, the determination whether a successor satisfies the continuous affiliation requirement of paragraph (d)(2)(i) or (g)(2)(ii) of this section is made by reference to its predecessor.

§1.1502–92 Ownership change of a loss group or a loss subgroup.

(a) *Scope.* This section provides rules for determining if there is an ownership change for purposes of section 382 with respect to a loss group or a loss subgroup. See §1.1502–94 for special rules for determining if there is an ownership change with respect to a new loss member and §1.1502–96(b) for special rules for determining if there is an ownership change of a subsidiary.

(b) *Determination of an ownership change*—(1) *Parent change method*—(i) *Loss group.* A loss group has an ownership change if the loss group's common parent has an ownership change under section 382 and the regulations thereunder. Solely for purposes of determining whether the common parent has an ownership change—

(A) The losses described in §1.1502–91(c) are treated as net operating losses (or a net unrealized built-in loss) of the common parent; and

(B) The common parent determines the earliest day that its testing period can begin by reference to only the attributes that make the group a loss group under §1.1502–91(c).

(ii) *Loss subgroup.* A loss subgroup has an ownership change if the loss subgroup parent has an ownership change under section 382 and the regulations thereunder. The principles of §1.1502–95(b) (relating to ceasing to be a member of a consolidated group) apply in determining whether the loss subgroup parent has an ownership change. Solely for purposes of determining whether the loss subgroup parent has an ownership change—

(A) The losses described in §1.1502–91(d) are treated as net operating losses (or a net unrealized built-in loss) of the loss subgroup parent;

(B) The day that the members of the loss subgroup become members of the group (or a loss subgroup) is treated as a testing date within the meaning of §1.382–2(a)(4); and

(C) The loss subgroup parent determines the earliest day that its testing period can begin under §1.382–2T(d)(3) by reference to only the attributes that make the members a loss subgroup under §1.1502–91(d).

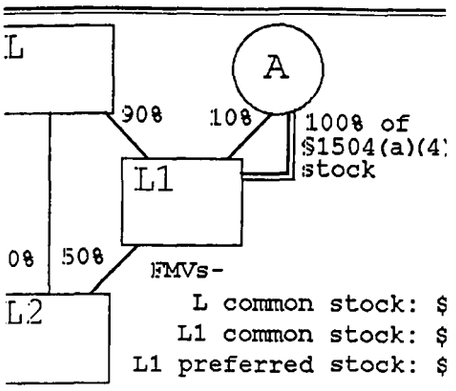
(iii) *Special rule if election regarding section 1504(a)(1) relationship is made*—(A) *Ownership change of deemed loss subgroup parent is an ownership change of loss subgroup.* If the common parent makes an election under §1.1502–91(d)(4), each of the members in the loss subgroup is treated as the loss subgroup parent for purposes of determining whether the loss subgroup has an ownership change under section 382 and the regulations thereunder on or after the day the members become members of the group.

(B) *Exception.* Paragraph (b)(1)(iii)(A) of this section does not apply to cause an ownership change of a loss subgroup if a deemed loss subgroup parent has an ownership change upon (or after) ceasing to be a member of the current group.

(2) *Examples.* The following examples illustrate the principles of this paragraph (b):

Example 1. Loss group—ownership change of the common parent. (i) A owns all the L stock. L owns 80 percent and B owns 20 percent of the L1 stock. For Year 1, the L group has a consolidated net operating loss that resulted from the operations of L1 and that is carried over to Year 2. The value of the L stock is $1000. The total value of the L1 stock is $600 and the value of the L1 stock held by B is $120. The L group is a loss group under §1.1502–91(c)(1) because it is entitled to use its net operating loss carryover from Year 1. On August 15, Year 2, A sells 51 percent of the L stock to C. The following is a graphic illustration of these facts:

(ii) Under paragraph (b)(1)(i) of this section, section 382 and the regulations thereunder are applied to L to determine whether it (and therefore the L loss group) has an ownership change with respect to its net operating loss carryover from Year 1 attrib-



utable to L1 on August 15, Year 2. The sale of the L stock to C causes an ownership change of L under §1.382–2T and of the L loss group under paragraph (b)(1)(i) of this section. The amount of consolidated taxable income of the L loss group for any post-change taxable year that may be offset by its pre-change consolidated attributes (that is, the net operating loss carryover from Year 1 attributable to L1) may not exceed the consolidated section 382 limitation for the L loss group for the taxable year.

Example 2. Loss group—owner shifts of subsidiaries disregarded. (i) The facts are the same as in *Example 1,* except that on August 15, Year 2, A sells only 49 percent of the L stock to C and, on December 12, Year 3, in an unrelated transaction, B sells the 20 percent of the L1 stock to D. A's sale of the L stock to C does not cause an ownership change of L under §1.382–2T nor of the L loss group under paragraph (b)(1)(i) of this section. The following is a graphic illustration of these facts:

(ii) B's subsequent sale of L1 stock is not taken into account for purposes of determining whether the L loss group has an ownership change under paragraph (b)(1)(i) of this section, and, accordingly, there is no ownership change of the L loss group. See paragraph (c) of this section, however, for a supplemental ownership change method that would apply to cause an ownership change if the purchases by C and D were pursuant to a plan or arrangement and certain other conditions are satisfied.

Example 3. Loss subgroup—ownership change of loss subgroup parent controls. (i) P owns all the L stock. L owns 80 percent and A owns 20 percent of the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On September 9, Year 2, P sells 51 percent of the L stock to B, and L1 is apportioned a portion of the Year 1 consolidated net operating loss under §1.1502–21(b), which it carries over to its next taxable year. L and L1 file a consolidated return for their first taxable year ending after the sale to B. The following is a graphic illustration of these facts:

(ii) Under §1.1502–91(d)(1), L and L1 compose a loss subgroup on September 9, Year 2, the day that they become members of the L group. Under paragraph (b)(1)(ii) of this section, section 382 and the regulations thereunder are applied to L to determine whether it (and therefore the L loss subgroup) has an ownership change with respect to the portion of the Year 1 consolidated net operating loss that is apportioned to L1 on September 9, Year 2. L has an ownership change resulting from P's sale of 51 percent of the L stock to A. Therefore, the L loss subgroup has an ownership change with respect to that loss.

Example 4. Loss group and loss subgroup—contemporaneous ownership changes. (i) A owns all the stock of corporation M, M owns 35 percent and B owns 65 percent of the L stock, and L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On May 19, Year 2, B sells 45 percent of the L stock to M for cash. M, L, and L1 thereafter file consolidated returns. L and L1 are each apportioned a portion of the Year 1 consolidated net operating loss, which they carry over to the M group's Year 2 and Year 3 consolidated return years. The M group has a consolidated net operating loss arising in Year 2 that is carried over to Year 3. On June 9, Year 3, A sells 70 percent of the M stock to C. The following is a graphic illustration of these facts:

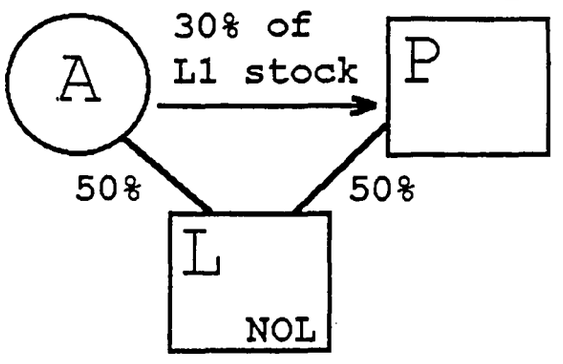
(ii) Under §1.1502–91(d)(1), L and L1 compose a loss subgroup on May 19, Year 2, the day they become members of the M group. Under paragraph (b)(1)(ii) of this section, section 382 and the regulations thereunder are applied to L to determine whether L (and therefore the L loss subgroup) has an ownership change with respect to the loss carryovers from Year 1 on May 19, Year 2, a testing date because of B's sale of L stock to M. The sale of L stock to M results in only a 45 percentage point increase in A's ownership of L stock. Thus, there is no ownership change of L (or the L loss subgroup) with respect to those loss carryovers under paragraph (b)(1)(ii) of this section on that day.

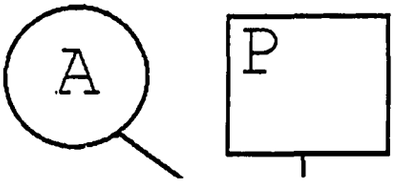
(iii) June 9, Year 3, is also a testing date with respect to the L loss subgroup because of A's sale of M stock to C. The sale results in a 56 percentage point increase in C's ownership of L stock, and L has an ownership change. Therefore, the L loss subgroup has an ownership change on that day with respect to the loss carryovers from Year 1.

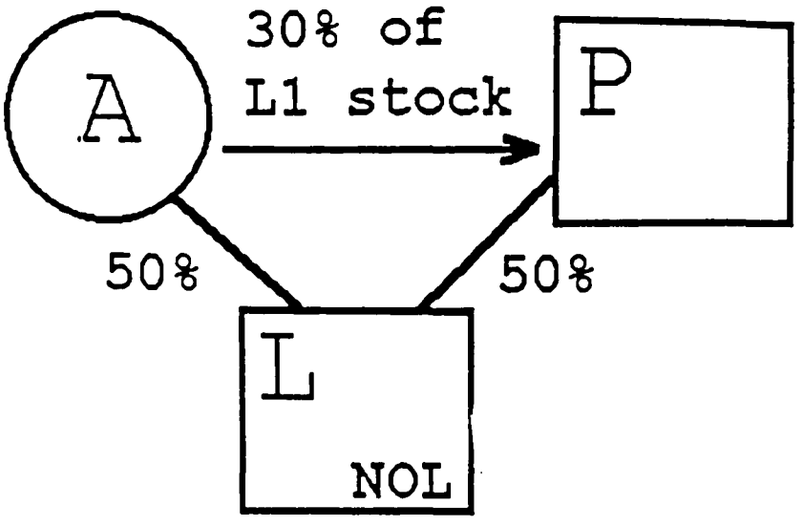
(iv) Paragraph (b)(1)(i) of this section requires that section 382 and the regulations thereunder be applied to M to determine whether M (and therefore the M loss group) has an ownership change with respect to the net operating loss carryover from Year 2 on June 9, Year 3, a testing date because of A's sale of M stock to C. The sale results in a 70 percentage point increase in C's ownership of M stock, and M has an ownership change. Therefore, the M loss group has an ownership change on that day with respect to that loss carryover.

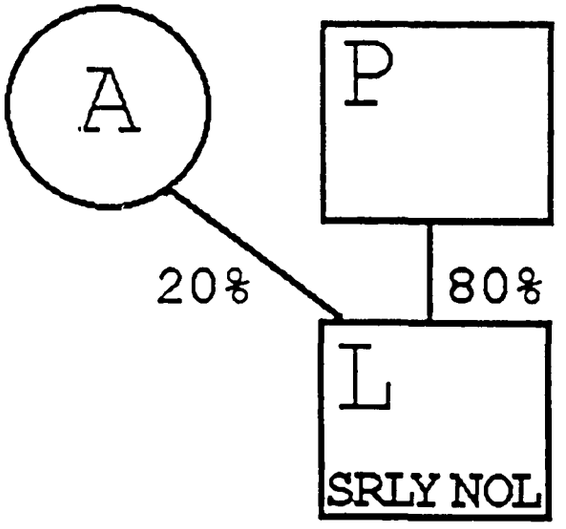
Example 5—Deemed subgroup parent. (i) P owns all the stock of L and L1 and 80 percent of the stock of T. A owns the remaining 20 percent of the stock of T. L1 owns all the stock of L2. P1, which owns 60 percent of the stock of P, acquires, at the beginning of Year 2, the T, L, and L1 stock owned by P, and T, L, L1, and L2 become members of the P1 group. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. L, L1, and L2 are each apportioned a portion of the Year 1 consolidated net operating loss under §1.1502–21(b), which they carry over to the P1 group's Year 2 and Year 3 consolidated return years. P1 makes the election described in §1.1502–91(d)(4) to treat T, L, L1 and L2 as meeting the section 1504(a)(1) requirement of §1.1502–91(d)(1)(ii). As a result of the election, T, L, L1 and L2 compose a loss subgroup and T, L, L1, and L2 are each treated as the loss subgroup parent for purposes of this paragraph (b). Because of P1's indirect ownership of T, L, L1, and L2 prior to P1's acquisition of the T, L, and L1 stock, P1's acquisition does not cause an ownership change of the loss subgroup.

(ii) On February 2, Year 3, L1 sells all of the stock of L2 to B. Although L2 is treated as a loss subgroup parent, the determination whether the loss subgroup comprised of T, L, and L1 has an ownership change under this paragraph (b) is made without regard to the sale of L2 because L2's ownership change occurred upon ceasing to be a member of the P1 group. See §1.1502–95(b) to determine the ap-









plication of section 382 to L2 when L2 ceases to be a member of the P1 group and the T, L, L1 and L2 loss subgroup.

(iii) On March 26, Year 3, A sells her 20 percent minority stock interest in T to C . C's purchase, together with the 32 percentage point owner shift effected by P1's acquisition of the T stock at the beginning of Year 2, causes an ownership change of T, and therefore of the loss subgroup comprised of T, L, and L1.

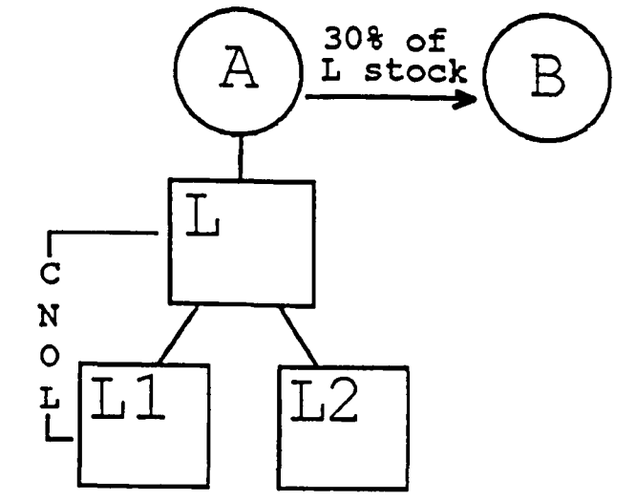
(3) *Special adjustments*—(i) Common parent succeeded by a new common parent. For purposes of determining if a loss group has an ownership change, if the common parent of a loss group is succeeded or acquired by a new common parent and the loss group remains in existence, the new common parent is treated as a continuation of the former common parent with appropriate adjustments to take into account shifts in ownership of the former common parent during the testing period (including shifts that occur incident to the common parent's becoming the former common parent). A new common parent may be a continuation of the former common parent even if, under §1.1502–91(g)(2)(ii), the new common parent is not included in determining whether the group has a net unrealized built-in loss.

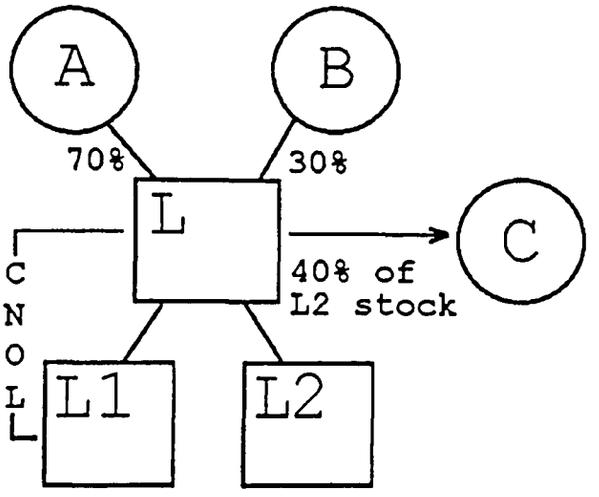
(ii) *Newly created loss subgroup parent.* For purposes of determining if a loss subgroup has an ownership change, if the member that is the loss subgroup parent has not been the loss subgroup parent for at least 3 years as of a testing date, appropriate adjustments must be made to take into account owner shifts of members of the loss subgroup so that the structure of the loss subgroup does not have the effect of avoiding an ownership change under section 382. (See paragraph (b)(3)(iii), *Example 3* of this section.)

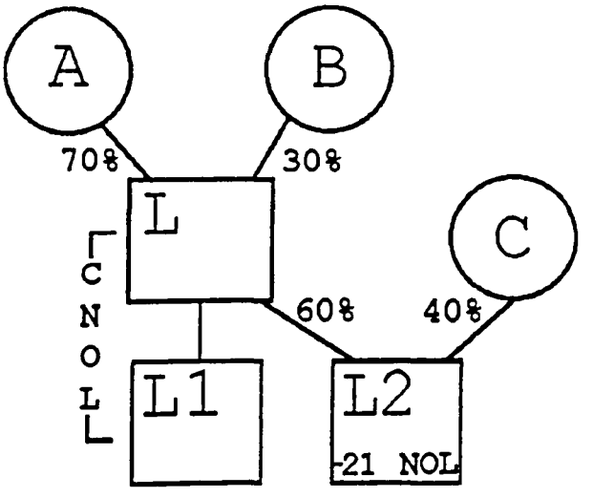
(iii) *Examples.* The following examples illustrate the principles of this paragraph (b)(3):

Example 1. New common parent acquires old common parent. (i) A, who owns all the L stock, sells 30 percent of the L stock to B on August 26, Year 1. L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On July 16, Year 2, A and B transfer their L stock to a newly created holding company, HC, in exchange for 70 percent and 30 percent, respectively, of the HC stock. HC, L, and L1 thereafter file consolidated returns. Under the principles of §1.1502– 75(d), the L loss group is treated as remaining in existence, with HC taking the place of L as the new common parent of the loss group. The following is a graphic illustration of these facts:

(ii) On November 11, Year 3, A sells 25 percent of the HC stock to B. For purposes of determining if the L loss group has an ownership change under paragraph (b)(1)(i) of this section on November 11, Year 3, HC is treated as a continuation of L under paragraph (b)(4)(i) of this section because it acquired L and became the common parent without terminating the L loss group. Accordingly, HC's testing period commences on January 1, Year 1, the

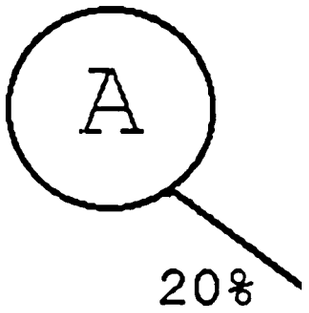


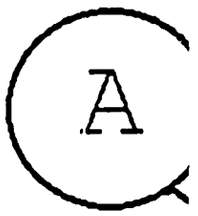




first day of the taxable year of the L loss group in which the consolidated net operating loss that is carried over to Year 3 arose (see §1.382-2T(d)(3)(i)). Immediately after the close of November 11, Year 3, B's percentage ownership interest in the common parent of the loss group (HC) has increased by 55 percentage points over its lowest percentage ownership during the testing period (zero percent). Accordingly, HC and the L loss group have an ownership change on that day.

Example 2. New common parent in case in which common parent ceases to exist. (i) A, B, and C each own one-third of the L stock. L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 2 that is carried over to Year 3. On November 22, Year 3, L is merged into P, a corporation owned by D, and L1 thereafter files consolidated returns with P. A, B, and C, as a result of owning stock of L, own 90 percent of P's stock after the merger. D owns the remaining 10 percent of P's





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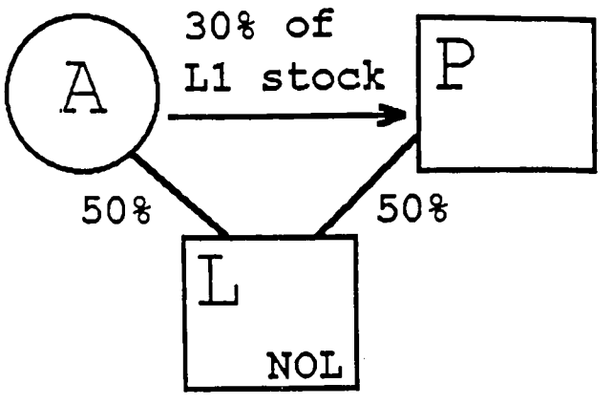
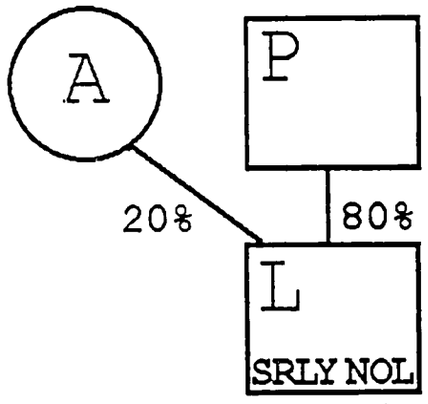
stock. The merger of L into P qualifies as a reverse acquisition of the L group under §1.1502-75(d)(3)(i), and the L loss group is treated as remaining in existence, with P taking the place of L as the new common parent of the L group. The following is a graphic illustration of these facts:

(ii) For purposes of determining if the L loss group has an ownership change on November 22, Year 3, the day of the merger, P is treated as a continuation of L so that the testing period for P begins on January 1, Year 2, the first day of the taxable year of the L loss group in which the consolidated net operating loss that is carried over to Year 3 arose. Immediately after the close of November 22, Year 3, D is the only 5-percent shareholder that has increased his ownership interest in P during the testing period (from zero to 10 percentage points).

(iii) The facts are the same as in paragraph (i) of this *Example 2*, except that A has held 23 1/3 shares (23 1/3 percent) of L's stock for five years, and A purchased an additional 10 shares of L stock from E





two years before the merger. Immediately after the close of the day of the merger (a testing date), A's ownership interest in P, the common parent of the L loss group, has increased by 6 2/3 percentage points over A's lowest percentage ownership during the testing period (23 1/3 percent to 30 percent).

(iv) The facts are the same as in (i) of this *Example 2*, except that P has a net operating loss arising in Year 1 that is carried to the first consolidated return year ending after the day of the merger. Solely for purposes of determining whether the L loss group has an ownership change under paragraph (b)(1)(i) of this section, the testing period for P commences on January 1, Year 2. P does not determine the earliest day for its testing period by reference to its net operating loss carryover from Year 1, which §§1.1502–1(f)(3) and 1.1502–75(d)(3)(i) treat as arising in a SRLY. See §1.1502–94 to determine the application of section 382 with respect to P's net operating loss carryover.

Example 3. Newly acquired loss subgroup parent. (i) P owns all the L stock and L owns all the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On January 19, Year 2, L issues a 20 percent stock interest to B. On February 5, Year 3, P contributes its L stock to a newly formed subsidiary, HC, in exchange for all the HC stock, and distributes the HC stock to its sole shareholder A. HC, L, and L1 thereafter file consolidated returns. A portion of the P group's Year 1 consolidated net operating loss is apportioned to L and L1 under §1.1502–21(b) and is carried over to the HC group's year ending after February 5, Year 3. HC, L, and L1 compose a loss subgroup within the meaning of §1.1502–91(d) with respect to the net operating loss carryovers from Year 1. The following is a graphic illustration of these facts:

(ii) February 5, Year 3, is a testing date for HC as the loss subgroup parent with respect to the net operating loss carryovers of L and L1 from Year 1. See paragraph (b)(1)(ii)(B) of this section. For purposes of determining whether HC has an ownership change on the testing date, appropriate adjustments must be made with respect to the changes in the percentage ownership of the stock of HC because HC was not the loss subgroup parent for at least 3 years prior to the day on which it became a member of the HC loss subgroup (a testing date). The appropriate adjustments include adjustments so that HC succeeds to the owner shifts of other members of the former group. Thus, HC succeeds to the owner shift of L that resulted from the sale of the 20 percent interest to B in determining whether the HC loss subgroup has an ownership change on February 5, Year 3, and on any subsequent testing date that includes January 19, Year 2.

(4) *End of separate tracking of certain losses.* If §1.1502–96(a) (relating to the end of separate tracking of attributes) applies to a loss subgroup, then, while one or more members that were included in the loss subgroup remain members of the consolidated group, there is an ownership change with respect to their attributes described in §1.1502–96(a)(2) only if the consolidated group is a loss group and has an ownership change under paragraph (b)(1)(i) of this section (or such a member has an ownership change under §1.1502–96(b) (relating to ownership changes of subsidiaries)). If, however, the loss subgroup has had an ownership change before §1.1502–96(a) applies, see §1.1502–96(c) for the continuing application of the subgroup's section 382 limitation with respect to its pre-change subgroup attributes.

(c) *Supplemental rules for determining ownership change*—(1) *Scope.* This paragraph (c) contains a supplemental rule for determining whether there is an ownership change of a loss group (or loss subgroup). It applies in addition to, and not instead of, the rules of paragraph (b) of this section. Thus, for example, if the common parent of the loss group has an ownership change under paragraph (b) of this section, the loss group has an ownership change even if, by applying this paragraph (c), the common parent would not have an ownership change. This paragraph (c) does not apply in determining an ownership change of a loss subgroup for which an election under §1.1502–1(d)(4) is made.

(2) *Cause for applying supplemental rule.* This paragraph (c) applies to a loss group (or loss subgroup) if—

(i) Any 5-percent shareholder of the common parent (or loss subgroup parent) increases its percentage ownership interest in the stock of both—

(A) A subsidiary of the loss group (or loss subgroup) other than by a direct or indirect acquisition of stock of the common parent (or loss subgroup parent); and

(B) The common parent (or loss subgroup parent);

(ii) Those increases occur within a 3 year period ending on any day of a consolidated return year or, if shorter, the pe-

riod beginning on the first day following the most recent ownership change of the loss group (or loss subgroup); and

(iii) Either—

(A) The common parent (or loss subgroup parent) has actual knowledge of the increase in the 5-percent shareholder's ownership interest in the stock of the subsidiary (or has actual knowledge of the plan or arrangement described in paragraph (c) (3)(i) of this section) before the date that the group's income tax return is filed for the taxable year that includes the date of that increase; or

(B) At any time during the period described in paragraph (c)(2)(ii) of this section, the 5-percent shareholder of the common parent is also a 5-percent shareholder of the subsidiary (determined without regard to paragraph (c)(3)(i) of this section) whose percentage increase in the ownership of the stock of the subsidiary would be taken into account in determining if the subsidiary has an ownership change (determined as if the subsidiary was a loss corporation and applying the principles of §1.382–2T(k), including the principles relating to duty to inquire).

(3) *Operating rules.* Solely for purposes of this paragraph (c)—

(i) A 5-percent shareholder of the common parent (or loss subgroup parent) is treated as increasing its ownership interest in the stock of a subsidiary to the extent, if any, that another person or persons increases its percentage ownership interest in the stock of a subsidiary pursuant to a plan or arrangement under which the 5-percent shareholder increases its percentage ownership interest in the common parent (or loss subgroup parent);

(ii) The rules in section 382(l)(3) and §§1.382–2T(h) and 1.382–4(d) (relating to constructive ownership) apply with respect to the stock of the subsidiary by treating such stock as stock of a loss corporation; and

(iii) In the case of a loss subgroup, a subsidiary includes any member of the loss subgroup other than the loss subgroup parent. (A loss subgroup parent is, however, a subsidiary of the loss group of which it is a member.)

(4) *Supplemental ownership change rules.* The determination whether the common parent (or loss subgroup parent) has an ownership change is made by applying paragraph (b)(1) of this section as modified by the following additional rules:

(i) *Additional testing dates for the common parent (or loss subgroup parent).* A testing date for the common parent (or loss subgroup parent) also includes—

(A) Each day on which there is an increase in the percentage ownership of stock of a subsidiary as described in paragraph (c)(2) of this section; and

(B) The first day of the first consolidated return year for which the group is a loss group (or the members compose a loss subgroup).

(ii) *Treatment of subsidiary stock as stock of the common parent (or loss subgroup parent).* The common parent (or loss subgroup parent) is treated as though it had issued to the person acquiring (or deemed to acquire) the subsidiary stock an amount of its own stock (by value) that equals the value of the subsidiary stock represented by the percentage increase in that person's ownership of the subsidiary (determined on a separate entity basis). Similar principles apply if the increase in percentage ownership interest is effected by a redemption or similar transaction.

(iii) *Different testing periods.* Stock treated as issued under paragraph (c)(4)(ii) of this section on a testing date is not treated as so issued for purposes of applying the ownership change rules of this paragraph (c) and paragraph (b) (1) of this section in a testing period that does not include that testing date.

(iv) *Disaffiliation of a subsidiary.* If a deemed issuance of stock under paragraph (c)(4)(ii) of this section would not cause the loss group (or loss subgroup) to have an ownership change before the day (if any) on which the subsidiary ceases to be a member of the loss group (or subgroup), then paragraph (c)(4) of this section shall not apply.

(v) *Subsidiary stock acquired first.* If an increase of subsidiary stock described in paragraph (c)(2)(i)(A) of this section occurs before the date that the 5-percent shareholder increases its percentage ownership interest in the stock of the common parent (or loss subgroup parent), then the deemed issuance of stock is treated as occurring on that later date, but in an amount equal to the value of the subsidiary stock on the date it was acquired.

(vi) *Anti-duplication rule.* If two or more 5-percent shareholders are treated as increasing their percentage ownership interests pursuant to the same plan or arrangement described in paragraph (c)(3)(i) of this section, appropriate adjustments must be made so that the amount of stock treated as issued is not taken into account more than once.

(5) *Examples.* The following examples illustrate the principles of this paragraph (c):

Example 1. Stock of the common parent under supplemental rules. (i) A owns all the L stock. L is not a member of an affiliated group and has a net operating loss carryover arising in Year 1 that is carried over to Year 6. On September 20, Year 6, L transfers all of its assets and liabilities to a newly created subsidiary, S, in exchange for S stock. L and S thereafter file consolidated returns. On November 23, Year 6, B contributes cash to L in exchange for a 45 percent ownership interest in L and contributes cash to S for a 20 percent ownership interest in S.

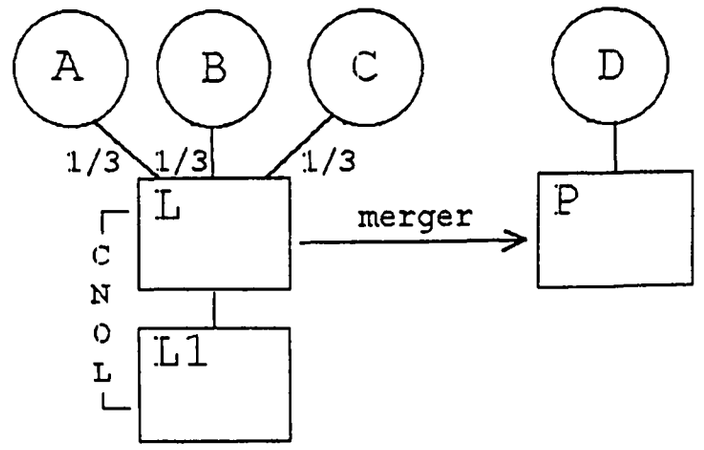
(ii) During the 3 year period ending on November 23, Year 6, B is a 5% shareholder of L and of S that increases its ownership interest in L and S during that period. Under paragraph (c)(4)(ii) of this section, the determination whether L (the common parent of a loss group) has an ownership change on November 23, Year 6 (or, subject to paragraph (c)(4)(iv) of this section, on any testing date in the testing period which includes November 23, Year 6), is made by applying paragraph (b)(1)(i) of this section and by treating the value of B's 20 percent ownership interest in S as if it were L stock issued to B. Because B is a 5% shareholder of both L and S during the 3 year period ending on November 23, Year 6, and B's increase in its percentage ownership in the stock of S would be taken into account in determining if S (if it were a loss corporation) had an ownership change, it is not relevant whether L has actual knowledge of B's acquisition of S stock.

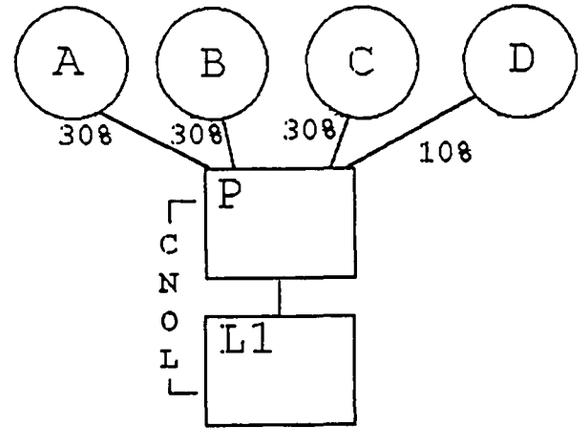
Example 2. Plan or arrangement—public offering of subsidiary stock. (i) A owns all the stock of L and L owns all the stock of L1. The L group has a consolidated net operating loss arising in Year 1 that resulted from the operations of L1 and that is carried over to Year 2. On October 7, Year 2, A sells 49 percent of the L stock to B. As part of a plan that includes the sale of L stock, A causes a public offering of L1 stock on November 6, Year 2. L has actual knowledge of the plan. The following is a graphic illustration of these facts:

(ii) A's sale of the L stock to B does not cause an ownership change of the L loss group on October 7, Year 2, under the rules of §1.382–2T and paragraph (b)(1)(i) of this section.

(iii) Because the issuance of L1 stock to the public occurs as part of the same plan as B's acquisition of L stock, and L has knowledge of the plan, paragraph (c)(4) of this section applies to determine whether the L loss group has an ownership change on November 6, Year 2 (or, subject to paragraph (c)(4)(iv) of this section, on any testing date for which the testing period includes November 6, Year 2).

(d) *Testing period following ownership change under this section.* If a loss group (or a loss subgroup) has had an ownership





change under this section, the testing period for determining a subsequent ownership change with respect to pre-change consolidated attributes (or pre-change subgroup attributes) begins no earlier than the first day following the loss group's (or loss subgroup's) most recent change date.

(e) *Information statements*—(1) *Common parent of a loss group.* The common parent of a loss group must file the information statement required by §1.382–2T(a)(2)(ii) for a consolidated return year because of any owner shift, equity structure shift, or other transaction described in §1.382–2T(a)(2)(i)—

(i) With respect to the common parent and with respect to any subsidiary stock subject to paragraph (c) of this section; and

(ii) With respect to an ownership change described in §1.1502–96(b) (relating to ownership changes of subsidiaries).

(2) *Abbreviated statement with respect to loss subgroups.* The common parent of a consolidated group that has a loss subgroup during a consolidated return year must file the information statement required by §1.382–2T(a)(2)(ii) because of any owner shift, equity structure shift, or other transaction described in §1.382–2T(a)(2)(i) with respect to the loss subgroup parent and with respect to any subsidiary stock subject to paragraph (c) of this section. Instead of filing a separate statement for each loss subgroup parent, the common parent (which is treated as a loss corporation) may file the single statement described in paragraph (e)(1) of this section. In addition to the information concerning stock ownership of the common parent, the single statement must identify each loss subgroup parent and state which loss subgroups, if any, have had ownership changes during the consolidated return year. The loss subgroup parent is, however, still required to maintain the records necessary to determine if the loss subgroup has an ownership change. This paragraph (e)(2) applies with respect to the attributes of a loss subgroup until, under §1.1502–96(a), the attributes are no longer treated as described in §1.1502–91(d) (relating to the definition of loss subgroup). After that time, the information statement described in paragraph (e)(1) of this section must be filed with respect to those attributes.

§1.1502–93 Consolidated section 382 limitation (or subgroup section 382 limitation).

(a) *Determination of the consolidated section 382 limitation (or subgroup section 382 limitation*—(1) *In general.* Following an ownership change, the consolidated section 382 limitation (or subgroup section 382 limitation) for any post-change year is an amount equal to the value of the loss group (or loss subgroup), as defined in paragraph (b) of this section, multiplied by the long-term tax-exempt rate that applies with respect to the ownership change, and adjusted as required by section 382 and the regulations thereunder. See, for example, section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)(3)(B) (relating to the section 382 limitation for the post-change year that includes the change date), section 382(h) (relating to recognized built-in gains and section 338 gains), and section 382(m)(2) (relating to short taxable years). For special rules relating to the recognized built-in gains of a loss group (or loss subgroup), see paragraph (c)(2) of this section.

(2) *Coordination with apportionment rule.* For special rules relating to apportionment of a consolidated section 382 limitation (or a subgroup section 382 limitation) or net unrealized built-in gain when one or more corporations cease to

be members of a loss group (or a loss subgroup) and to aggregation of amounts so apportioned, see §1.1502–95(c).

(b) *Value of the loss group (or loss subgroup)*—(1) *Stock value immediately before ownership change.* Subject to any adjustment under paragraph (b)(2) of this section, the value of the loss group (or loss subgroup) is the value, immediately before the ownership change, of the stock of each member, other than stock that is owned directly or indirectly by another member. For this purpose—

(i) Ownership is determined under §1.382–2T;

(ii) A member is considered to indirectly own stock of another member through a nonmember only if the member has a 5-percent or greater ownership interest in the nonmember; and

(iii) Stock includes stock described in section 1504(a)(4) and §1.382–2T(f)-(18)(ii) and (iii).

(2) *Adjustment to value*—(i) *In general.* The value of the loss group (or loss subgroup), as determined under paragraph (b)(1) of this section, is adjusted under any rule in section 382 or the regulations thereunder requiring an adjustment to such value for purposes of computing the amount of the section 382 limitation. See, for example, section 382(e)(2) (redemptions and corporate contractions), section 382(l)(1) (certain capital contributions) and section 382(l)(4) (ownership of substantial nonbusiness assets). For purposes of section 382(e)(2), redemptions and corporate contractions that do not effect a transfer of value outside of the loss group (or loss subgroup) are disregarded. For purposes of section 382(l)(1), capital contributions between members of the loss group (or loss subgroup)(or a contribution of stock to a member made solely to satisfy the loss subgroup parent requirement of paragraph (d)(1)(ii) or (2)(ii) of this section), are not taken into account. Also, the substantial nonbusiness asset test of section 382(l)(4) is applied on a group (or subgroup) basis, and is not applied separately to its members.

(ii) *Anti-duplication.* Appropriate adjustments must be made to the extent necessary to prevent any duplication of the value of the stock of a member, even though corporations that do not file consolidated returns may not be required to make such an adjustment. In making these adjustments, the group (or loss subgroup) may apply the principles of §1.382–8 (relating to controlled groups of corporations) in determining the value of a loss group (or loss subgroup) even if that section would not apply if separate returns were filed. Also, the principles of §1.382–5(d)(relating to successive ownership changes and absorption of a section 382 limitation) may apply to adjust the consolidated section 382 limitation (or subgroup section 382 limitation) of a loss group (or loss subgroup) to avoid a duplication of value if there are simultaneous (rather than successive) ownership changes.

(3) *Examples.* The following examples illustrate the principles of this paragraph (b):

Example 1. Basic case. (i) L, L1, and L2 compose a loss group. L has outstanding common stock, the value of which is $100. L1 has outstanding common stock and preferred stock that is described in section 1504(a)(4). L owns 90 percent of the L1 common stock, and A owns the remaining 10 percent of the L1 common stock plus all the preferred stock. The value of the L1 common stock is $40, and the value of the L1 preferred stock is $30. L2 has outstanding common stock, 50 percent of which is owned by L and 50 percent by L1. The L group has an ownership change. The following is a graphic illustration of these facts:

(ii) Under paragraph (b)(1) of this section, the L group does not include the value of the stock of any member that is owned directly or indirectly by another member in computing its consolidated section 382 limitation. Accordingly, the value of the stock of the loss group is $134, the sum of the value of—

(a) The common stock of L ($100);

(b) The 10 percent of the L1 common stock ($4) owned by A; and

(c) The L1 preferred stock ($30) owned by A.

Example 2—Indirect ownership. (i) L and L1 compose a consolidated group. L's stock has a value of $100. L owns 80 shares (worth $80) and corporation M owns 20 shares (worth $20) of the L1 stock. L also owns 79 percent of the stock of corporation M. The L group has an ownership change. The following is a graphic illustration of these facts:

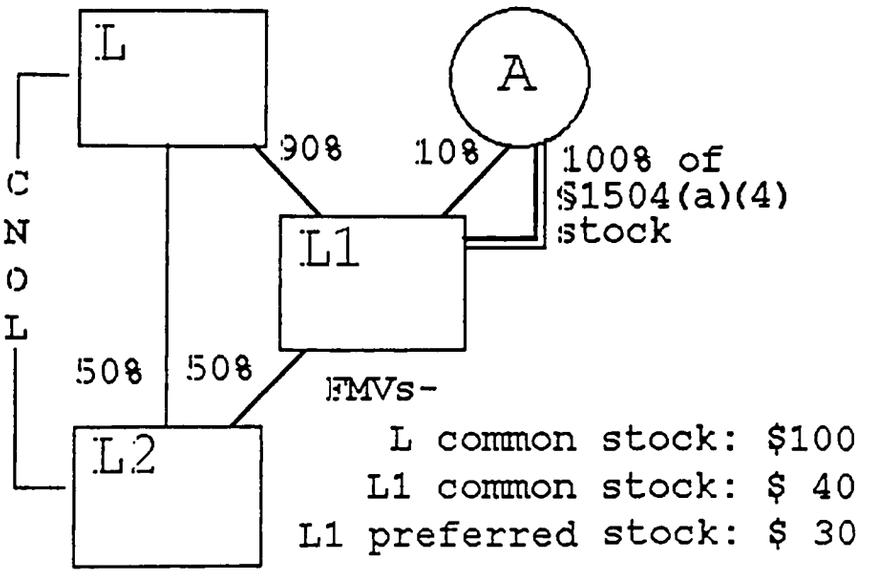
(ii) Under paragraph (b)(1) of this section, because of L's more than 5 percent ownership interest in M, a nonmember, L is considered to indirectly own 15.8 shares of the L1 stock held by M (79% x 20 shares). The value of the L loss group is $104.20, the sum of the values of—

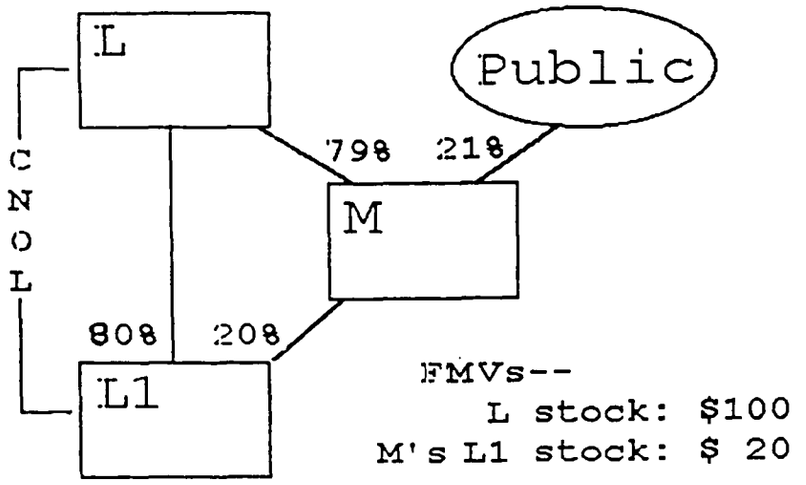
(a) The L stock ($100); and

(b) The L1 stock not owned directly or indirectly by L (21% × $20, or $4.20).

(c) *Recognized built-in gain of a loss group or loss subgroup*—(1) *In general.* If a loss group (or loss subgroup) has a net unrealized built-in gain, any recognized built-in gain of the loss group (or loss subgroup) is taken into account under section 382(h) in determining the consolidated section 382 limitation (or subgroup section 382 limitation).

(2) *Adjustments.* Appropriate adjustments must be made so that any recognized built-in gain of a member that increases more than one section 382 limitation (whether consolidated, subgroup, or separate) does not effect a duplication in the amount of consolidated taxable income that can be offset by pre-change net operating losses. For example, a consolidated section 382 limitation that is increased by recognized built-in gains is reduced to the extent that pre-change net operating losses of a loss subgroup absorb additional consolidated taxable income because the same recog-





nized built-in gains caused an increase in that loss subgroup's section 382 limitation. In addition, recognized built-in gain may not increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

(d) *Continuity of business*—(1) *In general.* A loss group (or a loss subgroup) is treated as a single entity for purposes of determining whether it satisfies the continuity of business enterprise requirement of section 382(c)(1).

(2) *Example.* The following example illustrates the principle of this paragraph (d):

Example. Continuity of business enterprise. L owns all the stock of two subsidiaries, L1 and L2. The L group has an ownership change. It has pre-change consolidated attributes attributable to L2. Each of the members has historically conducted a separate line of business. Each line of business is approximately equal in value. One year after the ownership change, L discontinues its separate business and the business of L2. The separate business of L1 is continued for the remainder of the 2 year period following the ownership change. The continuity of business enterprise requirement of section 382(c)(1) is met even though the separate businesses of L and L2 are discontinued.

(e) *Limitations of losses under other rules.* If a section 382 limitation for a post-change year exceeds the consolidated taxable income that may be offset by pre-change attributes for any reason, including the application of the limitation of §1.1502–21(c), the amount of the excess is carried forward under section 382(b)(2) (relating to the carryforward of unused section 382 limitation).

§1.1502–94 Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group.

(a) *Scope*—(1) *In general.* This section applies section 382 and the regulations thereunder to a corporation that is a new loss member of a consolidated group. A corporation is a new loss member if it—

(i) Carries over a net operating loss that arose (or is treated under §1.1502–21(c) as arising) in a SRLY with respect to the current group, and that is not described in §1.1502–91(d)(1); or

(ii) Has a net unrealized built-in loss (determined under paragraph (c) of this section immediately before it becomes a member of the current group by treating that day as a change date) that is not taken into account under §1.1502–91(d)(2) in determining whether two or more corporations compose a loss subgroup.

(2) *Successor corporation as new loss member.* A new loss member also includes any successor to a corporation that has a net operating loss carryover arising in a SRLY and that is treated as remaining in existence under §1.382–2(a)(1)(ii) following a transaction described in section 381(a).

(3) *Coordination in the case of a loss subgroup.* For rules regarding the determination of whether there is an ownership change of a loss subgroup with respect to a net operating loss or a net unrealized built-in loss described in §1.1502–91(d) (relating to the definition of loss subgroup) and the computation of a subgroup section 382 limitation following such an ownership change, see §§1.1502–92 and 1.1502–93.

(4) *End of separate tracking of certain losses.* If §1.1502–96(a) (relating to the end of separate tracking of attributes) applies to a new loss member, then, while that member remains a member of the consolidated group, there is an ownership change with respect to its attributes described in §1.1502–96(a)(2) only if the consolidated group is a loss group and has an ownership change under §1.1502–92(b)(1)(i) (or that member has an ownership change under §1.1502–96(b) (relating to ownership changes of subsidiaries)). If, however, the new loss member has had an ownership change before §1.1502–96(a) applies, see §1.1502–96(c) for the continuing application of the section 382 limitation with respect to the member's pre-change losses.

(5) *Cross-reference.* See section 382(a) and §1.1502–96(c) for the continuing effect of an ownership change after a corporation becomes or ceases to be a member.

(b) *Application of section 382 to a new loss member*—(1) *In general.* Section 382 and the regulations thereunder apply to a new loss member to determine, on a separate entity basis, whether and to what extent a section 382 limitation applies to limit the amount of consolidated taxable income that may be offset by the new loss member's pre-change separate attributes. For example, if an ownership change with respect to the new loss member occurs under section 382 and the regulations thereunder, the amount of consolidated taxable income for any post-change year that may be offset by the new loss member's pre-change separate attributes shall not exceed the section 382 limitation as determined separately under section 382(b) with respect to that member for such year. If the post-change year includes the change date, section 382(b)-(3)(A) is applied so that the section 382 limitation of the new loss member does not apply to the portion of the taxable income for such year that is allocable to the

period in such year on or before the change date. See generally §1.382-6 (relating to the allocation of income and loss).

(2) *Adjustment to value.* Appropriate adjustments must be made to the extent necessary to prevent any duplication of the value of the stock of a member, even though corporations that do not file consolidated returns may not be required to make such an adjustment. For example, the principles of §1.1502–93(b)(2)(ii) (relating to adjustments to value) apply in determining the value of a new loss member.

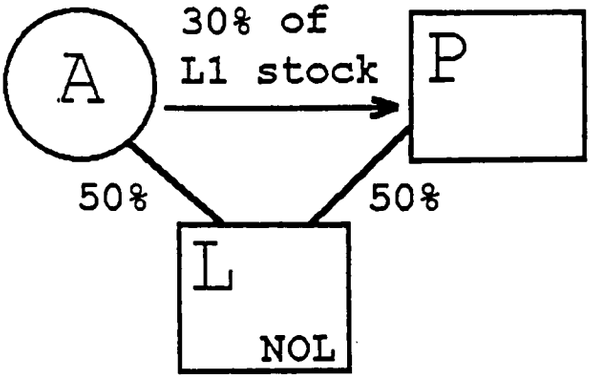
(3) *Pre-change separate attribute defined.* A pre-change separate attribute of a new loss member is—

(i) Any net operating loss carryover of the new loss member described in paragraph (a)(1) of this section; and

(ii) Any recognized built-in loss of the new loss member.

(4) *Examples.* The following examples illustrate the principles of this paragraph (b):

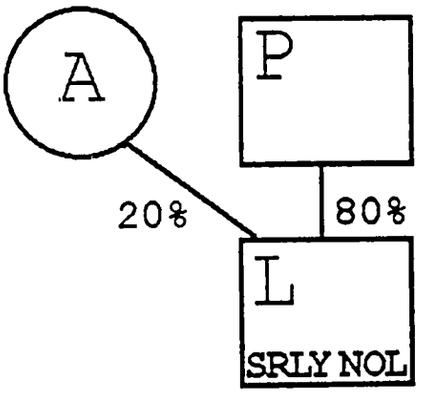
Example 1. Basic case. (i) A and P each own 50 percent of the L stock. On December 19, Year 6, P purchases 30 percent of the L stock from A for cash. L has net operating losses arising in Year 1 and Year 2 that it carries over to Year 6 and Year 7. The following is a graphic illustration of these facts:



(ii) L is a new loss member because it has net operating loss carryovers that arose in a SRLY with respect to the P group and L is not a member of a loss subgroup under §1.1502–91(d). Under section 382 and the regulations thereunder, L is a loss corporation on December 19, Year 6, that day is a testing date for L, and the testing period for L commences on December 20, Year 3.

(iii) P's purchase of L stock does not cause an ownership change of L on December 19, Year 6, with respect to the net operating loss carryovers from Year 1 and Year 2 under section 382 and §1.382-2T. The use of the loss carryovers, however, is subject to limitation under §1.1502–21(c).

Example 2. Multiple new loss members. (i) The facts are the same as in Example 1, and, on December 31, Year 6, L purchases all the stock of L1 from B for cash. L1 has a net operating loss of $40 arising in Year 3 that it carries over to Year 7. The following is a graphic illustration of these facts:



(ii) L1 is a new loss member because it has a net operating loss carryover from Year 3 that arose in a SRLY with respect to the P group and L1 is not a member of a loss subgroup under §1.1502–91(d)(1).

(iii) L's purchase of all the stock of L1 causes an ownership change of L1 on December 31, Year 6, under section 382 and §1.382-2T. Accordingly, a section 382 limitation based on the value of the L1 stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L1's loss from Year 3.

(iv) L1's ownership change upon becoming a member of the P group is an ownership change described in §1.1502–96(a). Thus, starting on January 1, Year 7, the P group no longer separately tracks owner shifts of the stock of L1 with respect to L1's loss from Year 3, and the P group is a loss group because L1's Year 3 loss is treated as a loss described in §1.1502–91(c).

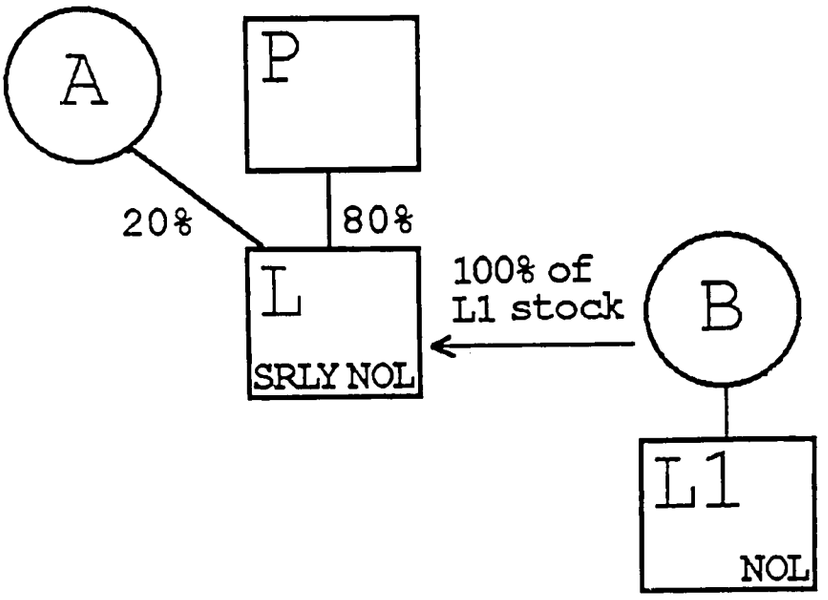
Example 3. Ownership changes of new loss members. (i) The facts are the same as in *Example 2*, and, on July 30, Year 7, C purchases all the stock of P for cash.

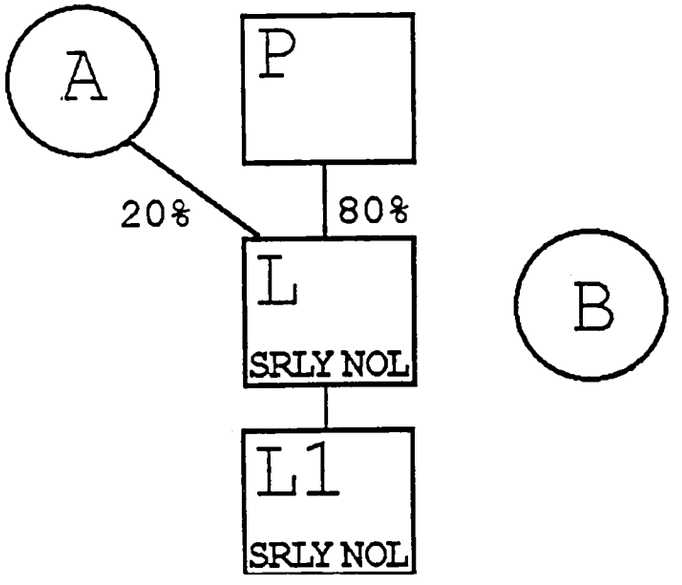
(ii) L is a new loss member on July 30, Year 7, because its Year 1 and Year 2 losses arose in SRLYs with respect to the P group and it is not a member of a loss subgroup under §1.1502–91(d)(1). The testing period for L commences on August 1, Year 4. C's purchase of all the P stock causes an ownership change of L on July 30, Year 7, under section 382 and §1.382–2T with respect to its Year 1 and Year 2 losses. Accordingly, a section 382 limitation based on the value of the L stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L's Year 1 and Year 2 losses. See §1.1502–21(c) for rules relating to an additional limitation.

(iii) The P group is a loss group on July 30, Year 7, because it is entitled to use L1's loss from Year 3, and such loss is no longer treated as a loss of a new loss member starting the day after L1's ownership change on December 31, Year 6. See §§1.1502–96(a) and 1.1502–91(c)(2). C's purchase of all the P stock causes an ownership change of P, and therefore the P loss group, on July 30, Year 7, with respect to L1's Year 3 loss. Accordingly, a consolidated section 382 limitation based on the value of the P stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L1's Year 3 loss.

(c) *Built-in gains and losses.* As the context may require, the principles of §§1.1502–91(g) and (h) and 1.1502–93(c) (relating to built-in gains and losses) apply to a new loss member on a separate entity basis. See §1.1502–91(g)(4). See §1.1502–13 (including Example 10 of §1.1502–13(c)(7)) for rules relating to the treatment of intercompany transactions.

(d) *Information statements.* The common parent of a consolidated group that has a new loss member subject to paragraph (b)(1) of this section during a consolidated return year must file the information statement required by §1.382–2T(a)(2)(ii) because of any owner shift, equity structure shift, or other trans-





action described in §1.382–2T(a)(2)(i). Instead of filing a separate statement for each new loss member, the common parent may file a single statement described in §1.382–2T(a)(2)(ii) with respect to the stock ownership of the common parent (which is treated as a loss corporation). In addition to the information concerning stock ownership of the common parent, the single statement must identify each new loss member and state which new loss members, if any, have had ownership changes during the consolidated return year. The new loss member is, however, required to maintain the records necessary to determine if it has an ownership change. This paragraph (d) applies with respect to the attributes of a new loss member until an event occurs which ends separate tracking under §1.1502–96(a). After that time, the information statement described in §1.1502–92(e)(1) must be filed with respect to these attributes.

§1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

(a) *In general*—(1) *Consolidated group.* This section provides rules for applying section 382 on or after the day that a member ceases to be a member of a consolidated group (or loss subgroup). The rules concern how to determine whether an ownership change occurs with respect to losses of the member, and how a consolidated section 382 limitation (or subgroup section 382 limitation) and a loss group's (or loss subgroup's) net unrealized built-in gain or loss is apportioned to the member.. As the context requires, a reference in this section to a loss group, a member, or a corporation also includes a reference to a loss subgroup, and a reference to a consolidated section 382 limitation also includes a reference to a subgroup section 382 limitation.

(2) *Election by common parent.* Only the common parent (not the loss subgroup parent) may make the election under paragraph (c) of this section to apportion a consolidated section 382 limitation (or subgroup section 382 limitation) or a loss group's (or loss subgroup's) net unrealized built-in gain.

(3) *Coordination with §§1.1502–91 through 1.1502–93.* For rules regarding the determination of whether there is an ownership change of a loss subgroup and the computation of a subgroup section 382 limitation following such an ownership change, see §§1.1502–91 through 1.1502–93.

(b) *Separate application of section 382 when a member leaves a consolidated group*—(1) *In general.* Except as provided in §§1.1502–91 through 1.1502–93 (relating to rules applicable to loss groups and loss subgroups), section 382 and the regulations thereunder apply to a corporation on a separate entity basis after it ceases to be a member of a consolidated group (or loss subgroup). Solely for purposes of determining whether a corporation has an ownership change—

(i) Any portion of a consolidated net operating loss that is apportioned to the corporation under §1.1502–21(b) is treated as a net operating loss of the corporation beginning on the first day of the taxable year in which the loss arose;

(ii) The testing period may include the period during which (or before which) the corporation was a member of the group (or loss subgroup); and

(iii) Except to the extent provided in §1.1502–96(d) (relating to reattributed losses), the day it ceases to be a member of a consolidated group is treated as a

testing date of the corporation within the meaning of §1.382-2(a)(4).

(2) *Effect of a prior ownership change of the group.* If a loss group has had an ownership change under §1.1502–92 before a corporation ceases to be a member of a consolidated group (the former member)—

(i) Any pre-change consolidated attribute that is subject to a consolidated section 382 limitation continues to be treated as a pre-change loss with respect to the former member after it is apportioned to the former member and, if any net unrealized built-in loss is allocated to the former member under paragraph (e) of this section, any recognized built-in loss of the former member is a pre-change loss of the member;

(ii) The section 382 limitation with respect to such pre-change attribute is zero unless the common parent, under paragraph (c) of this section, apportions to the former member all or part of the consolidated section 382 limitation applicable to such attribute. The limitation applicable to a pre-change attribute other than a recognized built-in loss may be increased to the extent that the common parent has apportioned all or part of the loss group's net unrealized built-in gain to the former member, and the former member recognizes built-in gain during the recognition period;

(iii) The testing period for determining a subsequent ownership change with respect to such pre-change attribute (or such net unrealized built-in loss, if any) begins no earlier than the first day following the loss group's most recent change date; and

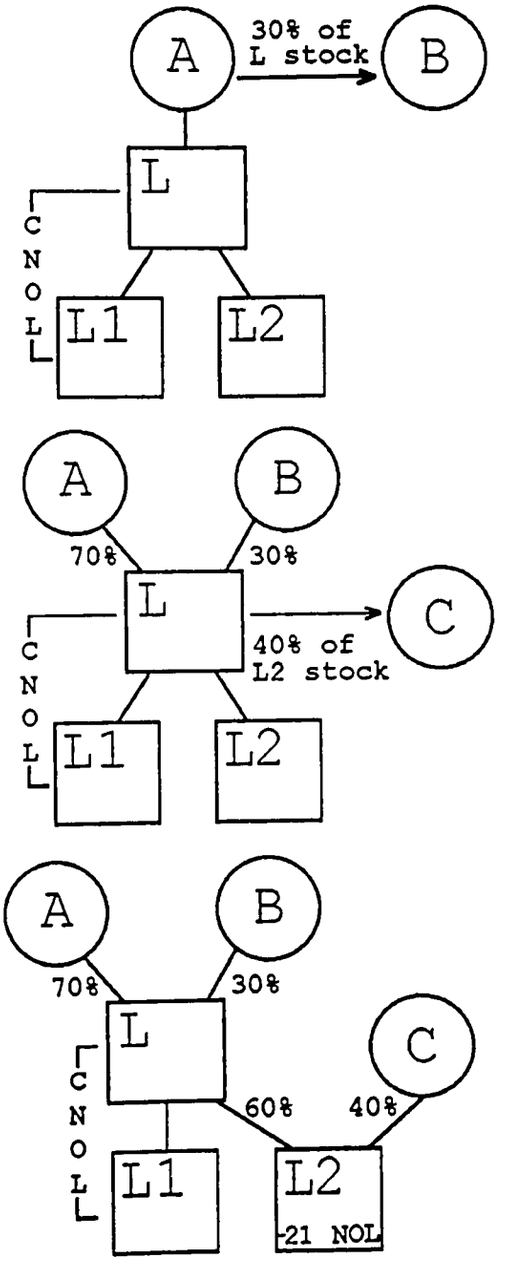
(iv) As generally provided under section 382, an ownership change of the former member that occurs on or after the day it ceases to be a member of a loss group may result in an additional, lesser limitation amount with respect to such losses.

(3) *Application in the case of a loss subgroup.* If two or more former members are included in the same loss subgroup immediately after they cease to be members of a consolidated group, the principles of paragraphs (b), (c) and (e) of this section apply to the loss subgroup. Therefore, for example, an apportionment by the common parent under paragraph (c) of this section is made to the loss subgroup rather than separately to its members. If the common parent of the consolidated group apportions all or part of a limitation (or net unrealized built-in gain) separately to one or more former members that are included in a loss subgroup because the common parent of the acquiring group makes an election under §1.1502–91(d)(4) with respect to those members, the aggregate of those separate amounts is treated as the amount apportioned to the loss subgroup. Such separate apportionment may occur, for example, because the election under §1.1502–91(d)(4) has not been filed at the time that the election of apportionment is made under paragraph (f) of this section.

(4) *Examples.* The following examples illustrate the principles of this paragraph (b):

Example 1. Treatment of departing member as a separate corporation throughout the testing period. (i) A owns all the L stock. L owns all the stock of L1 and L2. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On January 12, Year 2, A sells 30 percent of the L stock to B. On February 7, Year 3, L sells 40 percent of the L2 stock to C, and L2 ceases to be a member of the group. A portion of the Year 1 consolidated net operating loss is apportioned to L2 under §1.1502–21(b) and is carried to L2's first separate return year, which ends December 31, Year 3. The following is a graphic illustration of these facts:

(ii) Under paragraph (b)(1) of this section, L2 is a loss corporation on February 7, Year 3. Under



paragraph (b)(1)(iii) of this section, February 7, Year 3, is a testing date. Under paragraph (b)(1)(ii) of this section, the testing period for L2 with respect to this testing date commences on January 1, Year 1, the first day of the taxable year in which the portion of the consolidated net operating loss apportioned to L2 arose. Therefore, in determining whether L2 has an ownership change on February 7, Year 3, B's purchase of 30 percent of the L stock and C's purchase of 40 percent of the L2 stock are each owner shifts. L2 has an ownership change under section 382(g) and §1.382–2T because B and C have increased their ownership interests in L2 by 18 and 40 percentage points, respectively, during the testing period.

Example 2. Effect of prior ownership change of loss group. (i) L owns all the L1 stock and L1 owns all the L2 stock. The L loss group had an ownership change under §1.1502–92 in Year 2 with respect to a consolidated net operating loss arising in Year 1 and carried over to Year 2 and Year 3. The consolidated section 382 limitation computed solely on the basis of the value of the stock of L is $100. On December 31, Year 2, L1 sells 25 percent of the stock of L2 to B. L2 is apportioned a portion of the Year 1 consolidated net operating loss which it carries over to its first separate return year ending after December 31, Year 2. L2's separate section 382 limitation with respect to this loss is zero unless L elects to apportion all or a part of the consolidated section 382 limitation to L2. (See paragraph (c) of this section for rules regarding the apportionment of a consolidated section 382 limitation.) L apportions $50 of the consolidated section 382 limitation to L2, and the remaining $50 of the consolidated section 382 limitation stays with the loss group composed of L and L1.

(ii) On December 31, Year 3, L1 sells its remaining 75 percent stock interest in L2 to C, resulting in an ownership change of L2. L2's section 382 limitation computed on the change date with respect to the value of its stock is $30. Accordingly, L2's section 382 limitation for post-change years ending after December 31, Year 3, with respect to its pre-change losses, including the consolidated net operating losses apportioned to it from the L group, is $30, adjusted for a short taxable year, carryforward of unused limitation, or any other adjustment required under section 382.

(c) *Apportionment of a consolidated section 382 limitation*—(1) *In general.* The common parent may elect to apportion all or any part of a consolidated section 382 limitation to a former member (or loss subgroup). The common parent also may elect to apportion all or any part of the loss group's net unrealized built-in gain to a former member (or loss subgroup).

(2) *Amount which may be apportioned*—(i) *Consolidated section 382 limitation.* The common parent may apportion all or part of each element of the consolidated section 382 limitation determined under §1.1502–93. For this purpose, the consolidated section 382 limitation consists of two elements—

(A) The value element, which is the element of the limitation determined under section 382(b)(1) (relating to value multiplied by the long-term tax-exempt rate) without regard to such adjustments as those described in section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)(3)(B)(relating to the section 382 limitation for the post-change year that includes the change date), section 382(h)(relating to built-in gains and section 338 gains), and section 382(m)(2)(relating to short taxable years); and

(B) The adjustment element, which is so much (if any) of the limitation for the taxable year during which the former member ceases to be a member of the consolidated group that is attributable to a carryover of unused limitation under section 382(b)(2) or to recognized built-in gains under 382(h).

(ii) *Net unrealized built-in gain.* The aggregate amount of the loss group's net unrealized built-in gain that may be apportioned to one or more former members that cease to be members during the same consolidated return year cannot exceed the loss group's excess, immediately after the close of that year, of net unrealized built-in gain over recognized built-in gain, determined under section 382(h)(1)(A)(ii) (relating to a limitation on recognized built-in gain). For this purpose, net unrealized built-in gain apportioned to former members in prior consolidated return years is treated as recognized built-in gain in those years.

(3) *Effect of apportionment on the consolidated group*—(i) *Consolidated section 382 limitation.* The value element of the consolidated section 382 limitation for any post-change year ending after the day that a former member (or loss subgroup) ceases to be a member(s) is reduced to the extent that it is apportioned under this paragraph (c). The consolidated section 382 limitation for the post-change year in which the former member (or loss subgroup) ceases to be a member(s) is also reduced to the extent that the adjustment element for that year is apportioned under this paragraph (c).

(ii) *Net unrealized built-in gain.* The amount of the loss group's net unrealized built-in gain that is apportioned to the former member (or loss subgroup) is treated as recognized built-in gain for a prior taxable year ending in the recognition period for purposes of applying the limitation of section 382(h)(1)(A)(ii) to the loss group's recognition period taxable years beginning after the consolidated return year in which the former member (or loss subgroup) ceases to be a member.

(4) *Effect on corporations to which an apportionment is made*—(i) *Consolidated section 382 limitation.* The amount of the value element that is apportioned to a former member (or loss subgroup) is treated as the amount determined under section 382(b)(1) for purposes of determining the amount of that corporation's (or loss subgroup's) section 382 limitation for any taxable year ending after the former member (or loss subgroup) ceases to be a member(s). Appropriate adjustments must be made to the limitation based on the value element so apportioned for a short taxable year, carryforward of unused limitation, or any other adjustment required under section 382. The adjustment element apportioned to a former member (or loss subgroup) is treated as an adjustment under section 382(b)(2) or section 382(h), as appropriate, for the first taxable year after the member (or members) ceases to be a member (or members).

(ii) *Net unrealized built-in gain.* For purposes of determining the amount by which the former member's (or loss subgroup's) section 382 limitation for any taxable year beginning after the former member (or loss subgroup) ceases to be a member(s) is increased by its recognized built-in gain—

(A) The amount of net unrealized built-in gain apportioned to a former member (or loss subgroup) is treated as if it were an amount of net unrealized built-in gain determined under section 382(h)(1)(A)(i)(without regard to the threshold of section 382(h)(3)(B)) with respect to such member or loss subgroup, and that amount is not reduced under section 382(h)(1)(A)(ii) by the loss group's recognized built-in gain;

(B) The former member's (or loss subgroup's) 5 year recognition period begins on the loss group's change date;

(C) In applying section 382(h)(1)(A)(ii), the former member (or loss subgroup) takes into account only its prior taxable years that begin after it ceases to be a member of the loss group; and

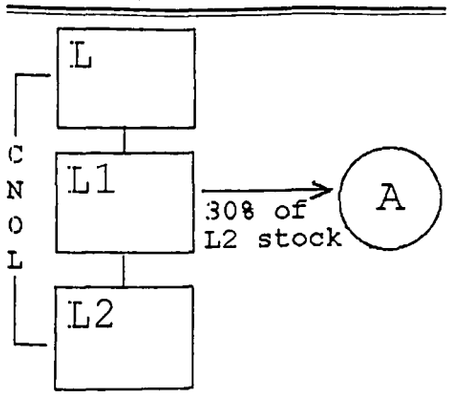
(D) The former member's (or loss subgroup's) recognized built-in gain on the disposition of an asset is determined under section 382(h)(2)(A), treating references to the change date in that section as references to the loss group's change date.

(5) *Deemed apportionment when loss group terminates.* If a loss group terminates, to the extent the consolidated section 382 limitation or net unrealized built-in gain is not apportioned under paragraph (c)(1) of this section, the consolidated section 382 limitation or net unrealized built-in gain is deemed to be apportioned to the loss subgroup that includes the common parent, or, if there is no loss subgroup that includes the common parent immediately after the loss group terminates, to the common parent. A loss group terminates on the first day of the first taxable year that is a separate return year with respect to each member of the former loss group.

(6) *Appropriate adjustments when former member leaves during the year.* Appropriate adjustments are made to the consolidated section 382 limitation for the consolidated return year during which the former member (or loss subgroup) ceases to be a member(s) to reflect the inclusion of the former member in the loss group for a portion of that year.

(7) *Examples.* The following examples illustrate the principles of this paragraph (c):

Example 1. Consequence of apportionment. (i) L owns all the L1 stock and L1 owns all the L2 stock. The L group has a $200 consolidated net operating loss arising in Year 1 that is carried over to Year 2. At the close of December 31, Year 1, the group has an ownership change under §1.1502–92. The ownership change results in a consolidated section 382 limitation of $10 based on the value of the stock of the group. On August 29, Year 2, L1 sells 30 percent of the stock of L2 to A. L2 is apportioned $90 of the group's $200 consolidated net operating loss under §1.1502–21(b). L, the common parent,



elects to apportion $6 of the consolidated section 382 limitation to L2. The following is a graphic illustration of these facts:

(ii) For its separate return years ending after December 31, Year 2, L2's section 382 limitation with respect to the $90 of the group's net operating loss apportioned to it is $6, adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment. For its consolidated return year ending December 31, Year 2 the L group's consolidated section 382 limitation with respect to the remaining $110 of pre-change consolidated attribute is $4 ($10 minus the $6 value element apportioned to L2), adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment.

(iii) For the L group's consolidated return year ending December 31, Year 2, the value element of its consolidated section 382 limitation is increased by $4 (rounded to the nearest dollar), to account for the period during which L2 was a member of the L group ($6, the consolidated section 382 limitation apportioned to L2, times 241/365, the ratio of the number of days during Year 2 that L2 is a member of the group to the number of days in the group's consolidated return year). See paragraph (c)(6) of this section. Therefore, the value element of the consolidated section 382 limitation for Year 2 of the L group is $8 (rounded to the nearest dollar).

(iv) The section 382 limitation for L2's short taxable year ending December 31, Year 2, is $2 (rounded to the nearest dollar), which is the amount that bears the same relationship to $6, the value element of the consolidated section 382 limitation apportioned to L2, as the number of days during that short taxable year, 124 days, bears to 365. See §1.382–5(c).

Example 2. Consequence of no apportionment. The facts are the same as in *Example 1,* except that L does not elect to apportion any portion of the consolidated section 382 limitation to L2. For its separate return years ending after August 29, Year 2, L2's section 382 limitation with respect to the $90 of the group's pre-change consolidated attribute apportioned to L2 is zero under paragraph (b)(2)(ii) of this section. Thus, the $90 consolidated net operating loss apportioned to L2 cannot offset L2's taxable income in any of its separate return years ending after August 29, Year 2. For its consolidated return years ending after August 29, Year 2, the L group's consolidated section 382 limitation with respect to the remaining $110 of pre-change consolidated attribute is $10, adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment.

Example 3. Apportionment of adjustment element. The facts are the same as in *Example 1,* except that L2 ceases to be a member of the L group on August 29, Year 3, and the L group has a $4 carryforward of an unused consolidated section 382 limitation (under section 382(b)(2)) to the Year 3 consolidated return year. The carryover of unused limitation increases the consolidated section 382 limitation for the Year 3 consolidated return year from $10 to $14. L may elect to apportion all or any portion of the $10 value element and all or any portion of the $4 adjustment element to L2.

(d) *Rules pertaining to ceasing to be a member of a loss subgroup*—(1) *In general.* A corporation ceases to be a member of a loss subgroup on the earlier of—

(i) The first day of the first taxable year for which it files a separate return; or

(ii) The first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent (treating for this purpose the loss subgroup parent as the common parent described in section 1504(a)(1)(A)).

(2) *Exceptions.* Paragraph (d)(1)(ii) of this section does not apply to a member of a loss subgroup while that member remains a member of the current group—

(i) If an election under §1.1502–91(d)(4)(relating to treating the subgroup parent requirement as satisfied) applies to the members of the loss subgroup;

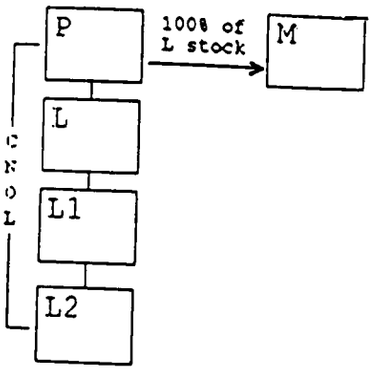
(ii) Starting on the day after the change date (but not earlier than the date the loss subgroup becomes a member of the group), if there is an ownership change of the loss subgroup within six months before, on, or after becoming members of the group; or

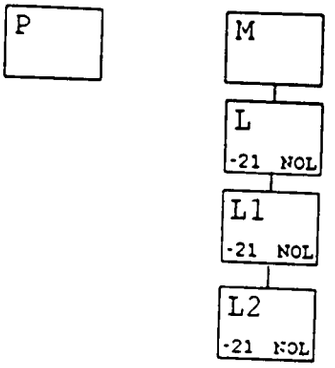
(iii) Starting the day after the period of 5 consecutive years following the day that the loss subgroup become members of the group during which the loss subgroup has not had an ownership change.

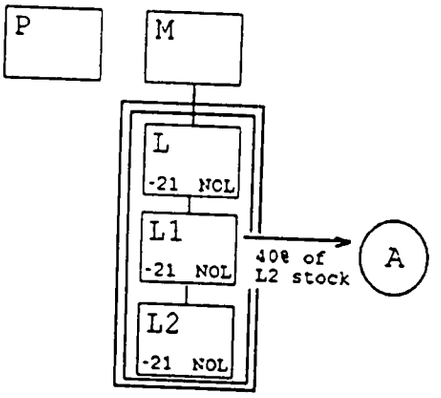
(3) *Examples.* The principles of this paragraph (d) are illustrated by the following examples:

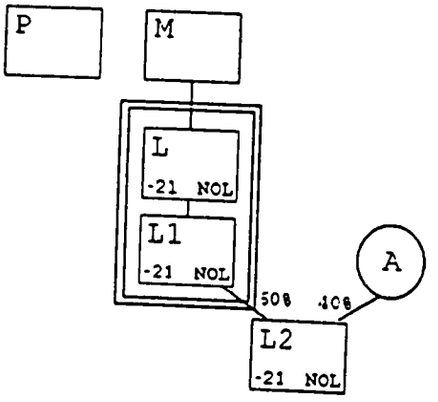
Example 1. Basic case. (i) P owns all the L stock, L owns all the L1 stock and L1 owns all the L2 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On December 11, Year 2, P sells all the stock of L to corporation M. Each of L, L1, and L2 is apportioned a portion of the Year 1 consolidated net operating loss, and thereafter each joins with M in filing consolidated returns. Under §1.1502–92, the L loss subgroup has an ownership change on December 11, Year 2. The L loss subgroup has a subgroup section 382 limitation of $100. The following is a graphic illustration of these facts:

(ii) On May 22, Year 3, L1 sells 40 percent of the L2 stock to A. L2 carries over a portion of the P group's net operating loss from Year 1 to its separate return year ending December 31, Year 3. Under paragraph (d)(1) of this section, L2 ceases to be a member of the L loss subgroup on May 22, Year 3, which is both (1) the first day of the first taxable year for which it files a separate return and (2) the day it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent, L. The net operating loss of L2 that is carried over from the P group is treated as a pre-change loss of L2 for its separate return years ending after May 22, Year 3. Under paragraphs (a)(2) and (b)(2) of this section, the separate section 382 limitation with respect to this loss is zero unless M elects to apportion all or a









part of the subgroup section 382 limitation of the L loss subgroup to L2.

Example 2. Formation of a new loss subgroup. The facts are the same as in *Example 1*, except that A purchases 40 percent of the L1 stock from L rather than purchasing L2 stock from L1. L1 and L2 file a consolidated return for their first taxable year ending after May 22, Year 3, and each of L1 and L2 carries over a part of the net operating loss of the P group that arose in Year 1. Under paragraph (d)(1) of this section, L1 and L2 cease to be members of the L loss subgroup on May 22, Year 3. The net operating losses carried over from the P group are treated as pre-change subgroup attributes of the loss subgroup composed of L1 and L2. The subgroup section 382 limitation with respect to those losses is zero unless M elects to apportion all or part of the subgroup section 382 limitation of the L loss subgroup to the L1 loss subgroup. The following is a graphic illustration of these facts:

Example 3. Ownership change upon becoming members of the group. (i) A owns all the stock of P, and P owns all the stock of L1 and L2. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3 and Year 4. Corporation M acquires all the stock of P on November 11, Year 3, and P, L1, and L2 thereafter file consolidated returns with M. M's acquisition results in an ownership change of the P loss subgroup under §1.1502–92(b)(1)(ii).

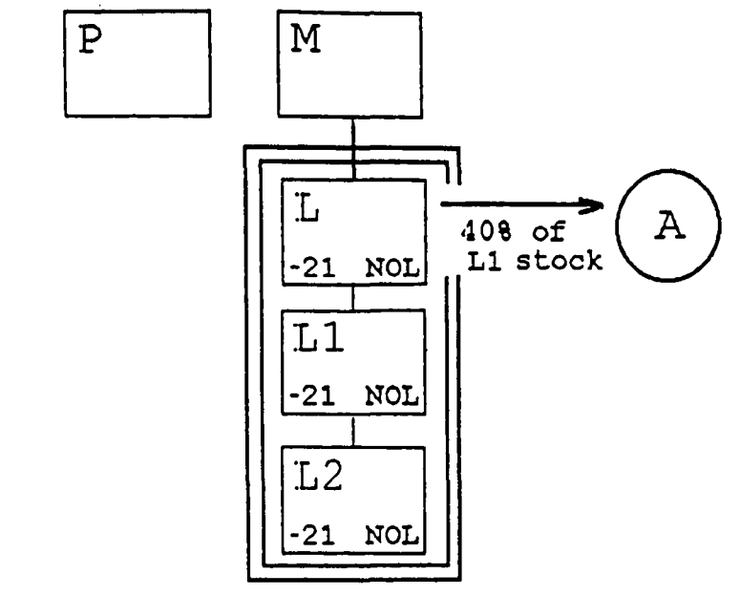
(ii) P distributes the L2 stock to M on October 7, Year 4, and L2 ceases to bear the relationship described in section 1504(a)(1) to P, the P loss subgroup parent. However, under

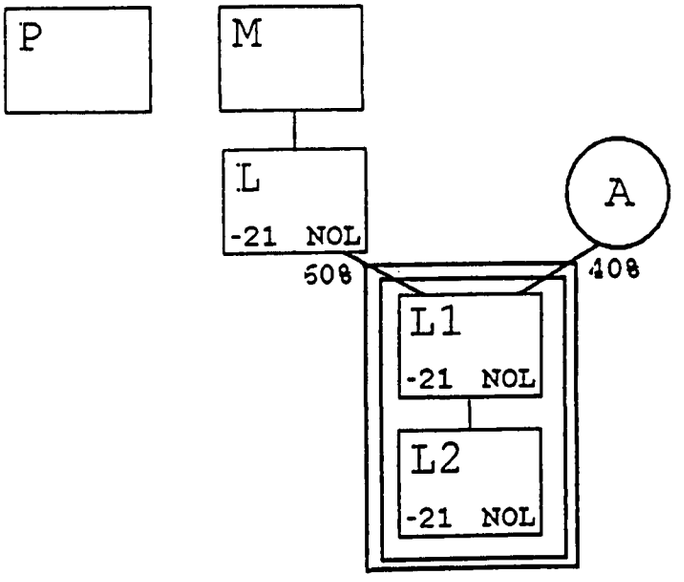
paragraph (d)(2) of this section, L2 does not cease to be a member of the P loss subgroup because the P loss subgroup had an ownership change upon becoming members of the M group and L2 remains in the M group.

Example 4. Ceasing to bear a section 1504 (a)(1) to the loss subgroup parent. (i) A owns all the stock of P, and P owns all the stock of L1 and L2. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 7. At the close of Year 2, X acquires all of the stock of P, causing an ownership change of the loss subgroup composed of P, L1 and L2 under §1.1502–92(b)(1)(ii). In Year 4, M, which is owned by the same person that owns X, acquires all of the stock of P, and the M acquisition does not cause a second ownership change of the P loss subgroup.

(ii) P distributes the L2 stock to M on February 3, Year 6 (less than 5 years after the P loss subgroup became members of the M group) and L2 ceases to bear the relationship described in section 1504(a)(1) to P, the loss subgroup parent. Thus, the section 382 limitation from the Year 2 ownership change that applies with respect to the pre-change attributes attributable to L2 is zero except to the extent M elects to apportion all or part of the P loss subgroup section 382 limitation to L2.

Example 5. Relationship through a successor. The facts are the same as in *Example 3*, except that M's acquisition of the P stock does not result in an ownership change of the P loss subgroup, and, instead of P's distributing the stock of L2, L2 merges into L1 on October 7, Year 4. L1 (as successor to L2 in the merger within the meaning of §1.1502–1(f)(4)) continues to bear a relationship described in





section 1504(a)(1) to P, the loss subgroup parent. Thus, L2 does not cease to be a member of the P loss subgroup as a result of the merger.

Example 6. Reattribution of net operating loss carryover under §1.1502–20(g). The facts are the same as in *Example 3*, except that, instead of distributing the L2 stock to M, P sells that stock to B, and, under §1.1502–20(g), M reattributes $10 of L2's net operating loss carryover to itself. Under §1.1502–20(g), M succeeds to the reattributed loss as if the loss were succeeded to in a transaction described in section 381(a). M, as successor to L2, does not cease to be a member of the P loss subgroup.

(e) *Allocation of net unrealized built-in loss*—(1) *In general.* This paragraph (e) provides rules for the allocation of a loss group's (or loss subgroup's) net unrealized built-in loss if a member ceases to be a member of a loss group (or loss subgroup). This paragraph (e) applies if—

(i) A loss group (or loss subgroup) has a net unrealized built-in loss on a change date; and

(ii) Immediately after the close of the consolidated return year in which the departing member ceases to be a member, the amount of the loss group's (or loss subgroup's) excess of net unrealized built-in loss over recognized built-in loss, determined under section 382(h)(1)(B)(ii) (relating to a limitation on recognized built-in loss), is greater than zero. (The amount of such excess is referred to as the remaining NUBIL balance.) In applying section 382(h)(1)(B)(ii) for this purpose, net unrealized built-in loss allocated to departing members in prior consolidated return years is treated as recognized built-in loss in those years.

(2) *Amount of allocation*—(i) *In general.* The amount of net unrealized built-in loss allocated to a departing member is equal to the remaining NUBIL balance, multiplied by a fraction. The numerator of the fraction is the amount of the built-in loss, taken into account on the change date under §1.1502–91(g), in the assets held by the departing member immediately after the member ceases to be a member of the loss group (or loss subgroup). The denominator of the fraction is the sum of the numerator, plus the amount of the built-in loss, taken into account under §1.1502–91(g) on the change date, in the assets held by the loss group (or loss subgroup) immediately after the close of the taxable year in which the departing member ceases to be a member. (Fluctuations in value of the assets between the change date and the date that the member ceases to be a member of the group (or loss subgroup), or the close of the taxable year in which the member ceases to be a member of the loss group, are disregarded.) Because the amount of built-in loss on the change date with respect to a departing member's assets is taken into account (rather than that member's separately computed net unrealized built-in loss on the change date), a departing member can be apportioned all or part of the loss group's net unrealized built-in loss, even if the departing member had a separately computed net unrealized built-in gain on the change date. Amounts taken into account under section 382(h)(6)(C) (relating to certain deduction items) are treated as if they were assets in determining the numerator and denominator of the fraction.

(ii) *Transferred basis property and deferred gain or loss.* For purposes of paragraph (b)(2)(i) of this section, assets held by the departing member immediately after it ceases to be a member of the group (or by other members immediately after the close of the taxable year) include—

(A) Assets held at that time that are transferred basis property that was held

by any member of the group (or loss subgroup) on the change date; and

(B) Assets held at that time by any member of the consolidated group with respect to which gain or loss of the group member or loss subgroup member at issue has been deferred in an intercompany transaction and has not been taken into account.

(iii) *Assets for which gain or loss has been recognized.* For purposes of paragraph (b)(2)(i) of this section, assets held by the departing member immediately after it ceases to be a member of the group (or by other members immediately after the close of the taxable year) do not include assets with respect to which gain or loss has previously been recognized and taken into account during the recognition period (including gain or loss recognized in an intercompany transaction and taken into account immediately before the member leaves the group). Appropriate adjustments must be made if gain or loss on an asset has been only partially recognized and taken into account.

(iv) *Exchanged basis property.* The rules of §1.1502–91(h) apply for purposes of this paragraph (e) (disregarding stock received from the departing member or another member that is a member immediately after the close of the taxable year).

(v) *Two or more members depart during the same year.* If two or more members cease to be members during the same consolidated return year, appropriate adjustments must be made to the denominator of the fraction for each departing member by treating the other departing members as if they had not ceased to be members during that year and as if the assets held by those other departing members immediately after they cease to be members of the group (or loss subgroup) are assets held by the group immediately after the close of the taxable year.

(vi) *Anti-abuse rule.* If assets are transferred between members or a member ceases to be a member with a principal purpose of causing or affecting the allocation of amounts under this paragraph (e), appropriate adjustments must be made to eliminate any benefit of such acquisition, disposition, or allocation.

(3) *Effect of allocation on the consolidated group.* The amount of the net unrealized built-in loss that is allocated to the former member is treated as recognized built-in loss for a prior taxable year ending in the recognition period for purposes applying the limitation of section 382(h)(1)(B)(ii) to a loss group's (or loss subgroup's) recognition period taxable years beginning after the consolidated return year in which the former member ceases to be a member.

(4) *Effect on corporations to which the allocation is made.* For purposes of determining the amount of the former member's recognized built-in losses in any taxable year beginning after the former member ceases to be a member—

(i) The amount of the loss group's (or loss subgroup's) net unrealized built-in loss that is allocated to the former member is treated as if it were an amount of net unrealized built-in loss determined under section 382(h)(1)(B)(i)(without regard to the threshold of section 382(h)(3)-(B)) with respect to such member or loss subgroup, and that amount is not reduced under section 382(h)(1)(B)(ii) by the loss group's (or loss subgroup's) recognized built-in losses;

(ii) The former member's 5 year recognition period begins on the loss group's (or loss subgroup's) change date;

(iii) In applying section 382(h)(1)-(B)(ii), the former member takes into account only its prior taxable years that begin after it ceases to be a member of the loss group (or loss subgroup); and

(iv) The former member's recognized built-in loss on the disposition of an asset is determined under section 382(h)(2)(B), treating references to the change date in that section as references to the loss group's (or loss subgroup's) change date.

(5) *Subgroup principles.* If two or more former members are members of the same consolidated group (the second group) immediately after they cease to be members of the current group, the principles of paragraphs (e)(1), (2) and (4) of this section apply to those former members on an aggregate basis. Thus, for example, the amount of net unrealized built-in loss allocated to those members is based on the assets held by those members immediately after they cease to be members of the current group and the limitation of section 382(h)(1)(B)(ii) on recognized built-in losses is applied by taking into account the aggregate amount of net unrealized built-in loss allocated to the former members and the aggregate recognized losses of those members in taxable years beginning after they cease to be members of the current group. If one or more of such members cease to be members of the second group, the principles of this paragraph (e) are applied with respect to those members to allocate to them all or part of any remaining unrecognized amount of net unrealized built-in loss allocated to the members that became members of the second group.

(6) *Apportionment of consolidated section 382 limitation (or subgroup section 382 limitation)*—(i) *In general.* For rules relating to the apportionment of a consolidated section 382 limitation (or subgroup section 382 limitation) to a former member, see paragraph (c) of this section.

(ii) *Special rule for former members that become members of the same consolidated group.* If recognized built-in losses of one or more former members would be subject to a consolidated section 382 limitation (or subgroup section 382 limitation) if recognized immediately before the member (or members) cease to be members of the group, an apportionment of that limitation may be made, under paragraph (c) of this section, to a loss subgroup that includes such member (or members), and the recognized built-in losses (if any) of that member (or members) will be subject to that apportioned limitation. If two or more of such former members are not included in a loss subgroup immediately after they cease to be members of the group (for example, because they do not have net operating loss carryovers or, in the aggregate, a net unrealized built-in loss), but are members of the same consolidated group, an apportionment of the consolidated section 382 limitation (or subgroup section 382 limitation) may be made to them as if they were a loss subgroup.

(7) *Examples.* The following examples illustrate the principles of this paragraph (e):

Example 1. Basic allocation case. (i) P owns all of the stock of L1 and L2. On September 4, Year 1, A purchases all of the P stock, causing an ownership change of the P group. On that date P has two assets (other than the L1 and L2 stock), asset 1 with an adjusted basis of $40 and a fair market value of $15 and asset 2 with an adjusted basis of $50 and a fair market value of $100. L1 has two assets, asset 3 , with a fair market value of $50 and an adjusted basis of $100, and asset 4, with an adjusted basis of $125 and a fair market value of $75. L2 has two assets,

asset 5, with a fair market value of $150 and an adjusted basis of $100, and asset 6, with an adjusted basis of $90 and a fair market value of $40. Thus, the P loss group has a net unrealized built-in loss of $75.

(ii) On March 19, Year 3, P sells all of the L2 stock to M. At that time, asset 5, which has appreciated in value, has a fair market value of $250 and an adjusted basis of $100. Asset 6, which has declined in value, has an adjusted basis of $90 and a fair market value of $10.

(iii) On April 8, Year 3, P sells asset 1, and has a recognized built-in loss of $25 that is subject to the P group's section 382 limitation. On November 11, Year 4, L2 sells asset 6 for its then fair market value, $10, recognizing a loss of $80. On June 3, Year 5, L1 sells asset 4, recognizing a loss of $50.

(iv) Immediately after the close of Year 3, the P loss group's remaining NUBIL balance is $50 ($75 net unrealized built-in loss reduced by the $25 recognized built-in loss of P). The portion of the remaining NUBIL balance that is allocated to L2 is $17 (rounded to the nearest dollar). Seventeen dollars is the product obtained by multiplying $50 (the remaining NUBIL balance) by $50/$150. The numerator of the fraction ($50) is the amount of built-in loss in asset 6, taken into account on the change date under §1.1502–91(g). The denominator ($150) is the sum of the numerator ($50) and the amount of built-in loss in assets 3 and 4, taken into account on the change date under §1.1502–91(g) ($100). The built-in loss in asset 1 is not included in the denominator of the fraction because it is not held by the P group immediately after the close of Year 3.

(v) Seventeen dollars of L2's $80 loss on the sale of asset 6 is a recognized built-in loss and subject to a section 382 limitation of zero, unless P apportions some or all of the P group's consolidated section 382 limitation to L2 (adjusted for a short taxable year, carryover of unused limitation, or any other adjustment required under section 382).

(vi) Thirty-three dollars of L1's $50 loss on the sale of asset 4 is subject to the P group's consolidated section 382 limitation, reduced by the amount of such limitation apportioned to L2, and adjusted for any short taxable year, a carryforward of unused limitation, or other adjustment. (In applying section 382(h)(1)(B)(ii) with respect to Year 5, the P group's net unrealized built-in loss is reduced by P's $25 recognized built-in loss in Year 3 and the $17 of net unrealized built-in loss allocated to L2, thus limiting the P group's recognized built-in loss in Year 5 to $33.)

Example 2. Two members depart in the same year. The facts are the same as in *Example 1*, except that P sells all of the stock of L1 to C on November 1, Year 3. The amount of net unrealized built-in loss apportioned to L2 (rounded to the nearest dollar) is $17 ($50 remaining NUBIL balance × $50/$150). The amount of net unrealized built-in loss apportioned to L1 (rounded to the nearest dollar) is $33 ($50 remaining NUBIL balance × $100/$150).

(8) *Reporting requirement.* If a net unrealized built-in loss is allocated under this paragraph (e), the common parent must file a statement with its income tax return for the taxable year in which the former member(s) (or a new loss subgroup that includes that member) ceases to be a member. The statement must provide the name and employer identification number (E.I.N.) of the departing member, the amount of remaining NUBIL balance for the taxable year in which the member departs, and the amount of the net unrealized built-in loss allocated to the departing member. The common parent must also deliver a copy of the statement to the former member on or before the day the group files its income tax return for the consolidated return year that the former member ceases to be a member. A copy of the statement must be attached to the first income tax return of the former member (or the first return in which the former member joins) that is filed after the close of the consolidated return year of the group of which the former member (or a new loss subgroup that includes that member) cease to be a member. This paragraph (e)(8) does not apply if the required information (other than the amount of remaining NUBIL balance) is included in a statement of election under paragraph (f) of this section (relating to apportioning a section 382 limitation).

(f) *Filing the election to apportion the section 382 limitation and net unrealized built-in gain*—(1) *Form of the election to apportion.* An election under paragraph (c) of this section must be made by the common parent. The election must be made in the form of the following statement: "THIS IS AN ELECTION UNDER §1.1502–95 OF THE INCOME TAX REGULATIONS TO APPORTION ALL OR PART OF THE [insert THE CONSOLIDATED SECTION 382 LIMITATION, THE SUBGROUP SECTION 382 LIMITATION, THE LOSS GROUP'S NET UNREALIZED BUILT-IN GAIN, THE LOSS SUBGROUP'S NET UNREALIZED BUILT-IN GAIN, as appropriate] TO [insert name and E.I.N. of the corporation (or the corporations that compose a new loss subgroup) to which allocation is made]". The declaration must also include the following information, as appropriate—

(i) The date of the ownership change that resulted in the consolidated section 382 limitation (or subgroup section 382 limitation) or the loss group's (or loss subgroup's) net unrealized built-in gain;

(ii) The amount of the departing member's (or loss subgroup's) pre-change net operating loss carryovers and the taxable years in which they arose that will be subject to the limitation that is being apportioned to that member (or loss subgroup);

(iii) The amount of any net unrealized built-in loss allocated to the departing member (or loss subgroup) under paragraph (e) of this section, which, if recognized, can be a pre-change attribute subject to the limitation that is being apportioned;

(iv) If a consolidated section 382 limitation (or subgroup section 382 limitation) is being apportioned, the amount of the consolidated section 382 limitation (or subgroup section 382 limitation) for the taxable year during which the former member (or new loss subgroup) ceases to be a member of the consolidated group (determined without regard to any apportionment under this section);

(v) If any net unrealized built-in gain is being apportioned, the amount of the loss group's (or loss subgroup's) net unrealized built-in gain (as determined under paragraph (c) (2)(ii) of this section) that may be apportioned to members that ceased to be members during the consolidated return year;

(vi) The amount of the value element and adjustment element of the consolidated section 382 limitation (or subgroup section 382 limitation) that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section;

(vii) The amount of the loss group's (or loss subgroup's) net unrealized built-in gain that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section;

(viii) If the former member is allocated any net unrealized built-in loss under paragraph (e) of this section, the amount of any adjustment element apportioned to the former member that is attributable to recognized built-in gains (determined in a manner that will enable both the group and the former member to apply the principles of §1.1502–93(c));

(ix) The name and E.I.N. of the common parent making the apportionment.

(2) *Signing of the election.* The election statement must be signed by both the common parent and the former member (or, in the case of a loss subgroup, the common parent and the loss subgroup parent) by persons authorized to sign their

respective income tax returns. If the allocation is made to a loss subgroup for which an election under §1.1502–91(d)(4) is made, and not separately to its members, the election statement under this paragraph (e) must be signed by the common parent and any member of the new loss subgroup by persons authorized to sign their respective income tax returns.

(3) *Filing of the election.* The election statement must be filed by the common parent of the group that is apportioning the consolidated section 382 limitation (or the subgroup section 382 limitation) or the loss group's net unrealized built-in gain (or loss subgroup's net unrealized built-in gain) with its income tax return for the taxable year in which the former member (or new loss subgroup) ceases to be a member. The common parent must also deliver a copy of the statement to the former member (or the members of the new loss subgroup) on or before the day the group files its income tax return for the consolidated return year that the former member (or new loss subgroup) ceases to be a member. A copy of the statement must be attached to the first return of the former member (or the first return in which the members of a new loss subgroup join) that is filed after the close of the consolidated return year of the group of which the former member (or the members of a new loss subgroup) ceases to be a member.

(4) *Revocation of election.* An election statement made under paragraph (c) of this section is revocable only with the consent of the Commissioner.

§1.1502–96 Miscellaneous rules.

(a) *End of separate tracking of losses*—(1) *Application.* This paragraph (a) applies to a member (or a loss subgroup) with a net operating loss carryover that arose (or is treated under §1.1502–21(c) as arising) in a SRLY, or a member (or loss subgroup) with a net unrealized built-in loss determined at the time that the member (or loss subgroup) becomes a member of the consolidated group if there is—

(i) An ownership change of the member (or loss subgroup) within six months before, on, or after becoming a member of the group; or

(ii) A period of 5 consecutive years following the day that the member (or loss subgroup) becomes a member of a group during which the member (or loss subgroup) has not had an ownership change.

(2) *Effect of end of separate tracking*—(i) *Net operating loss carryovers.* If this paragraph (a) applies with respect to a member (or loss subgroup) with a net operating loss carryover, then, starting on the day after the earlier of the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group) or the last day of the 5 consecutive year period described in paragraph (a)(1)(ii) of this section, such loss carryover is treated as described in §1.1502–91(c)(1)(i). The preceding sentence also applies for purposes of determining whether there is an ownership change with respect to such loss carryover following such change date or 5 consecutive year period. Thus, for example, starting the day after the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group) or the end of the 5 consecutive year period—

(A) The consolidated group which includes the new loss member or loss subgroup is no longer required to separately track owner shifts of the stock of the new loss member or subgroup parent to determine if an ownership change occurs with respect to the loss carryover of the new loss member or members included in the loss subgroup;

(B) The group is a loss group because the member's loss carryover is treated as a loss described in §1.1502–91(c)(1)(i);

(C) There is an ownership change with respect to such loss carryover only if the group has an ownership change; and

(D) If the group has an ownership change, such loss carryover is a pre-change consolidated attribute subject to the loss group's consolidated section 382 limitation.

(ii) *Net unrealized built-in losses.* If this paragraph (a) applies with respect to a new loss member described in §1.1502–94 (a)(1)(ii) (or a loss subgroup described in §1.1502–91(d)(2)) then, starting on the day after the earlier of the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the group) or the last day of the 5 consecutive year period described in paragraph (a)(1)(ii) of this section, the member (or members of the loss subgroup) are treated, for purposes of applying §1.1502–91(g)(2)(ii), as if they have been affiliated with the common parent for 5 consecutive years. Starting on that day, the member's (or the members of the loss subgroup's) separately computed net unrealized built-in loss is included in the determination whether the group has a net unrealized built-in loss, and there is an ownership change with respect to the member's separately computed net unrealized built-in loss only if the group (including the member) has a net unrealized built-in loss and has an ownership change. Thus, for example, starting the day after the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group), or the end of the 5 consecutive period–

(A) The consolidated group which includes the new loss member or loss subgroup is no longer required to separately track owner shifts of the stock of the new loss member or subgroup parent to determine if an ownership change occurs with respect to the net unrealized built-in loss of the new loss member or members of the loss subgroup;

(B) The group includes the member's (or the loss subgroup members') separately computed net unrealized built-in loss in determining whether it is a loss group under §1.1502–91(c)(1)(iii);

(C) There is an ownership change with respect to such net unrealized built-in loss only if the group is a loss group and has an ownership change; and

(D) If the group has an ownership change, the member's separately computed net unrealized built-in loss and its assets are taken into account in determining the group's pre-change consolidated attributes described in §1.1502–91(e)(1) (relating to recognized built-in losses) that are subject to the group's consolidated section 382 limitation.

(iii) *Common parent not common parent for five years.* If the common parent has become the common parent of an existing group within the previous 5-year period in a transaction described in §1.1502–75(d)(2)(ii) or (3), appropriate adjustments must be made in applying paragraphs (a)(2)(ii) and (3) of this section. In such a case, as the context requires, references to the common parent are to the former common parent.

(3) *Continuing effect of end of separate tracking*—(i) *In general.* As the context may require, a current group determines which of its members are included in a loss subgroup on any testing date by taking into account the application of this section in the former group. See the example in §1.1502–91(f)(2). For this purpose, corporations that are treated under paragraph (a)(2)(ii) of this section as having been affiliated with the common parent of the former group for 5 consecutive years are also treated as having been affiliated with any other members that have been (or are treated as having been) affiliated with the common parent. The corporations are treated as having been affiliated with such other members for the same period of time that those members have been (or are treated as having been) affiliated with the common parent. If two or more corporations become members of the group at the same time, but paragraph (a)(1) of this section does not apply to every such corporation, then immediately after the corporations become members of the group, the corporations to which paragraph (a)(1) of this section applied are treated as not having been previously affiliated, for purposes of applying this paragraph (a)(3), with the corporations to which paragraph (a)(2)(ii) of this section did not apply.

(ii) *Example.* The following example illustrates the principles of this paragraph (a)(3):

Example. (i) L has owned all the stock of L1 for three years. At the close of December 31, Year 1, the M group purchases all the L stock, and L and L1 become members of the M group. Other than the stock of L1, L has one asset (the L loss asset) with a net unrealized built-in loss of $200 on this date. L1 has one asset with a net unrealized built-in gain of $50 (the L1 gain asset). L and L1 do not compose a loss subgroup because they do not meet the five year affiliation requirement of §1.1502–91(d)(2)(i). L is a new loss member, and M's purchase of L causes an ownership change of L. At the close of December 31, Year 4, at a time when L1 has been affiliated with the M group for three years and has been affiliated with L for six years, the S group purchases all the M stock. On this date, the L loss asset has a net unrealized built-in loss of $300, the L1 gain asset has a net unrealized built-in gain of $80, and M, the common parent of the M group, has one asset with a net unrealized built-in gain of $200.

(ii) Paragraph (a)(1) of this section applies to L because L is a new loss member described in §1.1502–94(a)(1)(ii) that has an ownership change upon becoming a member of the M group on December 31, Year 1. Accordingly, L is treated as having been affiliated with M for 5 consecutive years, and the L loss asset with a net unrealized built-in loss of $300 is included in the determination whether the M group has a net unrealized built-in loss.

(iii) The S group determines which of its members are included in a loss subgroup by taking into account application of paragraph (a) of this section in the M group. For this purpose, application of paragraph (a) of this section causes L to be treated as having been affiliated with M (or as having been a member of the M group) for 5 consecutive years as of January 1, Year 2. Therefore, the S group includes L in the determination whether the M subgroup acquired by S on December 31, Year 4, has a net unrealized built-in loss.

(iv) Because paragraph (a)(1) of this section applied to L when L became a member of the M group, but did not apply to L1, L is treated as not having been affiliated with L1 before L and L1 joined the M group. Also, L1 is not included in the determination whether the M subgroup has a net unrealized built-in loss because L1 has not been continuously affiliated with members of the M group for the five consecutive year period ending immediately before they become members of the S group. See §1.1502–91(g)(2).

(4) *Special rule for testing period.* For purposes of determining the beginning of the testing period for a loss group, the member's (or loss subgroup's) net operating loss carryovers (or net unrealized built-in loss) described in paragraph (a)(2) of this section are considered to arise—

(i) In a case described in paragraph (a)(1)(i) of this section, in a taxable year that begins not earlier than the later of the day following the change date or the day that the member becomes a member of the group; and

(ii) In a case described in paragraph (a)(1)(ii) of this section, in a taxable year that begins 3 years before the end of the 5 consecutive year period.

(5) *Limits on effects of end of separate tracking.* The rule contained in this paragraph (a) applies solely for purposes of §§1.1502–91 through 1.1502–95 and this section (other than paragraph (b)(2)(ii)(B) of this section (relating to the definition of pre-change attributes of a subsidiary)) and §1.1502–98, and not for purposes of other provisions of the consolidated return regulations. However, the rule contained in this paragraph (a) does apply in §§1.1502–15(g), 1.1502–21(g) and 1.1502–22(g) for purposes of determining the composition of loss subgroups defined in §1.1502–91(d). See also paragraph (c) of this section for the continuing effect of an ownership change with respect to pre-change attributes.

(b) *Ownership change of subsidiary*—(1) *Ownership change of a subsidiary because of options or plan or arrangement.* Notwithstanding §1.1502–92, a subsidiary may have an ownership change for purposes of section 382 with respect to its attributes which a group or loss subgroup includes in making a determination under §1.1502–91(c)(1) (relating to the definition of loss group) or §1.1502–91(d) (relating to the definition of loss subgroup). The subsidiary has such an ownership change if it has an ownership change under the principles of §1.1502–95(b) and section 382 and the regulations thereunder (determined on a separate entity basis by treating the subsidiary as not being a member of a consolidated group) in the event of—

(i) The deemed exercise under §1.382–4(d) of an option or options (other than an option with respect to stock of the common parent) held by a person (or persons acting pursuant to a plan or arrangement) to acquire more than 20 percent of the stock of the subsidiary; or

(ii) An increase by 1 or more 5-percent shareholders, acting pursuant to a plan or arrangement to avoid an ownership change of a subsidiary, in their percentage ownership interest in the subsidiary by more than 50 percentage points during the testing period of the subsidiary through the acquisition (or deemed acquisition pursuant to §1.382–4(d)) of ownership interests in the subsidiary and in higher-tier members with respect to the subsidiary.

(2) *Effect of the ownership change*—(i) *In general.* If a subsidiary has an ownership change under paragraph (b)(1) of this section, the amount of consolidated taxable income for any post-change year that may be offset by the pre-change losses of the subsidiary shall not exceed the section 382 limitation for the subsidiary. For purposes of this limitation, the value of the subsidiary is determined solely by reference to the value of the subsidiary's stock.

(ii) *Pre-change losses.* The pre-change losses of a subsidiary are—

(A) Its allocable part of any consolidated net operating loss which is attributable to it under §1.1502–21(b) (determined on the last day of the consolidated return year that includes the change date) that is not carried back and absorbed in a taxable year prior to the year including the change date;

(B) Its net operating loss carryovers that arose (or are treated under §1.1502–21(c) as having arisen) in a SRLY; and

(C) Its recognized built-in loss with respect to its separately computed net unrealized built-in loss, if any, determined on the change date.

(3) *Coordination with §§1.1502–91, 1.1502–92, and 1.1502–94.* If an increase in percentage ownership interest causes an ownership change with respect to an attribute under this paragraph (b) and under §1.1502–92 on the same day, the ownership change is considered to occur only under §1.1502–92 and not under this paragraph (b). See §1.1502–94 for anti-duplication rules relating to value.

(4) *Example.* The following example illustrates paragraph (b)(1)(ii) of this section:

Example. Plan to avoid an ownership change of a subsidiary. (i) L owns all the stock of L1, L1 owns all the stock of L2, L2 owns all the stock of L3, and L3 owns all the stock of L4. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. L has assets other than its L1 stock with a value of $900. L1, L2, and L3 own no assets other than their L2, L3, and L4 stock. L4 has assets with a value of $100. During Year 2, A, B, C, and D, acting pursuant to a plan to avoid an ownership change of L4, acquire the following ownership interests in the members of the L loss group: (A) on September 11, Year 2, A acquires 20 percent of the L1 stock from L and B acquires 20 percent of the L2 stock from L1; and (B) on September 20, Year 2, C acquires 20 percent of the stock of L3 from L2 and D acquires 20 percent of the stock of L4 from L3.

(ii) The acquisitions by A, B, C, and D pursuant to the plan have increased their respective percentage ownership interests in L4 by approximately 10, 13, 16, and 20 percentage points, for a total of approximately 59 percentage points during the testing period. This more than 50 percentage point increase in the percentage ownership interest in L4 causes an ownership change of L4 under paragraph (b)(2) of this section.

(c) *Continuing effect of an ownership change.* A loss corporation (or loss subgroup) that is subject to a limitation under section 382 with respect to its pre-change losses continues to be subject to the limitation regardless of whether it becomes a member or ceases to be a member of a consolidated group. See §1.382–5(d) (relating to successive ownership changes and absorption of a section 382 limitation).

(d) *Losses reattributed under §1.1502–20(g)*—(1) *In general.* This paragraph (d) contains rules relating to net operating carryovers that are reattributed to the common parent under §1.1502–20(g). References in this paragraph (d) to a subsidiary are references to the subsidiary (or lower tier subsidiary) whose net operating loss carryover is reattributed to the common parent.

(2) *Deemed section 381(a) transaction.* Under §1.1502–20 (g)(1), the common parent succeeds to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). In general, §§1.1502–91 through 1.1502–95, this section, and §1.1502–98 are applied to the reattributed net operating loss carryovers in accordance with that characterization. See generally, §1.382–2(a)(1)(ii)(relating to distributor or transferor loss corporations in transactions under section 381), §1.1502– (1)(f)(4)(relating to the definition of predecessor and successor) and §1.1502–91(j)(relating to predecessor and successor corporations). For example, if the reattributed net operating loss carryover is a pre-change attribute subject to a section 382 limitation, it remains subject to that limitation following the reattribution. In certain cases, the limitation applicable to the reattributed loss is zero unless the common parent apportions all or part of the limitation to itself. (See paragraph (d)(4) of this section.)

(3) *Rules relating to owner shifts*—(i) *In general.* Any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3)) in connection with the disposition of the stock of the subsidiary is not taken into account in determining whether there is an ownership change with respect to the reattributed net operating loss carryover. However, any owner shift with respect to the successor corporation that is treated as continuing in existence under §1.382–2(a)(1)(ii) must be taken into account for such purpose if such owner shift is effected by the reattribution and an owner shift of the stock of the subsidiary not held directly or indirectly by the common parent would have been taken into account if such shift had occurred immediately before the reattribution. See paragraph (d)(3)(ii) *Example 2* of this section.

(ii) Examples. The following examples illustrate the principles of this paragraph (d)(3):

Example 1. No owner shift for reattributed loss. (i) P, the common parent of a consolidated group, owns 60% of the stock of L, and B owns the remaining 40%. L has a net operating loss carryover of $100 from year 1 that it carries over to Years 2, 3, and 4. At the beginning of Year 2, P purchases 40% of the L stock from B, which does not cause an ownership change of L. On December 31, Year 3, P sells all of the L stock to M. Pursuant to §1.1502–20(g), P reattributes $10 of L's $100 net operating loss carryover to itself, and L carries $90 of its net operating loss carryover to its Year 4.

(ii) The sale of the L stock to M does not cause an owner shift that is taken into account in determining if there is an ownership change with respect to the $10 reattributed loss. Following the reattribution, §1.1502–94(b) continues to apply to determine if there is an ownership change with respect to the $10 reattributed loss, until, under paragraph (a) of this section, the loss is treated as described in §1.1502–91(c)(1)(i). In applying §1.1502–94(b), the 40 percentage point increase by the P shareholders prior to the reattribution is taken into account. The sale of the L stock to M does cause an ownership change of L with respect to the $90 of its net operating loss that it carries over to Year 4.

Example 2. Owner shift for reattributed loss. The facts are the same as in *Example 1*, except that P only purchases 20% of the L stock from B and sells 80% of the L stock to M. L isa new loss member, and, under §1.1502–94(b)(1), an owner shift of the stock of L not held directly or indirectly by the common parent (the 20% of L stock still held by B) would have been taken into account if such shift had occurred immediately before the reattribution. Following the reattribution, §1.1502–94(b) continues to apply to determine if there is an ownership change with respect to the $10 reattributed loss, until, under paragraph (a) of this section, the loss is treated as described in §1.1502–91(c)(1)(i). With respect to the $10 reattributed loss, the P shareholders have increased their percentage ownership interest by 40 percentage points. The P shareholders have increased their ownership interests by 20 percentage points as a result of P's purchase of stock from B, and, under §1.382–2(a)(1)(ii), are treated as increasing their interests by an additional 20 percentage points as a result of the reattribution. (The acquisition of the L stock by M does not, however, effect an owner shift for the $10 of reattributed loss.) The sale of the L stock to M causes an ownership change of L with respect to the $90 of net operating loss that L carries over to Year 4.

(4) *Rules relating to the section 382 limitation*—(i) *Reattributed loss is a pre-change separate attribute of a new loss member.* If the reattributed net operating loss carryover is a pre-change separate attribute of a new loss member that is subject to a separate section 382 limitation prior to the disposition of subsidiary stock, the common parent's limitation with respect to that loss is zero, except to the extent that the common parent apportions to itself, under paragraph (d)(5) of this section, all or part of such limitation. A separate section 382 limitation is the

limitation described in §1.1502–94(b) that applies to a pre-change separate attribute.

(ii) *Reattributed loss is a pre-change subgroup attribute.* If the reattributed net operating loss carryover is a pre-change subgroup attribute subject to a subgroup section 382 limitation prior to the disposition of subsidiary stock, and, immediately after the reattribution, the common parent is not a member of the loss subgroup, the section 382 limitation with respect to that net operating loss carryover is zero, except to the extent that the common parent apportions to itself, under paragraph (d)(5) of this section, all or part of the subgroup section 382 limitation. See, however, §1.1502–95(d)(3) *Example 6,* for an illustration of a case where the common parent, as successor to the subsidiary, is a member of the loss subgroup immediately after the reattribution.

(iii) *Potential application of section 382(l)(1).* In general, the value of the stock of the common parent is used to determine the section 382 limitation for an ownership change with respect to the reattributed net operating loss carryover that occurs at the time of, or after, the reattribution. For example, if the net operating loss carryover is a pre-change consolidated attribute, the value of the stock of the common parent is used to determine the section 382 limitation, and no adjustment to that value is required because of the deemed section 381(a) transaction. However, if the net operating loss carryover is a pre-change separate attribute of a new loss member (or is a pre-change attribute of a loss subgroup member and the common parent was not the loss subgroup parent immediately before the reattribution), the deemed section 381(a) transaction is considered to constitute a capital contribution with respect to the new loss member (or loss subgroup member) for purposes of section 382(l)(1). Accordingly, if that section applies because the deemed capital contribution is (or is considered under section 382(l)(1)(B) to be) part of a plan described in section 382(l)(1)(A), the value of the stock of the common parent after the deemed section 381(a) transaction must be adjusted to reflect the capital contribution. Ordinarily, this will require the value of the stock of the common parent to be reduced to an amount that represents the value of the stock of the subsidiary (or loss subgroup of which the subsidiary was a member) when the reattribution occurred.

(iv) *Duplication or omission of value.* In determining any section 382 limitation with respect to the reattributed net operating loss carryover and with respect to other pre-change losses, appropriate adjustments must be made so that value is not improperly omitted or duplicated as a result of the reattribution. For example, if the subsidiary has an ownership change upon its departure, and the common parent (as successor) has an ownership change with respect to the reattributed pre-change separate attribute upon its reattribution under paragraph (d)(3)(i) of this section, proper adjustments must be made so that the value of the subsidiary is not taken into account more than once in determinining the section 382 limitation for the reattributed loss and the loss that is not reattributed.

(v) *Special rule for continuity of business requirement.* If the reattributed net operating loss carryover is a pre-change attribute of new loss member and the reattribution occurs within the two year period beginning on the change date, then, starting immediately after the reattribution, the continuity of business requirement of section 382(c)(1) is applied with respect to the business enterprise of the common parent. Similar principles apply if the reattributed net operating loss carryover is a pre-change subgroup attribute and, on the day after the reattribution, the common parent is not a member of the loss subgroup.

(5) *Election to reattribute section 382 limitation*—(i) *Effect of election.* The common parent may elect to apportion to itself all or part of any separate section 382 limitation or subgroup section 382 limitation to which the net operating loss carryover is subject immediately before the reattribution. However, no net unrealized built-in gain of the member (or loss subgroup) whose net operating loss carryover is reattributed can be apportioned to the common parent. The principles of §1.1502–95(c) apply to the apportionment, treating, as the context requires, references to the former member as references to the common parent, and references to the consolidated section 382 limitation as references to the separate section 382 limitation (or subgroup section 382 limitation) that is being apportioned. Thus, for example, the common parent can reattribute to itself all or part of the value element or adjustment element of the limitation, and any part of such element that is apportioned requires a corresponding reduction in such element of the separate section 382 limitation of the subsidiary whose net operating loss carryover is reattributed (or in the subgroup section 382 limitation if the reattributed loss is a pre-change subgroup attribute). Appropriate adjustments must be made to the separate section 382 limitation (or subgroup section 382 limitation) for the consolidated return year in which the reattribution is made to reflect that the reattributed net operating loss carryover is an attribute acquired by the common parent during the year in a transaction to which section 381(a) applies. The election is made by the common parent as part of the election to reattribute the net operatingloss carryover. See §1.1502–20(g)-(4) for the time and manner of making the election.

(ii) *Examples.* The following examples illustrate the principles of this paragraph (d)(5):

Example 1. Consequence of apportionment. (i) P, the common parent of a consolidated group, purchases all of the stock of L on December 31, Year 1. L carries over a net operating loss arising in Year 1 to each of the next 5 taxable years. The purchase of the L stock causes an ownership change of L, and results in a separate section 382 limitation of $10 for L's net operating loss carryover based on the value of the L stock. On July 2, Year 3, P sells 30 percent of the L stock to A. Under §1.1502–20(g), P elects to apportion to itself $110 of L's $200 net operating loss carryover. P also elects to apportion to itself $6 of the $10 value element of the separate section 382 limitation.

(ii) For the consolidated return years ending after December 31, Year 3, P's separate section 382 limitation with respect to the reattributed net operating loss carryover is $6, adjusted as appropriate for any short taxable year, unused section 382 limitation, or other adjustment. For the P group's consolidated return year ending December 31, Year 3, the separate section 382 limitation for L's net operating loss carryover is $8, the sum of $5 and $3. Five dollars of the limitation is the amount that bears the same relationship to $10 as the number of days in the period ending with the deemed section 381(a) transaction, 183 days, bears to 365. Three dollars of the limitation is the amount that bears the same relationship to $6 as the number of days in the period between July 3 and December 31, 182, bears to 365.

(iii) For L's taxable years ending after December 31, Year 3, L's separate section 382 limitation for its $90 of net operating loss carryover that was not reattributed to P is $4, adjusted as appropriate for any

short taxable year, unused section 382 limitation, or other adjustment. For L's short taxable year ending December 31, Year 3, the section 382 limitation for its $90 of net operating loss carryover is $2, the amount that bears the same relationship to $4 (the portion of the value element that was not apportioned to P), as the number of days during the short taxable year, 182 days, bears to 365. See §1.382–5(c).

Example 2. No apportionment required for consolidated pre-change attribute. (i) P, the common parent of a consolidated group, forms L. For Year 1, L has an operating loss of $70 that is not absorbed and is included in the group's consolidated net operating loss that is carried over to subsequent years. On January 1 of Year 3, A buys all of the P stock and the P group has an ownership change. The consolidated section 382 limitation based on the value of the P stock is $10.

(ii) On April 13 of Year 4, P sells all of the stock of L to B and, under §1.1502–20(g), elects to reattribute to itself $45 of L's net operating loss carryover. Following the reattribution, the $45 portion of the Year 1 net operating loss carryover retains its character as a pre-change consolidated attribute, and remains subject to so much of the $10 consolidated section 382 limitation as P does not elect to apportion to L under §1.1502–95(c).

(e) *Time and manner of making election under §1.1502–91(d)(4)*—(1) *In general.* This paragraph (e) prescribes the time and manner of making the election under §1.1502–91(d)(4), relating to treating two or more corporations as treating the section 1504(a)(1) requirement of §1.1502–91(d) (1)(ii) and (d) (2)(ii) as satisfied.

(2) *Election statement.* An election under §1.1502–91(d)(4) must be made by the common parent. The election must be made in the form of the following statement: "THIS IS AN ELECTION UNDER §1.1502–91(d)(4) TO TREAT THE FOLLOWING CORPORATIONS AS MEETING THE REQUIREMENTS OF §1.1502–91(d)(1)(ii) AND (d)(2)(ii) IMMEDIATELY AFTER THEY BECAME MEMBERS OF THE GROUP." [List separately the name of each corporation, its E.I.N., and the date that it became a member of the group]. If separate elections are being made for corporations that became members at different times or that were acquired from different affiliated groups, provide a separate statement and list for each election.

(3) The election statement must be filed by the common parent with its income tax return for the consolidated return year in which the members with respect to which the election is made become members of the group. Such election must be filed on or before the due date for such income tax return, including extensions.

(4) An election made under this paragraph (e) is irrevocable.

§1.1502–97 Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case. [Reserved]

§1.1502–98 Coordination with section 383.

The rules contained in §§1.1502–91 through 1.1502–96 also apply for purposes of section 383, with appropriate adjustments to reflect that section 383 applies to credits and net capital losses. Similarly, in the case of net capital losses, general business credits, and excess foreign taxes that are pre-change attributes, §1.383–1 applies the principles of §§1.1502–91 through 1.1502–96. For example, if a loss group has an ownership change under §1.1502–92 and has a carryover of unused general business credits from a pre-change consolidated return year to a post-change consolidated return year, the amount of the group's regular tax liability for the post-change year that can be offset by the carryover cannot exceed the consolidated section 383 credit limitation for that post-change year, determined by applying the principles of §§1.383–1(c)(6) and 1.1502–93 (relating to the computation of the consolidated section 382 limitation).

§1.1502–99 Effective dates.

(a) *In general.* Except as provided in paragraphs (b) and (c) of this section, §§1.1502–91 through 1.1502–96 and §1.1502–98 apply to any testing date on or after June 25, 1999. Sections 1.1502–94 through 1.1502–96 also apply to a corporation that becomes a member of a group or ceases to be a member of a group (or loss subgroup) on any date on or after June 25, 1999.

(b) *Special rules*—(1) *Election to treat subgroup parent requirement as satisfied.* Section 1.1502–91(d)(4), §1.1502–91(d)-(7), *Example 4,* §1.1502–92(b)(1)(iii), §1.1502–92(b)(2), *Example 5,* the last two sentences of §1.1502–95(b)(3), §1.1502–95(d)(2)(i), and §1.1502–96(e) (all of which relate to the election under §1.1502–91(d)(4) to treat the loss subgroup parent requirement as satisfied) apply to corporations that become members of a consolidated group in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999.

(2) *Principal purpose of avoiding a limitation.* The third sentence of §1.1502–91(d)(5) (relating to members excluded from a loss subgroup) applies to corporations that become members of a consolidated group on or after June 25, 1999.

(3) *Ceasing to be a member of a loss subgroup*—(i) *Ownership change of a loss subgroup.* Section 1.1502–95(d)(2)-(ii) and §1.1502–95(d)(3), *Example 3* apply to corporations that cease to bear a relationship described in section 1504(a)(1) to a loss subgroup parent in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999.

(ii) *Expiration of 5-year period.* Section 1.1502–95(d)(2) (iii) applies with respect to the day after the last day of any 5 consecutive year period described in that section that ends in a taxable year for which the due date of the income tax return (without extensions) is after June 25, 1999.

(4) *Reattribution of net operating loss carryovers under §1.1502–20(g).* Section 1.1502–96(d) applies to reattributions of net operating loss carryovers (or capital loss carryovers) in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999; except that the election under §1.1502–96(d)(5)(relating to an election to reattribute section 382 limitation) can be made with any election under §1.1502–20(g)(4) to reattribute to the common parent a net operating loss or net capital loss that is timely filed on or after June 25, 1999.

(5) *Election to apportion net unrealized built-in gain.* In the case of corporations that cease to be members of a loss group (or loss subgroup) before June 25, 1999 in a taxable year for which the due date of the income tax return (without extensions) is after June 25, 1999, §1.1502–95(a),(b), (c), and (f) apply to those corporations if the common parent makes the election described in the second sentence of paragraph (c)(1) of §1.1502–95 in the time and manner prescribed in paragraph (f) of §1.1502–95.

(c) *Testing period may include a period beginning before June 25, 1999*—(1) *In general.* A testing period for purposes of §§1.1502–91 through 1.1502–96 and 1.1502–98 may include a period beginning before June 25, 1999. Thus, for example, in applying §1.1502–92(b)(1)(i) (relating to the determination of an ownership change of a loss group), the determination of the lowest percentage of ownership interest of any 5-percent shareholder of the common parent during a testing period ending on a testing date occurring on or after June 25, 1999 takes into account the period beginning before June 25, 1999, except to the extent that the period is more than 3 years before the testing date or is otherwise before the beginning of the testing period. See §1.1502–92(b)(1).

(2) *Transition rule for net unrealized built-in loss.* A loss group (or loss subgroup) that has a net unrealized built-in loss on a testing date on or after June 25, 1999 may apply §1.1502–91A(g)(and §1.1502–96A(a) as it relates to §1.1502–91A(g)) for the period ending on the day before June 25, 1999 to determine under §1.382–2T(d)(ii)(A) the earliest date that its testing period begins (treating the day before June 25, 1999 as the end of a taxable year.) Thus, for example, if a consolidated group with no net operating losses has a net unrealized built-in loss determined under §1.1502–91(g) on a testing date after June 25, 1999, but, under §1.1502–91A(g), does not have a net unrealized built-in loss for the period ending on the day before June 25, 1999, the group's testing period begins no earlier than June 25, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 15. In §602.101, paragraph (b) is amended by removing the entry for §1.1502–95T, revising the entry for §1.1502–20, and adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–20	1545–1160 1545–1218
* * * * *	
1.1502–95	1545–1218
1.1502–96	1545–1218
1.1502–95A	1545–1218
* * * * *	

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved June 18, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 25, 1999, 1:27 p.m., and published in the issue of the Federal Register for July 2, 1999, 64 F.R. 36116)

Section 1397E.—Credits to Holders of Qualified Zone Academy Bonds

26 CFR 1.1397E–1T: Qualified zone academy bonds.

T.D. 8826

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance to state and local government issuers of qualified zone academy bonds. These temporary regulations change the method of ascertaining the qualified zone academy bond credit rate and provide reimbursement rules. State and local governments that issue qualified zone academy bonds will be affected by these temporary regulations. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–105327–99) on this subject on page 117.

DATES: *Effective Date:* These regulations are effective July 1, 1999.

Applicability Date: For dates of applicability, see §1.1397E–1T(j).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Timothy L. Jones (202) 622-3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 226(a) of the Taxpayer Relief Act of 1997, Public Law 105–34, (111 Stat. 788), amended the Internal Revenue Code by redesignating section 1397E as 1397F and adding a new section 1397E. Section 1397E authorizes a new type of debt instrument known as a qualified zone academy bond. Temporary regulations interpreting section 1397E were published on January 7, 1998 (63 F.R. 671).

Explanation of Provisions

In General

A qualified zone academy bond is a taxable bond issued by a state or local government, the proceeds of which are used to improve certain eligible public schools. In lieu of receiving periodic interest payments from the issuer, an eligible holder of a qualified zone academy bond is generally allowed annual federal income tax credits while the bond is outstanding. These credits compensate the holder for lending money to the issuer and function as payments of interest on the bond.

Credit Rate

Under section 1397E(b)(2), the Secretary shall determine a credit rate for qualified zone academy bonds that the Secretary estimates will permit the bonds to be issued without discount and without interest cost to the issuer. Section 1.1397E–

1T(b) provides that the credit rate for a qualified zone academy bond is equal to 110 percent of the long-term applicable Federal rate (AFR), compounded annually, for the month in which the bond is issued.

Comments have been received that the credit rate established by §1.1397E–1T(b) is generally lower than the rate required to permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuer. Comments have also been received that a single credit rate applicable to obligations issued during a monthly period is too rigid and non-responsive to market interest rate movements.

The revised regulations state that the Secretary will determine monthly (or more often as the Secretary deems necessary) a credit rate that will generally permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuers. The revised regulations also provide that the manner for ascertaining the credit rate determined by the Secretary will be set forth in procedures, notices, forms, and instructions as prescribed by the Commissioner. A notice to be published in the Internal Revenue Bulletin will further provide that, until otherwise provided, the qualified zone academy bond credit rate will be determined daily and will be published on the Internet site for State and Local Government Bonds. The credit rate to be applied to a qualified zone academy bond will be the daily rate for the first day on which there is a binding contract in writing for the sale or exchange of the bond. Treasury and the IRS will monitor the issuance of qualified zone academy bonds to determine if future adjustments in the credit rate may be required.

Coordination with Reimbursement Rules

These temporary regulations provide that the proceeds of a qualified zone academy bond may be used to reimburse a qualified expenditure (including any qualified non-capital expenditure) made prior to the date the bond was issued. The temporary regulations provide that rules similar to the reimbursement rules set forth in §1.150–2 will apply. Comments are solicited about whether these rules provide adequate guidance regarding reimbursement matters for issuers of qualified zone academy bonds.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. See also the Special Analysis Section of the notice of proposed rulemaking on qualified zone academy bonds in the Proposed Rules Section of this issue of the Federal Register. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Timothy L. Jones, Office of Assistant Chief Counsel (Financial Institutions & Products). However, other personnel from IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1397E–1T is amended as follows:

1. Revising paragraphs (b) and (j);

2. Redesignating paragraph (h) as paragraph (i);

3. Adding new paragraph (h).

The revisions and additions read as follows:

§1.1397E–1T Qualified zone academy bonds (temporary).

* * * * *

(b) *Credit Rate.* The Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates will generally permit the issuance of a qualified zone academy bond without discount and without interest cost to the issuer. The manner for ascertaining the credit rate for a qualified zone academy bond as determined by the Secretary shall be set forth in procedures, notices, forms, or instructions prescribed by the Commissioner.

* * * * *

(h) *Reimbursement.* An expenditure for a qualified purpose may be reimbursed with proceeds of a qualified zone academy bond. For this purpose, rules similar to those in §1.150–2 shall apply.

* * * * *

(j) *Effective dates.* Except as provided in this paragraph (j), this section applies to a qualified zone academy bond issued on or after January 1, 1998. Paragraph (b) and paragraph (h) of this section shall apply to a qualified zone academy bond sold on or after July 1, 1999. Paragraph (b) of this section as in effect on January 7, 1998 (See 26 CFR Part 1 as revised April 1, 1999), shall apply to a qualified zone academy bond sold prior to July 1, 1999. This section shall not apply to a qualified zone academy bond sold after January 5, 2001.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 22, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1999, 64 F.R. 35573)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 446, 481, 6213, 6405, 6621, 7121, 7123, 7430; 1.446–1, 1.481–1, 1.481–2, 1.481–4, 301.6213–1, 301.6405–1, 301.6621–1, 301.7121–1, 301.7430–1.)

Rev. Proc. 99–28

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SECTION 1. PURPOSE AND BACKGROUND

This revenue procedure describes the method by which a taxpayer may request an early referral of one or more unresolved issues from the Examination or Collection Division to the Office of Appeals (Appeals). Section 7123 of the Internal Revenue Code (IRC), as added by § 3465 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub L. No. 105–206, 112 Stat. 685, provides that the Secretary shall prescribe procedures by which any taxpayer may request such an early referral. Early referral is a process to resolve cases more expeditiously through the District and Appeals working simultaneously. This process is optional and may be requested by any taxpayer. This revenue procedure also describes the method by which a taxpayer may request early referral of one or more unagreed issues with respect to an involuntary change in method of accounting, employment tax, employee plans, or exempt organizations.

SECTION 2. EXAMINATION EARLY REFERRAL PROCEDURES

.01 In general. Except as provided in section 2.03 of this revenue procedure, a taxpayer may request early referral to Appeals of any developed, unagreed issue under the jurisdiction of the District Director arising from an audit. The District will continue to develop issues that have not been referred to Appeals. This revenue procedure does not alter the District Director's authority to audit the returns of a taxpayer as to other issues nor limit or expand the District Director's authority to resolve any other issues, including the authority in Delegation Order No. 236 (Rev. 3).

.02 **Appropriate issues for early referral.** Appropriate issues for early referral are limited to those that:

(1) if resolved, can reasonably be expected to result in a quicker resolution of the entire case;

(2) both the taxpayer and the District agree should be referred to Appeals early;

(3) are fully developed; and

(4) are part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

Industry Specialization Program (ISP) issues can also be referred to Appeals for early resolution under these early referral procedures. ISP issues are listed in Exhibit 8.7.1–1 of the Internal Revenue Manual. For specific procedures for the early referral of issues arising during the examination of the tax-exempt status of a bond issue, see Notice 98–58, 1998–49 I.R.B. 13, or any subsequent procedure.

.03 Issues excluded from early referral. Early referral does not include an issue:

(1) with respect to which a 30-day letter has been issued. Thus, a qualified offer under § 7430(c), may not be made as part of the early referral process because such offers may only be made subsequent to the issuance of a 30-day letter;

(2) that is not fully developed;

(3) when the remaining issues in the case are expected to be completed before Appeals could resolve the early referral issue;

(4) that is designated for litigation by the Office of Chief Counsel;

(5) for which the taxpayer has filed a request for Competent Authority assistance, or issues for which the taxpayer intends to seek Competent Authority assis-

tance. Taxpayers are encouraged to request the simultaneous Appeals/Competent Authority procedure described in section 8 of Rev. Proc. 96–13, 1996–1 C.B. 616, or a subsequent revenue procedure. If a taxpayer enters into a settlement with Appeals (including an Appeals settlement through the early referral process), and then requests Competent Authority assistance, the U.S. competent authority will endeavor only to obtain a correlative adjustment with the treaty country and will not take any actions that would otherwise amend the settlement. *See* section 7.05 of Rev. Proc. 96–13; or

(6) that is part of a whipsaw transaction. (The term "whipsaw" refers to the situation produced when the government is subjected to conflicting claims of taxpayers. A potential whipsaw situation exists whenever there is a transaction between two parties and differing characteristics of transactions will benefit one and hurt the other for tax purposes.)

.04 Initiating the early referral request. A request for early referral must be submitted in writing by the taxpayer to the case/group manager. The case/group manager may suggest that a taxpayer make such a request.

.05 Statement of issues and position. The taxpayer's early referral request must:

(1) identify the taxpayer (and, where applicable, all related persons involved in the issues) and the tax periods to which those issues relate;

(2) state each issue for which early referral is requested; and

(3) describe the taxpayer's position with regard to the relevant early referral issues. This statement must contain a brief discussion of the material facts and an analysis of the facts and law as they apply to each early referral issue.

.06 Perjury Statement. The early referral request, and any supplemental submission (including additional documents), must include a declaration in the following form:

> **Under penalties of perjury, I declare that I have examined this request [or submission], including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.**

This declaration must be signed by any person currently authorized to sign the taxpayer's federal income tax returns.

.07 Signatures. The early referral request must be signed by the taxpayer or the taxpayer's authorized representative. It is preferred that Form 2848, Power of Attorney and Declaration of Representative, be used to designate an authorized representative, with regard to an early referral request under this revenue procedure.

.08 Notification of action. The case/group manager will, where feasible, notify the taxpayer of the decision to accept or reject an issue in the early referral request within 14 days of receiving the request.

.09 Appeal of denial of early referral request. There is no formal taxpayer appeal if the early referral request is denied in whole or in part; however, the taxpayer can request a conference with the Internal Revenue Service supervisor of the case/group manager who denied the early referral request.

.10 Administrative appeal at a later time. If the case/group manager does not approve the early referral request with respect to any issue, the taxpayer retains the right to pursue the administrative appeal of any proposed deficiency related to that issue at a later time.

.11 Issuance of notice of proposed adjustment or explanation of adjustment. The District will complete a Form 5701, Notice of Proposed Adjustment, or an equivalent form (the Notification Form) for each early referral issue approved pursuant to this revenue procedure. The District will send the Notification Form to the taxpayer generally within 30 days from the date the early referral request was accepted. The Notification Form will describe the issue and explain the District's proposed adjustment. The issuance of the Notification Form for the early referral issue is not treated as the first letter of proposed deficiency for purposes of computing increased interest under § 6621(c), or for the award of administrative costs under § 7430(c).

.12 Taxpayer response to Notification Form. The taxpayer must respond in writing to each of the District's proposed adjustments set forth in the Notification Form. The response must contain an explanation of the taxpayer's position regarding the issues. The response shall be submitted to the case/group manager within 30 days (unless extended by the case/group manager) from the date that the proposed adjustment (the Notification Form) is sent to the taxpayer. The procedural requirements of sections 2.06 and 2.07 of this revenue procedure (perjury statement and signatures) also apply to the taxpayer's response to the Notification Form. If a response is not received for any issue within the time provided, the taxpayer's early referral request will be considered withdrawn regarding that particular issue without prejudice to the taxpayer's right to an administrative appeal at a later date. *See* section 2.18 of this revenue procedure.

.13 Early referral file sent to Appeals. Once the taxpayer has responded to the Notification Form, the District will send the early referral file to Appeals. Appeals will then take jurisdiction over the issues accepted for early referral. All other issues in the case remain in the District's jurisdiction. The early referral file should include copies of:

(1) applicable portions of tax returns and workpapers;

(2) the approved early referral request;

(3) the Notification Form;

(4) the taxpayer's written response to the Notification Form;

(5) the District's response to the taxpayer's position, if any; and

(6) an estimate of the potential tax effect of the proposed adjustment.

.14 Resolving the early referral issues. The taxpayer's written response to the Notification Form generally serves the same purpose as an Appeals protest. Established Appeals procedures, including those governing submissions and taxpayer conferences, apply to early referral issues. *See* section 601.106 *et seq.* of the Statement of Procedural Rules.

.15 Agreement reached. If an agreement is reached with respect to an early referral issue generally, a Form 906, Closing Agreement on Final Determination Covering Specific Matters, is prepared. *See* § 7121 and also Rev. Proc. 68–16, 1968–1 C.B. 770, which describes the preparation of closing agreements. The closing agreement is used to compute the

corrected tax as a partial agreement prior to or concurrently with the resolution of any other issues in the case. If an early referral issue results in a refund or credit requiring a report described in § 6405 that must be submitted to the Joint Committee on Taxation, the report must include a copy of the proposed closing agreement signed by or for the taxpayer, but not signed by or on behalf of the Commissioner. The Service will not sign the proposed agreement until after review by the Joint Committee.

.16 Agreement not reached. If early referral negotiations are unsuccessful and an agreement is not reached with respect to an early referral issue:

(1) Taxpayers may then request mediation for the issue, provided the early referral issue meets the requirements for mediation. See Announcement 98–99, 1998–46 I.R.B. 34, or any subsequent procedure. If mediation is not requested, Appeals will close the early referral file and return jurisdiction over the issue to the District. Appeals will send a copy of the Appeals Case Memorandum for the issue to the case/ group manager.

(2) Appeals will not reconsider an unagreed early referral issue if the entire case is later protested to Appeals, unless there has been a substantial change in the circumstances regarding the early referral issue.

.17 Effect of conclusion of examination.

(1) If the District concludes its examination of any issues not referred as part of the early referral process, it will issue a preliminary notice of deficiency ("30 day letter") with respect to unagreed issues. The letter will include any issues referred under the early referral process that are still pending in Appeals at the time the examination is concluded. The issuance of the 30 day letter generally will constitute the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review for purposes of the increased underpayment rate of interest for large corporations as provided in § 6621(c), or for the award of administrative costs under § 7430(c).

(2) If the only unagreed issues present in the case at the time the examination is concluded are issues that were considered by Appeals under the early referral process and returned to the District unagreed, no 30-day letter will be issued. Instead a statutory notice of deficiency ("90-day letter") will be issued. If a 90-day letter is issued instead of the 30-day letter, the 90-day letter will constitute the first letter of proposed deficiency for purposes of §§ 6621(c) and 7430(c).

.18 Appeals consideration after 30-day letter. If Appeals takes jurisdiction of the remaining issues in the case following the issuance of a 30-day letter, all issues including all early referral issues that have not yet been settled by Appeals will be considered under established Appeals procedures. The only exception is previously considered early referral issues described in section 2.16(2) of this revenue procedure. These issues will not be reconsidered.

.19 Withdrawal from the early referral process. If the taxpayer withdraws an early referral request with respect to one or more of the early referral issues after Appeals has taken jurisdiction over the issues, such withdrawal will be treated in the same manner as if no agreement of those early referral issues was reached. See section 2.16 of this revenue procedure. The withdrawal request must be communicated in writing to the Appeals Officer assigned the early referral.

SECTION 3. INTERNAL REVENUE SERVICE INITIATED CHANGE IN ACCOUNTING METHOD EARLY REFERRAL PROCEDURES

.01 In general. The IRS published a proposed revenue procedure, Notice 98–31, 1998–22 I.R.B. 10, that outlines procedures under § 446(b) for changes in accounting methods initiated by the IRS. Although the early referral procedures in section 2 of this revenue procedure generally apply to all examination issues, section 3.02 of this revenue procedure provides accounting method issues that are appropriate for early referral.

.02 Appropriate issues for early referral. Examples of appropriate issues for early referral include whether :

(1) the taxpayer's practice is a method of accounting;

(2) the IRS is precluded from changing the taxpayer's method of accounting because, for example, the taxpayer obtained audit protection by initiating a voluntary accounting method change;

(3) the taxpayer's present method of accounting clearly reflects income under § 446;

(4) the method of accounting proposed by the IRS clearly reflects income under § 446;

(5) the methodology used by the IRS to compute the § 481(a) adjustment is appropriate; or

(6) the methodology used by the IRS to compute the § 481(b) adjustment is appropriate.

SECTION 4. EMPLOYMENT TAX EARLY REFERRAL PROCEDURES

.01 Background.

(1) In 1996, the Service adopted the classification settlement program (CSP) for worker classification cases for a two-year test period. The Service announced in Notice 98–21, 1998–15 I.R.B. 14, that the CSP would be extended until further notice. The CSP is an optional settlement program that allows businesses and tax examiners to resolve worker classification cases as early in the administrative process as possible, thereby reducing taxpayer burden. In the CSP, examiners can offer a business under audit a worker classification settlement using a standard closing agreement developed for this purpose. The CSP procedures also ensure that the taxpayer relief provisions under § 530 of the Revenue Act of 1978, as amended, are properly applied. When a taxpayer does not agree with the CSP terms offered by the Service or is not eligible for a settlement under the CSP, consideration should be given to requesting early referral to Appeals under these procedures.

(2) Section 530 provides businesses with relief from federal employment tax obligations if certain requirements are met. It terminates the business' employment tax liability under IRC Subtitle C (Federal Insurance Contributions Act and Federal Unemployment Tax Act taxes, federal income tax withholding, and Railroad Retirement Tax Act taxes) and any interest or penalties attributable to such liability for employment taxes (Rev. Proc. 85–18, 1985–1 C.B. 518). Section 530 does not affect the employment tax liability of a worker.

(3) Section 530(e)(3) is generally effective after December 31, 1996 and clar-

ifies that the determination of whether a business is entitled to relief under § 530 is not dependent upon whether the relevant workers are first determined to be employees. As a result, IRS examiners will now consider the taxpayer's eligibility for relief under § 530 before initiating any examination of the relationship between a business and a worker.

(4) Taxpayers that disagree with the District's position regarding the application of § 530 have the option of immediately requesting early referral of the issue from the District to Appeals. In attempting to resolve the § 530 issue, Appeals will follow the procedures set forth in this revenue procedure. If the § 530 issue remains unresolved, or if it is determined that the taxpayer is not eligible for relief under § 530, the case will be returned to the District for consideration of the worker classification issues. If the taxpayer and the District are unable to agree on the worker classification issues, the taxpayer will be encouraged strongly to request early referral of the unagreed issue from the District to Appeals. It is not necessary for a taxpayer to request early referral when the IRS examiner determines that the taxpayer is not entitled to relief under § 530. The taxpayer also may wait until the IRS examiner has determined the § 530 and worker classification issues before requesting early referral of the issues to Appeals.

(5) The Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788, added § 7436 to the Code, which provides new judicial review rights concerning certain employment tax determinations. Generally, § 7436 became effective on August 5, 1997 and applies to employment tax cases in which the Service has determined that at least one worker should be reclassified as an employee and that the taxpayer is not entitled to relief under § 530. The law requires that any employment tax that depends upon such determinations cannot be assessed unless the taxpayer has been given an opportunity to file a petition for United States Tax Court review of the Service's determinations on those two issues. In all cases involving worker classification and § 530 issues, the District will inform taxpayers about the opportunity to seek Tax Court review at the same time as they are informed of their appeal rights. See Notice 98–43, 1998-33 I.R.B. 13.

.02 In general. The early referral procedures in section 2 of this revenue procedure generally apply to employment tax issues. Sections 4.03 through 4.06 of this revenue procedure specifically apply to the early referral of employment tax issues.

.03 Appropriate issues for early referral. Examples of appropriate employment tax issues for early referral include:

(1) Worker classification issues, including whether a worker is an employee or independent contractor under the common law; whether a worker is a statutory employee or statutory non-employee.

(2) Liability issues, including whether § 530 applies; whether § 3509 rates are appropriate; and whether the taxpayer qualifies for an interest-free adjustment.

(3) Other issues, including whether certain payments are excepted from the definition of "wages" (e.g., a fringe benefit that would be excludable from the employee's gross income under § 132); and whether certain services are excepted from the definition of "employment."

.04 Issuance of employment tax report. If an issue is approved for transfer from the District to Appeals, the District will prepare an employment tax report for each early referral issue approved pursuant to this revenue procedure, by following the procedures in section 2.11 of this revenue procedure. The issuance of the employment tax report is not treated as the first letter of proposed assessment of tax for purposes of computing increased interest under § 6621(c), or for the award of administrative costs under § 7430(c).

.05 Agreement reached. If an agreement is reached with respect to an employment tax early referral issue, a Form 2504, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment — Excise or Employment Tax, or a Form 2504 AD, Excise or Employment Tax — Offer of Agreement to Assessment and Collection of Additional Tax and Offer of Acceptance of Overassessment, should be labeled "Partial Agreement" and may be used for factual or non-complex issues that do not affect subsequent years. Notice 98–43 provides that if a taxpayer settles a § 530 or worker classification issue on an agreed basis, the taxpayer must formally waive the restrictions on assessment contained in §§ 7436(d)(1) and 6213. The following waiver must be included:

I understand that by signing this agreement, I am waiving the restrictions on assessment provided in §§ 7436(d) and 6213(a) of the Internal Revenue Code of 1986.

A closing agreement generally will be prepared for issues where a settlement is complex or affects subsequent years. See § 7121 and also Rev. Proc 68–16, 1968–1 C.B. 770, which describes the preparation of closing agreements. Appeals will coordinate effects on subsequent years with the District and District Counsel.

.06 Agreement not reached.

(1) If one or more of the early referral employment tax issues are unagreed, the case will be returned to the District. The employment tax dependent upon a § 530 or worker classification issue may not be assessed at that time. See § 7436(d)(1) and Notice 98–43. Instead, the District must send the taxpayer, via certified or registered mail, a "Notice of Determination Concerning Worker Classification Under Section 7436."

(2) With respect to any unagreed early referral employment tax issues that do not relate to a § 530 or worker classification issue (so that the unagreed issue(s) is not subject to § 7436), a 30-day letter will not be issued. Rather, the District will process the portion of the case that is not dependent upon a § 530 or worker classification issue for assessment of tax due from the taxpayer that relates to that portion of the case only, which will start the period for the increased underpayment rate for large corporate underpayments under § 6621(c), or for the award of administrative costs under § 7430(c).

SECTION 5. COLLECTION EARLY REFERRAL PROCEDURES

.01 In general. Early referral to Appeals is also available for collection issues. Procedures for utilizing the early referral process are described in Publication 1660, "Collection Appeal Rights." Each taxpayer subject to a lien, levy or seizure will receive a copy of Publication 1660. Early referral of collection issues is a different process than the due process procedures described in § 6320 for liens and § 6330 for levies. Specifically, denial of relief pursuant to the early referral pro-

cedures will not be reviewable in the Tax Court or in a U.S. District Court. In addition, the early referral procedures apply to a broader range of collection issues than the due process procedures.

.02 Appropriate issues for early referral. Appropriate collection issues for early referral include proposed:

(1) notices of federal tax liens;

(2) levies;

(3) seizures; and

(4) denials or terminations of installment agreements.

SECTION 6. EMPLOYEE PLANS/EXEMPT ORGANIZATIONS (EP/EO) EARLY REFERRAL PROCEDURES

.01 In general. The early referral procedures in section 2 of this revenue procedure generally apply to EP/EO issues. Thus, for example, only issues under audit are eligible for early referral. EP/EO issues excluded from the early referral process are identified in sections 6.02 and 6.03 of this revenue procedure.

.02 Employee Plans issues excluded from early referral. Early referral does not apply to:

(1) procedural issues relating to matters that may be eligible for Administrative Policy Regarding Self-Correction, or submitted under VCR, Walk-in CAP, or the Audit Closing Agreement Program. See Rev. Proc. 98–22, 1998–12 I.R.B. 11, or its successors;

(2) issues relating to excise taxes in § 4975; or

(3) issues concerning plan qualification if such issues are not covered by published precedent or are issues for which there may be nonuniformity between offices.

.03 Exempt Organizations issues excluded from early referral. Early referral does not apply to:

(1) issues subject to § 7428, including issues related to exemption or private foundation status;

(2) issues arising in Church tax inquiries and examinations subject to § 7611;

(3) issues relating to excise taxes in § 507 and Chapters 41 and 42 of the IRC; or

(4) issues relating to the revocation of exempt status.

SECTION 7. NO USER FEE

There is no user fee for an early referral request.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96–9 is superseded.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for requests for early referral filed after July 19, 1999, the date this revenue procedure is published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Thomas Carter Louthan, Director, Office of Alternative Dispute Resolution and Customer Service Programs, and Sandy Cohen from the Office of Alternative Dispute Resolution and Customer Service Programs, National Office Appeals. For further information regarding this revenue procedure, please contact Mr. Louthan at (202) 694-1842, or Mr. Cohen at (202) 694-1818 (not toll-free numbers).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Withdrawal of Notice of Federal Tax Lien in Certain Circumstances

REG-101519-97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the withdrawal of notices of federal tax liens in certain circumstances. The proposed regulations reflect changes made to section 6323 of the Internal Revenue Code of 1986 by the Taxpayer Bill of Rights 2. The proposed regulations affect all taxpayers seeking withdrawals of notices of federal tax liens.

DATES: Written comments and requests for a public hearing must be received by September 27, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-101519-97), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:DOM:CORP:R (REG-101519-97), room 5228, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regslist.html.

FOR FURTHER INFORMATION CONTACT: Kevin B. Connelly, (202) 622-3640 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to the withdrawal of notices of federal tax liens under section 6323 of the Internal Revenue Code (Code). Section 501(a) of the Taxpayer Bill of Rights 2 (TBOR2), Public Law 104–168, 110 Stat. 1452 (1996), amended section 6323 to authorize the Secretary to withdraw a notice of federal tax lien in certain limited circumstances. Section 501(a) also requires the Secretary to notify credit reporting agencies, financial institutions and creditors of the withdrawal upon the written request of the taxpayer. These proposed regulations reflect the amendments made by Section 501(a) of TBOR2.

Explanation of Provisions

Section 501(a) of TBOR2 amended section 6323 of the Code by authorizing the Secretary to withdraw a notice of federal tax lien under certain conditions and providing that upon written request of the taxpayer the Secretary will notify any credit reporting agency and any financial institution or creditor identified by the taxpayer. These proposed regulations implement section 501(a).

The proposed regulations provide that a district director, the director of a service center or the Assistant Commissioner (International)(the relevant person being referred to as "the director") may withdraw a notice of federal tax lien if the director determines that one of the conditions enumerated in paragraph (b) of the regulations exists. The notice of federal tax lien is withdrawn by filing a notice of withdrawal in the office in which the notice of federal tax lien is filed and providing the taxpayer with a copy of the notice. Following the withdrawal of a notice of federal tax lien, chapter 64 of subtitle F, relating to collection, is applied as if the IRS had never filed a notice of federal tax lien. The withdrawal of a notice of federal tax lien does not affect the underlying tax lien. The withdrawal simply relinquishes any lien priority the IRS had obtained under section 6323 of the Code when the IRS filed the notice being withdrawn.

The proposed regulations provide that the director has the authority to withdraw a notice of federal tax lien if one of the following conditions exists: (1) the filing of the notice of federal tax lien was premature or otherwise not in accordance with the administrative procedures of the Secretary; (2) the taxpayer has entered into an agreement under section 6159 to satisfy the liability for which the lien was imposed by means of installment payments, unless the agreement by its terms provides that the notice will not be withdrawn; (3) the withdrawal of notice will facilitate collection of the tax liability for which the lien was imposed; or (4) the withdrawal of notice would be in the best interest of the taxpayer, as determined by the National Taxpayer Advocate, and in the best interest of the United States, as determined by the director.

The fourth ground for withdrawal (i.e., withdrawal based on the best interests of the parties) requires that the withdrawal be in the best interests of both the United States and the taxpayer. Therefore, two distinct determinations must be made before a director may withdraw a notice of federal tax lien based on the best interests of the parties. Under the proposed regulations the director alone will determine whether the withdrawal of a notice of federal tax lien is in the United States' best interest. The National Taxpayer Advocate generally will determine whether the withdrawal of a notice is in the taxpayer's best interest; however, if a taxpayer requests the director to withdraw a notice and has not requested the National Taxpayer Advocate to determine the taxpayer's best interest, a finding by the director that the withdrawal is in the taxpayer's, as well as the United States', best interest will be sufficient to support the withdrawal of notice. The director is not authorized to determine that the withdrawal of a notice is not in the taxpayer's best interest. Only the National Taxpayer Advocate is authorized to make that determination.

The proposed regulations provide that a person may request the withdrawal of a notice of federal tax lien by writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice is filed. A written request for withdrawal must include: (1) the name, current address, and taxpayer identification number of the person requesting withdrawal of the notice of federal tax lien; (2) a copy of the notice of federal tax lien affecting the property, if available; (3) the grounds upon which the

withdrawal of notice of federal tax lien is being requested; (4) a list of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien; and (5) a request to disclose information relating to the withdrawal to the persons or entities listed.

The director must consider each taxpayer's request for withdrawal of notice of federal tax lien and determine whether any of the conditions authorizing withdrawal exists and whether to issue a withdrawal. The director also may issue a notice of withdrawal based on information received from a source other than the taxpayer.

If the director grants a withdrawal of notice of federal tax lien, the taxpayer may supplement the list of credit reporting agencies and financial institutions or creditors provided with the request for withdrawal. If no list was submitted with the request to withdraw, a list may be submitted after the notice is withdrawn. A request to supplement the list must be sent in writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice of federal tax lien is filed. The request must contain: (1) the name, current address, and taxpayer identification number of the person requesting the notification; (2) a copy of the notice of withdrawal; (3) the names and addresses of the persons or entities the taxpayer wishes the IRS to contact; and (4) a request to disclose the withdrawal to the persons or entities listed.

The regulations as proposed will be effective when the final regulations are published in the **Federal Register** with respect to withdrawals of any notice of federal tax lien occurring after such date regardless of when the notice was filed.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the collection of information in the regulation is exempt pursuant to 5 U.S.C. 601(7)(B), the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (preferably a signed original and eight (8) copies) to the IRS. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http:// www.irs.ustreas.gov/prod/tax_regslist.html. All comments will be available for public inspection and copying. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Kevin B. Connelly, Office of Assistant Chief Counsel (General Litigation) CC:EL:GL, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, the IRS proposes to amend 26 CFR part 301 as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6323(j)–1 is added to read as follows:

§301.6323(j)–1 Withdrawal of notice of federal tax lien in certain circumstances.

(a) *In general.* A district director, the Assistant Commissioner (International), or the director of a service center (collectively the director) may withdraw a notice of federal tax lien filed under this section, if the director determines that any of the conditions in paragraph (b) of this section exist. A notice of federal tax lien is withdrawn by the director filing a notice of withdrawal in the office in which the notice of federal tax lien is filed. If a notice of withdrawal is filed, chapter 64 of subtitle F, relating to collection, will be applied as if the withdrawn notice had never been filed. A copy of the notice of withdrawal will be provided to the taxpayer. Upon written request by a taxpayer with respect to whom a notice of federal tax lien has been or will be withdrawn, the director will promptly make reasonable efforts to notify any credit reporting agency and any financial institution or creditor identified by the taxpayer of the withdrawal of such notice. The withdrawal of a notice of federal tax lien will not affect the underlying federal tax lien.

(b) *Conditions authorizing withdrawal.* The director may authorize the withdrawal of a notice of federal tax lien upon determining that one of the following conditions exists:

(1) *Premature or not in accordance with administrative procedures.* The filing of the notice of federal tax lien was premature or otherwise not in accordance with the administrative procedures of the Secretary.

(2) *Installment agreement.* The taxpayer has entered into an agreement under section 6159 to satisfy the liability for which the lien was imposed by means of installment payments. If, however, the agreement specifically provides that a notice of federal tax lien will not be withdrawn, the director may not grant a request for withdrawal of that notice of federal tax lien under this paragraph (b)(2).

(3) *Facilitate collection.* The withdrawal of the notice of federal tax lien will facilitate the collection of the tax liability for which the lien was imposed.

(4) *Best interests of the United States and the taxpayer*—(i) *In general.* The taxpayer or the National Taxpayer Advocate has consented to the withdrawal of the notice of federal tax lien, and withdrawal of the notice would be in the best interest of the taxpayer, as determined by the National Taxpayer Advocate, and the United States, as determined by the director.

(ii) *Best interest of the taxpayer.* The National Taxpayer Advocate generally will determine whether the withdrawal of a notice of federal tax lien is in the best interest of the taxpayer. If, however, a taxpayer requests the director to withdraw a notice and has not specifically requested the National Taxpayer Advocate to determine the taxpayer's best interest, a finding by the director that the withdrawal of notice is in the best interest of the taxpayer will be sufficient to support withdrawal.

(5) *Examples.* The following examples illustrate the provisions of this paragraph (b):

Example 1. A is an employee of X Corporation. A notice of federal tax lien has been filed to secure an outstanding tax liability against A. A, who has no assets and no other secured creditors, has agreed to pay the balance of tax due through payroll deductions at a rate higher than the Internal Revenue Service could obtain through a wage levy in order to get the notice of federal tax lien withdrawn. X Corporation has agreed to allow A to enter into a payroll deduction agreement. In this situation, the director may withdraw the notice of federal tax lien to facilitate collection.

Example 2. A owes $1,000 in federal income taxes. A enters into an agreement to pay the outstanding federal income tax liability in installments. The agreement provides that a notice of federal tax lien may be filed if the taxpayer defaults. A timely pays the installments each month and has not defaulted in any way. Eleven months after entering into the installment agreement, the Internal Revenue Service files a notice of federal tax lien. Noting that there has been no default, the taxpayer asks the Internal Revenue Service to withdraw the notice of federal tax lien. In this situation, the director may withdraw the notice of federal tax lien because the taxpayer has entered into an installment agreement that does not prohibit the withdrawal of the notice.

Example 3. A is the owner of a farm machinery dealership against whom a notice of federal tax lien has been filed to secure an outstanding tax liability. A currently is paying the tax liability by an installment agreement that prohibits the withdrawal of the notice of federal tax lien. X Corporation has agreed to provide A with 100 tractors to increase A's inventory if the notice of federal tax lien is withdrawn. A asks the Internal Revenue Service to withdraw the notice of federal tax lien. The director determines that the withdrawal of the notice of federal tax lien is in the best interest of the United States because it would enable A to generate additional tractor sales, and increased sales would enable A to increase the amount of his installment payments as well as reduce the amount of time needed to satisfy the liability. A, who has no other assets or secured creditors, has agreed to modify his installment agreement. If the National Taxpayer Advocate (or the director in lieu of the National Taxpayer Advocate) determines that the withdrawal is in the best interests of the taxpayer, the director may withdraw the notice of federal tax lien because withdrawal is in the best interest of the taxpayer and the United States. Alternatively, the director may withdraw the notice of federal tax lien to facilitate collection.

(c) *Determinations by the director.* The director must determine whether any of the conditions authorizing the withdrawal of a notice of federal tax lien exist if a taxpayer submits a request for withdrawal in accordance with paragraph (d) of this section. The director also may make this determination based on information received from a source other than the taxpayer. If the director determines that conditions authorizing the withdrawal are not present, the director may not authorize the withdrawal. If the director determines conditions for withdrawal are present, the director may (but is not required to) authorize the withdrawal. If the basis for the withdrawal is the best interests of the taxpayer and the Internal Revenue Service, the taxpayer or the National Taxpayer Advocate must consent to the withdrawal.

(d) *Procedures for request for withdrawal*—(1) *Manner.* A request for the withdrawal of a notice of federal tax lien must be made in writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice of federal tax lien is filed.

(2) *Form.* The written request will include the following information and documents—

(i) Name, current address, and taxpayer identification number of the person requesting the withdrawal of notice of federal tax lien;

(ii) A copy of the notice of federal tax lien affecting the taxpayer's property, if available;

(iii) The grounds upon which the withdrawal of notice of federal tax lien is being requested;

(iv) A list of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien; and

(v) A request to disclose the withdrawal of notice of federal tax lien to the persons listed in paragraph (d)(2)(iv) of this section.

(e) *Supplemental list of credit agencies, financial institutions, and creditors*—(1) *In general.* If the director grants a withdrawal of notice of federal tax lien, the taxpayer may supplement the list in paragraph (d)(2)(iv) of this section. If no list was provided in the request to withdraw the notice of federal tax lien, the list in paragraph (d)(2)(iv) of this section and the request for notification in paragraph (d)(2)(v) of this section may be submitted after the notice is withdrawn

(2) *Manner.* A request to supplement the list of any credit agencies and any financial institutions or creditors that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien must be sent in writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice of federal tax lien is filed.

(3) *Form.* The request must include the following information and documents—

(i) Name, current address, and taxpayer identification number of the taxpayer requesting the notification of any credit agency or any financial institution or creditor of the withdrawal of notice of federal tax lien;

(ii) A copy of the notice of withdrawal, if available;

(iii) A supplemental list, identified as such, of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien; and

(iv) A request to disclose the withdrawal of notice of federal tax lien to the persons listed in paragraph (e)(3)(iii) of this section.

(f) *Effective date.* This section applies on or after the date final regulations are published in the Federal Register with respect to a withdrawal of any notice of federal tax lien.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 29, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1999, 64 F.R. 35102)

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

REG-105327-99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: The IRS is issuing temporary regulations providing guidance to holders and issuers of qualified zone academy bonds. These proposed regulations would change the method of ascertaining the qualified zone academy bond credit rate and would provide reimbursement rules. State and local governments that issue qualified zone academy bonds would be affected by these proposed regulations. The text of the temporary regulations, T.D. 8826 on page 107, also serves as the text of these proposed regulations. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by September 28, 1999. Outlines of topics to be discussed at the public hearing scheduled for November 9, 1999, at 10 a.m. must be received by October 19, 1999.

ADDRESSES: Send Submissions to: CC:DOM:CORP:R (REG-105327-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-105327-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/reglist.html. The public hearing will be held in the room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Timothy L. Jones at 202-622-3980; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, Michael Slaughter at 202-622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 226(a) of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788 (1997) amended the Internal Revenue Code by redesignating section 1397E as 1397F and adding a new section 1397E. Section 1397E authorizes a new type of debt instrument known as a qualified zone academy bond. Temporary Regulations (T.D. 8755, 1998-10 I.R.B. 21) interpreting section 1397E were published on January 7, 1998, 63 F.R. 671, as §1.1397E-1T.

Temporary regulations amending §1.1397E-1T are published in T.D. 8826 on page 107. Section 1.1397E- 1T is amended by revising paragraphs (b) and (j), redesignating paragraph (h) as paragraph (i) and adding new paragraph (h). The text of the temporary regulations also serves as the text of these proposed regulations. An explanation of the regulations may be found in the preamble of the temporary regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply. The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because these regulations do not impose a collection of information on small entities. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments (a signed original and eight (8) copies, if written) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how the regulations may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 9, 1999, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments by September 28, 1999, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 19, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Timothy L. Jones, Office of Assistant Chief Counsel (Financial Institutions & Products). However, other personnel

from IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1397E-1 as proposed to be added at 63 F.R .708 is amended by:

1. Revising paragraphs (b) and (j);

2. Redesignating paragraph (h) as paragraph (i);

3. Adding new paragraph (h).

The revisions and addition read as follows:

§1.1397E-1 Qualified zone academy bonds.

[The text of proposed paragraphs (b), (h) and (j) is the same as the text of §1.1397E–1T(b), (h), and (j) published in T.D. 8826.]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1999, 64 F.R. 35579)

Foundations Status of Certain Organizations

Announcement 99–70

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

360 Degree Exchange Inc., Washington, DC
Adult and Children Transitional Shelter, Denver, CO
African American Cultural Education Foundation Inc., Washington, DC
Aide in Community Development Incorporated, Hamburg, AR
Alexander Band Boosters, Albany, OH
All Children Count Inc., Los Angeles, CA
Alliance for Lending Assistance to Students, Victoria, TX
American Association for Medical-Legal Education, North Charleston, SC
Animals Protected in Entertainment, Stockton, CA
Art for Kids Sake, Gladstone, OR
Art St. Ballet Society, Galveston, TX
Associate Benevolent Committee, Menomonie, WI
Association for the Support of Intercollegiate Speech Teams, Cheverly, MD
Atlantic Indoor Association, Powhatan, VA
Back Pain Society Inc., Woburn, MA
Baldwin Youth Work Institute, Inc., New York, NY
Ballet Eddy Toussaint USA Inc., Sarasota, FL
Bemidji Centennial Committee, Bemidji, MN
Berdan Support Fund, Mendenhall, PA
Bridgewater Creative Playground Inc., Bridgewater, NJ
Broomstones Curling Foundation, Framingham, MA
Celebrate Life City Wide Virginia Beach, Virginia Beach, VA
Center for African Development International Inc., Richmond Hill, NY
Center for Counseling Training and Development Inc., Tampa, FL
Center for the Applied Study of Prejudice & Ethnoviolence, Inc., Baltimore, MD
Child Health Institute Foundation, Inc., Shawnee Mission, KS
Chippewa Valley Concert Band Inc., Eau Claire, WI
Church Partners Inc., Dallas, TX
Coker Green Productions, Lubbock, TX
Community Help Fund, Redmond, OR
Community Housing Foundation, Penryn, CA
Covenant Life Ministries, Virginia Beach, VA
Cresthill Police Association, Joliet, IL
Crosslake Club Inc., Covington, LA
Crossroads Career Services, Inc., Atlanta, GA
D A R E Davenport Inc., Bettendorf, IA
Double Trouble in Recovery Inc., Brooklyn, NY
Drake School Parent Teacher Organization, Sugar Land, TX
Dunkirk-Fredonia Lions Club Barker Russell C. MRL Scholarship Fund, Dunkirk, NY
Eden Center, Chester, SC
Equestrian Therapy Center Inc., Wolfforth, TX
Ernies Museum of Black Arkansans Hall of Fame and Music Theater, Little Rock, AR
Eyestone Elementary School Parent Teacher Organization, Wellington, CO
Families on the Edge, Riverdale, MD
Florida Jr. Chamber of Commerce Disaster Relief Foundation, Lakeland, FL
For the Defense Ltd., Chicago, IL
Fort Worth Teen Center Inc., Fort Worth, TX
Friends of City Hall, New Orleans, LA
Friends of the Henderson County Library West, Seven Points, TX
Fund for the Advancement of Social Work Practice in New York City, New York, NY
General Care, Inc., Baton Rouge, LA
George Jenkins High School Band Boosters Inc., Lakeland, FL
Good News Ministries, Newport News, VA
Good Sports Inc., Miami, FL
Haparnes Inc., Brooklyn, NY
Hattie Larlham League of Hudson, Hudson, OH
Healthspeak Inc., Durham, NC
Heart of Gold Foundation Inc., Storm Lake, IA
Hickman County Band Boosters, Centerville, TN
Honduran Waves From the Americas Hola Corporation, Silver Spring, MD
International Society for Consciousness and the Arts, New York, NY
Jesus Christ King of Kings—Global Ministries Inc., Houston, TX

Junior Shooting Sports USA Inc., Spotsylvania, VA
Juvenile Educational Travel, Inc., Kernersville, NC
Kansas Academy of Theatrical Arts Inc., Kansas City, KS
Kenny Neighborhood Association, Minneapolis, MN
Kent Bramlett Foundation Inc., Nashville, TN
Laredo Independent School District Educational Foundation, Laredo, TX
The Leadership Trust, Greensboro, NC
Learning Institute for Employability, Elmhurst, NY
Life Bridges Inc., Libertyville,IL
Life Outreach Urban Development Corporation, Baltimore, MD
Maranatha 2 Ministries, Inc., Lakewood, NJ
Massid Al-Mubeen, Inc., Glassboro, NJ
Meals on Wheels of Quince Orchard Inc., Gaithersburg, MD
Meherrin River Arts Council Inc., Emporia, VA
Metropolitan Housing Development Corporation, Kansas City, MO
Midatlantic Credit Counseling Services Inc., Dover, DE
National Book Exchange, Pawtucket, RI
National Museum of Coal Mining Inc., Golf, IL
National Parent Alliance Inc., Jamaica, NY
Network Aiken, Aiken, SC
New American Revolution, New York, NY
North Metro Arts Roundtable Inc., Atlanta, GA
Northeast Fine Arts Boosters, Goose Lake, IA
Northwood Youth Futures Inc., Eagle River, WI
Oelwein Friends of Education Foundation, Oelwein, IA
Oklahoma Judo Development Institute, Norman, OK
Omnificent Ink Productions, Inc., New York, NY
Opera Northeast of New England Inc., Gardner, MA
Organplan Foundation Inc., New York, NY
Padrinos In Education, Irving, TX
Paragon Foundation, Austin, TX
Parents Supporting Parents of Maryland Inc., Kensington, MD
Peach County Partnership Coalition, Fort Valley, GA
Perry Community Development Inc., Perry, IA
Philadelphia Health Care Trust, Philadelphia, PA
Point Men of Fort Worth, Arlington, TX
Powerhouse Productions Inc., Chicago, IL
Power in One Foundation, Drums, PA
Public Integrity Research Corporation, Gilbert, AZ
Public Interest Science Conference, Eugene, OR
Pulaski County Youth Emergency Shelter Inc., Pulaski, VA
Red Sea International Heritage, Inc., New York, NY
Resident Assistance Corporation, St. Louis, MO
Sandia Softball Booster Club, Albuquerque, NM
Sartell Arena Association, Sartell, MN
Sea Rescue Group Inc., Miami, FL
Self Educational Art Institute Inc., Menomonee Falls, WI
Seminole Warhawk Band Aides Boosters Inc., Seminole, FL
Seneca Boosters Club, Louisville, KY
Shelter the Children, Ft. Worth, TX
Society for Jewish Music, Skokie, IL
South Central Oklahoma Christian Broadcasting, Inc., Ada, OK
Special Defenders, Inc., Orlando, FL
Speelyay Inc., Chesterton, IN
Starting Over of New York Inc., New York, NY
Stephens County Veterans Council Incorporated, Duncan, OK
Tal Psycho-Social Research Center Inc., New York, NY
Teens Reaching Out, Detroit, MI
Tennessee Education Support Systems, Millington, TN
The American Sports Academy Inc., Oxon Hill, MD
Through Education and Art Comes Hope, Chicago, IL
Town of Tonawanda Lightning Hockey Association, Buffalo, NY
Tri-Cities Kids at Play Inc., Grand Haven, MI
Tri-State Ecumenical Counsel, Morrisville, PA
Turner Chapel Community Development, Inc., Raleigh, MS
T W Hellman Educational Foundation, Kirkwood, MD
U S Registry of Alcohol Victims & Survivors, Washington, DC
UDT Seal Memorial Park, Virginia Beach, VA
Ohio Education Fund, Columbus, OH
Ultimate Housing Co-Partnership, West Valley City, UT
Under Two Flags, Gettysburg, PA
Union County Genealogical Society, Creston, IA
Union Lancers Youth Soccer Association, Glen Ridge, NJ
Union of Christians Inc., Tulsa, OK
Unite El Paso, El Paso, TX
United Campus Ministry of Pittsburgh, Pittsburgh, PA
United Caring and Sharing, Goshen, OH
United Catholic Development Inc., Overland Park, KS
United Chambers Scholarship Foundation Inc., Sanford, FL
United Children Services, Houston, TX
United Childrens Protection Coalition Inc., Holiday, FL
United Christian Ministries Inc., Port Orange, FL
United Endeavors Inc., New York, NY
United Housing Contractors Association, New Orleans, LA
United Latins of America, Orange, NJ
United Security Institution Academy, Columbus, OH
United Senior Citizens Association of Texas Inc., Houston, TX
United Soccer of Adamsville Club Inc., Adamsville, AL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 954.—Foreign Base Company Income

26 CFR 1.954–1: Foreign base company income.

T.D. 8827

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Removal of Regulations Providing Guidance Under Subpart F Relating to Partnerships and Branches

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Removal of temporary and final regulations.

SUMMARY: This document removes regulations relating to the treatment under subpart F of certain payments involving branches of a controlled foreign corporation (CFC) that are treated as separate entities for foreign tax purposes or partnerships in which CFCs are partners, as published in the **Federal Register** on March 26, 1998. Removal of the temporary regulations will allow Congress and the Treasury the opportunity to consider in greater depth the issues pertaining to hybrid transactions.

EFFECTIVE DATES: These regulations are removed effective March 23, 1998.

FOR FURTHER INFORMATION CONTACT: Valerie Mark, (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On March 23, 1998 (63 F.R. 14669, March 26, 1998), the IRS issued proposed regulations (REG–104537–97, 1998–16 I.R.B. 21) relating to the treatment under subpart F of certain partnership and hybrid branch transactions. The provisions of the proposed regulations concerning hybrid branch transactions were also issued as temporary regulations (T.D. 8767, 1998–16 I.R.B. 4 [63 F.R. 14613, March 26, 1998]). Congress and taxpayers raised concerns about the proposed and temporary regulations relating to hybrid branch transactions. Accordingly, as announced in Notice 98–35 (1998–27 I.R.B. 35), the IRS has decided to withdraw the proposed regulations (see REG–113909–98 withdrawing proposed regulations and setting out new proposed regulations on page 125) and remove the temporary regulations. Removal of the temporary regulations will allow Congress and the Treasury the opportunity to consider in greater depth the issues pertaining to hybrid transactions.

Drafting Information

The principal author of these regulations is Valerie Mark, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 continues to read in part as follows:

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

§1.904–5 [Amended]

Par. 2. In §1.904–5, paragraph (o) is amended by removing the last sentence.

§1.904–5T [Removed]

Par. 3. §1.904-5T is removed.

§1.954–1 [Amended]

Par. 4. Section 1.954–1 is amended by removing paragraph (c)(1)(iv).

§1.954–1T [Removed]

Par. 5. Section 1.954–1T is removed.

§1.954–2T [Removed]

Par. 7. Section 1.954–2T is removed.

§1.954–9T [Removed]

Par. 9. Section 1.954-9T is removed.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 10. The authority citation for 26 CFR part 301 continues to read in part as follows:

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

§301.7701–3 [Amended]

Par. 11. In §301.7701–3, the last sentence in paragraph (f)(1) is removed.

§301.7701–3T [Removed]

Par. 12. Section 301.7701–3T is removed.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 29, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 9, 1999, 11:25 a.m., and published in the issue of the Federal Register for July 13, 1999, 64 F.R. 37677)

Section 6302.—Mode or Time of Collection

26 CFR 1.6302–4: Use of financial institutions in connection with income taxes; voluntary payments by electronic funds transfer.

T.D. 8828

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 20, 25, 31, and 40

Electronic Funds Transfer of Federal Deposits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the deposit of Federal taxes by electronic funds transfer (EFT). The final regulations affect certain taxpayers required to make deposits

of Federal taxes. For calendar years beginning after 1999, the final regulations provide rules under which certain taxpayers must make deposits by EFT.

DATES: *Effective Date:* These regulations are effective July 13, 1999.

Applicability Date: For dates of applicability, see §31.6302–1(h)(2).

FOR FURTHER INFORMATION CONTACT: Vincent Surabian, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains 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), the Employment Taxes and Collection of Income Tax at Source Regulations (26 CFR part 31), and the Excise Tax Procedural Regulations (26 CFR part 40). On March 23, 1999, a notice of proposed rulemaking (REG–100729–98, 1999–14 I.R.B. 9) was published in the **Federal Register** (64 F.R. 13940). A public hearing originally scheduled in the notice of proposed rulemaking for May 11, 1999, was canceled as there were no requests to speak. Three written comments were received. After consideration of all comments, the proposed regulations are adopted by this Treasury decision.

Explanation of Provisions

Section 6302(h) requires that, beginning in fiscal year 1999, 94 percent of employment taxes and 94 percent of other depository taxes be collected by EFT. The IRS and Treasury Department previously concluded that the deposit threshold had to be set at $50,000 to satisfy this statutory requirement. More recent experience suggests, however, that the statutory requirement can be satisfied even if the threshold is set at a substantially higher level. Moreover, an increase in the threshold would allow small businesses to make the transition to the EFT system at their own pace as they adopt electronic funds transfer in their other business operations. Accordingly, the final regulations increase the deposit threshold to $200,000 in aggregate Federal tax deposits during a calendar year.

The new $200,000 aggregate deposits threshold will be applied initially to 1998 deposits, and taxpayers that exceed the threshold in 1998 will be required to deposit by EFT beginning in 2000. Taxpayers that first exceed the threshold in 1999 or a subsequent year will similarly be required to deposit by EFT beginning in the second succeeding calendar year. A taxpayer that exceeds the threshold will not be permitted to resume making paper coupon deposits if its deposits fall below $200,000 in a subsequent year. Although a similar rule applies under the current regulations, taxpayers that are currently required to deposit by EFT will be given a fresh start and will not be required to use EFT unless they exceed the $200,000 threshold in 1998 or a subsequent calendar year.

The final regulations also expand the types of nondepository tax payments for which voluntary payment by EFT is allowed to include nondepository payments of Federal income, estate and gift, employment, and various specified excise taxes.

Public Comments

Two commentators on the proposed regulations opposed the increase in the threshold to $200,000. They were concerned that financial institutions and the Federal government would have to continue to process large volumes of checks and paper coupons. In addition, they stated that the increase in threshold does not seem justified since the requirement to deposit by EFT does not require an investment by the taxpayer in new technology and greater use of EFT payment methods will contribute to the maintenance of a secure and efficient payment system. The two commentators conclude that the Federal government should continue to use penalty waivers until taxpayers become adept at using the system of depositing by EFT efficiently and accurately. The two commentators did, however, agree with the use of an aggregate deposits test to determine whether a taxpayer is required to deposit by EFT.

As stated in the notice of proposed rulemaking, the IRS and Treasury Department are confident that most taxpayers currently required to deposit by EFT have come to appreciate the simplicity and convenience of the EFT system and will continue to deposit by EFT on a voluntary basis. Despite the increase in the threshold, the continued participation of these taxpayers, coupled with continuing efforts to encourage voluntary enrollment, should ensure the Congressionally-mandated 94 percent of collections by EFT. A lower threshold would, as the commentators suggest, result in even greater use of the EFT system. The IRS and Treasury Department have concluded, however, that the $200,000 threshold appropriately balances concerns relating to small businesses against the benefit of reduced paper transactions.

A third comment suggested removal of the rule in 31 CFR part 203 prohibiting banks from charging fees for processing paper coupon deposits. The regulations in 31 CFR part 203 are issued by the Financial Management Service (FMS) of the Treasury Department, rather than by the Internal Revenue Service. FMS has received similar comments and announced, in the preamble of the 1998 regulations revising 31 CFR part 203 (63 F.R. 5643), that it intends to issue a notice of proposed rulemaking on removing this prohibition.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Vincent Surabian, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel

from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, 31, and 40 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for §1.6302–4 to read in part as follows:

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

Section 1.6302–4 also issued under 26 U.S.C. 6302(a), (c), and (h). * * *

Par. 2. Section 1.6302–4 is revised to read as follows:

§1.6302–4 Use of financial institutions in connection with income taxes; voluntary payments by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax imposed by subtitle A of the Internal Revenue Code, including any payment of estimated tax. Such payment must be made in accordance with procedures prescribed by the Commissioner.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 is amended by adding an entry in numerical order to read in part as follows:

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

Section 20.6302–1 also issued under 26 U.S.C. 6302(a) and (h). * * *

Par. 4. Section 20.6302–1 is added to read as follows:

§20.6302–1 Voluntary payments of estate taxes by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 20 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority citation for part 25 is amended by adding an entry in numerical order to read in part as follows:

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

Section 25.6302–1 also issued under 26 U.S.C. 6302(a) and (h). * * *

Par. 6. Section 25.6302–1 is added to read as follows:

§25.6302–1 Voluntary payments of gift taxes by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 25 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 7. The authority citation for part 31 continues to read in part as follows:

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

Par. 8. Section 31.6302–1 is amended as follows:

1. The heading for paragraph (h)(2) is revised.

2. A heading is added for paragraph (h)(2)(i).

3. New paragraph (h)(2)(i)(C) is added.

4. Paragraph (h)(2)(ii) is revised

5. Paragraph (h)(2)(iii) is added.

6. Paragraph (m) is redesignated as paragraph (n).

7. Paragraph (k) is redesignated as new paragraph (m).

8. Paragraph (j) is redesignated as new paragraph (k).

9. New paragraph (j) is added.

The additions and revisions read as follows:

§31.6302–1 Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA) attributable to payments made after December 31, 1992.

* * * * *

(h) * * *

(2) *Applicability of requirement*—(i) *Deposits for return periods beginning before January 1, 2000.* (A) * * *

(C) This paragraph (h)(2)(i) applies only to deposits required to be made for return periods beginning before January 1, 2000. Thus, a taxpayer, including a taxpayer that is required under this paragraph (h)(2)(i) to make deposits by electronic funds transfer beginning in 1999 or an earlier year, is not required to use electronic funds transfer to make deposits for return periods beginning after December 31, 1999, unless deposits by electronic funds transfer are required under paragraph (h)(2)(ii) of this section.

(ii) *Deposits for return periods beginning after December 31, 1999.* Unless exempted under paragraph (h)(5) of this section, a taxpayer that deposits more than $200,000 of taxes described in paragraph (h)(3) of this section during a calendar year beginning after December 31, 1997, must use electronic funds transfer (as defined in paragraph (h)(4) of this section) to make all deposits of those taxes that are required to be made for return periods beginning after December 31 of the following year and must continue to deposit by electronic funds transfer in all succeeding years. Thus, a taxpayer that exceeds the $200,000 deposit threshold during calendar year 1998 is required to make deposits for return periods beginning in or after calendar year 2000 by electronic funds transfer.

(iii) *Voluntary deposits.* A taxpayer that is not required by this section to use electronic funds transfer to make a deposit of taxes described in paragraph (h)(3) of this section may voluntarily make the deposit by electronic funds transfer, but remains subject to the rules of paragraph (i) of this section, pertaining to deposits by Federal tax deposit (FTD) coupon, in making deposits other than by electronic funds transfer.

* * * * *

(j) *Voluntary payments by electronic funds transfer.* Any person may voluntarily remit by electronic funds transfer any payment of tax imposed by subtitle C of the Internal Revenue Code. Such payment must be made in accordance with procedures prescribed by the Commissioner.

* * * * *

PART 40—EXCISE TAX PROCEDURAL REGULATIONS

Par. 9. The authority citation for part 40 is amended by adding an entry in numerical order to read in part as follows:

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

Section 40.6302(a)–1 also issued under 26 U.S.C. 6302(a) and (h). * * *

Par. 10. Section 40.6302(a)–1 is added to read as follows:

§40.6302(a)–1 Voluntary payments of excise taxes by electronic funds transfer.

Any person may voluntarily remit by electronic funds transfer any payment of tax to which this part 40 applies. Such payment must be made in accordance with procedures prescribed by the Commissioner.

Charles O. Rossotti,
Commissioner of Internal Revenue.

Approved July 2, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 12, 1999, 8:45 a.m., and published in the issue of the Federal Register for July, 13, 1999, 64 F.R. 37675)

Part III. Administrative, Procedural, and Miscellaneous

Returns Relating to Payments of Qualified Tuition and Related Expenses; and Returns Relating to Payments of Interest on Education Loans

Notice 99–37

PURPOSE

This notice announces that eligible educational institutions and certain persons who receive payments of student loan interest will be required to report the same information under § 6050S of the Internal Revenue Code for the year 2000 as required for the years 1998 and 1999.

BACKGROUND

Section 6050S requires eligible educational institutions to file information returns with the Internal Revenue Service to assist taxpayers and the Service in determining the Hope Scholarship Credit and the Lifetime Learning Credit that taxpayers may claim under § 25A. Section 6050S also requires the institutions to furnish a corresponding statement to each individual named on the information return showing the information that is reported to the Service. The specific information reporting requirements applicable to eligible educational institutions for the years 1998 and 1999 are described in Notice 97–73, 1997–2 C.B. 335 (as modified by Notice 98–46, 1998–36 I.R.B. 21, and Notice 98–59, 1998–49 I.R.B. 16).

In addition, § 6050S requires certain persons who receive payments of interest on one or more qualified education loans, as defined in § 221(e)(1), ("payees") to file information returns with the Service to assist taxpayers and the Service in determining the amount of student loan interest that taxpayers may deduct under § 221. Section 6050S also requires payees to furnish a corresponding statement to each individual named on the information return showing the information that is reported to the Service. The specific information reporting requirements applicable to payees for the years 1998 and 1999 are described in Notice 98–7, 1998–3 I.R.B. 54 (as modified by Notice 98–54, 1998–46 I.R.B. 25).

The legislative history of recent amendments to § 6050S reflects that Congress intended that no additional reporting (i.e., beyond the reporting currently required in Notice 97–73) would be required of educational institutions until final regulations are issued under § 6050S. In addition, Congress intended that the final regulations would have an effective date that gives institutions sufficient time to implement additional required reporting. *See* H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess., at 321–322 (1998).

DISCUSSION

The Treasury Department and the Service expect to issue proposed regulations under § 6050S this year. (See the Office of Tax Policy and Internal Revenue Service 1999 Priority Guidance Plan.) Final regulations under § 6050S, however, will not be issued before 2000. Consistent with the intent of Congress that the current reporting requirements remain in effect until regulations are finalized, the information reporting requirements under § 6050S for the year 2000 will be the same as the reporting requirements described in Notice 97–73 (as modified) and Notice 98–7 (as modified).

Accordingly, for the year 2000, eligible educational institutions will be required to file Forms 1098-T, Tuition Payments Statement, that include the same information required by Notice 97–73 (as modified). Similarly, for the year 2000, payees will be required to file Forms 1098-E, Student Loan Interest Statement, that include the same information required by Notice 98–7 (as modified). Forms 1098-T and Forms 1098-E for the year 2000 must be filed with the Service by February 28, 2001, if filed on paper or by magnetic media, or by April 2, 2001, if filed electronically. A statement containing the same information as reported on any Form 1098-T or Form 1098-E filed with the Service must be furnished to the individual named on the information return by January 31, 2001.

Consistent with Notice 97–73 (as modified) and Notice 98–7 (as modified) and § 6050S, no penalties will be imposed under § 6721 or § 6722 prior to the issuance of final regulations for any failure to file correct information returns or to furnish correct statements required under § 6050S for the year 2000. Even after final regulations are issued, no penalties will be imposed under § 6721 or § 6722 for failure to file correct information returns or to furnish correct statements for the year 2000 if the institution or payee made a good faith effort to file information returns and furnish statements in accordance with this notice.

EFFECT ON OTHER DOCUMENTS

Notice 97–73, Notice 98–7, Notice 98–46, Notice 98–54, and Notice 98–59 are modified.

DRAFTING INFORMATION

The principal author of this notice is Donna Welch of the Office of the Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact her on (202) 622-4910 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking; Notice of Public Hearing; and Withdrawal

Withdrawal of Guidance Under Subpart F Relating to Partnerships and Branches; and Issuance of New Guidance Under Subpart F Relating to Certain Hybrid Transactions

REG–113909–98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document withdraws the notice of proposed rulemaking and notice of proposed rulemaking by cross-reference to temporary regulations that was published in the **Federal Register** on March 26, 1998, providing guidance under subpart F relating to partnerships and branches. This document contains new proposed regulations relating to the treatment under subpart F of certain transactions involving hybrid branches. These regulations are necessary to provide guidance on transactions relating to such entities. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments, and outlines of oral comments to be discussed at the public hearing scheduled for December 1, 1999, must be received by November 10, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–113909–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–113909–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Valerie Mark, (202) 622-3840; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On March 23, 1998 (63 F.R. 14669, March 26, 1998), the IRS issued proposed regulations (REG–104537–97, 1998–16 I.R.B. 21) relating to the treatment under subpart F of certain partnership and hybrid branch transactions. The provisions of the proposed regulations relating to hybrid branch transactions were also issued as temporary regulations (T.D. 8767, 1998–16 I.R.B. 4 [63 F.R. 14613, March 26, 1998]). Certain members of Congress and taxpayers raised concerns about the proposed and temporary regulations relating to hybrid branch transactions. On June 19, 1998, the Treasury announced in Notice 98–35 (1998–27 I.R.B. 35) that the temporary regulations would be removed and that the proposed regulations relating to hybrid transactions would be re-proposed with new dates of applicability to give Congress the opportunity to consider in greater depth the issues raised by hybrid transactions.

As provided in Notice 98–35, these proposed regulations substantially restate the regulations relating to hybrid transactions issued in March of 1998. These proposed regulations, however, contain certain clarifications requested by taxpayers. Further, as described in greater detail below, unlike the effective date rules announced in Notice 98–35, these regulations are proposed to be effective only for payments made in taxable years commencing after the date that is five years after the date of finalization of these regulations. The permanent grandfather relief described in Notice 98–35 remains unchanged.

These proposed regulations represent the IRS and Treasury's views of how current law should be enforced. Treasury is currently undertaking a comprehensive study of subpart F. These proposed regulations will not control the results of the study. For example, an objective analysis of the policies and goals of subpart F may lead to the conclusion that subpart F should be significantly restructured.

To the extent, however, that Congress does not restructure subpart F in a manner that would alter the rules enforced by these regulations, Treasury and the IRS believe that these regulations will be necessary to preserve the integrity of the current statutory scheme. The use of hybrid arrangements, which is greatly facilitated by the "check-the-box" entity classification regulations (§§301.7701–1 through 301.7701–3), would otherwise give rise to the following inconsistency: if sales income is shifted from one CFC to a related CFC in a different jurisdiction, subpart F income may arise; if sales income is shifted from one CFC to its branch in a different jurisdiction, subpart F income may arise; if income is shifted through interest payments from one CFC to a related CFC in a different jurisdiction, subpart F income may arise; however, if income is shifted through interest payments from one CFC to its hybrid branch in a different jurisdiction, subpart F income will not arise. This final result does not seem an appropriate policy outcome within the framework of current subpart F, and is almost certainly inconsistent with the Congressional intent underlying the rules being interpreted here.

Treasury anticipates that taxpayers will comment both on the appropriateness of these proposed regulations under current law, and on the contents of its subpart F study, including any conclusions that the study might draw about potential changes to subpart F. To allow proper time to consider all these issues, Treasury and the IRS have significantly modified and liberalized the effective date rules set forth in Notice 98–35. New regulations regarding the treatment of a controlled foreign corporation's distributive share of partnership income will be proposed at a later date.

Explanation of Provisions

I. *In General*

In these proposed regulations, Treasury and the IRS set forth a framework for dealing with issues arising under subpart F (sections 951 through 964) that relate to the use of certain entities that are regarded as fiscally transparent for purposes of U.S. tax law.

II. *Hybrid Branches*

Treasury and the IRS understand that certain taxpayers are using arrangements involving hybrid branches to circumvent the purposes of subpart F. These arrangements generally involve the use of deductible payments to reduce the taxable income of a CFC under foreign law, thereby reducing that CFC's foreign tax and, also under foreign law, the corresponding creation in another entity of low-taxed, passive income of the type to which subpart F was intended to apply. Because of the structure of these arrangements, however, taxpayers take the position that this income is not taxed under subpart F. Treasury and the IRS have concluded that use of these hybrid branch arrangements is contrary to the policies and rules of subpart F.

Under these proposed regulations, hybrid branch payments, as defined in the regulations, between a CFC and its hybrid branch, or between hybrid branches of the CFC may give rise to subpart F income. When certain conditions are present, the non-subpart F income of the CFC, in the amount of the hybrid branch payment, is recharacterized as subpart F income of the CFC. Those conditions include that: the hybrid branch payment reduces the foreign tax of the payor; the hybrid branch payment would have been foreign personal holding company income if made between separate CFCs; and there is a disparity between the effective rate of tax on the payment in the hands of the payee and the hypothetical rate of tax that would have applied if the payment had been taxed in the hands of the payor.

The proposed regulations would make clear that the CFC and the hybrid branch, or the hybrid branches, are treated as separate corporations only to recharacterize non-subpart F income as subpart F income in the amount of the hybrid branch payment, and to apply the tax disparity rule of §1.954–9(a)(5)(iv). For all other purposes (e.g., for purposes of the earnings and profits limitation of section 952), a CFC and its hybrid branch, or hybrid branches, would not be treated as separate corporations.

The proposed regulations would provide that the amount recharacterized as subpart F income is the gross amount of the hybrid branch payment limited by the amount of the CFC's earnings and profits attributable to non-subpart F income. This amount is the excess of current earnings and profits over subpart F income, determined after the application of the rules of sections 954(b) and 952(c) and before the application of these proposed regulations. To the extent that the full amount required to be recharacterized under this provision cannot be recharacterized because it exceeds earnings and profits attributable to non- subpart F income, there is no requirement to carry such amounts back or forward to another year.

The proposed regulations would provide that, under certain circumstances, the recharacterization rules will also apply to a CFC's proportionate share of any hybrid branch payment made between a partnership in which the CFC is a partner and a hybrid branch of the partnership, or between hybrid branches of such a partnership. When the partnership is treated as fiscally transparent by the CFC's taxing jurisdiction, the recharacterization rules are applied by treating the hybrid branch payment as if it had been made directly between the CFC and the hybrid branch, or as though the hybrid branches of the partnership had been hybrid branches of the CFC, as applicable. If the partnership is treated as a separate entity by the CFC's taxing jurisdiction, the recharacterization rules are applied to the partnership as if it were a CFC.

The proposed regulations would provide that income will not be recharacterized unless there is a disparity between the effective rate at which the hybrid branch payment is taxed to the payee and a hypothetical tax rate that measures the tax savings to the payor from the deductible payment. This provision is similar to the rule in §1.954–3(b), and adopts the same percentage tests as contained in that provision. The regulations also provide a special high tax exception applicable to the hybrid branch payment that is similar to the one contained in section 954(b)(4).

For purposes of determining the amount of taxes deemed paid under section 960, the amount of non-subpart F income recharacterized as subpart F income is treated as attributable to income in separate foreign tax credit baskets in proportion to the ratio of non-subpart F income in each basket to the total amount of non-subpart F income of the CFC for the taxable year.

III. *Related Provisions*

These proposed regulations would provide rules, contained in §1.954–1(c)(1)-(i)(B), to prevent expenses, including related person interest expense that would normally be allocable under section 954(b)(5) to subpart F income of a CFC, from being allocated to a payment from which the expense arises. The allocation limit applies: (i) to the extent such payment is included in the subpart F income of the CFC; (ii) if the expense arises from any payment between the CFC and a hybrid partnership in which the CFC is a partner; and (iii) if the payment reduces foreign tax and there is a significant disparity in tax rates between the payor and payee jurisdictions.

These proposed regulations also would address the application of the related person exceptions to the foreign personal holding company income rules in the context of partnership distributive shares and transactions involving hybrid branches. Under section 954(c)(3), foreign personal holding company income does not include certain interest, dividends, rents and royalties received from related corporations. These exceptions apply, in the case of interest and dividends, when the related corporate payor is organized in the country in which the CFC is organized and uses a substantial part of its assets in a trade or business in that country and, in the case of rents and royalties, when the rent or royalty payment is made for the use or privilege of using property within the CFC's country of incorporation.

Under these proposed regulations, if the partnership receives an item of income that reduces the foreign income tax of the payor, the related person exceptions of section 954(c)(3) would apply to ex-

clude the income from the foreign personal holding company income of the CFC partner only where: the exception would have applied if the CFC earned the income directly (testing relatedness and country of incorporation at the CFC partner level); and either the partnership is organized and operates in the CFC's country of incorporation, the partnership is treated as fiscally transparent in the CFC's countries of incorporation and operation, or there is no significant disparity between the effective rate of tax imposed on the income and the rate of tax that would be imposed on the income if earned directly by the CFC partner.

In addition, these proposed regulations contain rules that would apply the related person exceptions to certain payments involving hybrid branches. These rules would apply to payments by a CFC to a hybrid branch of a related CFC. Under these rules, the related person exceptions would apply to exclude the payments from the foreign personal holding company income of the recipient CFC only if the payment would have qualified for the exception if the hybrid branch had been a separate CFC incorporated in the jurisdiction in which the payment is subject to tax (other than a withholding tax).

IV. *Request for Comments*

Comments on policy issues that relate to subpart F and deferral, generally, including comments on legislative modifications to the current rules, and comments solicited on the broad policy issues mentioned in Notice 98–35, can be submitted in response to the study mentioned above. Treasury and the IRS invite comments on the appropriateness of these regulations under the current subpart F rules.

Proposed Effective Date

These proposed regulations will not be finalized before July 1, 2000. It is proposed that, when finalized, these regulations would be effective only for payments made in taxable years of a controlled foreign corporation commencing after the date that is five years after the date of finalization of these regulations. These regulations would not, however, apply to any payments made under hybrid arrangements entered into before June 19, 1998. This exception is permanent so long as the arrangement is not substantially modified on or after June 19, 1998. An illustrative list of events that would and would not constitute "substantial modification" of an arrangement is included in these regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Request for Comments

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of these proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 1, 1999, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments and an outline of topics to be discussed and time to be devoted to each topic (signed original and eight (8) copies) by November 10, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Valerie Mark, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

* * * * *

Withdrawal of Notice of Proposed Rulemaking and Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking amending 26 CFR Parts 1 and 301 that was published in the **Federal Register** on March 26, 1998, 63 F.R. 14669 (REG–104537–97), is withdrawn. In addition, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 continues to read in part as follows:

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

Par. 2. In §1.904–5, paragraph (k)(1) is revised to read as follows:

§1.904–5 Look-through rules as applied to controlled foreign corporations and other entities.

* * * * *

(k) *Ordering rules*—(1) *In general.* Income received or accrued by a related person to which the look-through rules apply is characterized before amounts included from, or paid or distributed by, that person and received or accrued by a re-

lated person. For purposes of determining the character of income received or accrued by a person from a related person if the payor or another related person also receives or accrues income from the recipient and the look-through rules apply to the income in all cases, the rules of paragraph (k)(2) of this section apply. Notwithstanding any other provision of this section, the principles of §1.954–1(c)(1)(i) will apply to any expense subject to §1.954–1(c)(1)(i).

* * * * *

Par. 3. Section 1.954–0 (b) is amended as follows:

1. The entry for §1.954–1(c)(1)(i) is revised.

2. Entries for §1.954–1(c)(1)(i)(A) through (c)(1)(i)(E) are added.

3. An entry for §1.954–2(a)(5) is added.

4. An entry for §1.954–2(a)(6) is added.

The revision and additions read as follows:

§954–0 Introduction.

* * * * *

(b) * * *

§1.954–1 Foreign base company income

* * * * *

(c) * * *

(1) * * *

(i) Deductions.

(A) Deductions against gross foreign base company income.

(B) Special rule for deductible payments to certain non-fiscally transparent entities.

(C) Limitations.

(D) Example.

(E) Effective date.

* * * * *

§1.954–2 Foreign personal holding company income.

(a) * * *

(5) Special rules applicable to distributive share of partnership income.

(i) Application of related person exceptions where payment reduces foreign tax of payor.

(ii) Certain other exceptions applicable to foreign personal holding company income. [Reserved]

(iii) Effective date.

(6) Special rules applicable to exceptions from foreign personal holding company income treatment in circumstances involving hybrid branches.

(i) In general.

(ii) Exception where no tax reduction or tax disparity.

(iii) Effective date.

* * * * *

Par. 4. Section 1.954–1 is amended as follows:

1. Paragraphs (c)(1)(i) heading and introductory text and (c)(1)(i)(A) through (c)(1)(i)(D) are redesignated as paragraphs (c)(1)(i)(A) heading and introductory text and (c)(1)(i)(A)(1) through (c)(1)(i)(A)(4), respectively.

2. A heading for paragraph (c)(1)(i) is added.

3. Paragraphs (c)(1)(i)(B) through (c)(1))(i)(E) are added.

The additions read as follows:

§1.954–1 Foreign base company income.

* * * * *

(c) * * *

(1) * * *

(i) *Deductions*—(A) *Deductions against gross foreign base company income.* * * *

(B) *Special rule for deductible payments to certain non-fiscally transparent entities.* Notwithstanding any other provision of this section, except as provided in paragraph (c)(1)(i)(C) of this section, an expense (including a distributive share of any expense) that would otherwise be allocable under section 954(b)(5) against the subpart F income of a controlled foreign corporation shall not be allocated against subpart F income of the controlled foreign corporation resulting from the payment giving rise to the expense if—

(*1*) Such expense arises from a payment between the controlled foreign corporation and a partnership in which the controlled foreign corporation is a partner and the partnership is not regarded as fiscally transparent, as defined in §1.954–9(a)(7), by any country in which the controlled foreign corporation does business or has substantial assets; and

(*2*) The payment from which the expense arises would have reduced foreign tax, under §1.954–9(a)(3), and would have fallen within the tax disparity rule of §1.954–9(a)(5)(iv), if those provisions had been applicable to the payment.

(C) *Limitations.* Paragraph (c)(1)(i)(B) of this section shall not apply to the extent that the controlled foreign corporation partner has no income against which to allocate the expense, other than its distributive share of a payment described in paragraph (c)(1)(i)(B) of this section. Similarly, to the extent an expense described in paragraph (c)(1)(i)(B) of this section exceeds the controlled foreign corporation partner's distributive share of the payment from which the expense arises, such excess amount of the expense may reduce subpart F income (other than such payment) to which it is properly allocable or apportionable under section 954(b)(5).

(D) *Example.* The following example illustrates the application of paragraphs (c)(1)(i)(B) and (C) of this section:

Example. CFC, a controlled foreign corporation in Country A, is a 70 percent partner in partnership P, located in Country B. Country A's tax laws do not classify P as a fiscally transparent entity. The rate of tax in country B is 15 percent of the tax rate in country A. P loans $100 to CFC at a market rate of interest. In year 1, CFC pays P $10 of interest on the loan. The interest payment would have caused the recharacterization rules of §1.954–9 to apply if the payment were made between the entities described in §1.954–9(a)(2). CFC's distributive share of P's interest income is $7, which is foreign personal holding company income to CFC under section 954(c). Under paragraph (c)(1)(i)(B) of this section, $7 of the $10 interest expense may not be allocated against any of CFC's subpart F income. However, to the extent the remaining $3 of interest expense is properly allocable to subpart F income of CFC other than its distributive share of P's interest income, this expense may offset such other subpart F income.

(E) *Effective date.* Paragraph (c)(1)(i)-(B), (C) and (D) of this section shall be applicable for all payments made or accrued in taxable years commencing after [date that is 5 years after publication of the final regulations in the federal register], under hybrid arrangements, unless such payments are made pursuant to an arrangement that would qualify for permanent relief under §1.954–9(c)(2) if made between a controlled foreign corporation and its hybrid branch, in which case the relief afforded under that section shall also be afforded under this section.

* * * * *

Par. 5. In §1.954–2, paragraphs (a)(5) and (a)(6) are added to read as follows:

§1.954–2 Foreign personal holding company income.

(a) * * *

(5) *Special rules applicable to distributive share of partnership income*—(i) *Application of related person exceptions where payment reduces foreign tax of payor.* If a partnership receives an item of income that reduced the foreign income tax of the payor (determined under the principles of §1.954–9(a)(3)), to determine the extent to which a controlled foreign corporation's distributive share of such item of income is foreign personal holding company income, the exceptions contained in section 954(c)(3) shall apply only if—

(A)(*1*) Any such exception would have applied to exclude the income from foreign personal holding company income if the controlled foreign corporation had earned the income directly (determined by testing, with reference to such controlled foreign corporation, whether an entity is a related person, within the meaning of section 954(d)(3), or is organized under the laws of, or uses property in, the foreign country in which the controlled foreign corporation is created or organized); and

(*2*) The distributive share of such income is not in respect of a payment made by the controlled foreign corporation to the partnership; and

(B)(*1*) The partnership is created or organized, and uses a substantial part of its assets in a trade or business in the country under the laws of which the controlled foreign corporation is created or organized (determined under the principles of paragraph (b)(4) of this section);

(*2*) The partnership is regarded as fiscally transparent, as defined in §1.954–9(a)(7), by all countries under the laws of which the controlled foreign corporation is created or organized or has substantial assets; or

(*3*) The income is taxed in the year when earned at an effective rate of tax (determined under the principles of §1.954–1(d)(2)) that is not less than 90 percent of, and not more than five percentage points less than, the effective rate of tax that would have applied to such income under the laws of the country in which the controlled foreign corporation is created or organized if such income were earned directly by the controlled foreign corporation partner from local sources.

(ii) *Certain other exceptions applicable to foreign personal holding company income.* [Reserved].

(iii) *Effective date.* Paragraph (a)(5)(i) of this section shall apply to all amounts paid or accrued in taxable years commencing after [date that is 5 years after publication of the final regulations in the federal register], under hybrid arrangements, unless such payments are made pursuant to an arrangement which would qualify for permanent relief under §1.954–9(c)(2) if made between a controlled foreign corporation and its hybrid branch, in which case the relief afforded under that section shall also be afforded under this section.

(6) *Special rules applicable to exceptions from foreign personal holding company income treatment in circumstances involving hybrid branches*—(i) *In general.* In the case of a payment between a controlled foreign corporation (or its hybrid branch, as defined in §1.954–9(a)(6)) and the hybrid branch of a related controlled foreign corporation, the exceptions contained in section 954(c)(3) shall apply only if the payment would have qualified for the exception if the payor were a separate controlled foreign corporation created or organized in the jurisdiction where foreign tax is reduced and the payee were a separate controlled foreign corporation created or organized under the laws of the jurisdiction in which the payment is subject to tax (other than a withholding tax).

(ii) *Exception where no tax reduction or tax disparity.* Paragraph (a)(6)(i) of this section shall not apply unless the payment would have reduced foreign tax, under §1.954–9(a)(3), and fallen within the tax disparity rule of §1.954–9(a)(5)(iv) if those provisions had been applicable to the payment.

(iii) *Effective date.* The rules of this section shall apply to all amounts paid or accrued in taxable years commencing after [date that is 5 years after publication of the final regulations in the federal register], under hybrid arrangements, unless such payments are made pursuant to an arrangement which would qualify for permanent relief under §1.954–9(c)(2) if made between a controlled foreign corporation and its hybrid branch, in which case the relief afforded under that section shall also be afforded under this section.

Par. 6. Section 1.954–9 is added to read as follows:

§1.954–9 Hybrid branches.

(a) *Subpart F income arising from certain payments involving hybrid branches*—(1) *Payment causing foreign tax reduction gives rise to additional subpart F income.* The non-subpart F income of a controlled foreign corporation will be recharacterized as subpart F income, to the extent provided in paragraph (a)(5) of this section, if—

(i) A hybrid branch payment, as defined in paragraph (a)(6) of this section, is made between the entities described in paragraph (a)(2) of this section;

(ii) The hybrid branch payment reduces foreign tax, as determined under paragraph (a)(3) of this section; and

(iii) The hybrid branch payment is treated as falling within a category of foreign personal holding company income under the rules of paragraph (a)(4) of this section.

(2) *Hybrid branch payment between certain entities*—(i) *In general.* Paragraph (a)(1) of this section shall apply to hybrid branch payments between—

(A) A controlled foreign corporation and its hybrid branch;

(B) Hybrid branches of a controlled foreign corporation;

(C) A partnership in which a controlled foreign corporation is a partner (either directly or through one or more branches or other partnerships) and a hybrid branch of the partnership; or

(D) Hybrid branches of a partnership in which a controlled foreign corporation is a partner (either directly or through one or more branches or other partnerships).

(ii) *Hybrid branch payment involving partnership*—(A) *Fiscally transparent partnership.* To the extent of the controlled foreign corporation's proportionate share of a hybrid branch payment, the rules of paragraphs (a)(3), (4) and (5) of this section shall be applied by treating the hybrid branch payment between the partnership and the hybrid branch as if it were made directly between the controlled foreign corporation and the hybrid branch, or as if the hybrid branches of the

partnership were hybrid branches of the controlled foreign corporation, if the hybrid branch payment is made between—

(*1*) A fiscally transparent partnership in which a controlled foreign corporation is a partner (either directly or through one or more branches or other fiscally transparent partnerships) and the partnership's hybrid branch; or

(2) Hybrid branches of a fiscally transparent partnership in which a controlled foreign corporation is a partner (either directly or through one or more branches or other fiscally transparent partnerships).

(B) *Non-fiscally transparent partnership.* To the extent of the controlled foreign corporation's proportionate share of a hybrid branch payment, the rules of paragraphs (a)(3) and (4) and (a)(5)(iv) of this section shall be applied to the non-fiscally transparent partnership as if it were the controlled foreign corporation, if the hybrid branch payment is made between—

(*1*) A non-fiscally transparent partnership in which a controlled foreign corporation is a partner (either directly or through one or more branches or other partnerships) and the partnership's hybrid branch; or

(*2*) Hybrid branches of a non-fiscally transparent partnership in which a controlled foreign corporation is a partner (either directly or through one or more branches or other partnerships).

(C) *Examples.* The following examples illustrate the application of this paragraph (a)(2)(ii):

Example 1. CFC, a controlled foreign corporation in Country A, is a 90 percent partner in partnership P, which is treated as fiscally transparent under the laws of Country A. P has a hybrid branch, BR, in Country B. P makes an interest payment of $100 to BR. Under Country A law, CFC's 90 percent share of the payment reduces CFC's Country A income tax. Under paragraph (a)(2)(ii)(A) of this section, the recharacterization rules of this section are applied by treating the payment as if made by CFC to BR. Ninety dollars of CFC's non-subpart F income, to the extent available, and subject to the earnings and profits and tax rate limitations of paragraph (a)(5) of this section, is recharacterized as subpart F income.

Example 2. CFC, a controlled foreign corporation in Country A, is a 90 percent partner in partnership P, which is treated as fiscally transparent under the laws of Country A. P has two branches in Country B, BR1 and BR2. BR1 is treated as fiscally transparent under the laws of Country A. BR2 is a hybrid branch. BR1 makes an interest payment of $100 to BR2. Under paragraph (a)(2)(ii)(A) of this section, the payment by BR1, the fiscally transparent branch, is treated as a payment by P, and the deemed payment by P, a fiscally transparent partnership, is treated as made by CFC. Under Country A law, CFC's 90 percent share of BR1's payment reduces CFC's Country A income tax. Ninety dollars of CFC's non-subpart F income, to the extent available, and subject to the earnings and profits and tax rate limitations of paragraph (a)(5) of this section, is recharacterized as subpart F income.

(3) *Application when payment reduces foreign tax.* For purposes of paragraph (a)(1) of this section, a hybrid branch payment reduces foreign tax when the foreign tax imposed on the income of the payor, or any person that is a related person with respect to the payor (as determined under the principles of section 954(d)(3)), is less than the foreign tax that would have been imposed on such income had the hybrid branch payment not been made, or the hybrid branch payment creates or increases a loss or deficit or other tax attribute which may be carried back or forward to reduce the foreign income tax of the payor or any owner in another year (determined by taking into account any refund of such tax made to the payor, payee or any other person).

(4) *Hybrid branch payment that is included within a category of foreign personal holding company income*—(i) *In general.* For purposes of paragraph (a)(1) of this section, whether the hybrid branch payment is treated as income included within a category of foreign personal holding company income is determined by treating a hybrid branch that is either the payor or recipient of the hybrid branch payment as a separate wholly-owned subsidiary corporation of the controlled foreign corporation that is incorporated in the jurisdiction under the laws of which such hybrid branch is created, organized for foreign law purposes, or has substantial assets. Thus, the hybrid branch payment will be treated as included within a category of foreign personal holding company income if, taking into account any specific exceptions for that category, the payment would be included within a category of foreign personal holding company income if the branch or branches were treated as separately incorporated for U.S. tax purposes.

(ii) *Extent to which controlled foreign corporation and hybrid branches treated as separate entities.* For purposes of this section, other than the determination under paragraph (a)(4)(i) of this section, a controlled foreign corporation and its hybrid branch, a partnership and its hybrid branch, or hybrid branches shall not be treated as separate entities. Thus, for example, if a controlled foreign corporation, including all of its hybrid branches, has an overall deficit in earnings and profits to which section 952(c) applies, the limitation of such section on the amount includible in the subpart F income of such corporation will apply. Similarly, for purposes of applying the *de minimis* and full inclusion rules of section 954(b)(3), a controlled foreign corporation and its hybrid branch, or hybrid branches shall not be treated as separate corporations. Further, a hybrid branch payment that would reduce foreign personal holding company income under section 954(b)(5) if made between two separate entities will not create an expense if made between a controlled foreign corporation and its hybrid branch, a partnership and its hybrid branch, or hybrid branches.

(5) *Recharacterization of income attributable to current earnings and profits as subpart F income*—(i) *General rule.* Non-subpart F income of a controlled foreign corporation in an amount equal to the excess of earnings and profits of the controlled foreign corporation for the taxable year over subpart F income, as defined in section 952(a), will be recharacterized as subpart F income under paragraph (a)(1) of this section only to the extent provided under paragraphs (a)(5)(ii) through (vi) of this section.

(ii) *Subpart F income.* For purposes of determining the excess of current earnings and profits over subpart F income under paragraph (a)(1) of this section, the amount of subpart F income is determined before the application of the rules of this section but after the application of the rules of sections 952(c) and 954(b). Further, such amount is determined by treating the controlled foreign corporation and all of its hybrid branches as a single corporation.

(iii) *Recharacterization limited to gross amount of hybrid branch payment*—(A) *In general.* The amount recharacterized as subpart F income under paragraph (a)(1) of this section is limited to the amount of the hybrid branch payment.

(B) *Exception for duplicative payments.* [Reserved].

(iv) *Tax disparity rule*—(A) *In general.* Paragraph (a)(1) of this section will apply only if the hybrid branch payment falls within the tax disparity rule. The hybrid branch payment falls within the tax disparity rule if it is taxed in the year when earned at an effective rate of tax that is less than 90 percent of, and at least 5 percentage points less than, the hypothetical effective rate of tax imposed on the hybrid branch payment, as determined under paragraph (a)(5)(iv)(B) of this section.

(B) *Hypothetical effective rate of tax*—(*1*) *In general.* The hypothetical effective rate of tax imposed on the hybrid branch payment is—

(*i*) For the taxable year of the payor in which the hybrid branch payment is made, the amount of income taxes that would have been paid or accrued by the payor if the hybrid branch payment had not been made, less the amount of income taxes paid or accrued by the payor; divided by

(*ii*) The amount of the hybrid branch payment.

(*2*) *Hypothetical effective rate of tax when hybrid branch payment causes or increases loss or deficit.* If the hybrid branch payment causes or increases a loss or deficit of the payor for foreign tax purposes, and such loss or deficit can be carried forward or back, the hypothetical effective rate of tax imposed on the hybrid branch payment is the effective rate of tax that would be imposed on the taxable income of the payor for the year in which the payment is made if the payor's taxable income were equal to the amount of the hybrid branch payment.

(C) *Examples.* The application of this paragraph (a)(5)(iv) is illustrated by the following examples:

Example 1. In 2006, CFC organized in Country A had net income of $60 from manufacturing for Country A tax purposes. It also had a branch (BR) in Country B. BR is a hybrid entity under paragraph (a)(1) of this section. CFC made a payment of $40 to BR, which was a hybrid branch payment under paragraph (a)(6) of this section, and was treated by CFC as a deductible payment for Country A tax purposes. CFC paid $30 of Country A taxes in 2006. It would have paid $50 of Country A taxes without the deductible payment. Country A did not impose any withholding tax on the $40 payment to BR. Country B also did not impose a tax on the $40 received by BR. Therefore, the effective rate of tax on that payment is 0%. Furthermore, the hypothetical effective rate of tax on the $40 hybrid branch payment is 50% ($50-$30/$40). The effective rate of tax (0%) is less than 90% of, and more than 5 percentage points less than, this hypothetical rate of tax of 50%. As a result, the $40 hybrid branch payment falls within the tax disparity rule of this paragraph (a)(5)(iv).

Example 2. Assume the same facts as in *Example 1*, except that CFC has a loss of $100 for the year for Country A tax purposes. Under Country A law, CFC can carry the loss forward for use in subsequent years. CFC paid no Country A taxes in 2006. The rate of tax in Country A is graduated from 20% to 50%. If the $40 hybrid branch payment were the only item of taxable income of CFC, Country A would have imposed tax at an effective rate of 30%. The effective rate of tax (0%) is less than 90% of, and more than 5 percentage points less than, the hypothetical effective rate of tax (30%) imposed on the hybrid branch payment. As a result, the $40 hybrid branch payment falls within the tax disparity rule of this paragraph (a)(5)(iv).

Example 3. Assume the same facts as in *Example 1*, except that Country B imposes tax on the $40 hybrid payment to BR at an effective rate of 50%. The effective rate of 50% is equal to the hypothetical effective rate of tax. As a result, the hybrid branch payment does not fall within the tax disparity rule of this paragraph (a)(5)(iv) and, thus, the recharacterization rules of paragraph (a)(1) of this section do not apply. See also the special high tax exception of paragraph (a)(5)(v) of this section.

(v) *Special high tax exception*—(A) *In general.* Paragraph (a)(1) of this section shall not apply if the non-subpart F income that would be recharacterized as subpart F income under this section was subject to foreign income taxes imposed by a foreign country or countries at an effective rate that is greater than 90 percent of the maximum rate of tax specified in section 11 for the taxable year of the controlled foreign corporation.

(B) *Effective rate of tax.* The effective rate of tax imposed on the non-subpart F income that would be recharacterized as subpart F income under this section is determined under the principles of §1.954–1(d)(2) and (3). See paragraph (b) of this section for the application of section 960 to amounts recharacterized as subpart F income under this section.

(vi) *No carryback or carryforward of amounts in excess of current year earnings and profits limitation.* To the extent that some or all of the amount required to be recharacterized under this section is not recharacterized as subpart F income because the hybrid branch payment exceeds the amount that can be recharacterized, as determined under paragraph (a)(5)(i) of this section, this excess shall not be carried back or forward to another year.

(6) *Definitions for this section.* For purposes of this section:

(i) *Arrangement* shall mean any agreement to pay interest, rents, royalties or similar amounts. It shall also include the declaration and payment of a dividend (but not an agreement or undertaking to pay future, unspecified dividends). An arrangement shall not, however, include the mere formation or acquisition (or similar event) of a hybrid branch that is intended to become a party to an arrangement.

(ii) *Entity* means any person that is treated by the United States or any jurisdiction as other than an individual.

(iii) *Hybrid branch* means an entity that—

(A) Is disregarded as an entity separate from its owner for federal tax purposes and is owned (including ownership through branches) by either a controlled foreign corporation or a partnership in which a controlled foreign corporation is a partner (either directly or indirectly through one or more branches or partnerships);

(B) Is treated as fiscally transparent by the United States; and

(C) Is treated as non-fiscally transparent by the country in which the payor entity, any owner of a fiscally-transparent payor entity, the controlled foreign corporation, or any intermediary partnership is created, organized or has substantial assets.

(iv) *Hybrid branch payment* means the gross amount of any payment (including any accrual) which, under the tax laws of any foreign jurisdiction to which the payor is subject, is regarded as a payment between two separate entities but which, under U.S. income tax principles, is not income to the recipient because it is between two parts of a single entity.

(7) *Fiscally transparent and non-fiscally transparent.* For purposes of this section an entity shall be treated as fiscally transparent with respect to an interest holder of the entity, if such interest holder is required, under the laws of any jurisdiction to which it is subject, to take into account separately, on a current basis, such interest holder's share of all items which, if separately taken into account by such interest holder, would result in an income tax liability for the interest holder in such jurisdiction different from that which would result if the interest holder did not take the share of such items into account separately. A non-fiscally trans-

parent entity is an entity that is not fiscally transparent under this paragraph (a)(7).

(b) *Application of section 960.* For purposes of determining the amount of taxes deemed paid under section 960, the amount of non-subpart F income recharacterized as subpart F income under this section shall be treated as attributable to income in separate categories, as defined in §1.904–5(a)(1), in proportion to the ratio of non-subpart F income in each such category to the total amount of non-subpart F income of the controlled foreign corporation for the taxable year.

(c) *Effective dates*—(1) *In general.* This section shall be applicable for all amounts paid or accrued in taxable years commencing after [date that is 5 years after publication of the final regulations in the federal register], under hybrid arrangements, except as otherwise provided.

(2) *Permanent Relief*—(i) *In general.* This section shall not apply to any payments made under hybrid arrangements entered into before June 19, 1998. This exception shall be permanent so long as the arrangement is not substantially modified, within the meaning of paragraph (c)(2)(ii) of this section, on or after June 19, 1998.

(ii) *Substantial modification*—(A) *In general.* Substantial modification of a hybrid arrangement includes—

(*1*) The expansion of the hybrid arrangement (other than de minimis expansion);

(2) A more than 50% change in the U.S. ownership (direct or indirect) of any entity that is a party to the hybrid arrangement, other than—

(*i*) A transfer of ownership of such party within a controlled group determined under section 1563(a), without regard to section 1563(a)(4); or

(*ii*) A change in ownership of the entire controlled group (determined under section 1563(a), without regard to section 1563(a)(4)) of which such party is a member;

(*3*) Any measure taken by a party to the arrangement (or any related party) that materially increases the tax benefit of the hybrid arrangement, regardless of whether such measure alters the legal relationship between the parties to the arrangement. For example, in the case of a hybrid branch payment determined with reference to a percentage of sales, a growth in the amount of the hybrid branch payment (and, thus, the tax benefit) caused by a growth of sales will not, in general, be a substantial modification. However, in the case of a significant sales growth resulting from a transfer of assets by a related party, that transfer would be a measure which materially increased the benefit of the arrangement, and that arrangement would be deemed to have been substantially modified.

(B) *Transactions not treated as substantial modification.* Substantial modification of a hybrid arrangement does not include—

(*1*) The daily reissuance of a demand loan by operation of law;

(*2*) The renewal of a loan, license or rental agreement on the same terms and conditions if—

(*i*) The renewal occurs pursuant to the terms of the agreement and without more than a de minimis amount of action of any party thereto;

(*ii*) As contemplated by the original agreement, the same parties agree to renew the agreement without modification; or

(*iii*) The renewal occurs solely by reason of a subsequent drawdown under a grandfathered master credit facility agreement;

(*3*) The renewal of a loan, license, or rental agreement by the same parties on terms which do not increase the tax benefit of the arrangement (other than a de minimis increase);

(*4*) The making of payments under a license agreement in respect of copyrights or patents (or know-how associated with such copyrights or patents), not in existence at the time the agreement was entered into, but only where the development of such property was anticipated by the agreement, and such property is substantially derived from (or otherwise incorporates substantial features of) copyrights and patents (or know-how associated with such copyrights or patents) in existence at the time of, and covered under, the original agreement;

(*5*) A final transfer pricing adjustment made by the taxation authorities of the jurisdiction in which the tax reduction occurs, so long as such adjustment would not have been a substantial valuation misstatement (as defined in section 6662(e)(1)(B)) if the adjustment had been made by the Internal Revenue Service; or

(*6*) A *de minimis* periodic adjustment by the parties to the arrangement made annually (or more frequently) to conform the payments to the requirements of section 482.

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 9, 1999, 11:25 a.m., and published in the issue of the Federal Register for July 13, 1999, 64 F.R. 37727)

Deletion From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 99–72

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on (Date) 1999, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428 (c)(1). For individual contributors, the maximum deduction protected is $1,000, with a hus-

band and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Horizon Alliance, Inc.
San Diego, CA

Requirements Respecting the Adoption or Change of Accounting Method; Extensions of Time To Make Elections; Correction

Announcement 99–73

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final regulations (T.D. 8742, 1998–5 I.R.B. 4), which were published in the **Federal Register** on Wednesday, December 31, 1997 (62 F.R. 68167), providing the procedures for requesting an extension of time to make certain elections under the Internal Revenue Code.

DATES: This correction is effective December 31, 1997.

FOR FURTHER INFORMATION CONTACT: Cheryl Lynn Oseekey (202) 622-4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Sections 301.9100–2 and 301.9100–3 of the Procedure and Administration Regulations are the subject of these corrections. These regulations require information to be collected from taxpayers seeking to obtain from the Commissioner extensions of time to make certain elections.

Need for Correction

As published, final regulations (T.D. 8742) contain errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, 26 CFR part 602 is corrected by making the following correcting amendment:

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Paragraph 1. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. In §602.101, paragraph (b) is amended by removing the entry for §301.9100–1 from the table and adding entries for §§301.9100–2 and 301.9100–3 to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
301.9100–2	1545–1488
301.9100–3	1545–1488
* * * * *	

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on July 12, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 13, 1999, 64 F.R. 37678)

Arbitrage Restrictions on Tax-Exempt Bonds; Correction

Announcement 99–74

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to final regulations (T.D. 8476, 1993–2 C.B. 13) which were published in the **Federal Register** on Friday, June 18, 1993 (58 F.R. 33510), relating to the arbitrage and related restrictions applicable to tax-exempt bonds issued by States and local governments. DATES: This correction is effective December 30, 1998.

FOR FURTHER INFORMATION CONTACT: David White, (202) 622-3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 148 of the Internal Revenue Code.

Need for Correction

As published, the final regulations (T.D. 8476) contain errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendments:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.148–11 is amended by adding paragraphs (b)(4), (h) and (i) to read as follows:

§1.148–11 Effective dates.

* * * * *

(b) * * *

(4) *No elective retroactive application for safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.* The provisions of §§1.148–5(d)(6)(iii) (relating to the safe harbor for establishing fair market value of guaranteed investment contracts and yield restricted defeasance escrow investments) and 1.148–5(e)-(2)(iv) (relating to a special rule for yield restricted defeasance escrow investments) may not be applied to any bond sold before December 30, 1998.

* * * * *

(h) *Safe harbor for establishing fair market value for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow.* The provisions of §1.148–5(d)(6)(iii) are applicable to bonds sold on or after March 1, 1999. Issuers may apply these provisions to bonds sold on or after December 30, 1998, and before March 1, 1999.

(i) *Special rule for investments purchased for a yield restricted defeasance escrow.* The provisions of §1.148–5(e)-(2)(iv) are applicable to bonds sold on or after March 1, 1999. Issuers may apply these provisions to bonds sold on or after December 30, 1998, and before March 1, 1999.

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on July 8, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 9, 1999, 64 F.R. 37037)

Payment by Credit Card and Debit Card; Correction

Announcement 99–75

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains a correction to temporary regulations (T.D. 8793, 1999–7 I.R.B. 15) that were published in the **Federal Register** on Tuesday, December 15, 1998 (63 F.R. 68995) relating to the payment of taxes by credit card and debit card.

DATES: This correction is effective January 1, 1999.

FOR FURTHER INFORMATION CONTACT: Mitchel S. Hyman, (202) 622-3620 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are subject to this correction are under section 6311 of the Internal Revenue Code.

Need for correction

As published, the temporary regulations (T.D. 8793) contain an error that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR Part 301 is corrected by making the following correcting amendment:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6311–2T (c) (2) is amended by revising the first sentence to read as follows:

§301.6311–2T Payment by credit card and debit card (temporary).

* * * * *

(c) * * *

(2) Liability of financial institutions. If a taxpayer has tendered a payment of internal revenue taxes by credit card or debit card, and the credit card or debit card transaction has been guaranteed expressly by a financial institution, and the United States is not duly paid, the United States shall have a lien for the guaranteed amount of the transaction upon all the assets of the institution making such guarantee. * * *

* * * * *

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on July 6, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 7, 1999, 64 F.R. 36569)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Changes

The adjusted applicable federal long-term rate is set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for August 1999.

Rev. Rul. 99–32

This revenue ruling provides various prescribed rates for federal income tax purposes for August (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 99–32 TABLE 1

Applicable Federal Rates (AFR) for August 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	5.43%	5.36%	5.32%	5.30%
110% AFR	5.99%	5.90%	5.86%	5.83%
120% AFR	6.53%	6.43%	6.38%	6.35%
130% AFR	7.09%	6.97%	6.91%	6.87%
Mid-Term				
AFR	5.96%	5.87%	5.83%	5.80%
110% AFR	6.56%	6.46%	6.41%	6.37%
120% AFR	7.16%	7.04%	6.98%	6.94%
130% AFR	7.78%	7.63%	7.56%	7.51%
150% AFR	9.00%	8.81%	8.72%	8.65%
175% AFR	10.53%	10.27%	10.14%	10.06%
Long-Term				
AFR	6.23%	6.14%	6.09%	6.06%
110% AFR	6.86%	6.75%	6.69%	6.66%
120% AFR	7.51%	7.37%	7.30%	7.26%
130% AFR	8.14%	7.98%	7.90%	7.85%

REV. RUL. 99–32 TABLE 2

Adjusted AFR for August 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.69%	3.66%	3.64%	3.63%
Mid-term adjusted AFR	4.47%	4.42%	4.40%	4.38%
Long-term adjusted AFR	5.18%	5.11%	5.08%	5.06%

REV. RUL. 99–32 TABLE 3

Rates Under Section 382 for August 1999

Adjusted federal long-term rate for the current month	5.18%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.18%

REV. RUL. 99–32 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for August 1999

Appropriate percentage for the 70% present value low-income housing credit	8.43%
Appropriate percentage for the 30% present value low-income housing credit	3.61%

REV. RUL. 99–32 TABLE 5

Rate Under Section 7520 for August 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, page 135.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, page 135.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 1999. See Rev. Rul. 99–32, page 135.

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 99–38

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for June 1999 is 6.04 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
July	1999	6.03	5.42 to 6.33	5.42 to 6.63

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number).

Rev. Proc. 99–29

Use this revenue procedure to prepare Tax Year *1999* and prior year information returns for submission to Internal Revenue Service (IRS) using any of the following:

- Magnetic Tape
- Tape Cartridge
- 8mm, 4mm, and Quarter Inch Cartridges
- 3½-Inch Diskette
- Electronic Filing

Caution to filers:

To be in compliance with Year 2000 changes, the bisynchronous electronic filing communications package and the 5¼-inch diskette filing have been discontinued.

Please read this publication carefully. Persons or businesses required to file information returns magnetically or electronically may be subject to penalties for failure to file or include correct information if they do not follow the instructions in this revenue procedure.

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Part A. General

Revenue procedures are generally revised annually to reflect legislative and form changes. Comments concerning this revenue procedure, or suggestions for making it more helpful, can be addressed to:

Internal Revenue Service
Martinsburg Computing Center
Attn: IRB, Information Support Section
230 Murall Drive
Kearneysville, WV 25430

Sec. 1. Purpose

.01 The purpose of this revenue procedure is to provide the specifications for filing Forms 1098, 1099, 5498, and W-2G magnetically or electronically, which includes ½-inch magnetic tape; IBM 3480, 3490 or AS400 compatible tape cartridges (including 8mm); or 3½-inch diskette with IRS. ***IRS/MCC has discontinued processing 8-inch, 5¼-inch diskette, and the mainframe electronic filing system. The previously used BBS (Bulletin Board System) has also been replaced.*** This revenue procedure must be used for the preparation of Tax Year 1999 information returns and information returns for tax years prior to 1999 that are required to be filed. This revenue procedure must be used to prepare current and prior year information returns ***filed beginning January 1, 2000 and received by IRS/MCC or postmarked by December 15, 2000.*** Specifications for filing the following forms are contained in this revenue procedure.

(a) Form 1098, Mortgage Interest Statement.
(b) Form 1098-E, Student Loan Interest Statement
(c) Form 1098-T, Tuition Payments Statement
(d) Form 1099-A, Acquisition or Abandonment of Secured Property
(e) Form 1099-B, Proceeds From Broker and Barter Exchange Transactions
(f) Form 1099-C, Cancellation of Debt
(g) Form 1099-DIV, Dividends and Distributions
(h) Form 1099-G, Certain Government and *Qualified State Tuition Program Payments*
(i) Form 1099-INT, Interest Income
(j) Form 1099-LTC, Long-Term Care and Accelerated Death Benefits
(k) Form 1099-MISC, Miscellaneous Income
(l) Form 1099-MSA, Distributions From an MSA *or Medicare+ Choice MSA*
(m) Form 1099-OID, Original Issue Discount
(n) Form 1099-PATR, Taxable Distributions Received From Cooperatives
(o) Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
(p) Form 1099-S, Proceeds From Real Estate Transactions
(q) Form 5498, IRA Contribution Information

(r) Form 5498-MSA *or Medicare+ Choice MSA* Information

(s) Form W-2G, Certain Gambling Winnings

.02 Specifications for filing Forms W-2 on magnetic media are available from the Social Security Administration (SSA) **only.** Filers can call *(1-800-SSA-6270)* to obtain the phone number of the SSA Magnetic Media Coordinator for their area.

.03 IRS/MCC does **not** process Forms W-2. Paper **and/or** magnetic media for Forms W-2 must be sent to SSA. IRS/MCC does, however, process waiver requests (Form 8508), extension of time to file requests (Form 8809) for Forms W-2 and requests for an extension of time to provide the employee copies of Forms W-2.

.04 Generally, the box numbers on the paper forms correspond with the amount codes used to file magnetically/electronically; however, if discrepancies occur, the instructions in this revenue procedure govern.

.05 This revenue procedure also provides the requirements and specifications for magnetic media or electronic filing under the Combined Federal/State Filing Program.

.06 The following revenue procedures and publications provide more detailed filing procedures for certain other information returns.

(a) *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G" provides specific instructions on completing and submitting information returns to IRS.

(b) Publication 1179, Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 5498, and W-2G.

(c) Publication 1239, Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically

(d) Publication 1187, Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Magnetically or Electronically

(e) Publication 1245, Specifications for Filing Form W-4, Employee's Withholding Allowance Certificate, Magnetically or Electronically.

.07 This revenue procedure supersedes Rev. Proc. 98–35 published as Publication 1220 (Rev. *5-98*) Specifications for Filing Forms 1098, 1099, 5498, and W-2G Magnetically or Electronically.

.08 Refer to Part A, Sec. 17, for definitions of terms used in this publication.

Sec. 2. Nature of Changes—Current Year (Tax Year *1999*)

.01 In this publication, all pertinent changes for Tax year *1999* are emphasized by the use of *italics.* Portions of text which require special attention have been **bolded.** Filers are always encouraged to read the publication in its entirety.

.02 Programming Changes

a. Global Changes Affecting All Records

(1) For all forms - In all date fields that have a one-digit month (January through September) and a one-digit day (1 through 9), the number must be preceded by a zero. The date fields, in all cases, are numeric; therefore, blanks, alphas, or special characters are not acceptable. Example: January 2, 1999 (19990102). The four-digit year must precede the month and the day to be Y2K compliant.

(2) The following types of media are no longer accepted by IRS/MCC:

(a) 5¼-inch diskettes

(b) 3½-inch diskettes created on a non-MS-DOS system

(c) 3½-inch diskettes created on a System 36 or AS400

(3) All references in text to 5¼-inch diskettes and instructions applicable to 5¼-inch diskettes have been deleted.

(4) Part C (previously Bisynchronous - Mainframe Electronic Filing Specifications) has been changed to Electronic Filing Specifications.

(a) The new phone number for electronic filing is *(1-304-262-2400).*

(5) Part D (previously Asynchronous - IRP-BBS) has been changed to Magnetic/Electronic Specifications For Extensions of Time.

(6) In Part D, Sec. 3. Record Layout - Field Position 186; Code 6 has been added for Form 5498-MSA.

(7) Electronic test files only may be submitted beginning November 1, 1999, and as late as January 31, 2000.

(8) The due date of information returns filed **electronically** has been changed to March 31, 2000. This change **does not** apply to the Forms 5498 or 5498-MSA nor to magnetic media filing.

(9) Filers who submitted information returns via the Information Reporting Program-Bulletin Board System or Mainframe may submit data via the new electronic filing system. See Part C for filing instructions and specifications.

(10) The following QIC (Quarter-Inch Cartridge) sizes have been deleted from Part B, Section 4:

Size	Tracks	Density	Capacity
QIC-11	4/5	4 (8000BPI)	22Mb or 30Mb
QIC-320	26	17 (16000 BPI)	320Mb
QIC-1350	30	18 (51667 BPI)	1.3Gb

(11) The telephone number for filing Form W-2 information magnetically with the Social Security Administration has changed to *1-800-SSA-6270.*

b. Programming Changes - Transmitter "T" Record

(1) For all forms, Payment Year, Field positions 2-5, must be incremented to reflect the 4 digit report year (1998 to 1999), unless reporting prior year data.

(2) Field positions 296-303, Total Number of Payees, is no longer a required field.

c. Programming Changes – Payer "A" Record

(1) For all forms, Payment Year, Field Positions 2-5, must be incremented to reflect the 4 digit year (1998 to 1999), unless reporting prior year data.

(2) **Form 1098** - Mortgage Interest Statement, Field Positions 28-39: Amount Code 4 has been added for the use by the interest recipient to provide other information, such as real estate taxes or insurance paid from escrow.

(3) **Form 1098-T** - Tuition Payments Statement, Field Positions 28-39: For Tax Year 1999, payers are only required to report entity information (TIN, name, address and the appropriate student indicators).

(4) **Form 1099-G** - Certain Government and Qualified State Tuition Program Payments, Field Positions 28-39: Amount Code 5 has been added for Qualified state tuition program earnings.

(5) **Form 1099-INT** - Interest Income, Field Positions 28-39: Amount Code 5 has been renamed to represent Investment expenses and Foreign tax paid is now Amount Code 6.

(6) **Form 1099-MSA** - Distributions From an MSA or Medicare+Choice MSA, Field Positions 28-39: Amount Code 4 was added for Fair market value of the account at date of death.

(7) **Form 1099-OID** - Original Issue Discount, Field Positions 28-39: Two new amount codes were added:

Amount Code 6 - Original issue discount on U.S. Treasury obligations

Amount Code 7 - Investment expenses

(8) For all information returns - Field Positions 48, 49, and 50: a note has been added to instruct filers to select only one indicator for each Payer "A" Record. Corrections and originals may be submitted on the same media, however, they must be filed under separate "A" Records.

(9) For Tax Year 1999, Form 1098-E, Student Loan Interest Statement and Form 1098-T, Tuition Payments Statement, may be reported on paper regardless of the 250 return threshold.

d. Programming Changes — Payee "B" Record

(1) For all forms, Payment Year, Field Positions 2-5 must be incremented to reflect the 4-digit reporting year (1998 to 1999), unless reporting prior year data.

(2) **Form 1099-MSA** - Distributions From an MSA or Medicare+Choice MSA:

a) Field Position 545, Distribution Code - Code 6, Death distribution after year of death to a nonspouse beneficiary, has been added.

b) Field Position 547 - A new Medicare+Choice Indicator has been added to specifically identify this type of distribution.

(3) **Form 1099-R** – Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. - Field positions 545-546 - The following codes have been **deleted**:

a) Code B – May be eligible for death benefit exclusion

b) Code C – May be eligible for both A and B

c) Code K – Distribution from a 1998 Roth conversion IRA in first 5 years.

The following code has been **added:**

a) Code R – Recharacterized IRA contribution.

The following code has be **changed:**

a) Code J – Distribution from a Roth IRA.

(4) **Form 5498** – Field Position 551 has been changed to Recharacterization indicator.

(5) **Form 5498-MSA** – Field Positions 544-750 have been created to accommodate changes to the form.

3. Editorial Changes — General

(a) Files containing information returns on magnetic media; Form 4804, Transmittal of Information Returns reported Magnetically/Electronically; Form 4419, Application for Filing Information Returns Magnetically/Electronically, and any correspondence regarding information returns (i.e. suggestions, name and/or address changes) must be sent to the following address:

Internal Revenue Service
Martinsburg Computing Center
Attn: Information Returns Branch
230 Murall Drive
Kearneysville, WV 25430

(b) Magnetically filed requests for extension of time to file as well as Form 8809, Request for Extension of Time To File Information Returns, and Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media, must be sent to the following address:

Internal Revenue Service
Martinsburg Computing Center
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

(c) Only tests submitted electronically may be submitted and/or resubmitted through January 31, 2000.

(d) In Part A, Sec. 5.14, reference to *Operation Allied Force (Yugoslavia)* has been added.

(e) In Part A, Sec. 8.04, the statement instructing filers submitting hard copy prints for tests has been deleted. Hard copy print tests are no longer acceptable.

(f) Information has been added to Part A, Sec. 10.01, regarding filing methods and applicable due dates.

(g) The following note has been added to Part A, Sec. 10.01, supporting the changed due date for electronic filing:

As a result of recent legislation, electronically filed Forms 1099, 1098 or W-2G are due to the IRS by March 31, 2000. The due date for magnetically filed Forms 1099, 1098 and W-2G remains unchanged (February 28, 2000).

(h) Due to security regulations at IRS/MCC, a note has been added to Part A, Sec. 10.05 alerting filers to the hours of delivery for PDSs.

(i) Part A, Sec. 11.02 – A footnote was added in reference to Internal Revenue Code Section 6071(b) which eliminates the necessity for electronic filers of information returns to request an extension of the filing date from February 28, 2000, to March 31, 2000, effective for returns required to be filed after December 31, 1999.

(j) Part A, Sec. 11.10 – Additional information has been added to the note referencing the extension of time to file electronically.

(k) In Part A, Sec. 12.05 – A note of clarification has been added to the term correction.

(l) Form 1099-G – The title of the form has been changed to Certain Government and Qualified State Tuition Program Payments.

(m) Form 1099-MSA – The title of the form has been changed to Distributions From an MSA or Medicare+Choice MSA.

(n) Form 5498-MSA – The title of the form has been changed to MSA or Medicatre + Choice MSA Information.

(o) In Part A, Sec. 17, Definition of Terms – The term bisynchronous and the related definition has been deleted.

(p) In Part A, Sec. 17, Definition of Terms – The term ISDN (Integrated Services Digital Network) and related definition has been added.

(q) In Part A, Sec. 17, Definition of Terms – A note has been added under the definition of Payer to identify the eligible educational institution that received the qualified tuition and related expenses in 1999 as the payer.

(r) In Part B, Sec. 4.07.(d), clarification has been added in describing the typical capacity of DDS.

Sec. 3. Where To File and How to Contact the IRS, Martinsburg Computing Center

.01 All information returns filed magnetically or electronically are processed at IRS/MCC. Files containing information returns and requests for IRS magnetic media and electronic filing information should be sent to the following address:

If by Postal Service, truck or air freight:
IRS-Martinsburg Computing Center
Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

.02 Send a magnetically filed extension of time request, undue hardship waivers, and requests for extensions of time to file returns or to furnish the statements to recipients to the following address:

If by Postal Service, truck or air freight:
IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

.03 Telephone inquiries for the Information Reporting Program Call Site may be made between 8:30 a.m. and 4:30 p.m. Eastern time, Monday through Friday.

.04 The telephone numbers for magnetic media inquiries or electronic submissions are:

304-263-8700 – Call Site – Part A, Sec 3.10

304-267-3367 – TDD
(Telecommunication Device for the Deaf)

304-264-5602 – Fax Machine

Electronic Filing

304-262-2400

**********(These are not toll-free telephone numbers.)**********

TO OBTAIN FORMS:

1-800-TAX-FORM (1-800-829-3676)

www.irs.ustreas.gov – INTERNET access to forms (*See Note.*)

☛ **Caution to filers:** ***Because the IRS processes paper forms by machine (optical character recognition equipment), you cannot file the IRS Form 1096 or Copy A of Forms 1098, 1099, 5498, or W-2G printed from the IRS Internet Web Site or the CD-ROM.***

.05 The *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G" have been included in the Publication 1220 for your convenience. The Form 1096 is used only to transmit Copy A of **paper** Forms 1099, 1098, 5498, and W-2G. If filing paper returns, follow the mailing instructions on the Form 1096 and submit the paper returns to the appropriate IRS Service Center.

.06 Requests for paper Forms 1096, 1098, 1099, 5498, and W-2G, and publications related to magnetic media/electronic filing should be made by calling the IRS toll-free number **1-800-TAX-FORM (1-800-829-3676) or by using the IRS Web Site at www.irs.ustreas.gov.**

.07 Questions pertaining to magnetic media filing of Forms W-2 **must** be directed to the Social Security Administration (SSA). Filers can call *1-800-SSA-6270* to obtain the phone number of the SSA Magnetic Media Coordinator for their area.

.08 Payers **should not** contact IRS/MCC if they have received a penalty notice and need additional information or are requesting an abatement of the penalty. A penalty notice contains an IRS representative's name and/or phone number for contact purposes; or, the payer may be instructed to respond in writing to the address provided. IRS/MCC does **not** issue penalty notices and does **not** have the authority to abate penalties. For penalty information, refer to the Penalty section of the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G."

.09 A taxpayer or authorized representative may request a copy of a tax return, including Form W-2 filed with a return, by submitting Form 4506, Request for Copy or Transcript of Tax Form, to IRS. This form may be obtained by calling **1-800-TAX-FORM (1-800-829-3676).**

.10 The IRS Centralized Call Site answers both magnetic media and tax law questions relating to the filing of information returns (Forms 1096, 1098, 1099, 5498, 8027, W-2G, 1042-S, and W-4). The Call Site also answers tax law and paper filing related questions about Forms W-2 and W-3, as well as handling inquiries dealing with backup withholding due to missing and incorrect taxpayer identification numbers. The Call Site is located at IRS/MCC and operates in conjunction with the Information Reporting Program. The Call Site provides service to the payer community (financial institutions, employers, and other transmitters of information returns). Recipients of information returns (payees) should continue to contact 1-800-829-1040 or other numbers specified in the tax return instructions with any questions on how to report information on their tax returns.

The Call Site accepts calls from all areas of the country. The number to call is **304-263-8700** or Telecommunications Device for the Deaf **(TDD) 304-267-3367.** These are toll calls. Hours of operation for the Call Site are Monday through Friday, 8:30 a.m. to 4:30 p.m. Eastern Time. The Call Site is in operation throughout the year to handle the questions of payers, transmitters, and employers. Due to the high demand for assistance at the end of January and February, it is advisable to call as soon as possible to avoid these peak filing seasons.

Sec. 4. Filing Requirements

.01 The regulations under section 6011(e)(2)(A) of the Internal Revenue Code provide that, any person, including a corporation, partnership, individual, estate, and trust, who is required to file 250 or more information returns must file such returns magnetically/electronically. **The 250* or more requirement applies separately for each type of return and separately to each type of corrected return.**

***Even though as many as 249 information returns may be submitted on paper to the Internal Revenue Service, IRS encourages filers to transmit information returns magnetically or electronically.**

.02 All filing requirements that follow apply individually to each reporting entity as defined by its separate Taxpayer Identification Number (TIN) [Social Security Number (SSN), Employer Identification Number (EIN), or Individual Taxpayer Identification

Number (ITIN)]. For example, if a corporation with several branches or locations uses the same EIN, the corporation must aggregate the total volume of returns to be filed for that EIN and apply the filing requirements to each type of return accordingly.

.03 Payers who are required to submit their information returns on magnetic media may choose to submit their documents by electronic filing. *Payers who submit their information returns electronically by March 31, 2000, are considered to have satisfied the magnetic media filing requirements.*

***.04** IRS/MCC has one method by which payers may submit their files electronically, which is included in Part C.*

.05 The following requirements apply separately to both originals and corrections filed magnetically/electronically:

1098 1098-E* 1098-T* 1099-A 1099-B 1099-C 1099-DIV 1099-G 1099-INT 1099-LTC 1099-MISC 1099-MSA 1099-OID 1099-PATR 1099-R 1099-S 5498 5498-MSA W-2G	**250 or more of any** of these forms require magnetic media or electronic filing with IRS. These are stand alone documents and are not to be aggregated for purposes of determining the 250 threshold. For example, if you must file 100 Forms 1099-B and 300 Forms 1099-INT, Forms 1099-B need not be filed magnetically or electronically since they do not meet the threshold of 250. However, Forms 1099-INT must be filed magnetically or electronically since they meet the threshold of 250.

*For Tax Year *1999*, Forms 1098-E and 1098-T may be reported on paper regardless of the 250 threshold.

.06 The above requirements do not apply if the payer establishes hardship (see Part A, Sec. 5).

Sec. 5. Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media

.01 If a payer is required to file on magnetic media but fails to do so (or fails to file electronically in lieu of magnetic media filing) and does not have an approved waiver on record, the payer will be subject to a penalty of $50 per return in excess of 250. (For penalty information, refer to the Penalty section of the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G.")

.02 If payers are required to file original or corrected returns on magnetic media, but such filing would create a hardship, they may request a waiver from these filing requirements by submitting Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media, to IRS/MCC.

.03 Even though a payer may submit as many as 249 corrections on paper, IRS encourages magnetically or electronically submitted corrections. Once the 250 threshold has been met, filers are required to submit any returns of 250 or more magnetically or electronically. However, if a waiver for original documents is approved, any corrections for the same type of returns will be covered under this waiver.

.04 Generally, only the payer may sign the Form 8508. A transmitter may sign if given power of attorney; however, a letter signed by the payer stating this fact must be attached to the Form 8508.

.05 A transmitter must submit a separate Form 8508 for each payer. Do not submit a list of payers.

.06 All information requested on the Form 8508 must be provided to IRS for the request to be processed.

.07 The waiver, if approved, will provide exemption from magnetic media filing for the current tax year only. Payers may not apply for a waiver for more than one tax year at a time; application must be made each year a waiver is necessary.

.08 Form 8508 may be photocopied or computer-generated as long as it contains all the information requested on the original form.

.09 Filers are encouraged to submit Form 8508 to IRS/MCC at least 45 days before the due date of the returns.

.10 File Form 8508 for the W-2 series of forms with IRS/MCC, not SSA.

.11 Waivers are evaluated on a case-by-case basis and are approved or denied based on criteria set forth in the regulations under section 6011(e) of the Internal Revenue Code. The transmitter must allow a minimum of 30 days for IRS/MCC to respond to a waiver request.

.12 If a waiver request is approved, the transmitter should keep the approval letter on file. **The transmitter should not send a copy of the approved waiver to the service center where the paper returns are filed.**

.13 An approved waiver from filing information returns on magnetic media does not provide exemption from all filing. The payer must timely file information returns on acceptable paper forms with the appropriate service center.

.14 Desert Storm/Operation Joint Guard (OJG), *Operation Allied Force (Yugoslavia)*, (Bosnia Region) Contributions [See Note] - If a payer is required to file a Form 5498 magnetically/electronically, the payer may request an **automatic** waiver to file Forms 5498 on paper for participants of Desert Storm or Operation Joint Guard/*Operation Allied Force (Yugoslavia).* The payer should clearly mark Desert Storm, Operation Joint Guard or *Operation Allied Force (Yugoslavia)* on the waiver request form.

☛ **Note: Military personnel under Operation Joint Guard (OJG) will be treated the same as military personnel under Operation Joint Endeavor (OJE) for purposes of Pub. L. 104-117 and Notice 96-34, 1996-1 C.B. 379. For more information on the reporting for *Operation Allied Force (Yugoslavia) see Pub. L. 106-21, 04/19/1999 and Notice 99-30.***

Sec. 6. Vendor List

.01 IRS/MCC prepares a list of vendors who support magnetic media or electronic filing. The Vendor List (Pub. 1582) contains the names of service bureaus that will produce files on the prescribed types of magnetic media or via electronic filing. It also contains the names of vendors who provide software packages for payers who wish to produce magnetic media or electronic files on their own computer systems. This list is compiled as a courtesy and in no way implies IRS/MCC approval or endorsement.

.02 If filers meeting the filing requirements engage a service bureau to prepare media on their behalf, the filers should be careful not to report duplicate data, which may cause penalty notices to be generated.

.03 The Vendor List may be updated in print every other year. The most recently printed copy will be available by contacting IRS/MCC at (304) 263-8700 or by way of a letter (see Part A, Sec. 3).

.04 A vendor, who offers a software package, has the ability to produce magnetic media for customers, or has the capability to electronically file information returns, and would like to be included on the list, must submit a written request to IRS/MCC. The request should include:

(a) Company name
(b) Address (include city, state, and ZIP code)
(c) Telephone number (include area code)
(d) Contact person
(e) Type(s) of service provided (e.g., service bureau and/or software)
(f) Type(s) of media offered (e.g., magnetic tape, tape cartridge, 3½-inch diskettes, or electronic filing)
(g) Type of return

Sec. 7. Form 4419, Application for Filing Information Returns Magnetically/Electronically

.01 Transmitters are required to submit Form 4419, Application for Filing Information Returns Magnetically/Electronically, to request authorization to file information returns with IRS/MCC. A single Form 4419 should be filed no matter how many types of returns the transmitter will be submitting magnetically/electronically. For example, if a transmitter plans to file Forms 1099-INT, one Form 4419 should be submitted. If, at a later date, another type of form (Forms 1098, 1099, 5498 and W-2G) is to be filed, the transmitter does not need to submit a new Form 4419.

EXCEPTIONS

An additional Form 4419 is required for filing each of the following types of returns: Forms 1042-S, 8027, and W-4.

FORM	TITLE	EXPLANATION
1042-S	Foreign Persons U.S. Source Income Subject to Withholding	Payments subject to withholding under Chapter 3 of the Code, including interest, dividends, royalties, pensions and annuities, gambling winnings and compensation for personal services.
8027	Employer's Annual Information Return of Tip Income and Allocated Tips	Receipts from operations where tipping is customary. Used by the employer to report employee's tips or allocated tips.
W-4 (See **Note**)	Employee's Withholding Allowance Certificate	Forms received during the quarter from employees still employed at the end of the quarter who claim the following:

(a) More than 10 withholding allowances
or
(b) Exempt status and wages normally would be more than $200 a week.

☛ **Note: Employers are not required to send other Forms W-4 unless notified to do so by the IRS.**

.02 Magnetic tape, tape cartridge, diskette, and electronically-filed returns may not be submitted to IRS/MCC until the application has been approved. Please read the instructions on the back of Form 4419 carefully. A Form 4419 is included in the Publication 1220 for the filer's use. This form may be photocopied. Additional forms may be obtained by calling **1-800-TAX-FORM (1-800-829-3676).** The form is also available on the **IRS Internet Web Site at www.irs.ustreas.gov.**

.03 Upon approval, a five-character alpha/numeric Transmitter Control Code (TCC) will be assigned and included in an approval letter. The TCC **must** be coded in the Transmitter "T" Record. If a transmitter uses more than one TCC to file, each TCC must be reported on separate media or in separate transmissions if filing electronically.

.04 Annually, a Publication 1220 containing the current revenue procedure, forms, and instructions will be sent to the attention of the contact person indicated on Form 4419.

.05 If **any** of the information (name, TIN or address) on the Form 4419 changes, please notify IRS/MCC in writing so the IRS/MCC database can be updated. However, a change in the method by which information returns are being submitted is not information which needs to be updated (i.e., tape to disk). The transmitter should include the TCC in all correspondence.

.06 Form 4419 may be submitted anytime during the year; however, it **must** be submitted to IRS/MCC at least 30 days before the due date of the return(s) for current year processing. This will allow IRS/MCC the minimum amount of time necessary to process and respond to applications. In the event that computer equipment or software is not compatible with IRS/MCC, a waiver may be requested to file returns on paper documents.

.07 IRS/MCC encourages transmitters who file for multiple payers to submit one application and to use the assigned TCC for all payers.

.08 If a payer's files are prepared by a service bureau, the payer may not need to submit an application to obtain a TCC. Some service bureaus will produce files, code their own TCC on the media, and send it to IRS/MCC for the payer. Other service bureaus will prepare magnetic media and return the media to the payer for submission to IRS/MCC. These service bureaus may require the payer to obtain a TCC to be coded in the Transmitter "T" Record. Payers should contact their service bureaus for further information.

.09 Once a transmitter is approved to file magnetically or electronically, it is not necessary to reapply each year **unless:**

(a) The payer has discontinued filing magnetically or electronically for two years; the payer's TCC may have been reassigned by IRS/MCC. Payers who are aware the TCC assigned will no longer be used are requested to notify IRS/MCC so these numbers may be reassigned; **or**

(b) The payer's magnetic media files were transmitted in the past by a service bureau using the service bureau's TCC, but now the payer has computer equipment compatible with that of IRS/MCC and wishes to prepare his or her own files. The payer must request a TCC by filing Form 4419.

.10 One Form 4419 may be submitted regardless of how many types of media or methods are used to file the return. **Multiple TCCs will only be issued to payers with multiple TINs. Only one TCC will be issued per TIN unless the filer has checked the application for the following forms in addition to the Forms 1098, 1099, 5498 or W-2G; Forms 1042-S, 8027, and/or W-4. A separate TCC will be assigned for each of these forms.**

.11 In accordance with Regulations section 1.6041–7(b), payments by separate departments of a health care carrier to providers of medical and health care services may be reported on separate returns on magnetic media. In this case, the headquarters will be considered the transmitter, and the individual departments of the company filing reports will be considered payers. A single Form 4419 covering all departments filing on magnetic media should be submitted. One TCC may be used for all departments.

.12 Approval to file does not imply endorsement by IRS/MCC of any computer software or of the quality of tax preparation services provided by a service bureau or software vendor.

Sec. 8. Test Files

.01 IRS/MCC does not require test files, **except** for filers wishing to participate in the Combined Federal/State Filing Program (See Part A, Sec. 16, for further information concerning the Combined Federal/State Filing Program).

.02 IRS/MCC encourages first-time magnetic media or electronic filers to submit a test. The test file must consist of a sample of each type of record:

(a) Transmitter "T" Record (all fields marked required must include transmitter information)

(b) Payer "A" Record (must not be fictitious data)

(c) Multiple Payee "B" Records **(at least 11 "B" Records per each "A" Record)**

(d) End of Payer "C" Record

(e) State Totals "K" Record, if participating in the Combined Federal/State Filing Program

(f) End of Transmission "F" Record (See Part B for record formats.)

.03 Use the Test Indicator "T" in Field Position 28 of the "T" Record to show this is a test file.

.04 IRS/MCC will check the file to ensure it meets the specifications of this revenue procedure. For current filers, sending a test file will provide the opportunity to ensure their software reflects any programming changes.

.05 Tests should be sent to IRS/MCC between November 1 and December 15. **Tests submitted on magnetic media must be received at MCC by December 15 in order to be processed.** Magnetic media filers may begin submitting test tapes and diskettes after October 1; however, the data will not be processed until on or after November 1.

Only tests submitted electronically may be submitted and resubmitted through January 31, 2000.

.06 For tests filed electronically, the transmitter must send or *fax* the signed Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically, the same day the transmission is made. Electronic tests may be submitted November 1, *1999*, through *January 31, 2000.* For tests filed on magnetic tape, tape cartridge, 8mm, 4mm, and quarter inch cartridge, and 3½-inch diskette, the transmitter must include the signed Form 4804 in the same package with the corresponding magnetic media. Mark the "TEST" box in Block 1 on the form. Also, mark "TEST" on the external media label.

.07 IRS/MCC will send a letter of acknowledgment to indicate the test results for magnetic media only. Unacceptable magnetic media files, along with documentation identifying the errors, will be returned. Resubmission of magnetic media test files must be received by IRS/MCC no later than December 15.

.08 Successfully processed media will not be returned to filers.

Sec. 9. Filing of Information Returns Magnetically/Electronically and Retention Requirements

.01 Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically, Form 4802, Transmittal of Information Returns Reported Magnetically/Electronically (Continuation), or a computer-generated substitute, must accompany **all** magnetic media shipments. For electronic transmissions, the Form 4804 and Form 4802, if applicable, must be sent or *faxed* the same day as the electronic transmission. Form 4802, is a continuation of Form 4804 and should only be used if the filer is reporting more than five types of returns and/or more than five payers. Form 4802 is not a stand-alone form; it can only accompany Form 4804.

.02 IRS/MCC allows for the use of computer-generated substitutes for Form 4804/4802. The substitutes must contain all information requested on the original forms including the affidavit and signature line. Photocopies are acceptable original signatures. **When using computer-generated forms, be sure to mark very clearly which tax year is being reported. This will eliminate a phone communication from IRS/MCC to question the tax year.**

.03 A transmitter may report for any combination of payers and/or documents in a submission. Each file must begin with a "T" Record and end with an "F" record for the end of a transmission. For example, if reporting Forms 1099-INT for Bank A, Forms 1099-DIV for Bank B, and Forms 1098 for Bank C, three separate tapes or diskettes need not be created. All three banks and all types of documents can be coded within a file on one tape or diskette as long as each bank or type of return has a separate "A" Record. Multiple tapes or diskettes can be sent in one package. For each separate type of media, the first record on the file must be the Transmitter "T" Record. **A Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically, must be submitted for every Transmitter "T" Record. Filers must include Form 4804, 4802, or computer-generated substitute with their shipment.**

.04 Multiple types of media may be submitted in a shipment. However, submit a separate Form 4804 for each type of media.

.05 Current and prior year data may be submitted in the same shipment; however, each tax year must be on separate media, and a separate Form 4804 must be prepared to clearly indicate each tax year.

.06 Filers who have prepared their information returns in advance of the due date are encouraged to submit this information to IRS/MCC no earlier than January 1 of the year the return is due.

.07 Do not report duplicate information. If a filer submits returns magnetically/electronically, identical paper documents must not be filed. This may result in erroneous penalty notices.

.08 Form 4804 may be signed by the payer or the transmitter, service bureau, paying agent, or disbursing agent (all hereafter referred to as agent), on behalf of the payer. **Failure to sign the affidavit on Form 4804 may delay processing or could result in the files being returned unprocessed.** An agent may sign the Form 4804 if the agent has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under state law and adds the caption "FOR: (name of payer)."

.09 Although an authorized agent may sign the affidavit, the payer is responsible for the accuracy of the Form 4804 and the returns filed. The payer will be liable for penalties for failure to comply with filing requirements.

.10 A self-adhesive external media label, created by the filer, must be affixed to each piece of magnetic media. (IRS no longer provides self-adhesive labels for this purpose.) For instructions on how to prepare an external media label, refer to Notice 210 in the forms section of this publication. *If diskettes are used, be certain that only MS-DOS compatible operating systems were used to prepare the diskettes. Non-MS-DOS diskettes are no longer acceptable at IRS-MCC.*

.11 On the outside of the shipping container, affix or attach a label which reads **"IRB Box ___of___"** reflecting the number of containers in the shipment. (Filers can create a label with this information or cut out one of the labels on the special label page provided in this publication.) If there is only one container, mark the outside as Box 1 of 1. For multiple containers, include the sequence for example, Box 1 of 3, 2 of 3, 3 of 3).

.12 When submitting files include the following:

(a) A **signed** Form 4804;

(b) Form 4802, if applicable;

(c) External media label (created by filer) affixed to magnetic media;

(d) IRB Box _____ of _____ outside label.

☛ **Note: See Part C for Electronic Submission Requirements.**

.13 Do not use special shipping containers for transmitting data to IRS/MCC. Shipping containers will not be returned.

.14 If returns from different locations (using the same name and TIN) are submitted on the same file, IRS encourages the filer to consolidate each type of information return under one "A" Record. For example, all "B" Records for the same type of return should be together under one "A" Record and followed by the End of Payer "C" Record.

.15 IRS/MCC will not pay for or accept "Cash-on-Delivery" or "Charge to IRS" shipments of tax information that an individual or organization is legally required to submit.

.16 Payers should retain a copy of the information returns filed with IRS or have the ability to reconstruct the data for at least 3 years from the reporting due date, with the exception of Form 1099-C. A financial entity must retain a copy of Form 1099-C, Cancellation of Debt, or have the ability to reconstruct the data required to be included on the return, for at least 4 years from the date such return is required to be filed. Whenever backup withholding is imposed, a 4 year retention is required.

Sec. 10. Due Dates

.01 The due dates for filing paper returns with IRS also apply to magnetic media. Filing of information returns is on a calendar year basis, except for Forms 5498 and 5498-MSA, which are used to report amounts contributed during or after the calendar year (but not later than April 15). The following due dates will apply to Tax Year *1999:*

Due Dates

Electronic Filing (See Note)	**Magnetic Filing**
Forms 1098, 1099, and W-2G	Forms 1098, 1099, and W-2G
Recipient Copy - January 31, 2000	Recipient Copy - January 31, 2000
IRS Copy - - - - - - *March 31, 2000*	IRS Copy - - - - - - February 28, 2000

☛ *Note: As a result of the Restructuring and Reform Act of 1998, the electronically filed Forms 1099, 1098, or W-2G are due to the IRS by March 31, 2000. The due date for magnetically filed Forms 1099, 1098, and W-2G remains unchanged (February 28, 2000).*

Legislation amended Internal Revenue Code section 6071(b), which eliminates the necessity for electronic filers of Forms 1099, 1098, and W-2G to request an extension of the filing date from February 28 to March 31, effective for returns required to be filed after December 31, 1999.

Electronic/Magnetic Filing
Forms 5498 and 5498-MSA
Participant Copy - May 31, 2000*
IRS Copy - - - - - - May 31, 2000
* Participants copy of Form 5498 for education IRA and fair market value information -January 31, 2000

.02 If any due date falls on a Saturday, Sunday or legal holiday, the return or statement is considered timely if filed or furnished on the next business day (i.e., the next day that is not a Saturday, Sunday, or legal holiday).

.03 Information returns filed magnetically for Forms 1098, 1099, and W-2G must be submitted to IRS/MCC postmarked on or before *February 28, 2000.*

.04 *Electronically filed information returns for Forms 1098, 1099 and W-2G must be submitted to IRS/MCC no later than March 31, 2000, and will be considered timely filed if submitted by that date. Electronically filed information returns submitted after March 31, 2000, will be considered late unless an extension has been applied for and approved.*

.05 Magnetic media returns postmarked by the United States Postal Service (USPS) on or before *February 28, 2000,* and delivered by United States mail to the IRS/MCC after the due date, are treated as timely under the "timely mailing as timely filing" rule. A similar rule applies to items delivered by private delivery services (PDSs) designated by the IRS. A PDS must be designated by the IRS before it will qualify for the timely mailing rule. (See Note.) Notices 98-47, 1998-37, I.R.B. 8, provides the list of designated PDSs. Designation is effective until the IRS issues a revised list. Notice 97-26 1997-1 C.B. 413, provides rules for determining the

date that is treated as the postmark date. For items delivered by a non-designated PDS, the actual date of receipt by IRS/MCC will be used as the filing date. For items delivered by a designated PDS, but through a type of service not designated in Notice 98-47, the actual date of receipt by IRS/MCC will be used as the filing date. The timely mailing rule also applies to furnishing statements to recipients and participants and filing Forms 5498 and 5498-MSA.

☛ *Note: Due to security regulations at MCC, the Internal Revenue police officers will not accept media from PDSs or couriers between the hours of 3:00 p.m. to 11:00 p.m., seven days a week, and 11:00 p.m. to 7:00 a.m., Saturday and Sunday.*

.06 Statements to recipients must be furnished on or before *January 31, 2000,* for *TY 1999.* Form 5498 statements to the participants must be furnished on or before *January 31, 2000,* for *TY 1999* for the fair market value of the account and for contributions to an education IRA and by *May 31, 2000,* for *TY 1999* for contributions made to all other types of IRAs for the prior calendar year.

.07 Forms 5498 and 5498-MSA filed magnetically or electronically must be filed with IRS/MCC on or before *May 31, 2000,* for *TY 1999.* Forms 5498 and 5498-MSA are filed for contributions to be applied to *1999* that are made *January 1, 1999* through *April 17, 2000,* and/or to report the fair market value of any IRA/SEP/SIMPLE (Form 5498) or medical savings account (Form 5498-MSA).

.08 Use this revenue procedure to prepare information returns filed magnetically or electronically beginning *January 1, 2000,* and received by IRS/MCC no later than *December 15, 2000.*

Sec. 11. Extensions of Time

.01 An extension of time to file may be requested for Forms 1099, 1098, 5498, 5498-MSA, W-2G, W-2 series of forms, 8027 and 1042-S.

.02 Form 8809, Request for Extension of Time to File Information Returns, should be submitted to IRS/MCC at the address *listed in .06 of this section.* This form may be used to request an extension of time to file information returns submitted on paper, magnetically or electronically *f*.

.03 Requesting an extension of time for multiple payers (50 or less) may be done by submitting Form 8809 and attaching a list of the payer names and associated TINs (EIN or SSN). **The listing must be attached to ensure an extension is recorded for all payers.** Form 8809 may be computer-generated or photocopied. Be sure that all the pertinent information is included. *For Forms 1098, 1099 and W-2G that will be filed electronically, Form 8809 must be submitted on or before March 31, 2000.*

.04 Requests for an extension of time to file for more than 50 payers are required to be submitted magnetically or electronically. Requests for an extension of time for 10 to 50 payers are encouraged to be filed magnetically or electronically. (See Part D, Sec. 3, for the record format.) The request may be filed on tape, tape cartridge, 3½-inch diskette, or electronically.

.05 If a filer does not have an IRS/MCC assigned Transmitter Control Code (TCC), a Form 4419, Application for Filing Information Returns Magnetically/Electronically, must be submitted to obtain a TCC. This number **must** be used to submit an extension request magnetically/electronically.

.06 All requests for an extension of time filed on Form 8809 or filed magnetically on tape, tape cartridge, or 3½-inch diskettes should be sent using the following address:

If by Postal Service, truck or air freight:

IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

.07 Requests for extensions of time for multiple payers will be responded to with one approval letter, accompanied by a list of payers covered under that approval.

.08 As soon as it is apparent that a 30-day extension of time to file is needed, Form 8809 may be submitted. It will take a minimum of 30 days for IRS/MCC to respond to an extension request. Under certain circumstances, a request for an extension of time could be denied. When a denial letter is received, any additional or necessary information may be resubmitted within 20 days.

.09 Form 8809 must be postmarked no later than the due date of the return for which an extension is requested. If requesting an extension of time to file several types of forms, use one Form 8809; however, the Form 8809 must be postmarked no later than the earliest due date. For example, if requesting an extension of time to file both Forms 1099-INT and 5498, submit Form 8809 postmarked on or before February 28, 2000. (See **NOTE:**) Complete more than one Form 8809 to avoid this problem.

☛ ***NOTE: For Tax Year 1999, if you will be filing Forms 1098, 1099, or W-2G electronically, the Form 8809 is not required unless an extension beyond March 31, 2000.***

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f Internal Revenue Code Section 6071(b) eliminates the necessity for electronic filers of the information returns to which this provision applies (Forms 1098, 1099, W-2G) to request an extension of the filing date from February 28 to March 31, effective for returns required to be filed after December 31, 1999.

.10 If an additional extension of time is needed, a second Form 8809 must be filed by the initial extended due date. Check line 7 on the form to indicate that an additional extension is being requested. A second 30-day extension will be approved only in cases of extreme hardship or catastrophic event. **If requesting a second 30-day extension of time, submit the information return files as soon as prepared. Do not wait for MCC's response to your second extension request.**

.11 If an extension request is approved, the approval letter should be kept on file. The approval letter or copy of the approval letter for an extension of time should not be sent to IRS/MCC with the magnetic media file or to the service center where the paper returns are filed.

.12 Request an extension for only one tax year.

.13 The extension request must be signed by the payer or a person who is duly authorized to sign a return, statement or other document for the payer.

.14 Failure to properly complete and sign the Form 8809 may cause delays in processing the request or result in a denial. Carefully read and follow the instructions on the back of the Form 8809.

.15 Form 8809 may be obtained by calling **1-800-TAX-FORM (1-800-829-3676).** The form is also available on the **IRS Internet Web Site www.irs.ustreas.gov**. A copy of the Form 8809 is also provided in the back of the Publication 1220.

.16 Request an extension of time to furnish the statements to recipients of Forms 1098, 1099, 5498, W-2G, W-2 series of forms, and 1042-S by submitting a letter to IRS/MCC at the *address listed in .06* of this section. The letter should contain the following information:

(a) Payer name
(b) TIN
(c) Address
(d) Type of return
(e) Specify that the extension request is to provide statements to recipients.
(f) Reason for delay
(g) Signature of payer or person duly authorized

Requests for an extension of time to furnish the statements to recipients for Forms 1098, 1099, 5498, W-2G, W-2 series of forms, and 1042-S are not automatically approved; however, if approved, generally an extension will allow a maximum of 30 additional days from the due date to furnish the statements to the recipients. The request must be postmarked by the date on which the statements are due to the recipients.

Sec. 12. Processing of Information Returns Magnetically/Electronically

.01 All data received at IRS/MCC for processing will be given the same protection as individual income tax returns (Form 1040). IRS/MCC will process the data and determine if the records are formatted and coded according to this revenue procedure.

.02 If the data is formatted incorrectly, the magnetic media will be returned for replacement accompanied by a Media Tracking Slip (Form 9267). When media is returned, it is because IRS/MCC encountered errors (not limited to format) and was unable to process the media, therefore, requiring a replacement. Open all packages immediately.

.03 Magnetic media files must be corrected and returned with the Media Tracking Slip (Form 9267) to IRS/MCC within 45 days from the date of the letter IRS/MCC included with the returned files. *Refer to Part C, Section 6, for procedures for correcting files submitted electronically.* A penalty for failure to file correct information returns by the due date will be assessed if the files are not corrected and returned within the 45 days **or if the incorrect files are returned by IRS/MCC for replacement more than two times.** A penalty for intentional disregard of filing requirements will be assessed if a replacement file is not received. (For penalty information, refer to the Penalty section of the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G.")

.04 Sample records identifying errors encountered will be provided with the returned media. It is the responsibility of the transmitter to check the entire file for similar errors.

.05 The following definitions have been provided to help distinguish between a correction and a replacement:

- A **correction** is an information return submitted by the transmitter to correct an information return that was previously submitted to and processed by IRS/MCC, but contained erroneous information..

☛ ***Note: Corrections should only be made to records that have been submitted incorrectly, not the entire file.***

- A **replacement** is an information return file that IRS/MCC has returned to the transmitter due to errors encountered during processing. After necessary changes have been made, the file must be returned for processing along with the Media Tracking Slip Form 9267) which was included in the shipment from IRS/MCC. (See **Note**).

☛ **Note: Filers should never send anything to IRS/MCC marked "Replacement" unless IRS/MCC returned media to them.**

.06 IRS/MCC will not return media after successful processing. Therefore, if the transmitter wants proof that IRS/MCC received a shipment, the transmitter should select a service with tracking capabilities or one that will provide proof of delivery. Do not use special shipping containers for transmitting data to IRS/MCC. Shipping containers will not be returned.

.07 IRS/MCC will work with filers as much as possible to assist with processing problems. **If the filer is contacted by IRS/MCC, a prompt response is important. IRS/MCC may have information that the filer needs to correct his or her file.**

.08 IRS/MCC contacts payers who have submitted payee data with missing TINs in an attempt to prevent errors that could result in penalties. Payers who submit data with missing TINs and have taken the required steps to obtain this information are encouraged to attach a letter of explanation to the required Form 4804. This will prevent unnecessary contact from IRS/MCC. This letter, however, will not prevent backup withholding notices (CP2100 or CP2100A) or penalties for missing or incorrect TINs.

Sec. 13. Corrected Returns

.01 The magnetic media filing requirement of information returns of 250 or more applies separately to both original and corrected returns.

EXAMPLE If a payer has 100 Forms 1099-A to be corrected, they can be filed on paper since they fall under the 250 threshold. However, if the payer has 300 Forms 1099-B to be corrected, they must be filed magnetically or electronically since they meet the 250 threshold. If for some reason a payer cannot file the 300 corrections on magnetic media, to avoid penalties, a request for a waiver must be submitted before filing on paper. If a waiver is approved for original documents, any corrections for the same type of return will be covered under this waiver.

.02 Corrections should be filed **as soon as possible.** Corrections filed after August 1 may be subject to the maximum penalty of $50 per return. Corrections filed by August 1 may be subject to a lesser penalty. (For information on penalties, refer to the Penalty section of the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G.") However, if payers discover errors after August 1, they may still be required to file corrections so they will not be subject to a penalty for intentional disregard of the filing requirements. Failure to correct information returns may result in penalties for failure to provide correct information. **All fields must be completed with the correct information, not just the data fields needing correction.** Submit corrections only for the returns filed in error, not the entire file. Furnish corrected statements to recipients as soon as possible.

.03 There are numerous types of errors, and in some cases, more than one transaction may be required to correct the initial error. **If the original return was filed as an aggregate, the filers must consider this in filing corrected returns.**

.04 Corrected returns may be included on the same medium as original returns; however, separate "A" Records are required. Corrected returns must be identified on the Form 4804 and the external media label by indicating "Correction." **If filers discover that certain information returns were omitted on their original file, they must not code these documents as corrections. The file must be coded and submitted as originals.**

.05 If a payer discovers errors for prior years that affect a large number of payees, in addition to sending IRS the corrected returns and notifying the payees, a letter containing the following information should be sent to IRS/MCC:

(a) Name and address of payer
(b) Type of error (please explain clearly)
(c) Tax year
(d) Payer TIN
(e) TCC
(f) Type of Return
(g) Number of Payees

This information will be forwarded to the appropriate office in an attempt to prevent erroneous notices from being sent to the payees. The correction must be submitted on an actual information return document or filed magnetically/electronically. Provide the correct tax year in Block 2 of the Form 4804 and on the external media label.

.06 Prior year data, original and corrected, **must** be filed according to the requirements of this revenue procedure. If submitting prior year corrections, use the record format for the current year and submit on separate media. However, use the actual year designation of the correction in Field Positions 2-5 of the "T", "A", and "B" Records. If filing electronically, a separate transmission must be made for each tax year.

.07 In general, filers should submit corrections for returns filed within the last 3 calendar years [4 years if the payment is a reportable payment subject to backup withholding under section 3406 of the Code and also for Form 1099-C, Cancellation of Debt under section 1.6050P–1(e)(7)].

.08 All paper returns, whether original or corrected, must be filed with the appropriate service center.

.09 Form 4804 and Form 4802 (if applicable), must be submitted with corrected files submitted magnetically or electronically.

.10 The "B" Record provides a 20-position field for the Payer's Account Number for the Payee. This number will help identify the appropriate incorrect return if more than one return is filed for a particular payee. **Do not enter a TIN in this field.** A payer's account number for the payee may be a checking account number, savings account number, serial number, or any other number assigned to the payee by the payer that will distinguish the specific account. This number should appear on the initial return and on the corrected return in order to identify and process the correction properly.

.11 The record sequence for filing corrections is the same as for original returns.

.12 Review the chart that follows. Errors normally fall under one of the two categories listed. Next to each type of error made is a list of instructions on how to file the corrected return.

Guidelines for Filing Corrected Returns Magnetically/Electronically

Error Made on the Original Return	How To File the Corrected Return
Two (2) separate transactions are required to make the following corrections properly. Follow the directions for both Transactions 1 and 2. (See Note 1)	
1. Original return was filed with one or more of the following errors: (a) No payee TIN (SSN, ITIN, or EIN) (b) Incorrect payee TIN (c) Incorrect payee name (d) Wrong type of return indicator	**Transaction 1:** Identify incorrect returns **A.** Prepare a new Form 4804/4802 that includes information related to this new file. **B.** Mark "Correction" in Block 1 of Form 4804. **C.** Prepare a new file. The first record on the file will be the Transmitter "T" Record. **D.** Make a separate "A" Record for each type of return and each payer being reported. The information in the "A" record will be **exactly** the same as it was in the original submission with one exception; the Correction File Indicator (Field Position 50), will be set to "1". **E.** The Payee "B" Records must contain **exactly the same** information as submitted previously, except, insert a Corrected Return Indicator Code of "G" in Field Position 6 of the "B" Records, and for all payment amounts, enter "0" (zeros). **F.** Corrected returns submitted to IRS/MCC using "G" coded "B" Records may be on the same file as those returns submitted with a "C" code; **however, separate "A" Records are required.** **G.** Prepare a separate "C" Record for each type of return and each payer being reported. **H.** Continue with Transaction 2 to complete the correction. **Transaction 2:** Report the correct information **A.** Make a separate "A" Record for each type of return and each payer being reported. The Correction File Indicator (Field Position 50), must be set to "1" (one). **B.** The Payee "B" Records must show the correct information as well as a Corrected Return Indicator Code of "C" in Field Position 6. **C.** Corrected returns submitted to IRS/MCC using "C" coded "B" Records may be on the same file as those returns submitted with "G" codes; **however, separate "A" Records are required.** **D.** Prepare a separate "C" Record for each type of return and each payer being reported. **E.** The last record on the file will be the End of Transmission "F" Record. **F.** Indicate "Correction" on the external media label.

☛ **Note 1: Payers who can show they have reasonable cause (defined in the regulations under section 6724 of the Internal Revenue Code) are not required to make corrections for returns filed with a missing or incorrect name and/or TIN. These payers should change their records in order to submit correct information in the future. Payers who cannot show reasonable cause are encouraged to make corrections for the current processing year by August 1 to reduce applicable penalties. Corrections filed by August 1 will reduce the $50 per return penalty for filing returns with missing or incorrect information to $30. The penalty is further reduced to $15 per return if the corrections are filed within 30 days of the due date. (For penalty information, refer to the Penalty section of the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G.") Corrections filed after August 1 will not reduce the penalty but will allow IRS to update the payee's records. The regulations for section 6724 are available in Publication 1586, Reasonable Cause Regulations and Requirements for Missing and Incorrect**

Name/TINs. The publication may be obtained by calling 1-800-TAX-FORM (1-800-829-3676) or from the IRS Internet Web Site www.irs.ustreas.gov.

One transaction is required to make the following corrections properly (See Note 2).

2. Original return was filed with one or more of the following errors:
   (a) Incorrect payment the Payer "A" Record the Payer "A" Record
   (b) Incorrect payment amounts in the Payer "B" Record
   (c) Incorrect code in the Distribution Code field in the Payee "B" Record
   (d) Incorrect payee address
   (e) Incorrect Direct sales indicator

   A. Prepare a new Form 4804/4802 that includes information relating to this new file.
   B. Mark "Correction" in Block 1 of Form 4804.
   C. Prepare a new file. The first record on the file will be the Transmitter "T" Record.
   D. Make a separate "A" Record for each type of return and each payer being reported. Information in the "A" Record may be the same as it was in the original submission. However, the Correction File Indicator (Field Position 50) must be set to "1" (one).
   E. The Payee "B" Records must show the correct record information as well as a Corrected Return Indicator Code of "G" in Field Position 6.
   F. Corrected returns submitted to IRS/MCC using "G" coded "B" Records may be on the same file as those returns submitted without the "G" coded "B" Records; **however, separate "A" Records are required.**
   G. Prepare a separate "C" Record for each type of return and each payer being reported.
   H. The last record on the file will be the End of Transmission "F" Record.
   I. Indicate "Correction" on the external media label.

☛ **Note 2: If a filer is correcting the name and/or TIN in addition to any errors listed in item 2 of the chart, two transactions will be required. If a filer is reporting "G" coded, "C" coded, and/or "Non-coded" (original) returns on the same media, each category must be reported under separate "A" Records.**

Sec. 14. Taxpayer Identification Number (TIN)

.01 Section 6109 of the Internal Revenue Code requires a person to furnish his/her TIN to the person obligated to file the information return.

.02 The payee's TIN and name combination is used to associate information returns reported to IRS/MCC with corresponding information on tax returns. It is imperative that **correct** Taxpayer Identification Numbers (TINs) for payees be provided to IRS/MCC. **Do not enter hyphens or alpha characters.** Entering all zeros, ones, twos, etc., will have the effect of an incorrect TIN.

.03 The payer and payee names with associated TINs should be consistent with the names and TINs used on other tax returns.

Also, the name and TIN provided **must** belong to the owner of the account. If the account is recorded in more than one name, furnish the name and TIN of one of the owners of the account. The TIN provided must be associated with the name of the payee provided in the first name line of the "B" Record. For individuals, the payee TIN is generally the payee's Social Security Number (SSN). For other entities, the payee TIN is the payee's Employer Identification Number (EIN). The payee TIN may also refer to an Individual Taxpayer Identification Number (ITIN) or Adoption Taxpayer Identification Number (ATIN). For sole proprietors, the payee TIN may be either an SSN or EIN but **the sole proprietor's name** (not the business name) **must be used on the first name line *and the SSN is preferred.***

.04 Failure to provide the correct name and corresponding TIN could result in a penalty and/or backup withholding notice (sometimes referred to as a "B" Notice).

.05 The following charts will help payers determine the TIN to be furnished to IRS/MCC for those persons for whom they are reporting information (payees).

Chart 1. Guidelines for Social Security Numbers

For this type of account	In the Taxpayer Identification Number Field 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. Individual	The individual	The individual
2. Joint account (two or more individuals, including husband and wife)	The actual owner of the account or, if combined funds, the first individual on the account	The individual whose SSN is entered
3. Custodian account of a minor (Uniform Gift, or Transfers, to Minors Act)	The minor	The minor
4. The usual revocable savings trust account (grantor is also trustee)	The grantor-trustee trustee	The grantor-trustee
5. A so-called trust account that is not a legal or valid trust under state law	The actual owner	The actual owner
6. Sole proprietorship	The owner (an SSN or EIN)	The owner, not the business name (The filer may enter the business name on the second name line.)

Chart 2. Guidelines for Employer Identification Numbers

For this type of account-	In the Taxpayer Identification Number Field of the Payee "B" Record, enter the EIN of-	In the First Payee Name Line of the Payee "B" Record, enter the name of-
1. A valid trust, estate, or pension trust	The legal entity [1]	The legal trust, estate, or pension trust
2. Corporate	The corporation	The corporation
3. Association, club, religious, charitable, educational, or other tax-exempt organization	The organization	The organization
4. Partnership account held in the name of the business	The partnership	The partnership

[1] Do not furnish the identification number of the personal representative or trustee unless the name of the representative or trustee is used in the account title.

Chart 2. Guidelines for Employer Identification Numbers—Continued

For this type of account-	In the Taxpayer Identification Number Field of the Payee "B" Record, enter the EIN of-	In the First Payee Name Line of the Payee "B" Record, enter the name of-
5. A broker or registered nominee/ middleman	The broker or nominee/middleman	The broker or nominee/middleman
6. Account with 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
7. Sole proprietorship	The business (an EIN or SSN)	The owner, not the business name (The filer may enter the business name on the second name line.)

Sec. 15. Effect on Paper Returns and Statements to Recipients

.01 Magnetic/electronic reporting of information returns eliminates the need to submit paper documents to the IRS. CAUTION: Do not send Copy A of the paper forms to IRS/MCC for any forms filed on magnetic media or electronically. This will result in duplicate filing; therefore, erroneous notices could be generated.

.02 Payers are responsible for providing statements to the payees as outlined in the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G." Refer to those instructions for filing information returns on paper with the IRS and furnishing statements to recipients.

.03 Statements to recipients should be clear and legible. If the official IRS form is not used, the filer must adhere to the specifications and guidelines in Publication 1179, "Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 5498, and W-2G."

Sec. 16. Combined Federal/State Filing Program

.01 The Combined Federal/State Filing (CF/SF) Program was established to simplify information returns filing for the taxpayer. IRS/MCC will forward this information to participating states free of charge for approved filers. Separate reporting to those states is not necessary. The following information returns may be filed under the Combined Federal/State Filing Program:

Form 1099-DIV — Dividends and Distributions
Form 1099-G — Certain Government *and Qualified State Tuition Program Payments*
Form 1099-INT — Interest Income
Form 1099-MISC — Miscellaneous Income
Form 1099-OID — Original Issue Discount
Form 1099-PATR — Taxable Distributions Received from Cooperatives
Form 1099-R — Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
Form 5498 — IRA Contribution Information

The following information returns **may not** be filed under this program:

Form 1098 — Mortgage Interest Statement
Form 1098-E — Student Loan Interest Statement
Form 1098-T — Tuition Payments Statement
Form 1099-A — Acquisition or Abandonment of Secured Property
Form 1099-B — Proceeds From Broker and Barter Exchange Transactions
Form 1099-C — Cancellation of Debt
Form 1099-LTC — Long-Term Care and Accelerated Death Benefits
Form 1099-MSA — Distributions From *an MSA or Medicare+Choice MSA*

Form 1099-S — Proceeds From Real Estate Transactions
Form 5498-MSA — *MSA or Medicare+Choice MSA Information*
Form W-2G — Certain Gambling Winnings

.02 To request approval to participate, a magnetic media test file coded for this program **must** be submitted to IRS/MCC between November 1, 1999, and December 15, 1999. *Electronic test files must be submitted between November 1, 1999, and January 31, 2000.*

.03 Attach a letter to the Form 4804 submitted with the test file to indicate a desire to participate in the Combined Federal/State Filing Program.

.04 A test file is only required for the first year. Each record, both in the test and the actual data file, must conform to this revenue procedure.

.05 If the test file is acceptable, IRS/MCC will send the filer an approval letter, and a Form 6847, Consent for Internal Revenue Service to Release Tax Information, which the payer **must** complete, sign, and return to IRS/MCC before any tax information can be released to the state. Filers must write their TCC on Form 6847.

.06 If the test file is not acceptable, IRS/MCC will return the media with a letter indicating the problems. The *new test* file must be returned to IRS/MCC no later than December 15.

.07 A separate Form 6847 is **required** for each payer. A transmitter may not combine payers on one Form 6847 even if acting as Attorney-in-Fact for several payers. Form 6847 may be computer-generated as long as it includes all information that is on the original form or it may be photocopied. If the Form 6847 is signed by an Attorney-in-Fact, the written consent from the payer must clearly indicate that the Attorney-in-Fact is empowered to authorize release of the information.

.08 Only code the records for participating states and for those payers who have submitted Form 6847.

.09 Some participating states require separate notification that the payer is filing in this manner. Since IRS/MCC acts as a forwarding agent only, **it is the payer's responsibility to contact the appropriate states for further information.**

.10 All corrections properly coded for the Combined Federal/State Filing Program will be forwarded to the participating states.

.11 Participating states and corresponding valid state codes are listed in **Table 1** of this section. The appropriate state code must be entered for those documents that meet the state filing requirements; **do not use state abbreviations.**

.12 To simplify filing, some of the participating states have provided their information return reporting requirements (see **Table 2). Each state's filing requirements are subject to change by the state. It is the payer's responsibility to contact the participating states to verify the criteria provided in this table.**

.13 Upon submission of the actual files, the transmitter must be sure of the following:

(a) All records should be coded exactly as required by this revenue procedure.

(b) The "C" Record **must be** followed by a State Totals "K" Record for each state being reported.

(c) Payment amount totals and the valid participating state code must be included in the State Totals "K" Record.

(d) The last "K" Record **must be** followed by an "A" Record or an End of Transmission "F" Record (if this is the last record of the entire file).

Table 1. Participating States and Their Codes

State	Code	State	Code	State	Code
Alabama	01	Idaho	16	Missouri	29
Arizona	04	Indiana	18	Montana	30
Arkansas	05	Iowa	19	New Jersey	34
California	06	Kansas	20	New Mexico	35
Delaware	10	Maine	23	North Dakota	38
District of Columbia	11	Massachusetts	25	Oregon	41
Georgia	13	Minnesota	27	South Carolina	45
Hawai	15	Mississipp	28	Tennessee	47
				Wisconsin	55

Table 2. Dollar Criteria for State Reporting

STATE	1099-DIV	1099-G	1099-INT	1099-MISC	1099-OID	1099-PATR	1099-R	5498
Alabama	$1500	$ NR	$1500	$1500	$1500	$1500	$1500	NR
Arkansas	100	2500	100	2500	2500	2500	2500	[a]
District of Columbia[b]	600	600	600	600	600	600	600	NR
Hawaii	10	[a]	10	600	10	10	600	[a]

Table 2. Dollar Criteria for State Reporting—Continued

STATE	1099-DIV	1099-G	1099-INT	1099-MISC	1099-OID	1099-PATR	1099-R	5498
Idaho	NR	NR	NR	600	NR	NR	[a]	[a]
Iowa	10	10	10	600	10	10	10	[a]
Minnesota	10	10	10	600	10	10	600	[a]
Mississippi	600	600	600	600	600	600	600	NR
Missouri	NR	NR	NR	1200[c]	NR	NR	NR	NR
Montana	10	10	10	600	10	10	600	[a]
New Jersey	1000	1000	1000	1000	1000	1000	1000	NR
Tennessee	100	NR	100	NR	NR	NR	NR	NR
Wisconsin	NR	NR	NR	600	NR	NR	600	NR

The preceding list is for information purposes only. The state filing requirements are subject to change by the states. For complete information on state filing requirements, contact the appropriate state tax agencies. Filing requirements for states in TABLE 1 not shown in TABLE 2 are the same as the federal requirement.

NR = No filing requirement.

Footnotes:

a. All amounts are to be reported.

b. Amounts are for aggregates of several types of income from the same payer.

c. Missouri would prefer those returns filed with respect to non-Missouri residents to be sent directly to its state agency.

Sec. 17. Definition of Terms

Element	*Description*
Asynchronous Protocols	This type of data transmission is most often used by microcomputers, PCs and some minicomputers. Asynchronous transmissions transfer data at arbitrary time intervals using the start-stop method. Each character transmitted has its own start bit and stop bit.
ATIN	A temporary taxpayer identification number assigned to a child who has been placed by an authorized placement agency in the household of a prospective adoptive parent prior to adoption. When the adoption becomes final, the adoptive parent must apply for a social security number for the child.
ß	Denotes a blank position. Enter blank(s) when this symbol is used (do not enter the letter "b"). This appears in numerous areas throughout the record descriptions.
Correction	A correction is an information return submitted by the transmitter to correct an information return that was previously submitted to and processed by IRS/MCC, but contained erroneous information.

☛ **Note: A correction should not be confused with a replacement. Only media returned to the filer by IRS/MCC due to processing problems should be marked replacement.**

CUSIP Number	A number developed by the Committee on Uniform Security Identification Procedures to serve as a common denominator in communications among users for security transactions and security information.
Employer Identification Number (EIN)	A nine-digit number assigned by IRS for federal tax reporting purposes.
Electronic Filing	Submission of information returns using switched telecommunications network circuits. These transmissions use modems, dial-up phone lines, and asynchronous protocols. See Parts A and C of this publication for specific information on electronic filing.

Element	*Description*
File	For purposes of this revenue procedure, a file consists of one Transmitter "T" Record at the beginning of the file, followed by a Payer "A" Record, Payee "B" Records, and an End of Payer "C" Record after each set of "B" Records. The last record on the file will be the End of Transmission "F" Record. Nothing should be reported after the End of Transmission "F" Record.
Filer	Person (may be payer and/or transmitter) submitting information returns to IRS.
Filing Year	The actual year in which the information returns are being submitted to IRS.
Golden Parachute Payment	A payment made by a corporation to a certain officer, shareholder, or highly compensated individual when a change in the ownership or control of the corporation occurs or when a change in the ownership of a substantial part of the corporate assets occurs.
Incorrect Taxpayer Identification Number (Incorrect TIN)	A TIN may be incorrect for several reasons: (a) The payee provided a wrong number or name (e.g., the payee is listed as the only owner of an account but provided someone else's TIN). (b) A processing error (e.g., the number or name was typed incorrectly). (c) The payee's status changed (e.g., a payee name change was not reported to the IRS or SSA).
Individual Taxpayer Identification Number (ITIN)	A nine digit number issued by IRS to individuals who are required to have a U.S. taxpayer identification number but are not eligible to obtain a social security number (SSN).
Information Return	The vehicle for submitting required information about another person to IRS. Information returns are filed by financial institutions and by others who make certain types of payments as part of their trade or business. The information required to be reported on an information return includes interest, dividends, pensions, nonemployee compensation for personal services, stock transactions, sales of real estate, mortgage interest, and other types of information. For this revenue procedure, an information return is a Form 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-DIV, 1099-G, 1099-INT, 1099-LTC, 1099-MISC, 1099-MSA, 1099-OID, 1099-PATR, 1099-R, 1099-S, 5498, 5498-MSA or W-2G.
ISDN - Integrated Services Digital Network	*ISDN's basic service is Basic Rate Interface (BRI) which is made up of two 64Kbps B channels and one 16Kbps D Channel. If both channels are combined into one, called bonding, the total data rate becomes 128KPBS and is 4½ times the bandwidth of a 28.8 modem.*
Magnetic Media	For this revenue procedure, the term "magnetic media" refers to ½-inch magnetic tape; IBM 3480/3490/3490E or AS400 compatible tape cartridge; 8mm, 4mm, and QIC (Quarter Inch Cartridge) cartridge or 3½-inch diskette.
Media Tracking Slip (Form 9267)	Form 9267 accompanies media that IRS/MCC has returned to the filer for replacement due to incorrect format or errors encountered when trying to process the media. **This must be returned with the replacement file.**
Missing Taxpayer Identification Number	The payee TIN on an information return is missing if: (a) there is no entry in the TIN field, (Missing TIN) (b) includes one or more alpha characters (a character or symbol other than an Arabic number) as one of the nine digits, OR (c) payee TIN has less than nine digits.
PS 58 Costs	The current cost of life insurance under a qualified plan taxable under section 72(m) and Regulations section 1.72–16(b). (See Part B, Sec. 14, Payee "B" Record, Distribution Code, Category of Distribution, Code 9.)

Element	*Description*
Payee	Person or organization receiving payments from the payer, or for whom an information return must be filed. The payee also includes a student (Form 1098-T), borrower (Forms 1098, 1098-E, and 1099-A), a debtor (Form 1099-C), a policyholder or insured (Form 1099-LTC), any IRA plan participant (Form 5498) or *MSA or Medicare+Choice MSA* participant (Form 5498-MSA), and a gambling winner (Form W-2G). For Form 1099-S, the payee is the seller or other transferor.
Payer	Includes the person making payments, a recipient of mortgage or student loan interest payments, a broker, a person reporting a real estate transaction, a barter exchange, a creditor, a trustee or issuer of any IRA or MSA plan, or a lender who acquires an interest in secured property or who has reason to know that the property has been abandoned. The payer will be held responsible for the completeness, accuracy, and timely submission of magnetic/electronic files.

☛ ***Note: For Form 1098-T, the eligible educational institution that received qualified tuition and related expenses is considered the payer.***

Replacement	A replacement is an information return file that IRS/MCC has returned to the transmitter due to errors encountered during processing.

☛ **Note: Filers should never submit media to IRS/MCC marked "Replacement" unless IRS/MCC returned media to the filers. When sending "Replacement" media, be sure to include the Media Tracking Slip (Form 9267) which will accompany media returned by IRS/MCC. Media that has been incorrectly marked as Replacement may result in duplicate filing.**

Service Bureau	Person or organization with whom the payer has a contract to prepare and/or submit information return files to IRS/MCC. A parent company submitting data for a subsidiary is not considered a service bureau.
Social Security Number (SSN)	A nine-digit number assigned by SSA to an individual for wage and tax reporting purposes.
Special Character	Any character that is **not** a numeric, an alpha, or a blank.
SSA	Social Security Administration.
Taxpayer Identification Number (TIN)	Refers to either an Employer Identification Number (EIN) Social Security Number (SSN), Individual Taxpayer Identification Number (ITIN), or Adoption Taxpayer Identification Number (ATIN).
Tax Year	Generally, the year in which payments were made by a payer to a payee.
Transfer Agent	The transfer agent, or paying agent, is the entity who has been contracted or authorized by the payer to perform the services of paying and reporting backup withholding (Form 945).
Transmitter	Refers to the person or organization submitting file(s) magnetically/electronically. The transmitter may be the payer or agent of the payer.
Transmitter Control Code (TCC)	A five character alpha/numeric number assigned by IRS/MCC to the transmitter prior to actual filing magnetically or electronically. This number is inserted in the "T" Record of the file and **must** be present before the file can be processed. An application Form 4419 must be filed with IRS/MCC to receive this number.
Vendor	Vendors include service bureaus that produce information return files on the prescribed types of magnetic media or via electronic filing for payers. Vendors also include companies who provide software for payers who wish to produce their own media or electronic files.

Sec. 18. State Abbreviations.

01 The following state and U.S. territory abbreviations are to be used when developing the state code portion of address fields. This table provides state and territory abbreviations only, and does not represent those states participating in the Combined Federal/State Filing Program.

State	Code	State	Code	State	Code
Alabama	AL	Kentucky	KY	Ohio	OH
Alaska	AK	Louisiana	LA	Oklahoma	OK
American Samoa	AS	Maine	ME	Oregon	OR
Arizona	AZ	Marshall Islands	MH	Pennsylvania	PA
Arkansas	AR	Maryland	MD	Puerto Rico	PR
California	CA	Massachusetts	MA	Rhode Island	RI
Colorado	CO	Michigan	MI	South Carolina	SC
Connecticut	CT	Minnesota	MN	South Dakota	SD
Delaware	DE	Mississippi	MS	Tennessee	TN
District of Columbia	DC	Missouri	MO	Texas	TX
Federated States		Montana	MT	Utah	UT
of Micronesia	FM	Nebraska	NE	Vermont	VT
Florida	FL	Nevada	NV	Virginia	VA
Georgia	GA	New Hampshire	NH	(U.S.) Virgin Islands	VI
Guam	GU	New Jersey	NJ	Washington	WA
Hawaii	HI	New Mexico	NM	West Virginia	WV
Idaho	ID	New York	NY	Wisconsin	WI
Illinois	IL	North Carolina	NC	Wyoming	WY
Indiana	IN	North Dakota	ND		
Iowa	IA	Northern			
Kansas	KS	Mariana Islands	MP		

.02 Filers must adhere to the city, state, and ZIP Code format for U. S. addresses in the "B" Record. This also includes American Samoa, Federated States of Micronesia, Guam, Marshall Islands, Northern Mariana Islands, Puerto Rico, and the U. S. Virgin Islands.

.03 For foreign country addresses, filers may use a 51 position free format which should include city, province or state, postal code, and name of country in this order. This is allowable only if a "1" (one) appears in the Foreign Country Indicator, Field Position 247 of the "B" Record.

.04 When reporting APO/FPO addresses use the following format:

EXAMPLE:

Payee Name	PVT Willard J. Doe
Mailing Address	Company F, PSC Box 100
	167 Infantry REGT
Payee City	APO (or FPO)
Payee State	AE, AA, or AP*
Payee ZIP Code	098010100

*AE is the designation for ZIPs beginning with 090-098, AA for ZIP 340, and AP for ZIPs 962-966.

Sec. 19. Major Problems Encountered

IRS/MCC encourages filers to verify the format and content of each type of record to ensure the accuracy of the data. This may eliminate the need for IRS/MCC to return files for replacement. This may be important for those payers who have either had their files prepared by a service bureau or who have purchased preprogrammed software packages.

Filers who engage a service bureau to prepare media on their behalf should be careful not to report duplicate data which may generate penalty notices.

The Major Problems Encountered lists some of the most frequently encountered problems with magnetic/electronic files submitted to IRS/MCC. These problems may result in media being returned for replacement. **Some of the problems resulted from not referring to the publication for instructions.**

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1. Incorrect Format

"READ" the Publication 1220 *carefully.*

☛ **NOTE: Due to major format changes in the Tax Year 1998 Publication 1220, IRS/MCC strongly encourages transmitters, vendors, and filers to read the Revenue Procedure in its entirety. See problem examples below:**

- **No Transmitter "T" Record - These files began with Payer "A" Record. All files must begin with a Transmitter "T" Record**

- **Incorrect year format - In order to be Y2K compliant, any date field in the information transmitted that does not reflect the 4 position year in the date field will result in media being returned. Date fields having the year/month/day are 8 characters (YYYYMMDD). Also, if the month and/or day is one position, i.e.; January through September or 1 through 9 for the day of the month, precede the month and/or day with a zero. All date fields are numeric, therefore, blanks, alphas, or special characters are not acceptable.**

  EXAMPLE: January 2, 1999 (19990102)

- **Invalid record length - Records not 750 Positions in length.**

- **Multiple Files on diskettes - Filers sending multiple files on diskettes. Please refer to Part B, Section 5. A file consists of one Transmitter "T" Record followed by a Payer "A" Record, Payee "B" Records, End of Payer "C" Record, State Totals "K" Record (if applicable for CF/SF Program), and the End of Transmission "F" Record. A file can contain multiple Payer "A" Records, but, only one Transmitter "T" Record.**

IRS/MCC continues to receive prior year data in prior year format instead of current year format. Never send prior year data in prior year format. Be sure to use **the current revenue procedure (Publication 1220)** for formatting data for prior years.

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2. No Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically

Each shipment of media sent to IRS/MCC must include a Form 4804. More than one type of media may be sent in the same shipment, (i.e., a tape, a diskette, or a tape cartridge) but must have a separate Form 4804 to accompany **each type of media.** In the following example, three separate Forms 4804 would be required in the total shipment However, multiples of one type of media (i.e., 6 diskettes) may be covered by one Form 4804. For electronically transmitted information returns, the Form 4804 **must** be mailed or faxed to IRS/MCC the same day as the transmission. Often, electronic files are transmitted and no Form 4804 is sent to MCC. A Form 4804 must be mailed or faxed immediately after the submission.

EXAMPLE:
A & B Company sends in the one shipment of the following magnetic media:

1 Magnetic Tape	=	1 Form 4804
2 Diskettes	=	1 Form 4804 covers both diskettes
3 Tape Cartridges	=	1 Form 4804 covers all three cartridges

Total Number of Forms 4804 for the above shipment = **3 Forms 4804**

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3. Discrepancy Between IRS/MCC Totals and Totals in Payer "C" Records

The "C" Record is a summary record for a type of return for a given payer as reported in the "B" Records. IRS balances the total number of payees and payment amounts and compares them with totals in the "C" Records. Filers should verify the accuracy of the records because imbalances may necessitate return of files for replacement.

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4. The Payment Amount Fields in the "B" Record Do Not Correspond to the Amount Codes in the "A" Record

If codes 2, 4, and 7 appear in the Amount Codes Field of the "A" Record, then the "B" Record must show payment amounts in only Payment Amount Fields 2, 4, and 7, right-justified and unused positions **must be** zero (0) filled.

EXAMPLE:	"A" RECORD	247ƀƀƀƀƀƀƀƀƀcƀ (Pos. 28-39)	— ('ƀ' denotes a blank)
	"B" RECORD	000000867599 (Pos. 67-78)	— (Payment Amount 2)
		000000709097 (Pos. 91-102)	— (Payment Amount 4)
		000000044985 (Pos. 127-138)	— (Payment Amount 7)

5. Blanks or Invalid Characters Appear in Payment Amount Fields in the "B" Record

Money amounts must be right-justified and zero (0) filled. **(Do not use blanks.)**

6. Incorrect TIN in Payer "A" Record

The Payer's TIN reported in positions 12-20 of the "A" Record must be nine numeric characters (no alphas or special characters) in order for IRS/MCC to process the media. The TIN provided in the "A" Record must correspond with the name provided in the first payer name line.

7. Incorrect Tax Year in the Transmitter "T" Record, Payer "A" Record and the Payee "B" Record

The tax year in the transmitter, payer and payee records should reflect the year of the information being reported. Filers need to check their files to ensure this information is correct.

☛ **Note: Due to Year 2000 compliance changes, the year format has been expanded to four (4) positions.**

8. Incorrect Reporting of Form W-2 Information to IRS

Form W-2 information is submitted to SSA, and **not** to IRS/MCC. SSA has its own magnetic media reporting program and specifications for wage information, and the media containing Forms W-2 is submitted to SSA. **Any media received at IRS/MCC that contains Form W-2 information will be forwarded to SSA. The filer will be notified of this action by letter.** To inquire about filing Form W-2 information magnetically, call *1-800-SSA-6270.*

9. Excessive Withholding Credits

Generally, for most information returns, other than Forms 1099-MISC, 1099-R, and W-2G, Federal withholding amounts should **not** exceed 31 percent of the income reported. Validate the total reported in the withholding field against the total income reported.

10. Incorrect Format for TINs in the Payee "B" Record

A check of "B" Records should be made to ensure the Taxpayer Identification Numbers (TINs) are formatted correctly. There should be nine numerics, **no alphas, hyphens, commas, or blanks.** Incorrect formatting of TINs may result in a penalty.

IRS/MCC contacts filers who have submitted payee data with missing TINs in an attempt to prevent errors that could result in penalties. Payers/transmitters who submit data with missing TINs, and have taken the required steps to obtain this information are encouraged to attach a letter of explanation to the required Form 4804. This will prevent unnecessary contact from IRS/MCC. This letter, however, will not prevent backup withholding notices (CP2100 and CP2100A) or penalties for missing or incorrect TINs. For penalty information, refer to the Penalty section of the "*1999* Instructions for Forms 1099, 1098, 5498, and W-2G."

11. Distribution Codes for Form 1099-R Reported Incorrectly

Distribution codes for Form 1099-R are being reported incorrectly or not being reported. See valid distribution codes for Form 1099-R in the Payee "B" Record layout, Field Positions 545-546.

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12. Incorrect Record Totals Listed on Form 4804

The Combined Total Payee Records listed on the Form 4804 (Block 9) are used in the verification process of information returns. The figure in this block should be the total number of Payee "B" Records contained on the media submitted with the Form 4804. The figures on the Form 4804 are compared against the total number of Payee "B" Records processed on the media. Imbalances may necessitate the return of the files for replacement.

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13. Invalid Use of IRA/SEP/SIMPLE Indicator (Form 1099-R)

The IRA/SEP/SIMPLE indicator for Form 1099-R should be used for the reporting of a distribution from a traditional IRA/SEP/SIMPLE or a Roth conversion. It may be used at your option for a distribution from a Roth or Ed IRA or for an IRA recharacterization. The total amount distributed from a traditional IRA/SEP/SIMPLE should be reported in Payment Amount Field A (IRA/SEP/SIMPLE Distribution) as well as Payment Amount Field 1. The amount reported in this payment amount field is the amount from Box 2a of Form 1099-R.

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14. Failure To Identify the Rollover Contributions and/or Fair Market Value of the Account for Form 5498.

Rollover contributions (Amount Code 2 of the "A" Record) and/or fair market value of the account (Amount Code 4 of the "A" Record) for Form 5498 must be identified as an IRA (position 547 of the "B" Record), SEP (position 548 of the "B" Record), SIMPLE (position 549 of the "B" Record), Roth IRA (position 550 of the "B" Record) Recharacterization (position 551 of the "B" Record), or Education IRA (position 552 of the "B" Record).

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15. Media Received Without Data

Transmitters/filers should verify the presence of Form 1099 information returns on the media before sending the shipment to IRS/MCC.

Part B. Magnetic Media Specifications

Sec. 1. General

.01 The specifications contained in this part of the revenue procedure define the required format and contents of the records to be included in the magnetic media/electronic file.

.02 A provision is made in the "B" Records for entries which are optional. If the field is not utilized, enter blanks to maintain a fixed record length of 750 positions. Each field description explains the intended use of specific field positions.

.03 Transmitters should be consistent in the use of recording codes and density on files. If the media does not meet these specifications, it will be returned to the transmitter for replacement. Filers are encouraged to submit a test prior to submitting the actual file. Contact IRS/MCC for further information at 304-263-8700.

Sec. 2. Tape Specifications ✇

.01 IRS/MCC can process most magnetic tape files if the following specifications are followed:

(a) 9 track EBCDIC (Extended Binary Coded Decimal Interchange Code) with:
  (1) Odd parity.
  (2) A density of 1600 or 6250 BPI.
  (3) If transmitters use UNISYS Series 1100, they must submit an interchange tape.

(b) 9 track ASCII (American Standard Coded Information Interchange) with:
  (1) Odd parity.
  (2) A density of 1600 or 6250 BPI.

Transmitters should be consistent in the use of recording codes and density on files.

.02 All compatible tape files must have the following characteristics: Type of tape - ½-inch (12.7 mm) wide, computer-grade magnetic tape on reels of up to 2,400 feet (731.52 m) within the following specifications:

(a) Tape thickness: 1.0 or 1.5 mils and

(b) Reel diameter: 10 ½-inch (26.67 cm), 8 ½-inch (21.59 cm), 7-inch (17.78 cm), or 6-inch.

.03 The tape records defined in this revenue procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,250 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 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked.

A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant

in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 750.

(d) Records may not span blocks.

.04 Labeled or unlabeled tapes may be submitted.

.05 For the purposes of this revenue procedure the following must be used:

Tape Mark:

(a) Signifies the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

.06 IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but **must** end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

Sec. 3. Tape Cartridge Specifications

.01 In most instances, IRS/MCC can process tape cartridges that meet the following specifications:

(a) Must be IBM 3480, 3490, 3490E, or AS400 compatible.

(b) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Tape cartridges will be ½-inch tape contained in plastic cartridges which are approximately 4-inches by 5-inches by 1-inch in dimension.

(2) Magnetic tape will be chromium dioxide particle based ½-inch tape.

(3) Cartridges must be 18-track or 36-track parallel (See **Note**).

(4) Cartridges will contain 37,871 CPI or 75,742 CPI (characters per inch).

(5) Mode will be full function.

(6) The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

(7) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used.

.02 The tape cartridge records defined in this revenue procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,250 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 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter [see item **(b)** above]. The block length must be evenly divisible by 750.

(d) Records may not span blocks.

.03 Tape cartridges may be labeled or unlabeled.

.04 For the purposes of this revenue procedure, the following must be used:

Tape Mark:

(a) Signifies the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

☛ **Note: Filers should indicate on the external media label and transmittal Form 4804 whether the cartridge is 18-track or 36-track.**

Sec. 4. 8mm, 4mm, and Quarter Inch Cartridge Specifications

.01 In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

(a) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Created from an AS400 operating system only.
(2) 8mm (.315-inch) tape cartridges will be 2 ½-inch by 3 ½-inch.
(3) The 8mm tape cartridges must meet the following specifications:

Tracks	Density	Capacity
1	20 (43245 BPI)	2.5 Gb (10Gb)
1	21 (45434 BPI)	5 Gb (20Gb)

(4) Mode will be full function.
(5) Compressed data is not acceptable.
(6) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used. However, IRS/MCC encourages the use of EBCDIC. This information must appear on the external media label affixed to the cartridge.
(7) A file may consist of more than one cartridge; however, no more than 250,000 documents may be transmitted per file or per cartridge. The filename, for example; IRSTAX, will contain a three digit extension. The extension will indicate the sequence of the cartridge within the file (e.g., 1 of 3, 2 of 3, and 3 of 3 will appear in the header label as IRSTAX.001, IRSTAX.002, and IRSTAX.003 on each cartridge of the file.) The Transmitter "T" Record must only appear on the first cartridge. **The end of transmission "F" Record should be placed only on the last cartridge for files containing multiple cartridges.**

.02 The 8mm (.315-inch) tape cartridge records defined in this revenue procedure may be blocked subject to the following:
(a) A block **must not** exceed 32,250 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; however, the last block of the file may be filled with 9's or truncated. **Do not pad a block with blanks.**
(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter [see item **(b)** above]. The block length must be evenly divisible by 750.
(d) Various COPY commands have been successful; however, the **SAVE OBJECT COMMAND** is not acceptable.
(e) Extraneous data following the "F" Record will result in media being returned for replacement.
(f) Records may not span blocks.
(g) No more than 250,000 documents per cartridge and per file.

.03 For faster processing, IRS/MCC encourages transmitters to use header labeled cartridges. IRSTAX may be used as a suggested filename.

.04 For the purposes of this revenue procedure, the following must be used:
Tape Mark:
(a) Signifies the physical end of the recording on tape.
(b) For even parity, use BCD configuration 001111 (8421).
(c) May follow the header label and precede and/or follow the trailer label.

.05 If extraneous data follows the End of Transmission "F" Record, the file will be returned for replacement. Therefore, IRS/MCC encourages transmitters to use blank tape cartridges, rather than cartridges previously used, in the preparation of data when submitting information returns.

.06 IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but must end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

.07 4mm (.157-inch) cassettes are now acceptable with the following specifications:
(a) 4mm cassettes will be 2 ½-inch by 3-inch.
(b) The tracks are 1 (one).
(c) The density is 19 (61000 BPI).
(d) The typical capacity is DDS (DAT data storage) at 1.3 Gb (*60 meter*) or 2 Gb (*90 meter*), or DDS-2 at 4Gb (*120 meter*).
(e) The general specifications for 8mm cartridges will also apply to the 4mm cassettes.

.08 Various Quarter Inch Cartridges (QIC) (¼-inch) are also acceptable.
(a) QIC cartridges will be 4″ by 6″.
(b) QIC cartridges must meet the following specifications:

Size	Tracks	Density	Capacity
QIC-24	8/9	5 (8000 BPI)	45Mb or 60Mb
QIC-120	15	15 (10000 BPI)	120Mb or 200Mb
QIC-150	18	16 (10000 BPI)	150Mb or 250Mb
QIC-525	26	17 (16000 BPI)	525Mb
QIC-1000	30	21 (36000 BPI)	1Gb
QIC-2Gb	42	34 (40640 BPI)	2Gb

(c) The general specifications that apply to 8mm cartridges will also apply to QIC cartridges.

Sec. 5. 3 ½-Inch Diskette Specifications

IRS/MCC has discontinued processing 5 ¼-inch diskettes. Filers must use other methods by which to submit information returns magnetically/electronically.

.01 To be compatible, a diskette file must meet the following specifications:

(a) 3 ½-inches in diameter.

(b) Data **must** be recorded in standard ASCII code.

(c) Records must be a fixed length of 750 bytes per record.

(d) Delimiter character commas (,) must not be used.

(e) Positions 749 and 750 of each record have been reserved for use as carriage return/line feed (CR/LF) characters, if applicable.

(f) Filename of IRSTAX must be used. Do not enter any other data in this field. If a file will consist of more than one diskette, the filename IRSTAX will contain a three-digit extension. This extension will indicate the sequence of the diskettes within the file. For example, if the file consists of three diskettes, the first diskette will be named IRSTAX.001, the second will be IRSTAX.002, and the third will be IRSTAX.003. The first diskette, IRSTAX.001 will begin with a "T" Record and the third diskette, IRSTAX.003 will have an "F" Record at the end of the file.

(g) A diskette will not contain multiple files as defined in Part A, Section 17. A file may have only **ONE** Transmitter "T" Record.

(h) Failure to comply with instructions will result in media being returned for replacement.

(i) Diskettes must meet one of the following specifications:

Capacity	Tracks	Sides/Density	Sector Size
1.44 mb	96tpi	hd	512
1.44 mb	135tpi	hd	512
1.2 mb	96tpi	hd	512

.02 IRS/MCC encourages transmitters to use blank or currently formatted diskettes when preparing files. If extraneous data follows the End of Transmission "F" Record, the file will be returned for replacement.

.03 *IRS/MCC will **only** accept 3 ½-inch diskettes created using MS-DOS.*

☛ **Notes:** ***IRS/MCC has discontinued processing 5 ¼-inch diskettes.***

IRS no longer has the capability to process non-MS-DOS compatible diskettes.

3 ½-inch diskettes created on a System 36 or AS400 are <u>not</u> acceptable.

.04 Transmitters should check media for viruses before submitting it to IRS/MCC.

Sec. 6. Transmitter "T" Record – General Field Descriptions

.01 The Transmitter "T" Record identifies the entity transmitting the magnetic media/electronic file and contains information which is supplied on the Form 4804, Transmittal of Information Returns reported Magnetically/Electronically. The "T" Record has been created to facilitate current magnetic/electronic processing of information returns at IRS/MCC.

.02 The Transmitter "T" Record is the first record on each file and is followed by a Payer "A" Record. See Part A, Sec. 17, Definition of Terms for the definition of file. A file will be returned to the transmitter for replacement if the "T" Record is not present. For transmitters with multiple diskettes, refer to Sec. 5. 3 ½-Inch Diskette Specifications.

.03 No money or payment amounts are reported in the Transmitter "T" Record.

.04 For all fields marked **"Required"**, the transmitter must provide the information described under Description and Remarks. For those fields not marked **"Required"**, a transmitter must allow for the field, but may be instructed to enter blanks or zeros in the indicated field positions and for the indicated length.

.05 All records must be a fixed length of 750 positions.

.06 The Transmitter "T" Record must be followed by the Payer "A" Record, which must be followed with Payee "B" Records; however, the initial record on each file must be a Transmitter "T" Record.

.07 All alpha characters entered in the "T" Record must be upper-case.

.08 When transmitting information on magnetic media or electronically, the Transmitter "T" Record must precede the first Payer "A" Record and reflect the person actually transmitting the information to IRS/MCC.

Record Name: Transmitter "T" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "T."
2–5	Payment Year	4	**Required.** Enter "*1999*" (unless reporting prior year data; report the year which applies [1997, 1998, etc.] and set the Prior Year Data Indicator in field position 6).
6	Prior Year Data Indicator	1	**Required.** Enter "P" **only** if reporting prior year data; otherwise, **enter blank.** *Do not enter a "P" if tax year is 1999.*
7–15	Transmitter's TIN	9	**Required.** Enter the transmitter's nine digit Tax Identification Number. May be an EIN, SSN or ITIN.
16–20	Transmitter Control Code	5	**Required.** Enter the five character alpha/numeric Transmitter Control Code (TCC) assigned by IRS/MCC. A TCC must be obtained to file data within this program.
21–22	Replacement Alpha Character	2	**Required for replacement files only.** Enter the alpha/numeric character which appears immediately following the TCC number on the Media Tracking Slip (Form 9267). The Form 9267 accompanies media that has been returned by IRS/MCC due to processing problems. This field must be blank unless media has been returned. If the file is being replaced magnetically, information is required in this field. If the file was originally sent magnetically, but the replacement is being sent electronically, the information is required in this field. Otherwise, leave blank for electronic files. Left justify information and fill unused positions with blanks. If this is not a replacement file, **enter blanks.**
23–27	Blank	5	**Enter blanks.**
28	Test File Indicator	1	**Required for test files only.** Enter "T" if this is a test file; otherwise, **enter a blank.**
29	Foreign Entity Indicator	1	Enter a "1" (one) if the transmitter is a foreign entity. If the transmitter is not a foreign entity, **enter a blank.**
30–69	Transmitter Name *(Used in course of business) This is not the person's name unless it is the name of the business transmitting the file.*	40	**Required.** Enter the name of the transmitter in the manner in which it is used in normal business. Left justify and fill unused positions with blanks.

Record Name: Transmitter "T" Record (Continued)

Field Position	Field Title	Length	Description and Remarks
70–109	Transmitter Name (Continuation)	40	Enter any additional information that may be part of the name. Left justify information and fill unused positions with blanks.

☛ **NOTE: All the information "Required" in Field Positions 110 through 280 MUST contain the address where media, which IRS/MCC was unable to process, may be returned. Any correspondence relating to problem media or electronic files will also be sent to this address.**

110–149	Company Name	40	**Required.** Enter the name of the company to be associated with the address where correspondence should be sent or media should be returned due to processing problems.
150–189	Company Name (Continuation)	40	Enter any additional information that may be part of the name of the company where correspondence should be sent or media should be returned due to processing problems.
190–229	Company Mailing Address	40	**Required.** Enter the mailing address where correspondence should be sent or media should be returned in the event IRS/MCC is unable to process.
230–269	Company City	40	**Required.** Enter the city, town, or post office where correspondence should be sent or media should be returned in the event IRS/MCC is unable to process.
270–271	Company State	2	**Required.** Enter the valid U. S. Postal Service state abbreviation. Refer to the chart of valid state codes in Part A, Sec.18.
272–280	Company ZIP Code	9	**Required.** Enter the valid nine digit ZIP Code assigned by the U. S. Postal Service. If only the first five digits are known, left justify information and fill unused positions with blanks
281–295	Blank	15	**Enter blanks.**
296–303	Total Number of Payees	8	*Enter the total number of Payee "B" Records reported in the file. Right justify information and fill unused positions with zeros.*
304–343	Contact Name	40	**Required.** Enter the name of the person to be contacted if IRS/MCC encounters problems with the file or transmission.
344–358	Contact's Phone Number & Extension	15	**Required.** Enter the telephone number of the person to contact regarding magnetic/electronic files. Omit hyphens. If no extension is available, left justify information and fill unused positions with blanks. For example, the IRS/MCC Call Site phone number of 304-263-8700 with an extension of 52345 would be 304263870052345.
359–360	Magnetic Tape File Indicator	2	**Required for magnetic tape/tape cartridge filers only.** Enter the letters "LS" (in uppercase only). Use of this field by filers using other types of media will be acceptable but is not required.
361–375	Electronic File Name For a Replacement File	15	**Required** for an incorrect original or correction electronic file for which a replacement is being sent. Enter the ORIGINAL or CORRECTION electronic file name assigned by the IRS electronic filing system.

EXAMPLE: If you have sent an original file, the TCC is 44444 and it is your first original file, then the filename would be ORIG.44444.0001.

If you are sending an original, correction or test file, then **enter blanks.**

Record Name: Transmitter "T" Record (Continued)			
Field Position	Field Title	Length	Description and Remarks
376–748	Blank	373	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Sec. 7. Transmitter "T" Record - Record Layout

Record Type	Payment Year	Prior Year Data Indicator	Transmitter's TIN	Transmitter Control Code	Replacement Alpha Character	Blank
1	2–5	6	7–15	16–20	21–22	23–27

Test File Indicator	Foreign Entity Indicator	Transmitter Name	Transmitter Name (Continuation)	Company Name	Company Name (Continuation)
28	29	30–69	70–109	110–149	150–189

Company Mailing Address	Company City	Company State	Company ZIP Code	Blank	Total Number of Payees	Contact Name
190–229	230–269	270–271	272–280	281–295	296–303	304–343

Contact's Phone Number & Extension	Magnetic Tape File Indicator	Electronic File Name For a Replacement File	Blank	Blank or CR/LF
344–358	359–360	361–375	376–748	749–750

Sec. 8. Payer "A" Record – General Field Descriptions

.01 The Payer "A" Record identifies the institution or person making payments, a recipient of mortgage interest payments, a broker, a person reporting a real estate transaction, a barter exchange, a creditor, a trustee, or issuer of an IRA, SEP, or SIMPLE, or a lender who acquires an interest in secured property or who has reason to know that the property has been abandoned. The payer will be held responsible for the completeness, accuracy, and timely submission of magnetic/electronic files. The Payer "A" Record also provides parameters for the succeeding Payee "B" Records. IRS computer programs rely on the absolute relationship between the parameters and data fields in the "A" Record and the data fields in the "B" Records to which they apply.

.02 The number of "A" Records depends on the number of payers and the different types of returns being reported. The payment amounts for one payer and for one type of return should be consolidated under one "A" Record if submitted on the same file.

.03 Do not submit separate "A" Records for each payment amount being reported. For example, if a payer is filing Form 1099-DIV to report Amount Codes 1, 2, and 3, all three amount codes should be reported under one "A" Record, not three separate "A" Records. For "B" Records that do not contain payment amounts for all three amount codes, enter zeros for those which have no payment to be reported.

.04 The second record on the file must be an "A" Record. A transmitter may include "B" Records for more than one payer on a tape or diskette. However, **each group** of "B" Records must be preceded by an "A" Record and followed by an End of Payer "C" Record. A single tape or diskette may contain different types of returns but the types of returns **must not** be intermingled. A separate "A" Record is required for each payer and each type of return being reported.

.05 All records must be a fixed length of 750 positions.

.06 The initial record on a file must be a "T" Record followed by an "A" Record. IRS/MCC will accept an "A" Record after a "C" Record to report an additional payer or a different type of return. An "A" Record may be blocked with "B" Records.

.07 Do not begin any record at the end of a block or diskette and continue the same record into the next block or diskette.

.08 All alpha characters entered in the "A" Record must be upper-case.

.09 When filing Form 1098, Mortgage Interest Statement, Form 1098-E, Student Loan Interest Statement, and Form 1098-T, Tuition Payments Statement, the "A" Record will reflect the name of the recipient of the interest referred to as the payer in these instructions. The "B" Record will reflect the individual paying the interest (borrower/payer of record) and the amount paid.

.10 For all fields marked **"Required"**, the transmitter must provide the information described under Description and Remarks. For those fields not marked **"Required"**, a transmitter must allow for the field, but may be instructed to enter blanks or zeros in the indicated media position(s) and for the indicated length.

Record Name: Payer "A" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "A."
2–5	Payment Year	4	**Required.** Enter "*1999*" (unless reporting prior year data; report the year which applies [1997, 1998, etc.]).
6–11	Blank	6	**Enter blanks.**
12–20	Payer's Taxpayer Identification Number (TIN)	9	**Required.** Must be the valid nine-digit Taxpayer Identification Number assigned to the payer. **Do not enter blanks, hyphens, or alpha characters.** All zeros, ones, twos, etc., will have the effect of an incorrect TIN.
☛ **Note: For foreign entities that are not required to have a TIN, this field must be blank. However, the Foreign Entity Indicator, position 52 of the "A" Record, must be set to "1" (one).**			
21–24	Payer Name Control	4	The Payer Name Control can be obtained only from the mail label on the Package 1099 that is mailed to most payers each December. To distinguish between Package 1099 and the Magnetic Media Reporting (MMR) Package, the Package 1099 contains *Form 7018-C, Order Blank for Forms,* and the mail label on the package contains a four (4) character name control. The MMR Package contains instructions for filing magnetically or electronically. *For a business, use the first four significant characters of the business name. Disregard the word "the" when it is the first word of the name, unless there are only two words in the name. A dash (–) and an ampersand (&) are the only acceptable special characters.* The mail label on the MMR Package **does not** contain a name control. Names of less than four (4) characters should be left justified, filling the unused positions with blanks. If a Package 1099 has not been received or the Payer Name Control is unknown, this field must be blank filled.
25	Last Filing Indicator	1	Enter a "1" (one) if this is the last year the payer will file; otherwise, **enter blank.** Use this indicator if the payer will not be filing information returns under this payer name and TIN in the future either magnetically, electronically, or on paper.
26	Combined Federal/State Filer	1	**Required for the Combined Federal/State Filing Program.** Enter "1" (one) if participating in the Combined Federal/State Filing Program; otherwise, **enter blank.** Refer to Part A, Sec. 16, for further information. **The only forms that may be filed under the Combined Federal /State Filing Program are: Forms 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R, and 5498.**

Record Name: Payer "A" Record (Continued)			
Field Position	Field Title	Length	Description and Remarks
27	Type of Return	1	**Required.** Enter the appropriate code from the table below: **Type of Return** — **Code** 1098 — 3 1098-E — 2 1098-T — 8 1099-A — 4 1099-B — B 1099-C — 5 1099-DIV — 1 1099-G — F 1099-INT — 6 1099-LTC — T 1099-MISC — A 1099-MSA — M 1099-OID — D 1099-PATR — 7 1099-R — 9 1099-S — S 5498 — L 5498-MSA — K W-2G — W
28–39	Amount Codes (See **Note**)	12	**Required.** Enter the appropriate amount codes for the type of return being reported. Generally, for each amount code entered in this field, a corresponding payment amount **must** appear in the Payee "B" Record. **In most cases, the box numbers on paper information returns correspond with the amount codes used to file magnetically/electronically. However, if discrepancies occur, this revenue procedure governs.** **The Amount Codes have been expanded from nine to twelve codes to accommodate three additional payment fields in the Payee "B" Record. Amount Codes 1 through 9 will remain numeric. Amount Codes 10, 11, and 12 will be A, B, and C, respectively.**

Example of Amount Codes:

If position 27 of the Payer "A" Record is "A" (for 1099-MISC) and positions 28-39 are "1247AC␣␣␣␣␣␣", this indicates the payer is reporting any or all six payment amounts (1247AC) in all of the following "B" Records. **(In this example, "␣" denotes blanks in the designated positions. Do not enter the letter "b".)**

The first payment amount field (1) will represent rents;
the second payment amount field (2) will represent royalties;
the third payment amount field (3) will be all "0" (zeros);
the fourth payment amount field (4) will represent Federal income tax withheld;
the fifth and sixth payment amount fields (5 and 6) will be all "0" (zeros);
the seventh payment amount field (7) will represent nonemployee compensation;
the eighth and ninth payment amount fields (8 and 9) will be all "0" (zeros);
the tenth payment amount field (A) will represent crop insurance proceeds;
the eleventh payment amount field (B) will be all "0" (zeros); and
the twelfth payment amount field (C) will represent gross proceeds paid to an attorney in connection with legal services.

Field Position	Field Title	Length	Description and Remarks

Enter the amount codes in **ascending sequence (i.e.,** 1247AC␣␣␣␣), left justify information, and fill unused positions with blanks. For further clarification of the amount codes, contact IRS/MCC. **(In this example, "␣" denotes blanks in the designated positions. Do not enter the letter "b.")**

☛ **Note: A type of return and an amount code must be present in every Payer "A" Record even if no money amounts are being reported. For a detailed explanation of the information to be reported in each amount code, refer to the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G."**

Amount Codes **Form 1098 -** Mortgage Interest Statement

For Reporting Mortgage Interest Received From Payers/Borrowers (Payer of Record) on Form 1098:

Amount Code	*Amount Type*
1	Mortgage interest received from payer(s)/borrower(s)
2	Points paid on purchase of principal residence
3	Refund (or credit) of overpaid interest
4	*Blank (Filer's use) See* ***Note.***

☛ **Note:** ***The interest recipient may use this box to furnish other information, such as real estate taxes or insurance paid from escrow.***

Amount Codes **Form 1098-E -** Student Loan Interest Statement

For Reporting Interest on Student Loans on Form 1098-E

Amount Code	*Amount Type*
1	Student loan interest received

☛ **Note:** ***Until regulations are adopted, no penalties will be imposed under section 6721 or 6722 for failure to file or furnish correct Forms 1098-E if you made a good faith effort to file and furnish them.***

Amount Codes **Form 1098-T -** Tuition Payments Statement

For Reporting Tuition Payments on Form 1098-T *(See Note.)*

Amount Code	*Amount Type*
1	For filer's use (See **Notes.**)
2	For filer's use (See **Notes.**)

☛ **Note: When reporting Form 1098-T magnetically/electronically, the filer must use Type of Return Code 8 in position 27, and Amount Codes 1 and 2 in positions 28 and 29 of the Payer "A" Record. However, if no money is being reported, the payment amount fields will contain zeros. There is no requirement for filers to report money amounts on Form 1098-T for Tax Year *1999*.**

PAYER: For Form 1098-T, payer refers to the eligible educational institution that received qualified tuition and related expenses in 1999. The payer is not the student or the parent/guardian of the student.

☛ **Note: Until regulations are adopted, no penalties will be imposed under section 6721 or 6722 for failure to file or furnish correct Forms 1098-T if you made a good faith effort to file and furnish them.**

Amount Codes **Form 1099-A -** Acquisition or Abandonment of Secured Property (See **Note.**)

For Reporting the Acquisition or Abandonment of Secured Property on Form 1099-A:

Amount Code	*Amount Type*
2	Balance of principal outstanding
4	Fair market value of property

Field Position	Field Title	Length	Description and Remarks

☛ **Note: If, in the same calendar year, a debt is canceled in connection with the acquisition or abandonment of secured property for one debtor and the filer would be required to file both Forms 1099-A and 1099-C (Cancellation of Debt), the filer is required to file Form 1099-C only. See the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G" for further information on coordination with Form 1099-C.**

Amount Codes **Form 1099-B** Proceeds From Broker and Barter Exchange Transactions

For Reporting on Form 1099-B:

Amount Code	*Amount Type*
2	Stocks, bonds, etc. (For forward contracts, see **Note 1.**)
3	Bartering (Do not report negative amounts.)
4	Federal income tax withheld (backup withholding) (Do not report negative amounts.)
6	Profit (or loss) realized in *1999* (See **Note 2.**)
7	Unrealized profit (or loss) on open contracts-12/31/98 (See **Note 2.**)
8	Unrealized profit (or loss) on open contracts-12/31/99 (See **Note 2.**)
9	Aggregate profit (or loss) (See **Note 2.**)

☛ **Note 1: The payment amount field associated with Amount Code 2 may be used to report a loss from a closing transaction on a forward contract. Refer to the "B" Record - General Field Descriptions, Payment Amount Fields, for instructions on reporting negative amounts.**

☛ **Note 2: Payment Amount Fields 6, 7, 8, and 9 are to be used for the reporting of regulated futures or foreign currency contracts.**

Amount Codes **Form 1099-C** - Cancellation of Debt (See **Note 1.**)

For Reporting Cancellation of Debt on Form 1099-C:

Amount Code	*Amount Type*
2	Amount of debt canceled
3	Interest, if included in Amount Code 2
7	Fair market value of property (See **Note 2.**)

☛ **Note 1: If, in the same calendar year, a debt is canceled in connection with the acquisition or abandonment of secured property for one debtor and the filer would be required to file both Forms 1099-C and 1099-A (Acquisition or Abandonment of Secured Property), the filer is required to file Form 1099-C only. See the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G" for further information on coordination with Form 1099-A.**

☛ **Note 2: Amount Code 7 will be used only if a combined Form 1099-A and 1099-C is being filed.**

Amount Codes **Form 1099-DIV** - Dividends and Distributions

See the *1999* "Instructions for Forms 1099, 1098, 5498 and W-2G" for further information on Form 1099-DIV.

For Reporting Payments on Form 1099-DIV:

Amount Code	*Amount Type*
1	Ordinary dividends
2	Total capital gains distributions
3	28% rate gain
4	Unrecaptured section 1250 gain
5	Section 1202 gain
6	Nontaxable distributions

Field Position	Field Title	Length	Description and Remarks
			7 Federal income tax withheld (backup withholding)
			8 Investment expenses
			9 Foreign tax paid
			A Cash liquidation distribution (See **Note.**)
			B Noncash liquidation distribution (See **Note.**)

☛ **Note:** ***Amount Codes A and B apply only to corporations in partial or complete liquidation. Amount Codes A and B reflect information in Boxes 8 and 9 on the Form 1099-DIV.***

Amount Codes **Form 1099-G** - *Certain Government and Qualified State Tuition Program Payments*

For Reporting Payments on Form 1099-G:

Amount Code	*Amount Type*
1	Unemployment compensation
2	State or local income tax refunds, credits, or offsets
4	Federal income tax withheld (backup withholding or voluntary withholding on unemployment compensation or Commodity Credit Corporation Loans, or certain crop disaster payments)
5	*Qualified state tuition program earnings*
6	Taxable grants
7	Agriculture payments

Amount Codes **Form 1099-INT** - Interest Income

For Reporting Payments on Form 1099-INT:

Amount Code	*Amount Type*
1	Interest income not included in Amount Code 3
2	Early withdrawal penalty
3	Interest on U.S. Savings Bonds and Treasury obligations
4	Federal income tax withheld (backup withholding)
5	*Investment expenses*
6	*Foreign tax paid*

Amount Codes **Form 1099-LTC**- Long-Term Care and Accelerated Death Benefits

For Reporting Payments on Form 1099-LTC:

Amount Code	*Amount Type*
1	Gross long-term care benefits paid
2	Accelerated death benefits paid

Amount Codes **Form 1099-MISC** - Miscellaneous Income (See **Note 1.**)

For Reporting Payments on Form 1099-MISC:

Amount Code	*Amount Type*
1	Rents
2	Royalties (See **Note 2.**)
3	Other income
4	Federal income tax withheld (backup withholding or withholding on payments of Indian gaming profits)
5	Fishing boat proceeds
6	Medical and health care payments
7	Nonemployee compensation

Field Position	Field Title	Length	Description and Remarks
			8 Substitute payments in lieu of dividends or interest
			A Crop insurance proceeds
			B Excess golden parachute payments
			C Gross proceeds paid to an attorney in connection with legal services

☛ **Note 1: If reporting the Direct Sales Indicator only in position 547 of the Payee "B" Record, use Type of Return Code A for 1099-MISC in position 27, and Amount Code 1 in position 28 of the Payer "A" record. All payment amount fields in the Payee "B" record will contain zeros.**

☛ **Note 2: Do not report timber royalties under a "pay-as-cut" contract; these must be reported on Form 1099-S.**

Amount Codes **Form 1099-MSA -** *Distributions From an MSA or Medicare+Choice MSA*

For Reporting Distributions from a Medical Savings Account or *Medicare+Choice MSA* on Form 1099-MSA:

Amount Code	*Amount Type*
1	Gross distribution
2	Earnings on excess contributions
4	*Fair market value of the account on date of death*

Amount Codes **Form 1099-OID** - Original Issue Discount

For Reporting Payments on Form 1099-OID:

Amount Code	*Amount Type*
1	Original issue discount for *1999*
2	Other periodic interest
3	Early withdrawal penalty
4	Federal income tax withheld (backup withholding)
6	*Original issue discount on U.S. Treasury obligations (See Note.)*
7	*Investment expenses (See Note.)*

☛ ***Note: See the 1999 "Instructions for Forms 1099, 1098, 5498 and W-2G" for further reporting information.***

Amount Codes **Form 1099-PATR -** Taxable Distributions Received From Cooperatives

For Reporting Payments on Form 1099-PATR:

Amount Code	*Amount Type*
1	Patronage dividends
2	Nonpatronage distributions
3	Per-unit retain allocations
4	Federal income tax withheld (backup withholding)
5	Redemption of nonqualified notices and retain allocations
Pass-Through Credits (See **Note.**)	
6	For filers use for pass-through credits
7	Investment credit
8	Work opportunity credit
9	Patron's alternative minimum tax (AMT) adjustment

☛ **Note: Amount Codes 6, 7, 8, and 9 are reserved for the patron's share of unused credits that the cooperative is passing through to the patron. Other credits, such as the Indian employment credit may be reported in Amount Code 6. The title of the credit reported in Amount Code 6 may be reported in the Special Data Entries Field in the Payee "B" Record. The**

Field Position	Field Title	Length	Description and Remarks

amounts shown for Amount Codes 6, 7, 8, and 9 must be reported to the payee. These Amount Codes and the Special Data Entries Field are for the convenience of the filer. This information is not needed by IRS/MCC.

Amount Codes **Form 1099-R** - Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

For Reporting Payments on Form 1099-R:

Amount Code	*Amount Type*
1	Gross distribution (See **Note 1.**)
2	Taxable amount (See **Note 2.**)
3	Capital gain (included in Amount Code 2)
4	Federal income tax withheld (See **Note 3.**)
5	Employee contributions or insurance premiums
6	Net unrealized appreciation in employer's securities
8	Other
9	Total employee contributions
A	Traditional IRA/SEP/SIMPLE distribution (See **Note 4.**)

☛ **Note 1: If the payment shown for Amount Code 1 is a total distribution, enter a "1" (one) in position 549 of the "B" Record. An amount must be shown in Payment Amount Field 1 unless reporting an amount ONLY in Payment Amount Field 8. If a distribution is a loss, do not enter a negative amount. For example, if stock is distributed but the value is less than the employee's after-tax contributions, enter the value of the stock in Payment Amount Field 1, enter "0" (zero) in Payment Amount Field 2, and enter the employee's contributions in Payment Amount Field 5.**

☛ **Note 2: If the taxable amount cannot be determined, enter a "1" (one) in position 547 of the "B" Record. For a traditional IRA, SEP, or SIMPLE distribution, generally enter in Payment Amount Field A the same amount entered in Payment Amount Field 1.**

☛ **Note 3: See the "1999 Instructions for Forms 1099, 1098, 5498, and W-2G" for information concerning Federal income tax withheld for Form 1099-R.**

☛ **Note 4: For Form 1099-R, report the total amount distributed from a Traditional IRA, SEP, or SIMPLE in Payment Amount Field A (IRA/SEP/SIMPLE Distribution), Field Positions 163-174 of the Payee "B" Record, and generally, the same amount in Payment Amount Field 1 (Gross Distribution), Field Positions 55-66 of the Payee "B" Record.** ***Amount Code A was created to identify the distribution as a Traditional IRA/SEP/SIMPLE. The IRA/SEP/SIMPLE Indicator should be set in Field Position 548 of the Payee "B" Record and the money should be reported in Payment Field A as well as Payment Field 1 of the Payee "B" Record; but, not in Payment Amount Field 2. The purpose for Payment Field A is to identify the amount of money reported is a Traditional IRA/SEP/SIMPLE distribution.*** **Refer to the "1999 Instructions for Forms 1099, 1098, 5498, and W-2G" for exceptions.**

Amount Codes **Form 1099-S** - Proceeds From Real Estate Transactions

For Reporting Payments on Form 1099-S:

Amount Code	*Amount Type*
2	Gross proceeds (See **Note.**)
5	Buyer's part of real estate tax

☛ **Note: Include payments of timber royalties made under a "pay-as-cut" contract, reportable under section 6050N. If timber royalties are being reported, enter "TIMBER" in the description field of the "B" record.**

Record Name: Payer "A" Record, Field Positions 28-39 (Continued)

Field Position	Field Title	Length	Description and Remarks
Amount Codes **Form 5498 -** IRA Contribution Information (See **Note 1.**)			For Reporting Information on Form 5498:

Amount Code	*Amount Type*
1	IRA contributions (other than amounts in Amount Codes 2, 3, and *7, 8, 9, and A*) ***(See Note 2.)***
2	Rollover contributions
3	Roth conversion amount
4	Fair market value of account
5	Life insurance cost included in Amount Code 1
7	Employer SEP contributions
8	SIMPLE contributions
9	Roth IRA contributions
A	Education IRA contributions

☛ **Note 1: For information regarding Inherited IRAs, refer to the *1999* "Instructions for Forms 1099, 1098, 5498, and W-2G" and Rev. Proc. 89-52, 1989-2 C.B. 632. Beneficiary information must be given in the Payee Name Line Field of the "B" Record.**

If reporting IRA contributions for a Desert Storm/Shield participant for other than *1999* or an Operation Joint Guard (OJG) (Bosnia Region) or *Operation Allied Force (Yugoslavia)* participant, enter "DS" for Desert Storm or Joint Endeavor or "JG" for Joint Guard, the year for which the contribution was made, and the amount of the contribution in the Special Data Entries Field of the "B" Record. Do not enter the contributions in Amount Code 1. For information concerning Desert Storm/Shield participant reporting, refer to the "1994 Instructions for Forms 1099, 1098, 5498, and W-2G," or Notice 91-17, 1991-1 C.B. 319. The instructions for filing Form 5498 for Desert Storm/Shield participants will also apply to participants of Joint Endeavor or Operation Joint Guard (OJG) (Bosnia Region) and *Operation Allied Force (Yugoslavia).*

☛ ***Note 2: Also include employee contributions to an IRA under a SEP plan but not salary reduction contributions. DO NOT include EMPLOYER contributions, these are included in Amount Code 7.***

Amount Codes **Form 5498-MSA**
MSA or Medicare+Choice MSA Information

For Reporting Information on 5498-MSA:

Amount Code	*Amount Type*
1	Employee or self-employed person's MSA contributions made in *1999* and *2000* for *1999*
2	Total MSA contributions made in *1999 (this would include any contributions made in 1999 for 1998. Optional for M+C MSA.)*
3	Total MSA contributions made in *2000* for *1999*
4	Rollover contributions (See **Note 1.**)
5	Fair market value of *MSA or M+C MSA* (See **Note 2.**)

☛ **Note 1: This is the amount of any rollover made to this MSA in *1999* after a distribution from another MSA. For detailed information on reporting, see the *1999* "Instructions for Forms 1099, 1098, 5498 and W-2G."**

☛ **Note 2: This is the fair market value (FMV) of the account on December 31, *1999*.**

Amount Codes **Form W-2G -** Certain Gambling Winnings

For Reporting Payments on Form W-2G:

Amount Code	*Amount Type*
1	Gross winnings
2	Federal income tax withheld
7	Winnings from identical wagers

Record Name: Payer "A" Record, Field Positions 28-39 (Continued)

Field Position	Field Title	Length	Description and Remarks
40–47	Blank	8	**Enter blanks.**
48	Original File Indicator	1	**Required for original files only.** Enter "1" (one) if the information is original data. Otherwise, **enter a blank.**
49	Replacement File Indicator	1	**Required for replacement files only.** Enter "1" (one) if the purpose of this file is to replace a file that IRS/MCC returned to the transmitter due to errors encountered in processing. This is a file that has not been successfully processed by IRS. Otherwise, **enter a blank.**

If selecting the Replacement File Indicator in Position 49, Field Positions 48 and 50 must be blank. Only one indicator may be selected for each Payer "A" Record.

50	Correction File Indicator	1	**Required for correction files only.** Enter "1" (one) if the purpose of this file is to correct information which was previously submitted to IRS/MCC, was processed, but contained erroneous information. Do not submit original information as corrections. Any information return which was inadvertently omitted from a file must be submitted as original. Otherwise, **enter a blank.**
51	Blank	1	**Enter a blank.**
52	Foreign Entity Indicator	1	Enter a "1" (one) if the payer is a foreign entity and income is paid by the foreign entity to a U. S. resident. If the payer is not a foreign entity, **enter a blank** (See **Note.**).

☛ **Note: If payers report the Foreign Entity Indicator erroneously, they may be subject to a penalty for providing incorrect information to IRS.**

53–92	First Payer Name Line	40	**Required.** Enter the name of the payer whose TIN appears in positions 12-20 of the "A" Record. Any extraneous information must be deleted. Left justify information, and fill unused positions with blanks. (Filers should not enter a transfer agent's name in this field. Any transfer agent's name should appear in the Second Payer Name Line Field.)

☛ **Note: When reporting Form 1098, Mortgage Interest Statement, and Form 1098-E, Student Loan Interest Statement, the "A" Record will reflect the name and TIN of the recipient of the interest or payment, the filer of Forms 1098 and 1098-E (the payer). The "B" Record will reflect the individual paying the interest (the borrower/payer of record) and the amount paid. For Form 1099-S, the "A" Record will reflect the person responsible for reporting the transaction (the filer of the Form 1099-S) and the "B" Record will reflect the seller/transferor. When reporting Form 1098-T, Tuition Payments Statement, the "A" Record will reflect the name and TIN of the educational institution receiving tuition payments. The "B" Record will reflect the name and TIN of the student on whose behalf the tuition is being paid.**

93–132	Second Payer Name Line	40	If the Transfer (or Paying) Agent Indicator (position 133) contains a "1" (one), this field must contain the name of the transfer (or paying) agent. If the indicator contains a "0" (zero), this field may contain either a continuation of the First Payer Name Line or blanks. Left justify information and fill unused positions with blanks.
133	Transfer Agent Indicator	1	**Required.** Identifies the entity in the Second Payer Name Line Field. (See Part A, Sec. 17 for a definition of transfer agent.)

Record Name: Payer "A" Record, Field Positions 28-39 (Continued)			
Field Position	Field Title	Length	Description and Remarks
			Code ***Meaning*** 1 The entity in the Second Payer Name Line Field is the transfer (or paying) agent. 0 (zero) The entity shown is **not** the transfer (or paying) agent (i.e., the Second Payer Name Line Field contains either a continuation of the First Payer Name Line Field or blanks).
134–173	Payer Shipping Address	40	**Required.** If the Transfer Agent Indicator in position 133 is a "1" (one), enter the shipping address of the transfer (or paying) agent. Otherwise, enter the **actual** shipping address of the payer. The street address should include number, street, apartment or suite number (or P. O. Box if mail is not delivered to street address). Left justify information, and fill unused positions with blanks.

For U.S. addresses, the payer city, state, and ZIP Code must be reported as a 40, 2, and 9 position field, respectively. **Filers must adhere to the correct format for the payer city, state, and ZIP Code.**

For foreign addresses, filers may use the payer city, state, and ZIP Code as a continuous 51 position field. Enter information in the following order: city, province or state, postal code, and the name of the country. When reporting a foreign address, the Foreign Entity Indicator in position 52 must contain a "1" (one).

174–213	Payer City	40	**Required.** If the Transfer Agent Indicator in position 133 is a "1" (one), enter the city, town, or post office of the transfer agent. Otherwise, enter the city, town, or post office of the payer. Left justify information, and fill unused positions with blanks. Do not enter state and ZIP Code information in this field.
214-215	Payer State	2	**Required.** Enter the valid U.S. Postal Service state abbreviations. Refer to the chart of valid state abbreviations in Part A, Sec.18.
216–224	Payer ZIP Code	9	**Required.** Enter the valid nine digit ZIP Code assigned by the U.S. Postal Service. If only the first five digits are known, left justify information and fill the unused positions with blanks. For foreign countries, alpha characters are acceptable as long as the filer has entered a "1" (one) in the Foreign Entity Indicator, located in Field Position 52 of the "A" Record.
225–239	Payer's Phone Number & Extension	15	Enter the payer's phone number and extension.
240–748	Blank	509	**Enter blanks.**
749–750	Blank	2	**Enter blanks** or carriage return/line feed (CR/LF) characters.

Sec. 9. Payer "A" Record - Record Layout

Record Type	Payment Year	Blank	Payer's TIN	Payer Name Control	Last Filing Indicator
1	2–5	6–11	12–20	21–24	25

Combined Federal/State Filer	Type of Return	Amount Codes	Blank	Original File Indicator	Replacement File Indicator	Correction File Indicator
26	27	28–39	40–47	48	49	50

Blank	Foreign Entity Indicator	First Payer Name Line	Second Payer Name Line	Transfer Agent Indicator	Payer Shipping Address
51	52	53–92	93–132	133	134–173

Payer City	Payer State	Payer ZIP Code	Payer's Phone Number and Extension	Blank	Blank or CR/LF
174-213	214-215	216-224	225-239	240-748	749-750

Sec. 10. Payee "B" Record - General Field Descriptions and Record Layouts

.01 The "B" Record contains the payment information from the information returns. When filing information returns, the format for the "B" Records will remain constant and is a fixed length of 750 positions. The record layout for field positions 1 through 543 is the same for all types of returns. Field positions 544 through 750 vary for each type of return to accommodate special fields for individual forms. In the "A" Record, the amount codes that appear in field positions 28 through 39 will be left-justified and filled with blanks. In the "B" Record, the filer **must** allow for all twelve Payment Amount Fields. For those fields not used, enter "0" (zero). For example, a payer reporting on Form 1099-MISC should enter "A" in field position 27 of the "A" Record, Type of Return. If reporting payments for Amount Codes 1, 2, 4, 7, A and C, the payer would report field positions 28 through 39 of the "A" Record as "1247AC␣␣␣␣␣␣." (In this example, "␣" denotes blanks. Do not enter the letter "␣".) In the "B" Record:

Positions 55 through 66 for Payment Amount 1 will represent rents.

Positions 67-78 for Payment Amount 2 will represent royalties.

Positions 79-90 for Payment Amount 3 will be "0" (zeros).

Positions 91-102 for Payment Amount 4 will represent Federal income tax withheld.

Positions 103-126 for Payment Amounts 5 and 6 will be "0" (zeros).

Positions 127-138 for Payment Amount 7 will represent nonemployee compensation.

Positions 139-162 for Payment Amounts 8 and 9 will be "0" (zeros).

Positions 163-174 for Payment Amount A will represent crop insurance proceeds.

Positions 175-186 for Payment Amount B will be "0" (zeros).

Positions 187-198 for Payment Amount C will represent gross proceeds paid to an attorney in connection with legal services.

.02 The following specifications include a field in the payee records called "Name Control" in which the first four characters of the payee's surname are to be entered by the filer;

(a) If filers are unable to determine the first four characters of the surname, the Name Control Field may be left blank. Compliance with the following will facilitate IRS computer programs in identifying the correct name control:

(1) The surname of the payee whose TIN is shown in the "B" Record should always appear first. If, however, the records have been developed using the first name first, the filer must leave a blank space between the first and last names.

(2) In the case of multiple payees, only the surname of the payee whose TIN (SSN, EIN, ITIN, or ATIN) is shown in the "B" Record must be present in the First Payee Name Line. Surnames of any other payees may be entered in the Second Payee Name Line.

.03 See Part A, Sec. 14, for further information concerning Taxpayer Identification Numbers (TINs).

.04 For all fields marked **"Required"**, the transmitter must provide the information described under Description and Remarks. For those fields not marked **"Required"**, the transmitter must allow for the field, but may be instructed to enter blanks or zeros in the indicated field position(s) and for the indicated length.

.05 All records must be a fixed length of 750 positions.

.06 A field is also provided in these specifications for Special Data Entries. This field may be used to record information required by state or local governments, or for the personal use of the filer. IRS does not use the data provided in the Special Data Entries Field; therefore, the IRS program does not check the content or format of the data entered in this field. It is the filer's option to use the Special Data Entry Field. This field will not affect the processing of the "B" Records.

.07 Following the Special Data Entries Field in the "B" Record, payment fields have been allocated for State Income Tax Withheld and Local Income Tax Withheld. These fields are for the convenience of the filers. The information will not be used by IRS/MCC.

.08 Those payers participating in the Combined Federal/State Filing Program must adhere to all of the specifications in Part A, Sec. 16, to participate in this program. Filers may not file Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-LTC, 1099-MSA, 1099-S, 5498-MSA, and W-2G under the Combined Federal/State Filing Program.

.09 All alpha characters in the "B" Record must be uppercase.

.10 Do not use decimal points (.) to indicate dollars and cents. Ten dollars must appear as 000000001000 in the payment amount field.

.11 IRS strongly encourages transmitters to review the data for accuracy before submission to prevent issuance of erroneous notices. Transmitters should be especially careful that the names, TINs, account numbers, types of income, and income amounts are correct.

.12 When reporting Form 1098, Mortgage Interest Statement and Form 1098-E, Student Loan Interest Statement, the "A" Record will reflect the name and TIN of the recipient of the interest or payment, the filer of the Forms 1098 and 1098-E (the payer). The "B" Record will reflect the individual paying the interest (borrower/payer of record) and the amount paid. For Form 1099-S, the "A" Record will reflect the person responsible for reporting the transaction (the filer of the Form 1099-S) and the "B" record will reflect the seller/transferor. When reporting Form 1098-T, Tuition Payments Statement, the "A" Record will reflect the name and TIN of the educational institution receiving tuition payments. The "B" Record will reflect the name and TIN of the student on whose behalf the tuition is being paid.

Record Name: Payee "B" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "B."
2–5	Payment Year	4	**Required.** Enter "*1999*" (unless reporting prior year data; report the year which applies [1997, 1998, etc.]).
6	Corrected Return Indicator (See **Note.**)	1	**Required for corrections only.** Indicates a corrected return. ***Code*** — ***Definition*** G — If this is a one-transaction correction or the first of a two-transaction correction C — If this is the second transaction of a two-transaction correction Blank — If this is not a return being submitted to correct information already processed by IRS

☛ **Note: C, G, and non-coded records must be reported using separate Payer "A" Records. Refer to Part A, Sec. 13, for specific instructions on how to file corrected returns.**

7-10	Name Control	4	If determinable, enter the first four characters of the surname of the person whose TIN is being reported in positions 12-20 of the "B" Record; otherwise, **enter blanks.** This usually is the payee. If the name that corresponds to the TIN is not included in the first or second payee name line and the correct name control is not provided, a backup withholding notice may be generated for the record. Surnames of less than four characters should be left-justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. In the case of a business, other than a sole proprietorship, use the first four significant characters of the business name. Disregard the word "the" when it is the first word of the name, unless there are only two words in the name. A dash (-) and an ampersand (&) are the only acceptable special characters. Surname prefixes are considered part of the surname, e.g., for Van Elm, the name control would be VANE.

Field Position	Field Title	Length	Description and Remarks

☛ **Note: Imbedded blanks, extraneous words, titles, and special characters (i.e., Mr., Mrs., Dr., period [.], apostrophe ['])** **should be removed from the Payee Name Lines. This information may be dropped during subsequent processing at IRS/MCC. A dash (-) and an ampersand (&) are the only acceptable special characters.**

The following examples may be helpful to filers in developing the Name Control:

	Name	Name Control
Individuals:		
	Jane **Brown**	BROW
	John A. **Lee**	LEE*
	James P. **En**, Sr	EN*
	John **O'Neill**	ONEI
	Mary **Van B**uren	VANB
	Juan **De Je**sus	DEJE
	Gloria A. **El-R**oy	EL-R
	Mr. John **Smit**h	SMIT
	Joe **McCa**rthy	MCCA
	Pedro **Torr**es-Lopes	TORR
	Maria **Lope**z Moreno**	LOPE
	Binh To **La**	LA*
	Nhat Thi **Pham**	PHAM
	Mark **D'All**esandro	DALL
Corporations:		
	The **Firs**t National Bank	FIRS
	The Hideaway	THEH
	A & B Cafe	A&BC
	11TH Street Inc.	11TH
Sole Proprietor:		
	Mark **Heml**ock DBA The Sunshine Club	HEML
Partnership:		
	Robert **Aspe**n and Bess Willow	ASPE
	Harold **Fir**, Bruce Elm, and Joyce Spruce et al Ptr	FIR*
Estate:		
	Frank **Whit**e Estate	WHIT
	Estate of Sheila **Blue**	BLUE
Trusts and Fiduciaries:		
	Daisy Corporation Employee Benefit Trust	DAIS
	Trust FBO The **Cherry**blossom Society	CHER
Exempt Organization:		
	Laborer's Union, AFL-CIO	LABO
	St. Bernard's Methodist Church Bldg. Fund	STBE

Record Name: Payee "B" Record (Continued)

Field Position	Field Title	Length	Description and Remarks
			*Name Controls of less than four significant characters must be left-justified and blank-filled. **For Hispanic names, when two last names are shown for an individual, derive the name control from the first last name.
11	Type of TIN	1	This field is used to identify the Taxpayer Identification Number (TIN) in positions 12-20 as either an Employer Identification Number (EIN), a Social Security Number (SSN), an Individual Taxpayer Identification Number (ITIN), or an Adoption Taxpayer Identification Number (ATIN). Enter the appropriate code from the following table: ***Code*** ***Type of TIN*** ***Type of Account*** 1 EIN A business, organization, sole proprietor, or other entity 2 SSN An individual, including a sole proprietor or 2 ITIN An individual required to have a taxpayer identification number, but who is not eligible to obtain an SSN or 2 ATIN An adopted individual prior to the assignment of a social security number Blank N/A If the type of TIN is not determinable, enter a blank.
12–20	Payee's Taxpayer Identification Number (TIN)	9	**Required.** Enter the nine digit Taxpayer Identification Number of the payee (SSN, ITIN, ATIN, or EIN). If an identification number has been applied for but not received, **enter blanks.** Do not enter hyphens or alpha characters. All zeros, ones, twos, etc., will have the effect of an incorrect TIN. If the TIN is not available, **enter blanks.** (See **Note.**)
			☛ **Note: IRS/MCC contacts payers who have submitted payee data with missing TINs in an attempt to prevent errors that could result in penalties. Payers who submit data with missing TINs, and have taken the required steps to obtain this information are encouraged to attach a letter of explanation to the required Form 4804. This will prevent unnecessary contact from IRS/MCC. This letter, however, will not prevent backup withholding notices (CP2100 or CP2100A Notices) or penalties for missing or incorrect TINs.**
21–40	Payer's Account Number For Payee	20	Enter any number assigned by the payer to the payee (e.g., checking or savings account number). Filers are encouraged to use this field. This number helps to distinguish individual payee records and should be unique for each document. Do not use the payee's TIN since this will not make each record unique. This information is particularly useful when corrections are filed. This number will be provided with the backup withholding notification and may be helpful in identifying the branch or subsidiary reporting the transaction. Do not define data in this field in packed decimal format. If fewer than twenty characters are used, filers may either left or right justify, filling the remaining positions with blanks.
41–44	Payer's Office Code	4	Enter office code of payer; otherwise, **enter blanks**. For payers with multiple locations, this field may be used to identify the location of the office submitting the information return.
45–54	Blank	10	**Enter blanks.**

Record Name: Payee "B" Record (Continued)			
Field Position	Field Title	Length	Description and Remarks
	Payment Amount Fields (Must be numeric) (See **Note.**)		**Required. Filers should allow for all payment amounts. For those not used, enter zeros.** For example: If position 27, Type of Return, of the "A" Record, is "A" (for 1099-MISC) and positions 28-39, Amount Codes, are "1247AC␣␣␣␣␣␣", this indicates the payer is reporting any or all six payment amounts in all of the following "B" Records. (In this example, "␣"denotes blanks in the designated positions. Do not enter the letter "b".) Payment Amount 1 will represent rents; Payment Amount 2 will represent royalties; Payment Amount 3 will be all "0" (zeros); Payment Amount 4 will represent Federal income tax withheld; Payment Amounts 5 and 6 will be all "0" (zeros); Payment amount 7 will represent nonemployee compensation, Payment Amounts 8 and 9 will be all "0" (zeros); Payment Amount A will represent crop insurance proceeds; Payment Amount B will be all "0" (zeros); and Payment Amount C will represent gross proceeds paid to an attorney in connection with legal services. Each payment field must contain 12 numeric characters. Each payment amount must contain U.S. dollars and cents. The right-most two positions represent cents in the payment amount fields. Do not enter dollar signs, commas, decimal points, or negative payments, except those items that reflect a loss on Form 1099-B. Positive and negative amounts are indicated by placing a "+" (plus) or "–" (minus) sign in the left-most position of the payment amount field. A negative over punch in the units position may be used, instead of a minus sign, to indicate a negative amount. If a plus sign, minus sign, or negative over punch is not used, the number is assumed to be positive. Negative over punch cannot be used in PC created files. Payment amounts must be right-justified and unused positions must be zero-filled. **Federal income tax withheld cannot be reported as a negative amount on any form.**

☛ **Note: Filers must enter numeric information in all payment fields when filing magnetically or electronically. However, when reporting information on the statement to recipient, the payer may be instructed to leave a box blank. Follow the guidelines provided in the paper instructions for the statement to recipient.**

55–66	Payment Amount 1*	12	The amount reported in this field represents payments for Amount Code 1 in the "A" Record.
67–78	Payment Amount 2*	12	The amount reported in this field represents payments for Amount Code 2 in the "A" Record.
79–90	Payment Amount 3*	12	The amount reported in this field represents payments for Amount Code 3 in the "A" Record.
91–102	Payment Amount 4*	12	The amount reported in this field represents payments for Amount Code 4 in the "A" Record.
103–114	Payment Amount 5*	12	The amount reported in this field represents payments for Amount Code 5 in the "A" Record.
115–126	Payment Amount 6*	12	The amount reported in this field represents payments for Amount Code 6 in the "A" Record.
127–138	Payment Amount 7*	12	The amount reported in this field represents payments for Amount Code 7 in the "A" Record.

Record Name: Payee "B" Record (Continued)			
Field Position	Field Title	Length	Description and Remarks
139–150	Payment Amount 8*	12	The amount reported in this field represents payments for Amount Code 8 in the "A" Record.
151–162	Payment Amount 9*	12	The amount reported in this field represents payments for Amount Code 9 in the "A" Record.
163–174	Payment Amount A*	12	The amount reported in this field represents payments for Amount Code A in the "A" Record.
175–186	Payment Amount B*	12	The amount reported in this field represents payments for Amount Code B in the "A" Record.
187–198	Payment Amount C*	12	The amount reported in this field represents payments for Amount Code C in the "A" Record.

***If there are discrepancies between the payment amount fields and the boxes on the paper forms, the instructions in this revenue procedure govern.**

199–246	Reserved	48	**Enter blanks.**
247	Foreign Country Indicator	1	**If the address of the payee is in a foreign country, enter a "1" (one) in this field;** otherwise, **enter blank.** When filers use this indicator, they may use a free format for the payee city, state, and ZIP Code. Address information must not appear in the First or Second Payee Name Line.
248–287	First Payee Name Line (See **Notes.**)	40	**Required.** Enter the name of the payee (preferably surname first) whose Taxpayer Identification Number (TIN) was provided in positions 12-20 of the "B" Record. Left justify and fill unused positions with blanks. If more space is required for the name, utilize the Second Payee Name Line Field. If there are multiple payees, only the name of the payee whose TIN has been provided should be entered in this field. The names of the other payees may be entered in the Second Payee Name Line Field. If reporting information for a sole proprietor, the individual's name must always be present, preferably on the First Payee Name Line. The use of the business name is optional in the Second Payee Name Line Field.

☛ **Note 1:** ***Extraneous words, titles, and special characters (i.e., Mr., Mrs., Dr., period [.], apostrophe [']) should be removed from the Payee Name Lines. This information may be dropped during subsequent processing at IRS/MCC. A dash (-) and an ampersand (&) are the only acceptable special characters.***

☛ **Note 2: End the First Payee Name Line with a full word. Do not split words.**

☛ **Note 3: When reporting Form 1098, Mortgage Interest Statement, and Form 1098-E, Student Loan Interest Statement, the "A" Record will reflect the name and TIN of the recipient of the interest or payment, the filer of Forms 1098 and 1098-E (the payer). The "B" Record will reflect the individual paying the interest (the borrower/payer of record) and the amount paid. For Form 1099-S, the "A" Record will reflect the person responsible for reporting the transaction (the filer of the Form 1099-S) and the "B" Record will reflect the seller/transferor.** ***When reporting Form 1098-T, Tuition Payments Statement, the "A" Record will reflect the name and TIN of the educational institution receiving tuition payments. The "B" Record will reflect the name and TIN of the student on whose behalf the tuition is being paid.***

Field Position	Field Title	Length	Description and Remarks
			☛ **Note 4: For Form 5498, Inherited IRAs, enter the beneficiary's name followed by the word "beneficiary." For example, "Brian Young as beneficiary of Joan Smith" or something similar that signifies that the IRA was once owned by Joan Smith. Filers may abbreviate the word "beneficiary" as, for example, "benef." Refer to the "*1999* Instructions for Forms 1099, 1098, 5498, and W-2G." The beneficiary's TIN must be reported in positions 12-20 of the "B" Record.**
			☛ **Note 5: When reporting Form 1099-LTC, Long-Term Care and Accelerated Death Benefits, the Payee Name Line of the "B" Record will reflect the policyholder. The name of the insured will be reported in Field Positions 557-596 of the Payee "B" Record.**
288–327	Second Payee Name Line	40	If there are multiple payees, (e.g., partners, joint owners, or spouses), use this field for those names not associated with the TIN provided in positions 12-20 of the "B" Record or if not enough space was provided in the First Payee Name Line, continue the name in this field. (See **Note.**) **Do not enter address information.** It is important that filers provide as much payee information to IRS/MCC as possible to identify the payee associated with the TIN. Left justify and fill unused positions with blanks. **Fill with blanks if no entries are present for this field.**
			☛ **Note: End the First Payee Name Line with a full word. Do not split words. Begin the Second Payee Name Line with the next sequential word.**
328–367	Blank	40	**Enter blanks.**
368–407	Payee Mailing Address	40	**Required.** Enter mailing address of payee. Street address should include number, street, apartment or suite number (or P.O. Box if mail is not delivered to street address). Left justify information and fill unused positions with blanks. This field **must not** contain any data other than the payee's mailing address.
			For U.S. addresses, the payee city, state, and ZIP Code must be reported as a 40, 2, and 9 position field, respectively. **Filers must adhere to the correct format for the payee city, state, and ZIP Code.** **For foreign addresses,** filers may use the payee city, state, and ZIP Code as a continuous 51 position field. Enter information in the following order: city, province or state, postal code, and the name of the country. When reporting a foreign address, the Foreign Country Indicator in position 247 must contain a "1" (one).
408–447	Blank	40	**Enter blanks.**
448–487	Payee City	40	**Required.** Enter the city, town or post office. Left justify information and fill the unused positions with blanks. Enter APO or FPO if applicable. Do not enter state and ZIP Code information in this field.
488–489	Payee State	2	**Required.** Enter the valid U.S. Postal Service state abbreviations for states or the appropriate postal identifier (AA, AE, or AP) described in Part A, Sec. 18.
490–498	Payee ZIP Code	9	**Required.** Enter the valid ZIP Code (nine or five digit) assigned by the U.S. Postal Service. If only the first five digits are known, left justify information and fill unused positions with blanks. For foreign countries, alpha characters are acceptable as long as the filer has entered a "1" (one) in the Foreign Country Indicator, located in position 247 of the "B" Record.
499–543	Blank	45	**Enter blanks.**

Standard Payee "B" Record Format For All Types of Returns, Positions 1-543

Record Type	Payment Year	Corrected Return Indicator	Name Control	Type of TIN	Payee's TIN	Payer's Account Number
1	2–5	6	7–10	11	12–20	21–40

Payer's Office Code	Blank	Payment Amount 1	Payment Amount 2	Payment Amount 3	Payment Amount 4	Payment Amount 5
41–44	45–54	55–66	67–78	79–90	91–102	103–114

Payment Amount 6	Payment Amount 7	Payment Amount 8	Payment Amount 9	Payment Amount A	Payment Amount B
115–126	127–138	139–150	151–162	163–174	175–186

Payment Amount C	Reserved	Foreign Country Indicator	First Payee Name Line	Second Payee Name Line	Blank
187–198	199–246	247	248–287	288–327	328–367

Payee Mailing Address	Blank	Payee City	Payee State	Payee ZIP Code	Blank
368–407	408–447	448–487	488–489	490–498	499–543

The following sections define the field positions for the different types of returns in the Payee "B" Record (positions 544-750):

(1) Forms 1098, 1098-E
(2) Form 1098-T
(3) Form 1099-A
(4) Form 1099-B
(5) Form 1099-C
(6) Form 1099-DIV*
(7) Form 1099-G*
(8) Form 1099-INT*
(9) Form 1099-LTC
(10) Form 1099-MISC*
(11) Form 1099-MSA
(12) Form 1099-OID*
(13) Form 1099-PATR*
(14) Form 1099-R*
(15) Form 1099-S
(16) Form 5498*
(17) Form 5498-MSA
(18) Form W-2G

* These forms may be filed through the Combined Federal/State Filing Program. IRS/MCC will forward these records to participating states for filers who have been approved for the program. See Part A, Sec. 16 for information about the program, including specific codes for the record layouts.

(1) Payee "B" Record - Record Layout Positions 544-750 for Forms 1098 and 1098-E

Field Position	Field Title	Length	Description and Remarks
544–662	Blank	119	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–748	Blank	26	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 Forms 1098 and 1098-E

Blank	Special Data Entries	Blank	Blank or CR/LF
544–662	663–722	723–748	749–750

☛ ***Note: Until regulations are adopted, no penalties will be imposed under section 6721 or 6722 for failure to file or furnish correct Forms 1098-T if you made a good faith effort to file and furnish them.***

(2) Payee "B" Record - Record Layout Positions 544-750 for Form 1098-T

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	*Half-time Student Indicator*	1	*Enter "1" (one) if the student was at least a half-time student during any academic period that began in 1999. Otherwise,* ***enter a blank.***
548	*Graduate Student Indicator*	1	*Enter "1" (one) if the student is enrolled exclusively in a graduate level program. Otherwise,* ***enter a blank.***
549–662	Blank	114	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for the filing requirements. If this field is not utilized, **enter blanks.**
723–748	Blank	26	**Enter blanks**
749–750	Blank	2	**Enter blanks** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 Form 1098-T

Blank	Half-time Student Indicator	Graduate Student Indicator	Blank	Special Data Entries	Blank	Blank or CR/LF
544–546	547	548	549–662	663–722	723–748	749–750

(3) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-A

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	Personal Liability Indicator	1	Enter the appropriate indicator from the table below: ***Indicator*** ***Usage*** 1 Borrower was personally liable for repayment of the debt. Blank Borrower was not personally liable for repayment of the debt.
548–555	Date of Lender's Acquisition or Knowledge of Abandonment	8	Enter the acquisition date of the secured property or the date the lender first knew or had reason to know the property was abandoned, in the format YYYYMMDD (i.e., *19991022*). **Do not enter hyphens or slashes.**

☛ *For dates with one-digit months (i.e., January-September) or days (i.e., 1-9), enter a zero before the month or day. January 1, 1999, would be 19990101. Do not enter blanks, alphas or special characters.*

556–594	Description of Property	39	Enter a brief description of the property. For real property, enter the address, or, if the address does not sufficiently identify the property, enter the section, lot and block. For personal property, enter the type, make and model (e.g., Car-1998 Buick Regal or Office Equipment). Enter "CCC" for crops forfeited on Commodity Credit Corporation loans. If fewer than 39 positions are required, left justify information and fill unused positions with blanks.
595–662	Blank	68	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for the filing requirements. If this field is not utilized, **enter blanks.**
723–748	Blank	26	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 Form 1099-A

Blank	Personal Liability Indicator	Date of Lender's Acquisition or Knowledge of Abandonment	Description of Property	Blank
544–546	547	548–555	556–594	595–662

Special Data Entries	Blank	Blank or CR/LF
663–722	723–748	749–750

(4) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-B

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" to indicate notificationby IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; **enter a blank.**
545–546	Blank	2	**Enter blanks.**
547	Gross Proceeds Indicator	1	Enter the appropriate indicator from the following table, to identify amount reported in Amount Code 2; otherwise, **enter blanks.** ***Indicator*** ***Usage*** 1 Gross proceeds 2 Gross proceeds less commissions and option premiums
548–555	Date of Sale	8	For broker transactions, enter the trade date of the transaction. For barter exchanges, enter the date when cash, property, a credit, or scrip is actually or constructively received in the format YYYYMMDD (e.g., *19991022*). Enter blanks if this is an aggregate transaction. **Do not enter hyphens or slashes.**
556–568	CUSIP Number	13	For broker transactions only, enter the CUSIP (Committee on Uniform Security Identification Procedures) number of the item reported for Amount Code 2 (stocks, bonds, etc.). Enter blanks if this is an aggregate transaction. Enter "0" (zeros) if the number is not available. Right justify information and fill unused positions with blanks.
569–607	Description	39	If fewer than 39 characters are required, left justify information and fill unused positions with blanks. For broker transactions, enter a brief description of the disposition item (e.g., 100 shares of XYZ Corp.). For regulated futures and forward contracts, enter "RFC" or other appropriate description (see **Note**). For bartering transactions, show the services or property provided.
608–662	Blank	55	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.

☛ *For dates with one-digit months (i.e., January-September) or days (i.e., 1-9), enter a zero before the month or day. January 2, 1999, would be 19990102. Do not enter blanks, alphas or special characters.*

(4) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-B (Continued)

Field Position	Field Title	Length	Description and Remarks
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries field.
747–748	Blank	2	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-B

Second TIN Notice (Optional)	Blank	Gross Proceeds Indicator	Date of Sale	CUSIP Number	Description
544	545–546	547	548–555	556–568	569–607

Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
608–662	663–722	723–734	735–746	747–748	749–750

(5) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-C

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	Bankruptcy Indicator	1	Enter "1" (one) to indicate the debt was discharged in bankruptcy, if known. Otherwise, **enter a blank.**
548–555	Date Canceled	8	Enter the date the debt was canceled in the format of YYYYMMDD (i.e., *19991022*). **Do not enter hyphens or slashes.**

☛ *For dates with one-digit months (i.e., January-September) or days (i.e., 1-9), enter a zero before the month or day. January 2, 1999, would be 19990102. Do not enter blanks, alphas or special characters.*

556–594	Debt Description	39	Enter a description of the origin of the debt, such as student loan, mortgage, or credit card expenditure. If a combined Form 1099-C and 1099-A is being filed, also enter a description of the property.
595–662	Blank	68	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**

(5) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-C (Continued)

Field Position	Field Title	Length	Description and Remarks
723–748	Blank	26	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-C

Blank	Bankruptcy Indicator	Date Canceled	Debt Description	Blank	Special Data Entries
544–546	547	548–555	556–594	595–662	663–722

Blank	Blank or CR/LF
723–748	749–750

(6) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-DIV

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, **enter a blank.**
545–546	Blank	2	**Enter blanks.**
547–586	Foreign Country or U.S. Possession	40	Enter the name of the foreign country or U.S.possession to which the withheld foreign tax (Amount Code 9) applies. Otherwise, **enter blanks.**
587–662	Blank	76	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.

(6) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-DIV (Continued)

Field Position	Field Title	Length	Description and Remarks
747–748	Combined Federal/ State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-DIV

Second TIN Notice (Optional)	Blank	Foreign Country or U.S. Possession	Blank	Special Data Entries
544	545-546	547-586	587-662	663-722

State Income Tax Withheld	Local Income Tax Withheld	Combined Federal/ State Code	Blank or CR/LF
723–734	735–746	747–748	749–750

(7) Payee "B" Record-Record Layout Positions 544-750 for Form 1099-G

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	Trade or Business Indicator	1	Enter "1" (one) to indicate the state or local income tax refund, credit, or offset (Amount Code 2) is attributable to income tax that applies exclusively to income from a a trade or business. ***Indicator*** ***Usage*** 1 Income tax refund applies exclusively to a trade or business. Blank Income tax refund is a general tax refund.
548–551	Tax Year of Refund	4	Enter the tax year for which the refund, credit, or offset (Amount Code 2) was issued. **The tax year must reflect the year for which the payment was made, not the tax year of the Form 1099-G. The tax year must be in the four position format of YYYY (i.e., *1998*).** The valid range of years for the refund is 1989 through 1998.
552–662	Blank	111	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. **You may enter your routing and transit number (RTN) here.** If this field is not utilized, **enter blanks.**

(7) Payee "B" Record-Record Layout Positions 544-750 for Form 1099-G

Field Position	Field Title	Length	Description and Remarks
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/ State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-G

Blank	Trade or Business Indicator	Tax Year of Refund	Blank	Special Data Entries	State Income Tax Withheld
544–546	547	548–551	552–662	663–722	723–734

Local Income Tax Withheld	Combined Federal/ State Code	Blank or CR/LF
735–746	747–748	749–750

(8) Payee "B" Record—Record Layout Positions 544-750 for Form 1099-INT

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, **enter a blank.**
545–546	Blank	2	**Enter blanks.**
547–586	Foreign Country or U.S. Possession	40	Enter the name of the foreign country or U.S. possession to which the withheld foreign tax (Amount Code 6) applies. Otherwise, **enter blanks.**
587–662	Blank	76	**Enter blanks.**

(8) Payee "B" Record—Record Layout Positions 544-750 for Form 1099-INT (Continued)

Field Position	Field Title	Length	Description and Remarks
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. You may enter your routing and transit number (RTN) here. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/ State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-INT

Second TIN Notice (Optional)	Blank	Foreign Country or U.S. Possession	Blank	Special Data Entries	State Income Tax Withheld
544	545–546	547–586	587–662	663–722	723–734

Local Income Tax Withheld	Combined Federal/ State Code	Blank or CR/LF
735–746	747–748	749–750

(9) Payee "B" Record—Record Layout Positions 544-750 for Form 1099-LTC

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	Type of Payment Indicator	1	Enter the appropriate indicator from the following table; otherwise, **enter blanks.**

(9) Payee "B" Record—Record Layout Positions 544-750 for Form 1099-LTC (Continued)

Field Position	Field Title	Length	Description and Remarks
			Indicator ***Usage*** 1 Per diem 2 Reimbursed amount
548–556	Social Security. Number of Insured	9	**Required.** Enter the Social Security Number of the insured
557–596	Name of Insured	40	**Required.** Enter the name of the insured.
597–636	Address of Insured	40	**Required.** Enter the address of the insured. Street address should include number, street, apartment or suite number (or P.O. Box if not delivered to street address). Left justify information and fill unused positions with blanks. This field **must not** contain any data other than payee's address.

For U.S. addresses, the payee city, state, and ZIP Code must be reported as a 40, 2, and 9 position field, respectively. **Filers must adhere to the correct format for the insured's city, state, and ZIP Code.**

For foreign addresses, filers may use the insured's city, state, and ZIP Code as a continuous 51 position field. Enter information in the following order: city, province or state, postal code, and the name of the country. When reporting a foreign address, the Foreign Country Indicator in position 247 must contain a "1" (one).

637–676	City of Insured	40	**Required.** Enter the city, town, or post office. Left justify information and fill the unused positions with blanks. Enter APO or FPO, if applicable. Do not enter state and Zip Code information in this field.
677–678	State of Insured	2	**Required.** Enter the valid U.S. Postal Service state abbreviations for states or the appropriate postal identifier (AA, AE, or AP) described in Part A, Sec. 18.
679–687	ZIP Code of Insured	9	**Required.** Enter the valid nine digit ZIP Code assigned by the U.S. Postal Service. If only the first five digits are known, left justify information and fill the unused positions with blanks. For foreign countries, alpha characters are acceptable as long as the filer has entered a "1" (one) in the Foreign Country Indicator, located in position 247 of the "B" Record.
688	Status of Illness Indicator (Optional)	1	Enter the appropriate code from the table below to indicate the status of the illness of the insured; otherwise, **enter blank:** ***Indicator*** ***Usage*** 1 Chronically ill 2 Terminally ill
689–696	Date Certified (Optional)	8	Enter the latest date of a doctor's certification of the status of the insured's illness. The format of the date is YYYYMMDD (e.g., *19991022*).

☛ *For dates with one-digit months (i.e., January-September) or days (i.e., 1-9), enter a zero before the month or day. January 2, 1999, would be 19990102. Do not enter blanks, alphas or special characters.*

697–722	Blank	26	**Enter blanks.**

(9) Payee "B" Record—Record Layout Positions 544-750 for Form 1099-LTC (Continued)

Field Position	Field Title	Length	Description and Remarks
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled.
747–748	Blank	2	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record—Record Layout Positions 544-750 for Form 1099-LTC

Blank	Type of Payment Indicator	SSN of Insured	Name of Insured	Address of Insured	City of Insured	State of Insured	ZIP Code of Insured
544–546	547	548–556	557–596	597–636	637–676	677–678	679–687

Status of Illness Indicator (Optional)	Date Certified (Optional)	Blank	State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
688	689–696	697–722	723–734	735–746	747–748	749–750

(10) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-MISC

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, **enter a blank.**
545–546	Blank	2	**Enter blanks.**
547	Direct Sales Indicator (See **Note.**)	1	Enter a "1" (one) to indicate sales of $5,000 or more of consumer products to a person on a buy-sell, deposit-commission, or any other commission basis for resale anywhere other than in a permanent retail establishment. Otherwise, **enter a blank.**

☛ **Note: If reporting a direct sales indicator only, use Type of Return "A" in Field Position 27, and Amount Code 1 in Field Position 28 of the Payer "A" Record. All payment amount fields in the Payee "B" Record will contain zeros.**

548–662	Blank	115	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**

(10) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-MISC (Continued)

Field Position	Field Title	Length	Description and Remarks
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/ State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record—Record Layout Positions 544-750 for Form 1099-MISC

Second TIN Notice (Optional)	Blank	Direct Sales Indicator	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld
544	545–546	547	548–662	663–722	723–734	735–746

Combined Federal/ State Code	Blank or CR/LF
747–748	749–750

(11) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-MSA

Field Position	Field Title	Length	Description and Remarks
544	Blank	1	**Enter blank.**
545	Distribution Code	1	**Required.** Enter the applicable code to indicate the type of payment: *Code* — *Category* 1 — Normal distribution 2 — Excess contributions 3 — Disability 4 — *Death distribution other than code 6 (This includes distributions to a spouse, nonspouse, or estate beneficiary in the year of death and to an estate after the year of death.)* 5 — Prohibited transaction

11) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-MSA (Continued)

Field Position	Field Title	Length	Description and Remarks
		6	*Death distribution **after year of death** to a nonspouse beneficiary (Do not use for distribution to an estate.)*
546	Blank	1	***Enter a blank.***
547	*Medicare+Choice Indicator*	1	*Enter "1" (one) if distributions are from a Medicare+Choice MSA. Otherwise, **enter a blank.***
548–662	Blank	115	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field .
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Blank	2	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record—Record Layout Positions 544-750 for Form 1099-MSA

Blank	Distribution Code	Blank	Medicare+ Choice MSA Indicator	Blank	Special Data Entries
544	545	546	547	548–662	663–722

State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
723–734	735–746	747–748	749–750

(12) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-OID

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" to indicate notification by IRS twice within three calendar years hat the payee provided an incorrect name and/or TIN combination; otherwise, **enter a blank.**
545–546	Blank	2	**Enter blanks.**
547–585	Description	39	**Required.** Enter the CUSIP number, if any. If there is no CUSIP number, enter the abbreviation for the stock exchange and issuer, the coupon rate, and year (**must be 4 digit year**) of maturity (e.g., NYSE XYZ 12 1/2 *1999*). Show the name of the issuer if other than the payer. If fewer than 39 characters are required, left justify information and fill unused positions with blanks.
586–662	Blank	77	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/ State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-OID

Second TIN Notice (Optional)	Blank	Description	Blank	Special Data Entries	State Income Tax Withheld
544	545–546	547–585	586–662	663–722	723–734

Local Income Tax Withheld	Combined Federal/ State Code	Blank or CR/FL
735–746	747–748	749–750

(13) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-PATR

Field Position	Field Title	Length	Description and Remarks
544	Second TIN Notice (Optional)	1	Enter "2" to indicate notification by IRS twice within three calendar years that the payee provided an incorrect name and/or TIN combination; otherwise, **enter a blank.**
545–662	Blank	118	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Combined Federal/ State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for 1099-PATR

Second TIN Notice (Optional)	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Combined Federal/ State Code	Blank or CR/LF
544	545–662	663–722	723–734	735–746	747–748	749–750

(14) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-R

Field Position	Field Title	Length	Description and Remarks
544	Blank	1	**Enter blank.**
545–546	Distribution Code (For a detailed explanation of the distribution codes see the "*1999* Instructions for	2	**Required.** *Enter at least one distribution code from the table below.* More than one code may apply. If only one code is required, it must be entered in position 545 and position 546 must be blank. A blank in position 545 is not acceptable. Position 545 must contain a numeric code in all cases ex cept when using Code D, E, F, G, H, J, L, M, P, or S. Distribution Code A, when applicable, must be entered in position 546 with the applicable

Field Position	Field Title	Length	Description and Remarks
	Forms 1099, 1098, 5498, and W-2G.")		numeric code in position 545. When using Code P for an IRA distribution under section 408(d)(4) of the Internal Revenue Code, the filer may also enter Code 1 or 2, if applicable. Only three numeric combinations are acceptable, Codes 8 and 1, 8 and 2, and codes 8 and 4, on one return. These three combinations can be used only if both codes apply to the distribution being reported. If more than one numeric code is applicable to different parts of a distribution, except the three combinations mentioned above, report two separate "B" Records. Distribution Codes E, F, and H cannot be used with any other codes. Distribution Code G may be used with Distribution Code 4 only, if applicable.

Code	*Category*
1	*Early distribution, no known exception *(in most cases, under age 59 ½)*
2	*Early distribution, exception applies [as defined in section 72(q), (t), or (v)] (other than Codes 3 or 4)
3	*Disability
4	*Death (includes payments to an estate or other beneficiary)
5	*Prohibited transaction
6	Section 1035 exchange *(a tax-free exchange of life insurance, annuity, or endowment contracts)*
7	*Normal distribution *(Do not use if Code J or M applies.)*
8	*Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 1999
9	PS 58 costs *(premiums paid by a trustee or custodian for current insurance protection)*
A	May be eligible for 5- or 10-year tax option
D	*Excess contributions plus earnings/excess deferrals taxable in *1997*
E	Excess annual additions under section 415
F	Charitable gift annuity
G	Direct rollover to IRA
H	*Direct rollover to qualified plan or tax-sheltered annuity or the distribution is from a conduit IRA and is made payable to the trustee of or is transferred to an employer plan
J	*Distribution from a Roth IRA. (This code may be used with Code 1, 2, 3, 4, 5, 8, or P.)*
L	Loans treated as deemed distributions under section 72(p)
M	Distribution from an education IRA (Ed IRA)
P	*Excess contributions plus earnings/excess deferrals taxable in 1998 (See the explanation for Code 8.)
R	*Recharacterized IRA contribution (To another type of IRA by a trustee-to-trustee transfer or with the same trustee) (See **Note.**)*
S	*Early distribution from a SIMPLE IRA in first 2 years, no known exception *(Do not use Code S if Code 3 or 4 applies.)*

(14) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-R (Continued)

Field Position	Field Title	Length	Description and Remarks
***If reporting an IRA, SEP, or SIMPLE distribution, use the IRA/SEP/SIMPLE Indicator of "1" (one) in position 548 of the Payee "B" Record.**			
☛ ***Note: The trustee of the first IRA must report the recharacterization as a distribution on Form 1099-R (and the original contribution and its character on Form 5498).***			
547	Taxable Amount Not Determined Indicator	1	Enter "1" (one) only if the taxable amount of the payment entered for Payment Amount Field 1 (Gross distribution) of the "B" Record cannot be computed; otherwise, **enter blank.** [If Taxable Amount Not Determined Indicator is used, enter "0" (zeros) in Payment Amount Field 2 of the Payee "B" Record.] Please make every effort to compute the taxable amount.
548	IRA/SEP/ SIMPLE Indicator	1	Enter "1" (one) for an IRA, SEP, or SIMPLE; otherwise, **enter a blank.** (See **Note.**) If the IRA/SEP/SIMPLE Indicator is used, enter the amount of the distribution in Payment Amount Field A of the Payee "B" Record. **It is not necessary to mark the indicator for a distribution from a Roth or education IRA or for an IRA recharacterization.**
☛ **Note: For Form 1099-R, generally, report the total amount distributed from a traditional IRA, SEP, or SIMPLE in Payment Amount Field A (IRA/SEP/SIMPLE Distribution), as well as Payment Amount Field 1 (Gross Distribution) of the "B" Record. Refer to the "*1999* Instructions for Forms 1099, 1098, 5498, and W-2G" for exceptions (Box 2a instructions).**			
549	Total Distribution Indicator (See **Note**)	1	Enter a "1" (one) only if the payment shown for Amount Code 1 is a total distribution that closed out the account; otherwise, **enter a blank.**
☛ **Note: A total distribution is one or more distributions within one tax year in which the entire balance of the account is distributed. Any distribution that does not meet this definition is not a total distribution.**			
550–551	Percentage of Total Distribution	2	Use this field when reporting a total distribution to more than one person, such as when a participant is deceased and a payer distributes to two or more beneficiaries. Therefore, if the percentage is 100, leave this field blank. If the percentage is a fraction, round off to thenearest whole number (for example, 10.4 percent will be 10 percent; 10.5 percent will be 11 percent). Enter the percentage received by the person whose TIN is included in positions 12-20 of the "B" Record. This field must be right justified, and unused positions must be zero-filled. If not applicable, **enter blanks.** Filers need not enter this information for any IRA distribution or for direct rollovers.
552–662	Blank	111	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. The state/ payer's state number, state distribution, name of locality, and/or local distribution can be entered in this field. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**

(14) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-R (Continued)

Field Position	Field Title	Length	Description and Remarks
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries field.
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record—Record Layout Positions 544-750 for Form 1099-R

Blank	Distribution Code	Taxable Amount Not Determined Indicator	IRA/SEP/SIMPLE Indicator	Total Distribution Indicator
544	545–546	547	548	549

Percentage of Total Distribution	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Combined Federal/ State Code	Blank or CR/LF
550–551	552–662	663–722	723–734	735–746	747–748	749–750

(15) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-S

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	Property or Services Indicator	1	**Required.** Enter "1" (one) if the transferor received or will receive property (other than cash and consideration treated as cash in computing gross proceeds) or services as part of the consideration for the property transferred. Otherwise, **enter a blank.**
548–555	Date of Closing	8	**Required.** Enter the closing date in the format YYYYMMDD (e.g., *19991022*). **Do not enter hyphens or slashes.**

☛ *For dates with one-digit months (i.e., January-September) or days (i.e., 1-9), enter a zero before the month or day. January 2, 1999, would be 19990102. Do not enter blanks, alphas or special characters.*

(15) Payee "B" Record - Record Layout Positions 544-750 for Form 1099-S

Field Position	Field Title	Length	Description and Remarks
556–594	Address or Legal Description	39	**Required.** Enter the address of the property transferred (including city, state, and ZIP Code). If the address does not sufficiently identify the property, also enter a legal description, such as section, lot, and block. For timber royalties, enter "TIMBER." If fewer than 39 positions are required, left justify information and fill unused positions with blanks.
595–662	Blank	68	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Blank	2	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 1099-S

Blank	Property or Services Indicator	Date of Closing	Address or Legal Description	Blank	Special Data Entries
544–546	547	548–555	556–594	595–662	663–722

State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
723–734	735–746	747–748	749–750

☛ **Note: When reporting Form 1099-S, the "B" Record will reflect the seller/transferor information.**

(16) Payee "B" Record - Record Layout Positions 544-750 for Form 5498

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**

(16) Payee "B" Record - Record Layout Positions 544-750 for Form 5498

Field Position	Field Title	Length	Description and Remarks
547	**IRA** Indicator (Individual Retirement Account)	1	**Required, if applicable.** Enter "1" (one) if only reporting a rollover (Amount Code 2) or Fair Market Value (Amount Code 4) for an IRA. Otherwise, **enter a blank.**
548	**SEP** Indicator (Simplified Employee Pension)	1	**Required, if applicable.** Enter "1" (one) if only reporting rollover (Amount Code 2) or Fair Market Value (Amount Code 4) for a SEP. Otherwise, **enter a blank.**
549	**SIMPLE** Indicator (Savings Incentive Match Plan for Employees)	1	**Required, if applicable.** Enter "1" (one) if only reporting a rollover (Amount Code 2) or Fair Market Value (Amount Code 4) for a SIMPLE. Otherwise, **enter a blank.**
550	**Roth IRA** Indicator	1	**Required, if applicable.** Enter "1" (one) if only reporting a rollover (Amount Code 2) or Fair Market Value (Amount Code 4) for a Roth IRA. Otherwise, **enter a blank.**
551	***Recharacterization* Indicator**	1	**Required, if applicable.** Enter "1" (one) if reporting any recharacterization. Otherwise, **enter a blank.**
552	**Education IRA** Indicator	1	**Required, if applicable.** Enter "1" (one) if only reporting a rollover (Amount Code 2) or Fair Market Value (Amount Code 4) for an Education IRA. Otherwise, **enter a blank.**
553–662	Blank	110	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–746	Blank	24	**Enter blanks.**
747–748	Combined Federal/State Code	2	If this payee record is to be forwarded to a state agency as part of the Combined Federal/State Filing Program, enter the valid state code from Part A, Sec. 16, Table 1. For those payers or states not participating in this program, **enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form 5498

Blank	IRA Indicator	SEP Indicator	SIMPLE Indicator	Roth IRA Indicator	*Recharacter -ization Indicator*	Education IRA Indicator
544–546	547	548	549	550	551	552

Payee "B" Record - Record Layout Positions 544-750 for Form 5498 (Continued)

Blank	Special Data Entries	Blank	Combined Federal/ State Code	Blank or CR/LF
553–662	663–722	723–746	747–748	749–750

(17) Payee "B" Record - Record Layout Positions 544-750 for Form 5498-MSA Information

Field Position	Field Title	Length	Description and Remarks
544–546	*Blank*	3	***Enter blanks.***
547	*Medicare+ Choice Indicator*	1	*Enter "1" for Medicare+Choice MSA.*
548–662	*Blank*	115	***Enter blanks.***
663–722	*Special Data Entries*	60	*This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements, If this field is not utilized,* ***enter blanks.***
723–748	*Blank*	26	***Enter blanks.***
749–750	*Blank*	2	***Enter blanks,*** *or carriage return/line feed (CR/LF) characters.*

Payee "B" Record - Record Layout Positions 544-750 for Form 5498-MSA

Blank	*Medicare + Choice MSA Indicator*	*Blank*	*Special Data Entries*	*Blank*	*Blank or CR/LF*
544–546	547	548–662	663–722	723–748	749–750

(18) Payee "B" Record - Record Layout Positions 544-750 for Form W-2G

Field Position	Field Title	Length	Description and Remarks
544–546	Blank	3	**Enter blanks.**
547	Type of Wager Code	1	**Required.** Enter the applicable type of wager code from the table below:

Code	*Category*
1	Horse race track (or off-track betting of a horse track nature)
2	Dog race track (or off-track betting of a dog track nature)
3	Jai-alai
4	State-conducted lottery
5	Keno
6	Bingo
7	Slot machines
8	Any other type of gambling winnings

(18) Payee "B" Record - Record Layout Positions 544-750 for Form W-2G (Continued)

Field Position	Field Title	Length	Description and Remarks
548–555	Date Won	8	**Required.** Enter the date of the winning transaction in the format *YYYYMMDD* (e.g., *19991022*). **Do not enter hyphens or slashes.** This is not the date the money was paid, if paid after the date of the race (or game).
☛ *For dates with one-digit months (i.e., January-September) or days (i.e., 1-9), enter a zero before the month or day. January 2, 1999, would be 19990102. Do not enter blanks, alphas or special characters.*			
556–570	Transaction	15	**Required** . For state-conducted lotteries, enter the ticket or other identifying number. For keno, bingo, and slot machines, enter the ticket or card number (and color, if applicable), machine serial number, or any other information that will help identify the winning transaction. For all others, **enter blanks.**
571–575	Race	5	If applicable, enter the race (or game) relating to the winning ticket; otherwise, **enter blanks.**
576–580	Cashier	5	If applicable, enter the initials or number of the cashier making the winning payment; otherwise, **enter blanks.**
581–585	Window	5	If applicable, enter the window number or location of the person paying the winning payment; otherwise, **enter blanks.**
586–600	First ID	15	For other than state lotteries, enter the first identification number of the person receiving the winning payment; otherwise, **enter blanks.**
601–615	Second ID	15	For other than state lotteries, enter the second identification number of the person receiving the winnings; otherwise, **enter blanks.**
616–662	Blank	47	**Enter blanks.**
663–722	Special Data Entries	60	This portion of the "B" Record may be used to record information for state or local government reporting or for the filer's own purposes. Payers should contact the state or local revenue departments for filing requirements. If this field is not utilized, **enter blanks.**
723–734	State Income Tax Withheld	12	State income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting state tax withheld, this field may be used as a continuation of the Special Data Entries Field.
735–746	Local Income Tax Withheld	12	Local income tax withheld is for the convenience of the filers. This information does not need to be reported to IRS. The payment amount must be right justified and unused positions must be zero-filled. If not reporting local tax withheld, this field may be used as a continuation of the Special Data Entries Field.
747–748	Blank	2	**Enter blanks.**
749–750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

Payee "B" Record - Record Layout Positions 544-750 for Form W-2G

Blank	Type of Wager Code	Date Won	Transaction	Race	Cashier	Window	First ID
544–546	547	548–555	556–570	571–575	576–580	581–585	586–600

Second ID	Blank	Special Data Entries	State Income Tax Withheld	Local Income Tax Withheld	Blank	Blank or CR/LF
601–615	616–662	663–722	723–734	735–746	747–748	749–750

Sec. 11. End of Payer "C" Record - General Field Descriptions and Record Layout

.01 The End of Payer "C" Record is a fixed record length of 750 positions. The control total fields are each 18 positions in length.

.02 The "C" Record consists of the total number of payees and the totals of the payment amount fields filed by a given payer and/or a particular type of return. The "C" Record must be written after the last "B" Record for each type of return for a given payer. For each "A" Record and group of "B" Records on the file, there must be a corresponding "C" Record.

.03 In developing the "C" Record, for example, if a payer used Amount Codes 1, 3, and 6 in the "A" Record, the totals from the "B" Records would appear in Control Totals 1 (positions 16-33), 3 (positions 52-69), and 6 (positions 106-123) of the "C" Record. In this example, positions 34-51, 70-105, and 124-231 would be zero filled. Positions 232-748 would be blank filled.

.04 Payers/Transmitters should verify the accuracy of the totals since data with missing or incorrect "C" Records will be returned for replacement.

Record Name: End of Payer "C" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "C."
2–9	Number of Payees	8	**Required.** Enter the total number of "B" Records covered by the preceding "A" Record. Right justify information and fill unused positions with zeros.
10–15	Blank	6	**Enter blanks.**
16–33	Control Total 1	18	**Required.** Accumulate totals of any payment amount fields in the "B" Record into the appropriate control total fields of the "C" Record. **Control totals must be right justified and unused control total fields zero-filled.** All control total fields are 18 positions in length.
34–51	Control Total 2	18	
52–69	Control Total 3	18	
70–87	Control Total 4	18	
88–105	Control Total 5	18	
106–123	Control Total 6	18	
124–141	Control Total 7	18	
142–159	Control Total 8	18	
160–177	Control Total 9	18	

Record Name: End of Payer "C" Record (Continued)

Field Position	Field Title	Length	Description and Remarks
178–195	Control Total A	18	
196–213	Control Total B	18	
214–231	Control Total C	18	
232–748	Blank	517	**Enter blanks.**
749-750	Blank	2	**Enter blanks,** or carriage return/line feed (CR/LF) characters.

End of Payer "C" Record - Record Layout

Record Type	Number of Payees	Blank	Control Total 1	Control Total 2	Control Total 3	Control Total 4	Control Total 5	Control Total 6
1	2–9	10–15	16–33	34–51	52–69	70–87	88–105	106–123

Control Total 7	Control Total 8	Control Total 9	Control Total A	Control Total B	Control Total C	Blank	Blank or CR/LF
124–141	142–159	160–177	178–195	196–213	214–231	232–748	749–750

Sec. 12. State Totals "K" Record - General Field Descriptions and Record Layout

.01 The State Totals "K" Record is a fixed record length of 750 positions. The control total fields are each 18 positions in length.

.02 The "K" Record is a summary for a given payer and a given state in the Combined Federal/State Filing Program, used **only** when state reporting approval has been granted.

.03 The "K" Record will contain the total number of payees and the totals of the payment amount fields filed by a given payer for a given state. The "K" Record(s) must be written after the "C" Record for the related "A" Record.

.04 In developing the "K" Record, for example, if a payer used Amount Codes 1, 3, and 6 in the "A" Record, the totals from the "B" Records coded for this state would appear in Control Totals 1, 3, and 6 of the "K" Record.

.05 There **must** be a separate "K" Record for **each state** being reported..

06 Refer to Part A, Sec. 16, for the requirements and conditions that **must** be met to file via this program.

(1) State Totals "K" Record - Record Layout Forms 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R, and 5498

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "K."
2–9	Number of Payees	8	**Required.** Enter the total number of "B" Records being coded for this state. Right justify information and fill unused positions with zeros.
10–15	Blank	6	**Enter blanks.**

(1) State Totals "K" Record - Record Layout Forms 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R, and 5498 (Continued)

Field Position	Field Title	Length	Description and Remarks
16–33	Control Total 1	18	**Required.** Accumulate totals of any payment amount fields in the "B" Records for each state being reported into the appropriate control total fields of the appropriate "K" Record. **Control totals must be right justified and unused control total fields zero-filled.** All control total fields are fields are 18 positions in length
34–51	Control Total 2	18	
52–69	Control Total 3	18	
70–87	Control Total 4	18	
88–105	Control Total 5	18	
106–123	Control Total 6	18	
124–141	Control Total 7	18	
142–159	Control Total 8	18	
160–177	Control Total 9	18	
178–195	Control Total A	18	
196–213	Control Total B	18	
214–231	Control Total C	18	
232–706	Blank	475	**Enter blanks.**
707–724	State Income Tax Withheld Total	18	State income tax withheld totals is for the convenience of the filers. Aggate totals of the state income tax withheld field in the Payee "B" Record; otherwise, **enter blanks.**
725–742	Local Income Tax Withheld Total	18	Local income tax withheld totals is for the convenience of the filers. Aggregate totals of the local income tax withheld field in the Payee "B" Record; otherwise, **enter blanks.**
743–746	Blank	4	**Enter blanks.**
747–748	Combined Federal/ State Code	2	**Required.** Enter the code assigned to the state which is to receive the information. (Refer to Part A, Sec. 16, Table 1.)
749–750	Blank	2	**Enter blanks** or carriage return/line feed (CR/LF) characters.

State Totals "K" Record - Record Layout Forms 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R, and 5498

Record Type	Number of Payees	Blank	Control Total 1	Control Total 2	Control Total 3	Control Total 4	Control Total 5	Control Total 6
1	2–9	10–15	16–33	34–51	52–69	70–87	88–105	106–123

State Totals "K" Record - Record Layout Forms 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 1099-R, and 5498 (Continued)

Control Total 7	Control Total 8	Control Total 9	Control Total A	Control Total B	Control Total C	Blank	State Income Tax Withheld Total	Local Income Tax Withheld Total
124–141	142–159	160–177	178–195	196–213	214–231	232–706	707–724	725–742

Blank	Combined Federal/State Code	Blank or CR/LF
743–746	747–748	749–750

Sec. 13. End of Transmission "F" Record - General Field Descriptions and Record Layout

.01 The End of Transmission "F" Record is a fixed record length of 750 positions. The "F" Record is a summary of the number of payers in the entire file.

.02 This record should be written after the last "C" Record (or last "K" Record, when applicable) of the entire file.

Record Name: End of Transmission "F" Record

Field Position	Field Title	Length	Description and Remarks
1	Record Type	1	**Required.** Enter "F."
2–9	Number of "A" Records	8	Enter the total number of Payer "A" Records in the entire file (right justify and zero fill) or enter all zeros.
10–30	Zero	21	Enter zeros.
31–748	Blank	718	**Enter blanks.**
749–750	Blank	2	**Enter blanks** or carriage return/line feed (CR/LF) characters.

End of Transmission "F" Record - Record Layout

Record Type	Number of "A" Records	Zero	Blank	Blank or CR/LF
1	2–9	10–30	31–748	749–750

Part C. Electronic Filing Specifications

Sec. 1. Background

.01 IRS/MCC is in the process of upgrading all of its hardware and software for electronic filing. Effective October 31, 1999, the Information Reporting Program-Bulletin Board System (IRP-BBS) and 3780 bisynchronous electronic filing systems will be discontinued. Starting November 1, 1999, users will be able to access the new electronic system via analog and ISDN BRI connections. Bisynchronous electronic filing will no longer be supported. The new system is designed to support the electronic filing of information returns only. The new telephone number for electronic filing is ***(1-304-262-2400).*** *Publications and forms will no longer be electronically available from MCC. Users needing the publications and forms no longer available on the IRP-BBS will need to* download them from the IRS's Internet Web Site at www.irs.ustreas.gov or order them by calling *1-800-TAX-FORM (1-800-829-3676).*

Sec. 2. Advantages of Filing Electronically

Some of the advantages of filing electronically are as follows: (1) Notification within 1-2 workdays as to the acceptability of the data transmitted.

(2) Later due dates than magnetic media or paper for electronically filed Forms 1099, 1098, and W-2G (refer to Part A, Section 10.01).

(3) Allowing more attempts than magnetic media filing to correct bad files before imposing penalties. (Refer to Part C, Section 6.05).

(4) Better customer service due to on-line availability of transmitters files for research purposes.

(5) Additional 45 days for testing - November 1, 1999, to January 31, 2000, instead of November 1, 1999, through December 15, 1999.

Sec. 3. General

.01 Electronic filing of Forms 1098, 1099, 5498, and W-2G, originals, corrections, and replacements of information returns is offered as an alternative to magnetic media (tape, tape cartridge, or diskette) or paper filing, but is not a requirement. Transmitters filing electronically will fulfill the magnetic media requirements for those payers who are required to file magnetically. It may also be used by payers who are under the filing threshold requirement, but would prefer to file their information returns this way. If the original file was sent magnetically, but was returned for replacement, the replacement may be transmitted electronically. Also, if the original file was submitted via magnetic media, any corrections may be transmitted electronically.

*.02 The electronic filing of information returns is not affiliated with the Form 1040 electronic filing program. These two programs are totally independent, and filers must obtain separate approval to participate in each of them. All inquiries concerning the electronic filing of information returns should be directed to IRS/MCC. IRS/MCC personnel cannot answer questions or assist taxpayers in the filing of Form 1040 tax returns. Filers with questions of this nature will be directed to the Customer Service toll-free number **(1-800-829-1040)** for assistance.*

.03 Files submitted to IRS/MCC electronically must be in standard ASCII code. No magnetic media or paper forms are to be submitted with the same information as the electronically submitted file.

.04 If a request for extension is approved, transmitters who file electronically will be granted an extension of time to file. Part A, Sec. 11, explains procedures for requesting extensions of time. Filers are encouraged to file their data as soon as possible.

*.05 The formats of the "T", "A", "B", "C", "K", and "F" Records are the same for electronically filed records as they are for 3 ½-inch diskettes, tapes, and tape cartridges, and must be in standard ASCII code. For electronically filed documents, each transmission is considered a separate file; therefore, each transmission **must** begin with a Transmitter "T" Record and end with an End of Transmission (EOT) "F" Record.*

Sec. 4. Electronic Filing Approval Procedure

.01 Filers must obtain, or already have, a Transmitter Control Code (TCC) assigned prior to submitting their files electronically. (Filers who currently have a TCC for magnetic media filing do not have to request a second TCC for electronic filing.) Refer to Part A, Sec. 7, for information on how to obtain a TCC.

.02 Once a TCC is obtained, electronic filers assign their own passwords and do not need prior or special approval.

*.03 With all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. Passwords are user assigned at first logon and are up to 8 alpha/numerics, which are case sensitive. However, if filers do forget their password, call **304-263-8700** for assistance.*

Note: Passwords are case sensitive.

Sec. 5. Test Files

*.01 Filers are not required to submit a test file; however, the submission of a test file is encouraged for all electronic filers because of the new hardware and software. If filers wish to submit an electronic test file for Tax Year 1999 (returns to be filed in 2000), it **must** be submitted to IRS/MCC **no earlier than** November 1, 1999, and **no later than** January 31, 2000.*

.02 If a filer encounters problems while transmitting the electronic test files, contact IRS/MCC for assistance.

.03 Filers can verify the status of their transmitted test data by dialing the electronic filing system phone number (1-304-262-2400). This information will be available within 1-2 workdays after their transmission is received by IRS/MCC.

.04 A test file is required from filers who want approval for the Combined Federal/State Filing Program. See Part A, Sec. 16, for further details.

Sec. 6. Electronic Submissions

*.01 Electronically filed information may be submitted to IRS/MCC 24 hours a day, 7 days a week. Technical assistance will be available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern Time by calling **304-263-8700.***

.02 ***Do not transmit data electronically from December 28, 1999, through January 5, 2000.*** *This will allow time for IRS/MCC to update their system to reflect current year changes.*

.03 Data compression is encouraged when submitting information returns electronically. MCC has the ability to decompress files created using several popular software compression programs such as ARC, COMPRESS, LHARC, and PKZIP.

The time required to transmit information returns electronically will vary depending on the modem speed and the type of data compression used, if any. ***The time required to transmit a file can be reduced by as much as 95 percent by using software compression and hardware compression.***

The following are actual transmission rates achieved in test uploads at MCC using compressed files. The actual transmission rates will vary depending on the modem speeds.

Transmission Speed in bps	*1000 Records*	*10,000 Records*	*100,000 Records*
19.2K	*34 Sec.*	*6 Min.*	*60 Min.*
56K	*20 Sec.*	*3½ Min.*	*33 Min.*
128K (ISDN)	*8 Sec.*	*1 Min.*	*10 Min.*

.04 Files submitted electronically will be assigned a unique filename by the IRS system (the users may name files anything they choose from their end). The IRS assigned filename will consist of, submission type [TEST, ORIG (original), CORR (correction), and REPL (replacement)], the filer's TCC and a four digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your first original file for the calendar year and your TCC is 44444, the IRS assigned filename would be ORIG.44444.0001. Record the filename. This information will be needed by MCC in order to identify the file, if assistance is required, and to complete Form 4804.

.05 If a file was submitted timely and is bad, the filer will have up to 60 days from the day the file was uploaded or 4 replacement attempts to transmit an acceptable file. If an acceptable file is not received after 60 days or within 4 replacement attempts, then the payer could be subject to late filing penalties. This only applies to files originally sent electronically.

.06 ***Filers are advised not to resubmit an entire file if records were omitted from the original transmission. This will result in duplicate filing. A new file should be sent consisting of the records that had not previously been submitted.***

.07 The TCC in the Transmitter "T" Record must be the TCC used to transmit the file; otherwise, the file will be considered in error.

Sec. 7. Transmittal Requirements

.01 The results of the electronic transmission will be available in the File Status area of the electronic system within 1-2 workdays; however, no further processing will occur until the signed Form 4804 is received. The Form 4804 must be postmarked by the due date of the return. ***No return is considered filed until a Form 4804 is received by IRS/MCC.***

.02 Form 4804 can be ordered by calling the IRS toll-free forms and publication order number ***1-800-TAX-FORM (1-800-829-3676),*** *or it may be computer-generated. It may also be obtained from the* ***IRS's Internet Web Site at www.irs.ustreas.gov.*** *If a filer chooses to computer-generate Form 4804, all of the information contained on the original form, including the affidavit, must also be contained on the computer-generated form.*

.03 The TCC used in the Transmitter "T" Record is the TCC which must appear on the transmittal Form 4804.

.04 Forms 4804 may be mailed to the following address:

If by Postal Service, air or truck freight:
IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Electronic Filing Coordinator
230 Murall Drive
Kearneysville, WV 25430

Please indicate on the envelope the following message:
CONTAINS FORM 4804 INFORMATION - NO MAGNETIC MEDIA

Sec. 8. Electronic Filing Specifications

.01 The Electronic Filing System is designed exclusively for the filing of Forms 1099, 1098, 5498, and W2-G.

.02 A transmitter must have a TCC before a file can be transmitted. If you have a TCC for magnetic media filing, that TCC can also be used for electronic filing.

.03 Filers can determine the acceptability of files submitted by checking the file status area of the system. These reports will be available on the electronic system in 1-2 workdays after the transmission is received by IRS/MCC.

.04 Contact the Electronic Filing System by dialing ***304-262-2400.*** *This number supports analog connections from 1200bps to 56Kbps or ISDN BRI 128Kbps connections. The system can be accessed via Dial-up network/web browser or a communications software package such as Hyperterminal, Procomm, PCAnywhere, etc. The Dial-up network/web browser will provide an Internet-like look without going through the Internet (point to point). If you do not have this capability, a text interface will be provided that can be accessed via typical communications software and will perform similar to the former IRP-BBS.*

Sec. 9. Dial-up Network/Browser Specifications (Web Interface)

.01 Due to the large number of communication products available, it is impossible to provide specific information on a particular software package or hardware configuration. Filers should contact their software or hardware supplier for assistance. Your browser will need to be capable of file uploads (i.e., Internet Explorer 4.0, Netscape Navigator 2.0 or higher). The following are some general instructions (many of these settings may already be set by default in your software):

.02 Dial-up network settings:

(a) Set dial-up server type to PPP
(b) Set network protocol to TCP/IP
(c) Enable software compression
(d) Enable PPP LCP extensions

.03 Browser settings:

(a) Set to receive "cookies"
(b) Enable JavaScript or Jscript
(c) Browser must be capable of file uploads (i.e., Internet Explorer 4.0, Netscape 2.0 or higher)
(d) Enter the URL address of http://10.225.224.2

Sec. 10. Communication Software Specifications (Text Interface)

.01 Communications software settings should be:

– No parity
– Eight data bits
– One stop bit
– Full duplex

Sec. 11. Modem Configuration

.01 Hardware features

(a) Enable hardware flow control
(b) Enable modem error control
(c) Enable modem compression

Sec. 12. Logon Procedures

.01 The first time you log on to the electronic system, you will need to create a new account. After completing the registration information, you will be prompted for a user name and password. Passwords are assigned by the user at first logon and are up to 8 alpha/numerics which are case sensitive. Remember your ***exact*** *user name and password for future reference. If you forget your user name and/or password, call IRS/MCC at 304-263-8700 for assistance.*

.02 Once you are an established user, select the logon option and then you will be prompted for your logon name and password. Once you have entered this information, you will be at the Main Menu. Select one of the following options:

(a) Electronic Filing - this option will allow you to send your files and provide us with current mailing address information in case we need to send any correspondence.
(b) File Status - this option will display the results of your file transfer and will be posted in this area after 1-2 business days.

Sec. 13. Common Problems Associated with Electronic Filing

.01 Refer to Part A, Sec. 19, for common format errors associated with magnetic/electronic files.

.02 The following are the major non-format errors associated with electronic filing:

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1. No Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically.

Even though you have sent your information returns electronically, you still need to mail a signed Form 4804 by the due date of the return. See Part C, Sec. 7.04, for the mailing address.

2. Transmitter does not dial back to the electronic system to determine file acceptability.

Within 1-2 business days, the results of your file transmission will be posted under the option called File Status. It is very important that you check this option because if your file is bad and we do not receive a timely replacement, you could be subject to a late filing penalty.

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3. Transmitter compresses several files into one.

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately and send 10 separate compressed files.

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4. Transmitter sends a file and File Status indicates that the file is good, but the transmitter wants to send a replacement or correction file to replace the original/correction/replacement file.

Once a file has been transmitted, you cannot send a replacement file unless File Status indicates the file is bad (1-2 business days after file was transmitted). If you do not want us to process the file, you must first contact us at 304-263-8700 to see if this is a possibility. However, this will count as a replacement. (See Part A. Sec. 17, for the definition of replacement.)

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5. Transmitter sends an original file that is good, then sends a correction file for the entire file even though there are only a few changes.

The correction file, containing the proper coding, should only contain the records needing correction, not the entire file.

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6. File is formatted as EBCDIC.

All files submitted electronically must be in standard ASCII code.

Part D. Magnetic/Electronic Specifications For Extensions of Time

Sec. 1. General

.01 The specifications in Part D include the required 200-byte record format for extensions of time to file requests submitted magnetically or electronically. Also included are the instructions for the information that is to be entered in the record. **Filers are advised to read this section in its entirety to ensure proper filing.**

.02 Only filers who have been assigned a Transmitter Control Code may request an extension of time magnetically or electronically. If you meet the threshold of more than 50 payers when requesting an extension but are below the 250 documents threshold, you must still submit a Form 4419, Application for Filing Information Returns Magnetically/Electronically. Requests for extensions of time may be made for Forms 1098, 1099, 5498, W-2G, W-2, 1042-S and 8027.

.03 For Tax Year *1999* (returns due to be filed in *2000*), transmitters requesting an extension of time to file for **more than 50 payers (not payees) are required to file the extension request magnetically or electronically.** Transmitters requesting an extension of time for 10 to 50 payers (not payees) are encouraged to file the request magnetically or electronically. The request may be filed on tape, tape cartridge, 3 ½-inch diskette, or electronically.

.04 For extension requests filed on magnetic media, the transmitter must mail the completed, signed Form 8809, Request for Extension of Time To File Information Returns, in the same package as the corresponding media or *fax it to 304-264-5602.* For extension requests filed electronically, the transmitter must FAX the Form 8809 the same day the transmission is made.

.05 Transmitters submitting an extension of time magnetically or electronically should not submit a list of payer names and TINs with the Form 8809 since this information is included on the magnetic or electronic file. However, Line 6 of the Form 8809 must be completed with the total number of records included on the magnetic media or electronic file.

.06 To be considered, an extension request must be postmarked or transmitted by the due date of the returns; otherwise, the request will be denied.

.07 A magnetically-filed request for an extension of time should be sent using the following address:

If by Postal Service, truck or air freight:
IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

☛ **Note: Due to the large volume of mail received by IRS/MCC and the time factor involved in processing the Form 8809, it is imperative that the attention line be present on all envelopes or packages containing Extension of Time (EOT) requests.**

.08 Requests for extensions of time to file postmarked by the United States Postal Service on or before the due date of the returns, and delivered by United States mail to the IRS/MCC after the due date, are treated as timely under the "timely mailing as timely filing" rule. A similar rule applies to designated private delivery services (PDSs). See Part A, Sec. 10, for more information on PDSs. For requests delivered by a designated PDS, but through a non-designated service, the actual date of receipt by IRS/MCC will be used as the filing date.

.09 Transmitters who submit their extensions of time requests magnetically or electronically will receive a letter from IRS/MCC with an attached list of the payers, based on information contained in the file, specifying approval and/or denial.

.10 Do not submit tax year 1999 extensions of time to file requests on magnetic media before *January 1, 2000* or electronically before *January 6, 2000.*

.11 Filers may request an extension of time **as soon as they are aware** that an extension is necessary but not later than the due date of the return. It will take a minimum of 30 days for IRS/MCC to respond to an extension request. Under certain circumstances a request for an extension of time could be denied. In such cases, the transmitter receives a denial letter. When this denial letter is received, the transmitter has 20 days to provide the additional or necessary information and resubmit the extension request to IRS/MCC.

.12 Each piece of magnetic media **must** have an external media label containing the following information:

(a) Transmitter name
(b) Transmitter Control Code (TCC)
(c) Tax year
(d) The words "Extension of Time"
(e) Record count

.13 A request for an extension of time to file is not automatically granted. Approval or denial is dependent on information provided on the Form 8809. *If the Form 8809 is not completed properly, processing may be delayed or the request may be denied.*

.14 If the first request for an extension of time to file was submitted magnetically or electronically, additional extension requests should be submitted in the same manner.

.15 If an additional extension of time is needed, a second Form 8809 and file may be submitted before the end of the initial extension period with a postmark reflecting the date mailed. Line 7 on the form should be checked to indicate that the original extension has been received and the additional extension is being requested.

.16 See Part A, Sec. 11, for complete information on requesting an extension of time to file information returns. If there are additional questions or concerns, contact IRS/MCC.

Sec. 2. Magnetic Tape, Tape Cartridge, 8mm, 4mm and QIC (Quarter Inch Cartridge), 3 ½-inch Diskette and Electronic Specifications

.01 Tape specifications are as follows:

(a) 9 track.
(b) EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) recording mode.
(c) 1600 or 6250 BPI.
(d) A block must not exceed 32,600 tape positions and must be a multiple of 200.
(e) Record length of 200 bytes.
(f) Labeled or unlabeled tapes may be submitted.

.02 Tape cartridge specifications are as follows:

(a) Must be IBM 3480, 3490, or AS400 compatible.
(b) Must meet American National Standard Institute (ANSI) standards and have the following characteristics:
  (1) Tape cartridges will be ½-inch tape contained in plastic cartridges which are approximately 4-inches by 5-inches by 1-inch in dimension.
  (2) Magnetic tape will be chromium dioxide particle based ½-inch tape.
  (3) Cartridges will be 18-track or 36-track parallel. Indicate on the external media label if the tape cartridge is 18- or 36-track.
  (4) Mode will be full function.
  (5) The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.
  (6) Either EBCDIC or ASCII.
(c) A block must not exceed 32,600 tape positions and must be a multiple of 200.
(d) Record length of 200 bytes.
(e) Labeled or unlabeled tape cartridges may be submitted.

.03 8mm, 4mm, and Quarter Inch Cartridge Specifications

(a) In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

(1) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(a) Created from an AS400 operating system **only.**

(b) 8mm (.315-inch) tape cartridges will be 2¼-inch by 3¼-inch.

(c) The 8mm tape cartridges must meet the following specifications:

Tracks	Density	Capacity
1	20 (43245 BPI)	2.5 Gb
1	21 (45434 BPI)	5 Gb

(d) Mode will be full function.

(e) **Compressed data is not acceptable.**

(f) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Infor mation Interchange) may be used. However, IRS/MCC encourages the use of EBCDIC. This information mus appear on the external media label affixed to the cartridge.

(g) A file may consist of more than one cartridge; however, no more than 250,000 documents may be transmitted pe file or per cartridge. The filename, for example; IRSEOT, will contain a three digit extension. The extension wil indicate the sequence of the cartridge within the file, 1 of 3, 2 of 3, or 3 of 3, and would appear in the header labe IRSEOT.001, IRSEOT.002, and IRSEOT.003 on each cartridge of the file.

(2) The 8mm (.315-inch) tape cartridge records defined in this revenue procedure may be blocked subject to the following

(a) A block must not exceed 32,600 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; however, the last block of the file may be filled with 9's or truncated. Do not pad a block with blanks.

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within a block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 200.

(d) Various SAVE commands have been successful, however, the **SAVE OBJECT COMMAND is not acceptable.**

(e) Records may not span blocks.

(3) For faster processing, IRS/MCC encourages transmitters to use header labeled cartridges. IRSEOT may be used as a suggested filename.

(4) For the purposes of this revenue procedure, the following must be used:
Tape Mark:

(a) Signifies the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

(5) IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but must end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

(a) 4mm (.157-inch) cassettes are now acceptable with the following specifications:

(1) 4mm cassettes will be 2 ¼-inch by 3-inch.

(2) The tracks are 1 (one).

(3) The density is 19 (61000 BPI).

(4) The typical capacity is DDS (DAT data storage) at 1.3 Gb or 2 Gb, or DDS-2 at 4 Gb.

(5) The general specifications for 8mm cartridges will also apply to the 4mm cassettes.

(b) Various Quarter Inch Cartridges (QIC) (¼-inch) are also acceptable.

(1) QIC cartridges will be 4" by 6".

(2) QIC cartridges must meet the following specifications:

Size	Tracks	Density	Capacity
QIC-24	8/9	5 (8000 BPI)	45Mb or 60Mb
QIC-120	15	15 (10000 BPI)	120Mb or 200Mb
QIC-150	18	16 (10000 BPI)	150Mb or 250Mb
QIC-525	26	17 (16000 BPI)	525Mb
QIC-1000	30	21 (36000 BPI)	1Gb
QIC-2Gb	42	34 (40640 BPI)	2Gb

(3) The general specifications that apply to 8mm cartridges will also apply to QIC cartridges.

.04 Diskette specifications are as follows:

(a) 3 ½-inches in diameter.

(b) ASCII recording mode **only.** Additional specifications may be found in Part B, Sec. 5, of this revenue procedure.

(c) Record length of 200 bytes.

(d) Diskettes must be created using the MS-DOS operating system.

(e) Filename of IRSEOT must be used. No other filenames are acceptable. If a file will consist of more than one diskette, the filename IRSEOT will contain a three-digit extension. This extension will indicate the sequence of the diskettes within the file. For example, the first diskette will be named IRSEOT.001, the second diskette will be name IRSEOT.002, etc.

(f) Delimiter character commas (,) or quotes ('') must not be used.

(g) Positions 199 and 200 of each record have been reserved for use as carriage return/line feed (cr/lf) characters, if applicable.

.05 Electronic Filing specifications (See Note.)

(a) A transmitter must have a Transmitter Control Code (TCC).

(b) Filers can determine the acceptability of files submitted by checking the file status area of the system. These reports will be available on the electronic system within 5 business days if the Form 8809 is received timely by IRS/MCC.

☛ ***Note: See Part C, Electronic Filing Specifications, for detailed information on filing with IRS/MCC electronically.***

Sec. 3. Record Layout

.01 Positions 6 through 185 of the following record should contain information about the payer for whom the extension of time to file is being requested. Do not enter transmitter information in these fields. **Only one TCC may be present in a file.**

Record Layout for Extension of Time

Field Position	Field Title	Length	Description and Remarks
1–5	Transmitter Control Code	5	**Required.** Enter the five digit Transmitter Control Code (TCC) issued by IRS. **Only one TCC per file is acceptable.**
6–14	Payer TIN	9	**Required.** Must be the valid nine-digit EIN/SSN assigned to the payer. **Do not enter blanks, hyphens or alpha characters.** All zeros, ones, twos, etc. will have the effect of an incorrect TIN. For foreign entities that are not required to have a TIN, this field may be blank; however, the Foreign Entity Indicator, position 187, **must** be set to "X."
15–54	Payer Name	40	**Required.** Enter the name of the payer whose TIN appears in positions 6-14. Left justify information and fill unused positions with blanks.
55–94	Second Payer Name	40	If additional space is needed this field may be used to continue name line information (e.g., c/o First National Bank); otherwise, **enter blanks.**
95–134	Payer Address	40	**Required.** Enter the payer's address. Street address should include number, street, apartment or suite number (or P.O. Box if mail is not delivered to a street address).
135–174	Payer City	40	**Required.** Enter the payer's city, town, or post office.
175–176	Payer State	2	**Required.** Enter the payer's valid U.S. Postal Service state abbreviation. (Refer to Part A, Sec. 18.)
177–185	Payer ZIP Code	9	**Required.** Enter the payer's ZIP Code. If using a five-digit ZIP Code, left justify information and fill unused positions with blanks.
186	Document Indicator (See **Note**)	1	**Required.** Enter the document for which you are requesting an extension of time using the following code:

Record Layout for Extension of Time			
Field Position	Field Title	Length	Description and Remarks
			Code ***Document*** 1 W-2 2 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-DIV, 1099-G, 1099-INT,1099-LTC, 1099-MISC, 1099-MSA, 1099-OID, 1099-PATR, 1099-R, 1099-S, or W-2G 3 5498 4 1042-S 5 REMIC Documents (1099-INT or 1099-OID) 6 5498- MSA
			☛ **Note: Do not enter any other values in this field. Submit a separate record for each document. For example, if you are requesting an extension for Form 1099-INT and Form 5498 for the same payer, submit one record with "2" coded in this field and another record with "3" coded in this field. If you are requesting an extension for Form 1099-DIV and Form 1099-MISC for the same payer, submit one record with "2" coded in this field.**
187	Foreign Entity Indicator	1	Enter character "X" if the payer is a foreign entity.
188–198	Blank	11	**Enter blanks.**
199–200	Blank	2	**Enter blanks.** Diskette filers may code the ASCII carriage return/line feed (CR/LF) characters.

Extension of Time Record Layout

Transmitter Control Code	Payer TIN	Payer Name	Second Payer Name	Payer Address	Payer City	Payer State
1–5	6–14	15–54	55–94	95–134	135–174	175–176

Payer ZIP Code	Document Indicator	Foreign Entity Indicator	Blank	Blank or CR/LF
77–185	186	187	188–198	199–200

Part E. Miscellaneous Information

Sec. 1. Addresses for Martinsburg Computing Center

To submit an application to file, correspondence, and magnetic media files, use the following:

Mailing by U. S. Postal Service, truck or air freight:

IRS—Martinsburg Computing Center
Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

To submit magnetically filed and paper extension of time requests and waiver request (forms), use the following address:

Mailing by U.S. Postal Service, truck or air freight:

IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

Sec. 2. Telephone Numbers for Contacting IRS/MCC

Information Reporting Program Call Site: 304-263-8700

Between 8:30 a.m. and 4:30 p.m. Eastern Time
Monday through Friday

Electronic Filing - 1-304-262-2400

Telecommunication Device for the Deaf (TDD): 304-267-3367

Information Returns FAX Machine: 304-264-5602

HOURS OF OPERATION -
24 HOURS A DAY
7 DAYS A WEEK

This is the end of Publication 1220 for Tax Year *1999*.

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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. 99–30

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 1997. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1997. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1996, see Rev. Proc. 98–31, 1998–23 I.R.B. 9.

SECTION 2. CHANGES

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 1998. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 1997, the relevant domestic asset/liability percentages are:

117.4 percent for foreign life insurance companies, and

174.3 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 1998. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 1997, the relevant domestic investment yields are:

7.6 percent for foreign life insurance companies, and

5.8 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 1998. The section 842(b) percentages to be used for the 1998 tax year are based on tax return data rather than annual statement data.

With regard to future updates of the section 842(b) percentages, the Service noted in Rev. Proc. 98–31 that it was considering the use of statistical sampling

techniques to collect data from the tax returns of domestic insurance companies. The sampling technique considered was the same used to select insurance company tax returns in IRS Statistics Division's Publication 16 (section 3 thereof). Although the Service solicited comments in Rev. Proc. 98–31 addressing the use of this statistical sampling technique to calculate the section 842(b) percentages, none were received. The Service has assessed the accuracy of using sampling techniques and found that percentages based on statistical sampling techniques would be reliable. However, the cost of obtaining population estimates of the applicable percentages does not warrant reliance on a sampling technique. Thus, the percentages for the 1998 tax year are based on the population of tax returns.

SECTION 3. APPLICATION — ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 1997, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the release of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 98–31 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 1997.

DRAFTING INFORMATION

The principal author of this revenue procedure is John W. Rogers III of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure, please contact Mr. Rogers at (202) 622-3870 (not a toll-free call), or write to the Internal Revenue Service, Office of the Associate Chief Counsel (International), 1111 Constitution Avenue, NW, Washington, DC 20224, Attention: CC:INTL:Br5, Room 4554.

Part IV. Items of General Interest

Tables in Publication 1212, *List of Original Issue Discount Instruments*

Announcement 99–71

The original issue discount tables of Publication 1212 will not be available electronically from the IRS bulletin board (IRS-BBS) in Martinsburg, WV, after October 1999. Beginning November 1999, these tables will be available on the IRS Internet web site at **www.irs.ustreas.gov.**

Foreign Contingent Debt; Request for Comments

Announcement 99–76

I. *Summary.*

The Department of Treasury ("Treasury") and the Internal Revenue Service (the "Service") intend, in the near future, to withdraw the proposed regulations under section 988 regarding contingent payment debt instruments, dual currency debt instruments and multi-currency debt instruments and are considering how new proposed regulations under section 988 should treat these types of debt instruments. This announcement is intended to apprise taxpayers of the general approach currently being considered by Treasury and the Service with respect to the taxation of contingent payment debt instruments that provide for payments denominated in or determined by reference to a nonfunctional currency ("nonfunctional currency contingent instruments") and to request comments regarding the proper treatment of these instruments. This announcement also provides details regarding the specific rules under consideration and presents examples of the application of these rules to nonfunctional currency contingent instruments.

II. *Background.*

On March 17, 1992, Treasury and the Service issued proposed regulations §§ 1.988–1(a)(3),(4) and (5), regarding contingent payment debt instruments, dual currency debt instruments and multi-currency debt instruments. The proposed regulations followed the general approach in the then proposed § 1.1275–4(g) contingent payment debt regulations (LR–189–84, 51 F.R. 12022 (1986), amended FI–189–84 56 F.R. 8308 (1991)) and bifurcated debt instruments into contingent and noncontingent components. After an instrument was bifurcated, the proposed regulations applied the rules in § 1.988–1 through -5, as appropriate, to the resulting components.

On December 16, 1994, Treasury and the Service did not adopt the bifurcation approach by withdrawing the then proposed § 1.1275–4(g) regulations. At the same time, they proposed a new set of § 1.1275–4 regulations that adopted the "noncontingent bond method." Under the noncontingent bond method, interest is accrued on the issue price of the instrument at a rate equal to the comparable yield. Such a yield is the yield at which an issuer would issue a fixed rate debt instrument with terms and conditions similar to those of the contingent payment debt instrument. The interest on the debt instrument is original issue discount and, therefore, is taken into account as it accrues, regardless of the taxpayer's normal method of accounting. The comparable yield is used to construct a projected payment schedule for the debt instrument, which includes a projected amount for each contingent payment.

If the actual amount of a contingent payment is greater than the projected amount, the difference is additional interest. If the actual amount of a contingent payment is less than the projected amount, the difference generally offsets current interest accruals. In some cases, the difference may result in a loss to the holder and income to the issuer. The proposed § 1.1275–4 regulations were finalized on June 14, 1996.

Treasury and the Service believe that proposed regulations §§ 1.988–1(a)(3),(4) and (5) should now be withdrawn and reproposed since they incorporate the bifurcation approach rather than the noncontingent bond method ultimately adopted under § 1.1275–4. Treasury and the Service continue to believe that, for purposes of accounting for interest and principal on nonfunctional currency contingent instruments, the principles that govern the accounting for interest and principal of functional currency contingent payment debt instruments should apply. Treasury and the Service believe that providing a consistent set of rules in this area is in the best interests of taxpayers. In addition, Treasury and the Service are concerned that, in the absence of regulations requiring the application of the principles of § 1.1275–4 to nonfunctional currency contingent instruments, taxpayers can avoid the application of these principles by denominating contingent payment debt instruments in a nonfunctional currency.

III. *General Approach Under Study.*

Treasury and the Service generally believe that with respect to nonfunctional currency contingent instruments issued for money or publicly traded property, regulations should apply the principles of § 1.1275–4(b) in the nonfunctional currency and provide for the translation of interest and principal into functional currency by applying principles similar to those that apply under section 988 to instruments with original issue discount. As explained further below, application of § 1.1275–4(b) principles to nonfunctional currency contingent instruments generally would require taxpayers to (i) accrue interest in the nonfunctional currency at a yield at which the issuer would issue a fixed rate debt instrument denominated in the nonfunctional currency with terms and conditions similar to those of the nonfunctional currency contingent debt instrument, (ii) translate the interest accrued from the nonfunctional currency into the functional currency (and account for foreign exchange gain or loss) under the principles of section 988, and (iii) account for gain or loss arising from non-currency contingencies consistent with the rules of § 1.1275–4(b).

IV. *Description of Instruments.*

Treasury and the Service have identified three classes of instruments for which guidance is needed: (1) debt instruments for which all payments of principal and interest are denominated in, or determined by reference to, a single nonfunctional currency and which have one or

more non-currency contingencies, (2) debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which have no non-currency contingencies, and (3) debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which also have one or more non-currency contingencies. Throughout this announcement these instruments will be referred to as Class One, Class Two and Class Three instruments, respectively.

A. *Class One Instruments.*

1. *In general.*

Class One instruments are debt instruments for which all payments of principal and interest are denominated in, or determined by reference to, a single nonfunctional currency and which have one or more non-currency contingencies. For example, with respect to a taxpayer whose functional currency is the U.S. dollar, a debt instrument issued by the taxpayer is a Class One instrument if the instrument is denominated in British pounds and provides for a payment at maturity that is contingent on the value of the stock of an unrelated corporation.

Treasury and the Service are contemplating a regulatory approach that would apply the principles of § 1.1275–4(b) to Class One instruments issued for money or publicly traded property. Under this approach, taxpayers would accrue interest under the noncontingent bond method in the nonfunctional currency. For example, an issuer of the above-described debt instrument would first determine the comparable yield of the instrument, i.e., the yield at which the issuer would issue a fixed rate instrument in British pounds with terms and conditions similar to those of the instrument actually being issued. Second, the issuer would construct a projected payment schedule applying that yield. Third, the amount of interest accrued in each taxable year would be based on the comparable yield and translated into dollars under the principles of section 988. Fourth, the issuer and holders would account for differences between the projected amount of payments and the actual amount of payments (*i.e.*, so-called "positive adjustments" and "negative adjustments") under rules similar to those in § 1.1275–4(b). Finally, foreign currency gain or loss would be determined with respect to accrued interest and principal. A more specific explanation of this approach and two examples of the potential application of these principles are set forth below.

Treasury and the Service are concerned that, under some circumstances, an issuer may have difficulties in determining the comparable yield at which it would issue a comparable nonfunctional currency fixed rate debt instrument. These difficulties may include a lack of adequate information about the yield at which the issuer could issue a comparable fixed rate debt instrument denominated in the nonfunctional currency with terms and conditions that are similar to those of the nonfunctional currency contingent instrument. Treasury and the Service request comments regarding this and other circumstances where computation of the comparable yield would be difficult and suggestions for addressing such circumstances.

2. *Rules For Accrual and Translation.*

(a) *Accrual of interest and determination of positive and negative adjustments.*

Pursuant to the approach under study, interest on a Class One instrument is accrued each taxable year in the nonfunctional currency at the comparable yield (determined in that nonfunctional currency) and translated into functional currency at the average exchange rate or, at the taxpayer's election, at the appropriate spot rate in accordance with the rules under § 1.988–2(b)(2)(iii)(B). A net positive adjustment, within the meaning of § 1.1275–4(b)(6), determined in the nonfunctional currency is treated as interest and translated from nonfunctional currency into the taxpayer's functional currency at the spot rate on the date the adjustment was taken into account.

A net negative adjustment, within the meaning of § 1.1275–4(b)(6), determined in nonfunctional currency first reduces interest that otherwise would be accrued by the taxpayer during the current tax year in the nonfunctional currency. Where a net negative adjustment exceeds the interest that otherwise would be accrued by the taxpayer during the current tax year in the nonfunctional currency, the excess is treated as an ordinary loss (if the taxpayer is a holder) or ordinary income (if the taxpayer is the issuer).

The amount treated as ordinary loss by a holder, however, is limited to the amount by which the holder's total interest inclusions on the debt instrument (determined in nonfunctional currency prior to translation into functional currency) exceed the total amount of the holder's net negative adjustments treated as ordinary loss on the debt instrument in prior taxable years (determined in nonfunctional currency). The amount treated as ordinary income by an issuer is limited to the amount by which the issuer's total interest deductions on the debt instrument (determined in nonfunctional currency prior to translation into functional currency) exceed the total amount of the issuer's net negative adjustments treated as ordinary income on the debt instrument in prior taxable years (determined in nonfunctional currency).

If the negative adjustment determined in nonfunctional currency exceeds the sum of the amounts treated as a reduction of interest income and as ordinary loss to the holder (or interest expense and ordinary income to the issuer) on the debt instrument for the taxable year, the excess is treated as a "negative adjustment carryforward" within the meaning of § 1.1275–4(b)(6). A negative adjustment carryforward arising in a year preceding the year of termination of the debt instrument is carried forward and treated as a negative adjustment denominated in nonfunctional currency in the immediately succeeding taxable year. A negative adjustment carryforward arising in the year of termination reduces (in the nonfunctional currency) the amount realized by the holder on such termination. For purposes of this reduction, both the negative adjustment carryforward and the amount realized are denominated in the nonfunctional currency. If an issuer has a negative adjustment carryforward in the year in which the debt instrument is terminated, the issuer recognizes ordinary income equal to the amount of the unutilized carryforward (computed in the nonfunctional currency and translated into functional currency at the spot rate on the date the instrument was issued).

(b) *Translation of adjustments.*

After determining the amount of a positive or negative adjustment, it may be necessary to translate such amount into functional currency. As previously stated, a net positive adjustment is translated into functional currency at the spot rate on the date the adjustment is taken into account.

One of three principles may apply to address translation issues with respect to a negative adjustment, depending on whether the net negative adjustment is allocated to interest accrued in the current taxable year, interest accrued and not paid in a prior taxable year or interest accrued and paid in a prior taxable year. With respect to a net negative adjustment that reduces interest accrued in the current year in nonfunctional currency, neither the portion of the net negative adjustment so used nor the interest reduced by such adjustment is translated into functional currency. With respect to a net negative adjustment that reduces interest accrued but not paid in a prior year, the taxpayer translates such net negative adjustment from the nonfunctional currency into its functional currency at the rate used to account for those interest accruals. For this purpose, net negative adjustments are attributable to interest accrued in the immediately preceding taxable year (to the extent the accrued interest was not paid in such year) and thereafter to interest accrued but not paid in each preceding taxable year. With respect to a net negative adjustment that reduces interest accrued and paid in a prior taxable year, the taxpayer translates such net negative adjustment at the spot rate on the issue date or purchase date, if later. Any negative adjustment carryforward is carried forward in nonfunctional currency and applied to reduce interest in subsequent years.

In a year in which the instrument is sold, exchanged or otherwise terminated, any negative adjustment carryforward not applied to interest reduces the holder's amount realized in nonfunctional currency, and no translation is required. With respect to the issuer, in a year in which the instrument is terminated any negative adjustment carryforward not applied to interest results in ordinary income equal to the amount of the carryforward not utilized. Such amount is computed in the nonfunctional currency and translated into functional currency at the spot rate on the date the instrument was issued.

(c) *Determination of basis.*

In general, a holder computes basis adjustments in nonfunctional currency under the principles of § 1.1275–4(b)(7)(iii) and translates such adjustments into functional currency. Thus, the regulations would provide that a holder's basis in a Class One instrument is increased by the holder's accrued but unpaid interest inclusions on the debt instrument and decreased by the amount of any noncontingent payment and the projected amount of any contingent payment previously made on the debt instrument to the holder. Under this approach, these amounts, determined in nonfunctional currency, are translated under the principles of § 1.988–2(b).

(d) *Determination of amount realized.*

Under § 1.1275–4(b)(7)(iv), for purposes of determining the amount realized by a holder on the scheduled retirement of a contingent payment debt instrument, the holder is treated as receiving the projected amount of any contingent payment due at maturity. In addition, the holder's amount realized is reduced by any negative adjustment carryforward. For purposes of determining the repurchase price paid by the issuer on the scheduled retirement of a contingent payment debt instrument, the issuer is treated as paying the projected amount of any contingent payment due at maturity. Pursuant to the approach under study, these determinations would be made in the nonfunctional currency and would not take into account foreign currency gain or loss, which would be computed separately.

With respect to the holder, in the absence of a negative adjustment carryforward, the amount realized in nonfunctional currency is translated into functional currency by separating the amount realized into its component parts. Consistent with the principles of § 1.988–2(b)(7), the portion of the amount realized equal to accrued but unpaid interest is translated into functional currency at the same rate used to translate those accruals in the relevant years. The remainder of the projected payment is translated into functional currency at the same rate used to translate principal in the year of issuance or purchase. (Foreign currency gain or loss is computed separately as set forth below.) A negative adjustment carryforward is applied and translated into functional currency under the rules set forth above.

(e) *Determination of foreign currency gain or loss.*

Foreign currency gain or loss is determined on a Class One instrument with respect to principal and interest based on the comparable yield and projected payment schedule under the principles of § 1.988–2(b). Except with respect to a positive adjustment described in § 1.1275–4 (b)(9)(ii)(A), no foreign currency gain or loss is computed with respect to positive or negative adjustments.

(f) *Source rules.*

Any contingent gain characterized as interest is sourced under rules applicable to interest (*i.e.*, sections 861(a)(1) and 862(a)(1)). Under Temp. Reg. § 1.865–1T(b)(2), losses by a holder from a contingent payment debt instrument is generally sourced by reference to § 1.1275–4(b)(9)(iv). Under § 1.1275–4(b)(9)(iv), a holder's deductions or loss related to a contingent payment debt instrument that are treated as ordinary losses are treated as deductions that are definitely related to the class of gross income to which income from such debt instrument belongs. Treasury and the Service believe that the same rule should apply for sourcing of losses related to Class One instruments. Accordingly, a holder's ordinary losses resulting from negative adjustments with respect to a Class One instrument would be given the same source as the interest income from the instrument. Similarly, Treasury and the Service believe that deductions or losses related to a Class One instrument that the holder treats as capital losses should, consistent with the general principles of § 1.865–1T(b)(2), be sourced based on the residence of the holder.

(g) *Netting.*

Treasury and the Service recognize that there are different character and source rules which relate to market gain or loss and currency gain or loss on a Class One

instrument and are studying the extent to which netting of such gains or losses should be permitted. For illustration purposes, in Example 2 below, the amounts related to currency gain or loss and market gain or loss are computed separately. Comments are requested regarding the extent to which netting should be permitted.

3. *Examples.*

The following examples are intended to illustrate the principles outlined above. In each example, assume that the instrument described is a debt instrument for federal income tax purposes. No inference is intended, however, as to whether the instrument is a debt instrument for federal income tax purposes.

Example 1.

On December 31, 1999, Z, a calendar year U.S. resident taxpayer whose functional currency is the U.S. dollar, purchases, at original issue, a zero-coupon debt instrument with a non-currency contingency for £1,000. The debt instrument was issued by a foreign corporation. The debt instrument would be subject to § 1.1275–4(b) if it were denominated in dollars. The debt instrument's comparable yield, determined in British pounds under §§ 1.988-2(b)(2) and 1.1275–4(b), is 10 percent, compounded annually, and the projected payment schedule, as constructed under the principles of § 1.1275–4(b), provides for a single payment of £1210 on December 31, 2001 (consisting of a noncontingent payment of £975 and a projected payment of £235).

The debt instrument is a capital asset in the hands of Z. The payment actually made on December 31, 2001, is £1300. The relevant pound/dollar spot rates over the term of the instrument are as follows:

Date	Spot rate (pounds to dollars)
Dec. 31, 1999	£1.00=$1.00
Dec. 31, 2000	£1.00=$1.10
Dec. 31, 2001	£1.00=$1.20

Accrual period	Average rate (pounds to dollars)
2000	£1.00=$1.05
2001	£1.00=$1.15

(i) *Treatment in 2000.* (A) *Determination of accrued interest.* Under the principles of section 988 and based on the comparable yield, Z accrues £100 of interest on the debt instrument for 2000 (issue price of £1,000 × 10 percent). Z translates the £100 at the average exchange rate for the year (1.05 × £100 = $105). Accordingly, Z has interest income in 2000 of $105, which is foreign source under section 862(a)(1).

(B) *Adjustments to issue price and basis relating to accrued interest.* The adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the accrued interest. Thus, on January 1, 2001, the adjusted issue price of the debt instrument is £1100. For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis is increased by the £100 translated at the rate at which interest was accrued for 2000. Accordingly, Z's adjusted basis in the instrument in dollars is $1105 as of January 1, 2001.

(ii) *Treatment in 2001.* (A) Determination of accrued interest. Based on the comparable yield, Z's accrued interest for 2001 is £110 (adjusted issue price of £1100 × 10 percent). For purposes of computing Z's interest inclusions in dollars, the £110 of accrued interest is translated at the average exchange rate for 2001 (1.15 × £110 = $126.50).

(B) *Effect of net positive adjustment.* The payment actually made on December 31, 2001, is £1300, rather than the projected £1210. Under the principles of § 1.1275–4(b)(6)(i), Z has a net positive adjustment of £90 on December 31, 2001, attributable to the difference between the amount of the actual payment and the amount of the projected payment. The £90 net positive adjustment is treated as interest income and translated into dollars at the spot rate on the date the payment is received (1.2 × £90 = $108). Accordingly, Z has a net positive adjustment of $108 resulting in a total interest inclusion for 2001 of $234.50 ($126.50 + $108).

(C) *Adjustments to issue price and basis relating to accrued interest.* Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is £1210 (£1100 plus £110 of accrued interest for 2001). Z's adjusted basis, in dollars, is $1231.50 ($1105 plus $126.50 of accrued interest for 2001).

(D) *Amount realized.*

(i) Even though Z receives £1300 at maturity, for purposes of determining the amount realized, Z is treated as receiving the projected amount of the contingent payment on December 31, 2001. Therefore, Z is treated as receiving £1210 on December 31, 2001.

(ii) For purposes of determining the amount realized (other than for purposes of determining foreign exchange gain or loss as calculated below) in dollars, £100 (representing the interest accrued in 2000) is translated into dollars at the rate at which it was accrued (£1 = $1.05), resulting in an amount realized of $105; £110 of the £1210 (representing the interest accrued in 2001) is translated into dollars at the rate at which such payment was accrued (£1 = $1.15), resulting in an amount realized of $126.50; and £1000 (representing a return of principal) is translated into dollars at the spot rate on the date the instrument was purchased (£1 = $1), resulting in an amount realized of $1000. Accordingly, Z's total amount realized is $1231.50, the same as its basis, and Z recognizes no gain or loss (prior to consideration of foreign exchange gain or loss) on the retirement of the instrument.

(E) *Foreign exchange gain or loss.* Z realizes foreign exchange gain under section 988 on the instrument as a result of the difference in the exchange rate at which interest was accrued on the instrument and the spot rate on the date the instrument matures. With respect to interest accrued in 2000, this foreign exchange gain equals £100 × ($1.2 – $1.05) = $15.00 (*i.e.*, the amount of the interest payment multiplied by the difference between the exchange rate on the date the interest payment was received (£1=$1.2) and the exchange rate at which interest was accrued during 2001 (£1=$1.05)). With respect to interest accrued in 2001, this foreign exchange gain equals £110 x ($1.2 – $1.15) = $5.50. Z also has foreign exchange gain on the repayment of the principal of the debt instrument. Such foreign exchange gain equals £1000 x ($1.2 – $1.0) = $200 (*i.e.*, the amount of principal received multiplied by the difference between the spot rate on the date the debt instrument matures and the spot rate on the date Z purchased the instrument). Thus, Z recognizes a total foreign

exchange gain on December 31, 2001, of $220.50

(F) *Source.* In 2001, Z has interest income of $234.50 (attributable to £110 of accrued interest and the £90 net positive adjustment) which under section 862(a)(1) is sourced by reference to the residence of the payor and is therefore foreign source. Z also has foreign exchange gain of $220.50, which under § 1.988-4 is sourced by reference to Z's residence and is therefore U.S. source.

Example 2.

Assume the same facts as in Example 1 except that at maturity Z receives £975 instead of £1300.

(i) *Treatment in 2000.* (A) *Determination of accrued interest.* Under the principles of section 988 and based on the comparable yield, Z accrues £100 of interest on the debt instrument for 2000 (issue price of £1,000 x 10 percent). Z translates the £100 at the average exchange rate for the year (1.05 × £100 = $105). Accordingly, Z has interest income in 2000 of $105, which is foreign source under section 862(a)(1).

(B) *Adjustments to issue price and basis relating to accrued interest.* The adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the accrued interest. Thus, on January 1, 2001, the adjusted issue price of the debt instrument is £1100. For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis is increased by the £100 translated at the rate at which interest was accrued for 2000. Accordingly, Z's adjusted basis in the instrument in dollars is $1105 as of January 1, 2001.

(ii) *Treatment in 2001.* (A) *Determination of accrued interest.* Based on the comparable yield, Z's total daily portions of accrued interest are £110 for 2001 (adjusted issue price of £1100 x 10 percent). Despite the effect of the net negative adjustment set forth in (ii)(B) below, for purposes of computing Z's adjusted basis and amount realized the £110 of accrued interest is translated into dollars at the average spot rate at which such interest was accrued (£1 = $1.15) to equal $126.50.

(B) *Effect of net negative adjustment on accrued interest.* Z has a net negative adjustment of £235 on December 31, 2001, attributable to the difference between the amount of the actual payment (£0) and the amount of the projected payment (£235). Applying the principles of § 1.1275–4, Z's accrued interest income of £110 in 2001 is reduced in pounds by the net negative adjustment to zero.

Further, because Z previously accrued interest of £100 in the year 2000, Z treats £100 of the remaining £125 net negative adjustment as an ordinary loss. This ordinary loss is attributable to interest accrued but not paid in the preceding year. Therefore, Z translates the loss into dollars at the average rate for such year (£1 = $1.05). Accordingly, Z has an ordinary loss of $105. (See paragraph (ii) (D) and (E) below for the treatment of the remaining £25 of net negative adjustment).

(C) *Adjustments to issue price and basis relating to accrued interest.* Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is £1210 (£1100 plus £110 of accrued interest for 2001). Z's adjusted basis in dollars is $1231.50 ($1105, representing Z's adjusted basis at the end of 2000 (calculated in (i)(B) above), plus $126.50 accrued interest for 2001).

(D) *Determination of amount realized.*

(i) *In pounds.* Even though Z receives only £975 at maturity, for purposes of determining the amount realized by Z on retirement of the debt instrument, Z is treated as receiving the projected amount of the contingent payment (in pounds) on December 31, 2001, reduced by the amount of Z's negative adjustment carryforward of £25. Therefore, Z is treated as receiving £1185 (£1210 – £25) on December 31, 2001.

(ii) *In dollars.* Z translates its amount realized into dollars and computes its gain or loss on the instrument (other than foreign exchange gain or loss) pursuant to the payment ordering rules of § 1.988–2(b)(7). Pursuant to these rules, of the £1185 amount realized, £100 represents interest accrued in 2000, £110 represents interest accrued in 2001, and £975 represents a return of principal.

Of the amount realized of £1185, £100 is translated based on the rate interest was accrued in 2000 (£1 = $1.05) to equal $105. Another £110 is translated based on the rate interest was accrued in 2001 (£1 = $1.15) to equal $126.50. The remaining £975 is translated into dollars at the spot rate on the date the instrument was purchased (£1 = $1) to equal $975.

Accordingly, Z's amount realized (without taking into account foreign exchange gain or loss) is $1206.50 ($105 + $126.50 + $975), and Z computes a capital loss of $25 on the retirement of the instrument ($1206.50 – $1231.50 = $25).

(E) *Foreign exchange gain or loss.* Z computes a foreign exchange gain on the repayment of principal as follows: £975 x (1.2 – 1.0) (*i.e.*, the amount of the principal payment multiplied by the difference between the spot rate on the date of payment (£1 = $1.2) and the spot rate on the date the instrument was purchased (£1 = $1.0)). Accordingly, Z's foreign exchange gain is $195. This foreign exchange gain is characterized as ordinary income. (Because the interest accrued in 2000 and 2001, as well as £25 of principal, was not actually received, no foreign exchange gain or loss is realized with respect to such amounts.)

(F) *Sourcing.*

(i) *Losses.* On December 31, 2001, Z has an ordinary loss of $105 (attributable to £100 of Z's previous interest inclusions) and a capital loss of $25. Under the principles of § 1.1275–4(b)(9)(iv), the $105 ordinary loss is allocated to the foreign source passive income category under section 904(d) and the regulations thereunder. Under the principles of § 1.865–1T(b)(2), the $25 capital loss is sourced based on Z's residence and, accordingly, is U.S. source.

(ii) *Foreign currency gain.* Z's foreign currency gain of $195 is sourced under section 988(a)(3) by reference to the residence of Z. Thus, Z's foreign currency gain is U.S. source.

(G) *Netting.* On December 31, 2001, Z has an ordinary loss of $105 (attributable to £100 of Z' s previous interest inclusions as computed in paragraph (B)), a capital loss of $25 (attributable to the net negative adjustment on the instrument as computed in paragraph (D)) and an overall foreign exchange gain on the instrument of $195 (as computed in paragraph (E)). Treasury and the IRS request comments concerning whether such amounts should be treated separately by taxpayers or whether netting of these gains and

losses for purposes of character and source should be required. Regulations could provide, for example, that taxpayers must net capital losses (resulting from net negative adjustments) against foreign exchange gains to avoid a character mismatch between gains and losses from a single instrument. This approach is similar to the one adopted by § 1.988-2(b)(8) with respect to the disposition of debt instruments.

B. *Class Two Instruments.*

Class Two instruments consist of contingent payment debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which have no non-currency contingencies. For example, this class would include both a debt instrument that pays a fixed euro interest rate and principal in British pounds and a debt instrument that pays a fixed dollar interest rate and principal in Japanese Yen.

Treasury and the Service are studying an approach under which the proper accounting for a Class Two instrument issued for money or publicly traded property would require a determination of the comparable yield in a single currency and accrual of interest at such yield under the principles of § 1.1275–4(b). Under this approach, the regulations would require that the comparable yield on the debt instrument be determined in the debt instrument's predominant currency. In general, Treasury and the Service expect that the debt instrument's predominant currency would be determined by comparing the functional currency value of the payments denominated in (or determined by reference to) each currency on the issue date, appropriately discounted to present value (in each relevant currency) and translated at the spot rate on such date. Accordingly, in the case of a debt instrument issued for euros that pays a fixed euro interest rate and principal in British pounds, the issuer would determine the predominant currency on the issue date and then apply the principles of § 1.1275–4(b) to determine the comparable yield and projected payment schedule in that currency. For this purpose, payments not denominated in (or determined by reference to) the predominant currency would be treated in the same manner as non-currency contingencies in a Class One instrument.

Where a significant portion of the payments (as determined on a present value basis as of the issue date) with respect to a Class Two instrument is made in the functional currency of the taxpayer, the Treasury and the Service are studying whether the regulations should treat the functional currency as the instrument's predominant currency. In such case, the comparable yield and projected payment schedule would be determined by applying the principles of § 1.1275–4(b) in the functional currency of the taxpayer. Payments denominated in the nonfunctional currency would be treated in the same manner as non-currency contingencies under § 1.1275–4(b). As a result, no section 988 foreign exchange gain or loss would be recognized with respect to a Class Two instrument for which a significant portion of payments is denominated in, or determined by reference to, the taxpayer's functional currency.

C. *Class Three Instruments.*

Class Three instruments are debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which also have one or more non-currency contingencies. Consistent with the treatment of Class One and Class Two debt instruments, Treasury and the Service are considering an approach that would require taxpayers to determine the comparable yield of a Class Three instrument issued for money or publicly traded property by applying the principles of § 1.1275–4(b) in a single currency (which would be determined under the same methodology used for determining the predominant currency of a Class Two instrument). The principles of § 1.1275–4(b) would then be applied with respect to all of the contingent payments on the Class Three instrument (i.e., contingent payments denominated in the predominant currency and all payments denominated in, or determined by reference to, any currency other than the predominant currency).

V. *Debt Issued for Non-publicly Traded Property.*

Section 1.1275–4(c) provides rules for the treatment of contingent payment debt instruments issued for non-publicly traded property. Treasury and the Service are considering an approach that would apply the principles of § 1.1275–4(c) in the relevant nonfunctional currency and would require the translation of the resulting interest and principal components into the taxpayer's functional currency under the principles of section 988 and the regulations thereunder.

VI. *Anti-abuse Rules.*

Treasury and the Service recognize that a contingent payment debt instrument can be unbundled. These unbundled components, together with the underlying contingent payment debt instrument may lead to timing, character and source distortions. Treasury and the Service request comments on how to draft a narrowly tailored rule that would provide taxpayers with flexibility and certainty with respect to nonfunctional currency contingent instruments while preventing abuse.

VII. *Comments.*

Treasury and Service request comments on the matters discussed in this announcement November 1, 1999. Written comments may be submitted to the Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attention: CC:DOM: CORP:R (Announcement 99-76), Room 5226, Washington DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM: CORP:R (Announcement 99–76), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington DC.

For further information regarding this announcement, contact Howard Wiener of the Office of Associate Chief Counsel (International) at 202-874-4160 (not a toll-free call).

Foundations Status of Certain Organizations

Announcement 99–78

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Akasha Foundation for Holistic Studies Inc., Camden, ME
Alabama Parent Parent Support Network Inc., Montgomery, AL
Alliance of Hong Kong Chinese in the United States, Santa Clara, CA
American International Bible Institute and Seminary Inc., West Rush, NY
Beis Chaim Yitzchok Inc., Monsey, NY
Columbia Sportsmen Association Inc., Columbia, MD
Comite Promejoras de San Jeronimo Silacayoapilla, Poway, CA
Community Hospices of America Inc., Springfield, MO
Community Relations Council of Brainerd, Chicago, IL
Cornerstone Youth Camps Inc., Suffolk, VA
Crandall Park Community Project, Hope Valley, RI
Current River Flyfishers Association, Licking, MO
D-Day Plus Fifty Years Inc., La Porte, TX
Danzartz Company Inc., Huntsville, AL
East-West Helpline Association Inc., Brooklyn, NY
Faith Production Ministries, Washington, DC
Fern Street Circus Inc., San Diego, CA
Franklin Institute for the Study of American Heritage, Newport Beach, CA
Friends of Cabin Creek Inc., Vinita, OK
Friends of Cheder Kol Hyom, Brooklyn, NY
Glac Inc., Beckley, WV
Global Commission to Fund the United Nations, Washington, DC
Harris Home Resident Management Corporation, Atlanta, GA
Health & Help Corporation, Staten Island, NY
Hurricane Volleyball Association, Tomball, TX
I Can Make a Difference Foundation Inc., Gainesville, FL
Indian Culture & Childrens Society, Hamilton, NJ
International Martial Arts Club of York County Inc., York, PA
Jamaican Progressive Society, Mattapan, MA
John Howland Foundation Inc., Fairhaven, MA
Lima News Empty Stocking Fund, Lima, OH
Loving Kids Inc., Atlanta, GA
Machon Yisrael Trust, New York, NY
March for Jesus of Michiana Inc., Elkhart, IN
Martin County Fair Board Inc., Inez, KY
Meisel Community Resource Fund, Dallas, TX
Mission of the Heart Rhode Island Chapter, Middletown, RI
Modern Classic Museum, Redmond, WA
Nations Capital Junior Golf Association, Washington, DC
New St. Paul Tabernacle Church of God in Christ Head Start Agency, Detroit, MI
Odyssey House of Atlanta, Inc., Atlanta, GA
Project Guantanamo Inc., Washington, DC
Rely on Winslow Outreach Inc., Sicklerville, NJ
S L A M, Ashtabula, OH
Sacramento Aquarium Corporation, Sacramento, CA
Silver Lake Community Playground Fund, Rochester, MN
Srpsko Humanitarno Drustvo Derventa, Chicago, IL
Street Corner of Virginia Inc., Hampton, VA
Tampa Bay Bird Club, San Antonio, FL
The Coup Coalition Oppossed to the Unity of Prejudice Inc., Tallahassee, FL
Verde Valley Umpires Association, Cottonwood, AZ
Vida Nueva of North Florida Inc., Tallahassee, FL
Wood River Affordable Housing Corporation, Wood River, NE
Yesterday Today Tomorrow, Inc., Lake Charles, LA
Young Speakers Association, Inc., Louisville, KY

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement 99–79

Revenue Procedure 98–44, 1998–32 I.R.B. 11, dated August 10, 1998, Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, magnetically or electronically, reprinted as Publication 1187 (Rev. 8-98), will be used to prepare Forms 1042-S for Tax Year (TY) 1999 filed in Calendar Year (CY) 2000.

Please use the 1999 Instructions for Form 1042-S and other appropriate publications listed in Part A, Sec. 1.04, in the preparation of 1999 Forms 1042-S.

Please make note of the following changes to the Publication 1187

(Rev. 8-98). These changes need to be adhered to in order for your Forms 1042-S to be filed correctly both magnetically/electronically with the Internal Revenue Service at the Martinsburg Computing Center.

1. The Tax Year reported in the Transmitter "T" Record, Recipient "Q" Record, and Withholding Agent "W" Record will be 1999, unless filing for a prior tax year.

2. The addresses for the Martinsburg Computing Center have changed.

A. The new address for filing Form 1042-S magnetically/electronically to the Martinsburg Computing Center is:

If by Postal Service, truck, or air freight:

IRS-Martinsburg Computing Center
Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

B. To send a magnetically filed extension of time request (Form 8809), undue hardship waivers (Form 8508), and requests for extension of time to file returns (Form 8809) or to furnish the statements to recipients use the following address:

If by Postal Service, truck or air freight:

IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Extension of Time Coordinator
240 Murall Drive
Kearneysville, WV 25430

NOTE: Due to security regulations at MCC, the Internal Revenue police officers will not accept media from Private Delivery Services (PDSs) or couriers between the hours of 3:00 p.m. to 11:00 p.m. seven days a week, and 11:00 p.m. to 7:00 a.m., Saturday and Sunday.

3. The following types of media are no longer accepted by IRS/MCC:

1. 5 ¼-inch diskettes
2. 3 ½-inch diskettes created on a non-MS-DOS system
3. 3 ½-inch diskettes created on a System 36 or AS400

4. The acceptable sizes of Quarter Inch Cartridges (QIC) have changed. Part B, Section 4.08(b) delete Quarter Inch Cartridges with a size of QIC-11, QIC-320, and QIC-1350.

5. Part C, Bisynchronous (Mainframe) Electronic Filing Specifications, and Part D, Asynchronous (IRP-BBS) Electronic Filing Specifications, contained in Publication 1187 (Rev. 8-98) **will no longer be used for electronic filing** of Forms 1042-S. A revised Part C, Electronic Filing Specifications, included below, must be used for submitting all electronic files to the Martinsburg Computing Center beginning November 1, 1999. The new telephone number for electronic filing is **304-262-2400.**

Part C. Electronic Filing Specifications

Sec. 1 Background

.01 IRS-MCC is in the process of upgrading all of its hardware and software for electronic filing. Effective October 31, 1999, the Information Reporting Program - Bulletin Board System (IRP-BBS) and 3780 bisynchronous electronic filing systems will be discontinued. Starting November 1, 1999, users will be able to access the new electronic filing system via analog and ISDN BRI connections. Bisynchronous electronic filing will no longer be supported. The new system is designed to support the electronic filing of information returns only. The new telephone number for electronic filing is **(304-262-2400).** Publications and forms will no longer be electronically available from MCC. Users needing the publications and forms no longer available on the IRP-BBS will need to download them from the IRS's Internet Web Site at www.irs.ustreas.gov or order them by calling 1-800-TAX-FORM (1-800-829-3676).

Sec. 2 Advantages of Filing Electronically

Some of the advantages of filing electronically are as follows:

(1) Acknowledgment of files received.

(2) Notification within 20 workdays as to the acceptability of the data transmitted (30 days for replacement transmissions).

(3) Better customer service due to on-line availability of transmitters files for research purposes.

Sec. 3 General

.01 Electronic filing of Forms 1042-S, originals, corrections, and replacements of information returns is offered as an alternative to magnetic media (tape, tape cartridge, or diskette) or paper filing, but is not a requirement. Transmitters filing electronically will fulfill the magnetic media requirements for those payers who are required to file magnetically. It may also be used by payers who are under the filing threshold requirement, but would prefer to file their information returns this way. If the original file was sent magnetically, but was returned for replacement, the replacement may be transmitted electronically. Also, if the original file was submitted via magnetic media, any corrections may be transmitted electronically.

.02 The electronic filing of information returns is not affiliated with the Form 1040 electronic filing program. These two programs are totally independent, and filers must obtain separate approval to participate in each of them. All inquiries concerning the electronic filing of information returns should be directed to IRS/MCC. IRS/MCC personnel cannot answer questions or assist taxpayers in the filing of Form 1040 tax returns. Filers with questions of this nature will be directed to the Customers Service toll-free number (1-800-829-1040) for assistance.

.03 Files submitted to IRS/MCC electronically must be in standard ASCII code. No magnetic media or paper forms are to be submitted with the same information as the electronically submitted file.

.04 If a request for extension is approved, transmitters who file electronically will be granted an extension of time to file. Part A, Sec. 11, explains procedures for requesting extensions of time. Filers are encouraged to file their data as soon as possible.

.05 The formats of the "T", "Q", "W", and "Y" Records are the same for electronically filed records as they are for 3 1/2-inch diskettes, tapes, and tape cartridges, and must be in standard ASCII code. For electronically filed documents, each transmission is considered a separate file; therefore, each transmission must begin with a Transmitter "T" Record and end with an End of Transmission (EOT) "Y" Record.

Sec. 4 Electronic Filing Approval Procedure

.01 Filers must obtain, or already have, a Transmitter Control Code (TCC) assigned prior to submitting their files electronically. (Filers who currently have a TCC for magnetic media filing of Form 1042-S, beginning with numbers "22", do not have to request a second TCC for electronic filing.) Refer to Part A, Sec. 7, for information on how to obtain a TCC.

.02 Once a TCC is obtained, electronic filers assign their own passwords and do not need prior or special approval.

.03 With all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. Passwords are user assigned at first logon and are up to 8 alpha/numerics, which are case sensitive. However, if filers do forget their password, call **304-263-8700** for assistance.

Note: Passwords are case sensitive.

Sec. 5. Test Files

.01 Filers are not required to submit a test file; however, the submission of a test file is encouraged for all electronic filers because of the new hardware and software. If filers wish to submit an electronic test file for Tax Year 1999 (returns to be filed in 2000), it **must** be submitted to IRS/MCC no earlier than December 1, 1999, and **no later than** February 15, 2000.

.02 If a filer encounters problems while transmitting the electronic test files, contact IRS/MCC for assistance.

.03 Filers can verify the status of their transmitted test data by dialing the electronic filing system phone number **(304-262-2400).** This information will be available within 20 workdays (30 workdays for replacements) after their transmission is received by IRS/MCC.

Sec. 6. Electronic Submissions

.01 Electronically filed information may be submitted to IRS/MCC 24 hours a day, 7 days a week. Technical assistance will be available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern Time by calling **304-263-8700.**

.02 Do not transmit data electronically from December 28, 1999, through January 5, 2000. This will allow time for IRS/MCC to update their system to reflect current year changes.

.03 Data compression is encouraged when submitting information returns electronically. MCC has the ability to decompress files created using several popular software compression programs such as ARC, COMPRESS, LHARC, and PKZIP.

The time required to transmit information returns electronically will vary depending on the modem speed and the type of data compression used, if any. **The time required to transmit a file can be reduced by as much as 95 percent by using software data compression and hardware compression.**

The following are actual transmission rates achieved in test uploads at MCC using compressed files. The actual transmission rates will vary depending on modem speeds.

Transmission Speed in bps	1000 Records	10,000 Records	100,000 Records
19.2K	23 Sec.	4 Min.	40 Min.
56K	14 Sec.	2 1/2 Min.	22 Min.
128K (ISDN)	5 Sec.	40 Sec.	4 Min.

.04 Files submitted electronically will be assigned a unique filename by the IRS system (the users may name files anything they choose from their end). The IRS assigned filename will consist of the submission type [TEST, ORIG (original), CORR (correction), and REPL(replacement)], filer's TCC and a four digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your original file for the calendar year and your TCC is 22000, the IRS assigned filename would be ORIG.22000.0001. Record the filename. This information will be needed by MCC in order to identify the file, if assistance is required, and to complete Form 4804.

.05 Electronic filers must transmit their files by the due date of the return. If a file is bad, the filer will have 45 days to transmit the first replacement, and 30 days thereafter, if additional replacements are necessary.

.06 Filers are advised not to resubmit an entire file if records were omitted from the original transmission. This will result in duplicate filing. A new file should be sent consisting of the records that had not previously been submitted.

.07 The TCC (beginning with the numbers "22") in the Transmitter "T" Record must be the TCC used to transmit the file; otherwise, the file will be considered in error.

Sec. 7. Transmittal Requirements

.01 The results of the electronic transmission will be available in the File Status area of the electronic system within 20 workdays (30 workdays for replacements); however, no further processing will occur until the signed Form 4804 is received. The Form 4804 must be postmarked by the due date of the return. No return is considered filed until a Form 4804 is received by IRS/MCC. The Form 4804 may be faxed to 304-264-5602.

.02 Form 4804 can be ordered by calling the IRS toll-free forms and publications order number **1-800-TAX-FORM (1-800-829-3676),** or it may be computer-generated. It may also be obtained from the **IRS's Internet Web Site at www.irs.ustreas.gov.** If a filer chooses to computer-generate Form 4804, all of the information contained on the original form, including the affidavit, must also be contained on the computer-generated form.

.03 The TCC used in the Transmitter "T" Record (beginning with numbers "22") is the TCC which must appear on the transmittal Form 4804.

.04 Forms 4804 may be mailed to the following address:

If by Postal Service, air or truck freight:

IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Electronic Filing Coordinator
230 Murall Drive
Kearneysville, WV 25430

Please indicate on the envelope the following message:
CONTAINS FORM 4804 INFORMATION - NO MAGNETIC MEDIA

Sec. 8. Electronic Filing Specifications

.01 The Electronic Filing System is designed exclusively for the filing of various information returns.

.02 A transmitter must have a TCC before a file can be transmitted. If you have a TCC for magnetic media filing which begins with the numbers "22", that TCC can also be used for electronic filing.

.03 Filers can determine the acceptability of files submitted by checking the file status area of the system. These reports will be available on the electronic system within 20 workdays (30 workdays for replacements) after the transmission is received by IRS/MCC.

.04 Contact the Electronic Filing System by dialing **304-262-2400.** This number supports analog connections from 1200 bps to 56Kbps or ISDN BRI 128 Kbps connections. The system can be accessed via Dial-up network/web browser or a communications software package such as Hyperterminal, Procomm, PCAnywhere, etc. The Dial-up network/ web browser will provide an Internet-like look without going through the Internet. If you do not have this capability, a text interface will be available that can be accessed via typical communications software and will perform similar to the former IRP-BBS.

Sec. 9. Dial-up Network/Browser Specifications (Web Interface)

.01 Due to the large number of communication products available, it is impossible to provide specific information on a particular software package or hardware configuration. Filers should contact their software or hardware supplier for assistance. Your browser will need to be capable of file uploads (i.e., Internet Explorer 4.0, Netscape Navigator 2.0 or higher). The following are some general instructions (many of these settings may already be set by default in your software):

.02 Dial-up network settings:

(a) Set dial-up server type to PPP

(b) Set network protocol to TCP/IP

(c) Enable software compression

(d) Enable PPP LCP extensions

.03 Browser settings:

(a) Set to receive 'cookies'

(b) Enable JavaScript or Jscript

(c) Browser must be capable of file uploads (i.e., Internet Explorer 4.0, Netscape 2.0 or higher)

(d) Enter the URL address of http://10.225.224.2

Sec. 10. Communication Software Specifications (Text Interface)

.01 Communications software settings should be:

- No parity
- Eight data bits
- One stop bit
- Full duplex

Sec. 11. Modem Configuration

.01 Hardware features

(a) Enable hardware flow control

(b) Enable modem error control

(c) Enable modem compression

Sec. 12. Logon Procedures

.01 The first time you log on to the electronic system, you will need to create a new account. After completing the registration information, you will be prompted for a user name and password. Passwords are assigned by the user at first logon and are up to 8 alpha/numerics which are case sensitive. Remember your **exact** user name and password for future reference. If you forget your user name and password, call IRS/MCC at 304-263-8700 for assistance.

.02 Once you are an established user, select the logon option and then you will be prompted for your logon name and password. Once you have entered the information, you will be at the Main Menu. Select one of the following options:

(a) Electronic Filing - this option will allow you to send your files and provide us with current mailing address information in case we need to send any correspondence.

(b) File Status - this option will display the results of your file transfer and will be posted in this area within 20 workdays (30 workdays for replacements).

Sec. 13. Common Problems Associated with Electronic Filing

.01 Refer to Part A, Section 17, for common format errors associated with magnetic/electronic files.

.02 The following are the major non-format errors associated with electronic filing:

1. No Form 4804, Transmittal of Information Returns Reported Magnetically/ Electronically

Even though you have sent your information returns electronically, you will still need to mail a signed Form 4804 by the due date of the return. See Part C, Sec. 7.04, for the mailing address. You may also fax the Form 4804 to IRS/MCC at 304-264-5602.

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2. Transmitter does not dial back to the electronic filing system to determine file acceptability.

Within 20 workdays (30 workdays for replacements), the results of your file transmission will be posted under the option called File Status. It is very important that you check this option because if your file is bad and we do not receive a timely replacement, you could be subject to a late filing penalty.

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3. Transmitter compresses several files into one.

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately, and send 10 separate compressed files.

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4. Transmitter sends a file and File Status indicates that the file is good, but the transmitter wants to send a replacement or correction file to replace the original/correction/replacement file.

Once a file has been transmitted, you cannot send a replacement file unless the File Status indicates the file is bad (20 workdays after the file was transmitted). If you do not want us to process the file, you must first contact us at 304-263-8700 to see if this is a possibility. However, this will be considered as a replacement file. (See Part A, Sec. 16, for the definition of replacement.)

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5. File is formatted as EBCDIC.

All files submitted electronically must be in standard ASCII code.

Actions Relating to Court Decisions

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. Nonacquiescence signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a nonacquiescence indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

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 decision:

Boyd Gaming Corporation v. Commissioner,[1]
___F.3d___(9th Cir. 1999), rev'g T.C. Memo. 1997-445 T.C. Dkt. Nos. 3433-95, 3434-95

[1] Acquiescence relating to whether a meal furnished by the taxpayer/employer on its business premises to an employee is furnished for "the convenience of the employer" within the meaning of that phrase in section 119 of the Internal Revenue Code.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 7122.–Compromises

26 CFR 301.7122–1T: Compromises (temporary).

T.D. 8829

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Compromises

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide additional guidance regarding the compromise of internal revenue taxes. The temporary regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998 and the Taxpayer Bill of Rights II. The text of these temporary regulations serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in REG–116991–98, on page 242.

DATES: *Effective date.* These temporary regulations are effective July 21, 1999.

Applicability date. For dates of applicability, see §301.7122–1T(j) of these regulations.

FOR FURTHER INFORMATION CONTACT: Carol A. Campbell, (202) 622-3620 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary regulations amending the Procedure and Administration Regulations (26 CFR part 301) under section 7122 of the Internal Revenue Code (Code). The regulations reflect the amendment of section 7122 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 1998") Public Law 105–206, (112 Stat. 685, 764) and by section 503 of the Taxpayer Bill of Rights II Public Law 104–168, (110 Stat. 1452, 1461).

As amended by RRA 1998, section 7122 provides that the Secretary will develop guidelines to determine when an offer to compromise is adequate and should be accepted to resolve a dispute. The legislative history accompanying RRA 1998 explains that Congress intended that factors such as equity, hardship, and public policy be evaluated in the compromise of individual tax liabilities, in certain circumstances, if such consideration would promote effective tax administration. H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998).

The current regulations under Treasury regulation §301.7122–1 permit the compromise of cases on only the grounds of doubt as to collectibility, doubt as to liability, or both. These regulations are being removed. Like the current regulations, the temporary regulations provide for compromise based on doubt as to liability and doubt as to collectibility; however, they also provide for compromise based upon specific hardship and/or equitable criteria if such a compromise would promote effective tax administration. The inclusion in these regulations of a standard that will allow compromise on grounds other than doubt as to liability or doubt as to collectibility represents a significant change in the IRS' exercise of compromise authority.

Section 7122 of the Code provides broad authority to the Secretary to compromise any case arising under the internal revenue laws, as long as the case has not been referred to the Department of Justice for prosecution or defense. Although the statutory language of Section 7122 does not explicitly place limits on the Secretary's authority to compromise, opinions of the Attorney General and the regulations issued under section 7122 prior to RRA 1998 authorized the Secretary to compromise a liability under the revenue laws only when there was doubt as to liability (uncertainty as to the existence or amount of the tax obligation) or doubt as to collectibility (uncertainty as to the taxpayer's ability to pay). The opinion of the Attorney General most often cited as the principal source of these limitations is the 1933 opinion of Attorney General Cummings that was issued in response to an inquiry from then Acting Secretary of the Treasury Acheson.

In requesting an opinion from the Attorney General, Acting Secretary of the Treasury Acheson expressed concern that the country was trying to recover from the depression. He suggested that the public interest required compromise of tax claims where collection of the tax would "destroy a business, ruin a tax producer, throw men out of employment, or result in the impoverishment of widows or minor children of a deceased taxpayer." The Secretary expressed the belief that in ordinary times, compromise of cases on public policy grounds should be rare but that, in light of the current state of the country, public policy should play a significantly greater role. Expressing the belief that it was more important that "the business of the taxpayer be preserved and not destroyed," Acting Secretary Acheson suggested that cases should be compromised where the taxpayer is insolvent, even though the tax is fully collectible, and that penalties and certain interest charges should be "compromisable wherever justice, equity, or public policy seems to justify the compromise. . . ." Letter from Treasury Department, XIII-47–7137 (July 31, 1933).

Attorney General Cummings replied that "[t]here is much to be said for the proposition that a liberal rule should exist, but my opinion is that if such a course is to be taken it should be at the instance of Congress. I conclude that where liability has been established by a valid judgment or is certain, and there is no doubt as to the ability of the Government to collect, there is no room for 'mutual concessions,' and therefore no basis for a 'compromise.'" Op. Atty. Gen. 6, XIII-47–7138 (October 24, 1933). See also Op. Atty. Gen. 7, XIII-47–7140 (October 2, 1934), wherein Attorney General Cummings stated that "[t]here appears to be no statutory authority to compromise *solely* upon the ground that a hard case is presented, which excites sympathy or is merely appealing from the standpoint of equity, but the power to compromise clearly authorizes the settlement of any case about which uncertainty exists as to liability or collection."

Although the 1933 opinion of Attorney General Cummings is the most often cited opinion regarding the limits of the IRS' compromise authority (prior to RRA 1998), the conclusion he reached mirrored conclusions reached by a number of his predecessors. Thus, since 1868, a number of Attorneys General opined that when liability is not at issue, the Secretary's compromise authority permitted compromise only when "the full amount of the debt" could not be collected. See, e.g., 12 Op. Atty. Gen. 543 (1868); 16 Op. Atty. Gen. 617 (1879) (the Secretary's authority to compromise does not permit the "voluntary relinquishment" of any part of a lawfully assessed tax from a solvent person or corporation).

Following the issuance of Attorney General Cummings' 1933 opinion, Commissioner Helvering established a policy that IRS tax collectors should make every endeavor to secure offers that represent the taxpayer's "maximum capacity to pay." Commissioner's Statement of Policy with Respect to the Compromise of Taxes, Interest, and Penalties, July 2, 1934. Commissioner Helvering recognized that the Attorney General's opinion did not specify or quantify the amount of doubt necessary to compromise, but concluded that ". . . the Treasury Department does not propose to compromise when there is merely the possibility of doubt. The doubt as to liability or collectibility must be supported by evidence and must be substantial in character, and when such doubt exists, the amount acceptable will depend upon the degree of doubt found in the particular case." *Id.* Implementing the policy established by Commissioner Helvering, the IRS concluded that an offer premised upon doubt as to collectibility should be accepted only when the amount offered represented the maximum amount the taxpayer could pay, taking into account net equity in assets and both current and future income.

The interpretation of section 7122 adopted by Attorney General Cummings (and reflected in Treasury reg. §301.7122–1(a)), together with the "maximum capacity to pay" policy established by Commissioner Helvering, have been the fundamental guiding principles for IRS offer in compromise programs for the past 65 years. From the 1930's to the early 1990's, offers to compromise were not widely used to resolve tax cases. In the early 1990s, however, the IRS determined that expanded use of offers to compromise could contribute to more effective tax administration in two important respects. First, the IRS determined that compromise could be used as a technique to enhance overall compliance by providing taxpayers with a reasonable avenue to resolve past difficulties. Second, the IRS determined that it should make more effective use of offers to compromise to help manage the inventory of delinquent tax accounts. Accordingly, while still operating within the basic legal and policy guidelines established in the 1930's, the IRS initiated two significant changes intended to enhance the compromise program.

In 1992, the IRS adopted a new compromise policy and issued revised compromise procedures. The policy provides that an offer to compromise will be accepted when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential. As set forth in the new policy statement, the goal of the compromise program is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government while providing taxpayers with a fresh start toward future voluntary compliance. Policy Statement, P-5-100. In administering its policies under the offer program, the threshold question of "doubt as to liability or doubt as to collectibility" set forth in the regulations constituted a legal requirement that must be followed; once that threshold was met, however, the IRS could legally accept less than the taxpayer's maximum capacity to pay. References in the offer procedures to "maximizing collection" and "maximum capacity to pay" were replaced with "reasonably reflects collection potential." *Id.*

In determining whether an offer reasonably reflects collection potential, the IRS takes into consideration amounts that might be collected from (1) the taxpayer's assets, (2) the taxpayer's present and projected future income, and (3) third parties (e.g., persons to whom the taxpayer had transferred assets). Although most doubt as to collectibility offers only involve consideration of the taxpayer's equity in assets and future disposable income over a fixed period of time, the IRS on occasion also will consider whether the taxpayer should be expected to raise additional amounts from assets in which the taxpayer's interest is beyond the reach of enforced collection (e.g., interests in property located in foreign jurisdictions or held in tenancies by the entirety). IRM 57(10)(10).1.

The compromise program was also affected by a 1995 IRS initiative designed to ensure uniform treatment of similarly situated taxpayers. In administering its collection operations, including both the installment agreement program and the compromise program, the IRS has always permitted taxpayers to retain sufficient funds to pay reasonable living expenses. Certain commentators had asserted that there were wide variances in the type and amount of such reasonable expense allowances within and between districts. In September of 1995, the IRS adopted and published national and local standards for determining allowable expenses, designed to apply to all collection actions, including offers to compromise. National expense standards derived from the Bureau of Labor Statistics Consumer Expenditure Survey were promulgated for expense categories such as food, clothing, personal care items, and housekeeping supplies. Local expense standards derived from Census Bureau data were promulgated for housing, utilities, and transportation.

The IRS allowable expense criteria play an important role in determining whether taxpayers are candidates for compromise or installment agreements. Although offers to compromise and installment agreements are separate mechanisms for resolving outstanding tax liabilities, there often is a significant interplay between the two programs, because a taxpayer's income available to satisfy the tax liability is determined after the deduction of allowable expenses. In some cases, the allowable expense criteria may be the determining factor in whether the taxpayer receives an installment agreement or a compromise. An installment agreement must provide for payment in full of the amount of the outstanding liability through regular, periodic payments (generally monthly). I.R.C. §6159. An offer to compromise, by contrast, reflects the fact that the taxpayer has no ability to pay the liability in full. Accordingly, taxpay-

ers entering into compromise agreements can pay an amount less than the full amount due in satisfaction of the liability. Congress now has directed the Secretary to consider factors other than doubt as to collectibility and doubt as to liability in determining whether to accept an offer to compromise. Under §7122(c), added by RRA 1998, factors such as equity, hardship, and public policy will be considered in certain circumstances where such consideration will promote effective tax administration. The legislative history of this provision (H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998)) states that —

> . . . the conferees expect that the present regulations will be expanded so as to permit the IRS, in certain circumstances, to consider additional factors (i.e., factors other than doubt as to liability or collectibility) in determining whether to compromise the income tax liabilities of individual taxpayers. For example, the conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration. The conferees anticipate that, among other situations, the IRS may utilize this new authority, to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability. The conferees believe that the ability to compromise tax liability and to make payments of tax liability by installment enhances taxpayer compliance. In addition, the conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.

Another consideration for compromise cases is Chief Counsel review. Since its enactment in section 102 of the Act of July 20, 1868 (15 Stat. 166), the statute authorizing the Secretary to compromise liabilities has contained a requirement that Counsel issue opinions regarding certain of those compromises. Section 7122(b) of the Code requires that the opinion of Counsel, with the reasons therefor, be placed on file whenever a compromise is made by the IRS. Chief Counsel opinions assess both whether the offer meets the legal requirements for compromise and whether the offer conforms to IRS policy and procedure. The opinion provided by Chief Counsel, however, does not have to be in favor of compromise. Pursuant to delegated authority, district directors, service center directors, and regional directors of Appeals have the authority to accept an offer that Counsel has opined does not conform to IRS policy.

Until passage of the Taxpayer Bill of Rights II (TBOR 2), Chief Counsel review was required in all cases in which the liability compromised was $500 or more. Under TBOR 2, such an opinion is required only in cases where the compromised liability is $50,000 or more.

Explanation of Provisions

The temporary regulations continue the traditional grounds for compromise based on doubt as to liability or doubt as to collectibility. In addition, to reflect the changes made in RRA 1998, the temporary regulations allow a compromise where there is no doubt as to liability or as to collectibility, but where either (1) collection of the liability would create economic hardship, or (2) exceptional circumstances exist such that collection of the liability would be detrimental to voluntary compliance. Compromise based on these hardship and equity bases may not, however, be authorized if it would undermine compliance. Although the temporary regulations set forth the conditions that must be satisfied to accept an offer to compromise liabilities arising under the internal revenue laws, they do not prescribe the terms or conditions that should be contained in such offers. Thus, the amount to be paid, future compliance or other conditions precedent to satisfaction of a liability for less than the full amount due are matters left to the discretion of the Secretary.

The temporary regulations also add provisions relating to the promulgation of requirements for providing for basic living expenses, evaluating offers from low income taxpayers, and reviewing rejected offers, as required by RRA 1998. The temporary regulations also add provisions relating to staying collection, modifying the dollar criteria for requiring the opinion of Chief Counsel in accepted offers, and setting forth the requirements regarding waivers and suspensions of the statute of limitations. Except for the provision related to dollar criteria for Chief Counsel review, all of the additional provisions of §301.7122–1T are authorized by RRA 1998. The modification of dollar criteria for Chief Counsel review is authorized by section 503(a) of the Taxpayer Bill of Rights II.

As required by §7122(c)(2)(A) and (B), added by RRA 1998, the temporary regulations provide for the development and publication of national and local living allowances that permit taxpayers entering into offers to compromise to have an adequate means to provide for their basic living expenses. The determination whether the published standards should be applied in any particular case must be based upon an evaluation of the individual facts and circumstances presented. The Secretary will determine the appropriate means to publish these national and local living allowances.

In accordance with §7122(c)(3)(A), the temporary regulations also require the development of supplemental guidelines for the evaluation of offers from "low income" taxpayers. The temporary regulations permit the Secretary to determine which taxpayers qualify as "low income" taxpayers based upon current dollar criteria applied by the U.S. Department of Health and Human Service under authority of section 673(2) of the Omnibus Budget Reconciliation Act of 1981, or any other measure reasonably designed to identify such taxpayers.

In accordance with §7122(d)(1), the temporary regulations provide that all proposed rejections of offers to compromise will receive independent administrative review prior to final rejection. Section 7122(d)(2) requires and the temporary regulations also provide that the taxpayer has the right to appeal any rejection of an offer to compromise to the IRS Office of Appeals. The temporary regulations provide, however, that when the IRS returns an offer to compromise because it was not processable under IRS procedures, because the offer was submitted solely to delay collection or because the taxpayer failed to provide requested information required by the IRS to evaluate the offer, such a return of the offer does not constitute a rejection and thus, does not entitle the taxpayer to appeal rights under this provision. In the event that an offer to compromise is returned under these circumstances and the IRS institutes collection action, the taxpayer may have the right to consideration of the whole of his

or her collection case under other provisions of the Code.

Pursuant to section 6331(k) of the Code, as amended by section 3462 of RRA 1998, the temporary regulations also provide that for offers pending on or submitted on or after January 1, 2000, no enforced collection activity may be taken by the IRS to collect a liability while an offer to compromise is pending, or for the 30 days following any rejection of an offer to compromise, or during any period that an appeal of any rejection, when such appeal is instituted within the 30 days following rejection, is being considered. Collection activity will not, however, be precluded in any case where collection is in jeopardy or the offer to compromise was submitted solely to delay collection.

Effective through December 31, 1999, the temporary regulations continue to require the taxpayer to waive the running of the statutory period of limitations on collection as a condition of acceptance of an offer to compromise. Effective January 1, 2000, waivers of the statute of limitations on collection will no longer be required for the acceptance of an offer to compromise. Instead, the statute of limitations for collection will be suspended during the period the offer to compromise is under consideration by the IRS. This provision of the temporary regulations implements section 3461 of RRA 1998.

The temporary regulations also implement section 503(a) of the Taxpayer Bill of Rights II by specifying that Chief Counsel review of an accepted offer to compromise is required only for offers in compromise involving $50,000 or more in unpaid liabilities.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that sections 553(b) & (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) do not apply to these regulations. Please refer to the cross-referenced notice of proposed rulemaking published in REG–116991–98, on page 242, for the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these temporary regulations is Carol A. Campbell of the Office of Assistant Chief Counsel (General Litigation). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

§301.7122–1—[Removed]

Par. 2. Section 301.7122–1 is removed.

Par. 3. Sections 301.7122–0T and 301.7122–1T are added to read as follows:

§301.7122–0T Table of contents.

This section list the captions that appear in the temporary regulations under §301.7122–1T.

§301.7122–1T Compromises (temporary).

(a) In general.
(b) Grounds for compromise.
(c) Procedures for submission and consideration of offers.
(d) Acceptance of an offer to compromise a tax liability.
(e) Rejection of an offer to compromise.
(f) Effect of offer to compromise on collection activity
(g) Deposits.
(h) Statute of limitations.
(i) Inspection with respect to accepted offers to compromise.
(j) Effective date.

§301.7122–1T Compromises (temporary).

(a) *In general.* (1) The Secretary may exercise his discretion to compromise any civil or criminal liability arising under the internal revenue laws prior to reference of a case involving such a liability to the Department of Justice for prosecution or defense.

(2) An agreement to compromise may relate to a civil or criminal liability for taxes, interest, or penalties. Unless the terms of the offer and acceptance expressly provide otherwise, acceptance of an offer to compromise a civil liability does not remit a criminal liability, nor does acceptance of an offer to compromise a criminal liability remit a civil liability.

(b) *Grounds for compromise.* (1) *In general.* The Secretary may compromise a liability on any of the following three grounds.

(2) *Doubt as to liability.* Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability. See §301.7122(e)(4) for special rules applicable to rejection of offers in cases where the IRS is unable to locate the taxpayer's return or return information to verify the liability.

(3) *Doubt as to collectibility.* (i) *In general.* Doubt as to collectibility exists in any case where the taxpayer's assets and income are less than the full amount of the assessed liability.

(ii) *Allowable Expenses.* A determination of doubt as to collectibility will include a determination of ability to pay. In determining ability to pay, the Secretary will permit taxpayers to retain sufficient funds to pay basic living expenses. The determination of the amount of such basic living expenses will be founded upon an evaluation of the individual facts and circumstances presented by the taxpayer's case. To guide this determination, guidelines published by the Secretary on national and local living expense standards will be taken into account.

(iii) *Nonliable spouses.* (A) *In general.* Where a taxpayer is offering to compro-

mise a liability for which the taxpayer's spouse has no liability, the assets and income of the nonliable spouse will not be considered in determining the amount of an adequate offer, except to the extent property has been transferred by the taxpayer to the nonliable spouse under circumstances that would permit the IRS to effect collection of the taxpayer's liability from such property, e.g., property that was conveyed in fraud of creditors, or as provided in paragraph (b)(3)(iii)(B) of this section. The IRS may, however, request information regarding the assets and/or income of the nonliable spouse for the sole purpose of verifying the amount of and responsibility for expenses claimed by the taxpayer.

(B) *Exception.* Where collection of the taxpayer's liability from the assets and/or income of the nonliable spouse is permitted by applicable state law (e.g., under state community property laws), the assets and income of the nonliable spouse will be considered in determining the amount of an adequate offer except to the extent that the taxpayer and the nonliable spouse demonstrate that collection of such assets and income would have a material and adverse impact on the standard of living of the taxpayer, the nonliable spouse, and their dependents.

(4) *Promote effective tax administration.* If there are no grounds for compromise under paragraphs (b)(2) and (3) of this temporary regulation, a compromise may be entered into to promote effective tax administration when—

(i) Collection of the full liability will create economic hardship within the meaning of §301.6343–1; or

(ii) Regardless of the taxpayer's financial circumstances, exceptional circumstances exist such that collection of the full liability will be detrimental to voluntary compliance by taxpayers; and

(iii) Compromise of the liability will not undermine compliance by taxpayers with the tax laws.

(iv) *Special rules for evaluating offers to promote effective tax administration.* (A) The determination to accept or reject an offer to compromise made on the ground that acceptance would promote effective tax administration within the meaning of this section will be based upon consideration of all the facts and circumstances, including the taxpayer's record of overall compliance with the tax laws.

(B) Factors supporting (but not conclusive of) a determination of economic hardship under paragraph (b)(4)(i) include–

(*1*) Taxpayer is incapable of earning a living because of a long term illness, medical condition, or disability and it is reasonably foreseeable that taxpayer's financial resources will be exhausted providing for care and support during the course of the condition;

(*2*) Although taxpayer has certain assets, liquidation of those assets to pay outstanding tax liabilities would render the taxpayer unable to meet basic living expenses; and

(*3*) Although taxpayer has certain assets, the taxpayer is unable to borrow against the equity in those assets and disposition by seizure or sale of the assets would have sufficient adverse consequences such that enforced collection is unlikely.

(C) Factors supporting (but not conclusive of) a determination that compromise would not undermine compliance by taxpayers with the tax laws include—

(*1*) Taxpayer does not have a history of noncompliance with the filing and payment requirements of the Internal Revenue Code;

(*2*) Taxpayer has not taken deliberate actions to avoid the payment of taxes; and

(*3*) Taxpayer has not encouraged others to refuse to comply with the tax laws.

(D) *Examples.* The following examples illustrate cases that may be compromised under the provisions of paragraph (b)(4)(i):

Example 1. Taxpayer has assets sufficient to satisfy the tax liability. Taxpayer provides full time care and assistance to her dependent child, who has a serious long-term illness. It is expected that the taxpayer will need to use the equity in her assets to provide for adequate basic living expenses and medical care for her child. Taxpayer's overall compliance history does not weigh against compromise.

Example 2. Taxpayer is retired and his only income is from a pension. The taxpayer's only asset is a retirement account, and the funds in the account are sufficient to satisfy the liability. Liquidation of the retirement account would leave the taxpayer without an adequate means to provide for basic living expenses. Taxpayer's overall compliance history does not weigh against compromise.

Example 3. Taxpayer is disabled and lives on a fixed income that will not, after allowance of adequate basic living expenses, permit full payment of his liability under an installment agreement. Taxpayer also owns a modest house that has been specially equipped to accommodate his disability. Taxpayer's equity in the house is sufficient to permit payment of the liability he owes. However, because of his disability and limited earning potential, taxpayer is unable to obtain a mortgage or otherwise borrow against this equity. In addition, because the taxpayer's home has been specially equipped to accommodate his disability, forced sale of the taxpayer's residence would create severe adverse consequences for the taxpayer, making such a sale unlikely. Taxpayer's overall compliance history does not weigh against compromise.

Example 4. Taxpayer is a business that despite the adoption of a wide array of precautions, including the employment of outside auditors, suffered an embezzlement loss. Although the taxpayer reviewed and signed employment tax returns and signed checks for payment of all employment tax liabilities, the embezzling employee successfully intercepted these checks and diverted the funds. At the time taxpayer discovers the diversions, taxpayer promptly contacts the IRS and begins proceedings to obtain recovery from the employee and the auditor. Taxpayer is unsuccessful in obtaining any recovery from either the employee or the auditor. While taxpayer has accounts receivable that will satisfy the tax delinquencies, taxpayer would be unable to remain in business if those receivables were seized by the IRS. Further, while taxpayer will continue to generate some profit if permitted to remain in business, those profits would not be sufficient to pay the accrued liabilities prior to the time collection of the liabilities became barred by the statute of limitations. Taxpayer's overall compliance history does not weigh against compromise.

(E) The following examples illustrate cases that may be compromised under paragraph (b)(4)(ii):

Example 1. In October of 1986, taxpayer developed a serious illness that resulted in almost continuous hospitalizations for a number of years. The taxpayer's medical condition was such that during this period the taxpayer was unable to manage any of his financial affairs. The taxpayer has not filed tax returns since that time. The taxpayer's health has now improved and he has promptly begun to attend to his tax affairs. He discovers that the IRS prepared a substitute for return for the 1986 tax year on the basis of information returns it had received and had assessed a tax deficiency. When the taxpayer discovered the liability, with penalties and interest, the tax bill is more than three times the original tax liability. Taxpayer's overall compliance history does not weigh against compromise.

Example 2. Taxpayer is a salaried sales manager at a department store who has been able to place $2,000 in a tax-deductible IRA account for each of the last two years. Taxpayer learns that he can earn a higher rate of interest on his IRA savings by moving those savings from a money management account to a certificate of deposit at a different financial institution. Prior to transferring his savings, taxpayer submits an E-Mail inquiry to the IRS at its Web Page, requesting information about the steps he must take to preserve the tax benefits he has enjoyed and to avoid penalties. The IRS responds in an answering E-Mail that the taxpayer may withdraw his

IRA savings from his neighborhood bank, but he must redeposit those savings in a new IRA account within 90 days. Taxpayer withdraws the funds and redeposits them in a new IRA account 63 days later. Upon audit, taxpayer learns that he has been misinformed about the required rollover period and that he is liable for additional taxes, penalties and additions to tax for not having redeposited the amount within 60 days. Had it not been for the erroneous advice that is reflected in the taxpayer's retained copy of the IRS E-Mail response to his inquiry, taxpayer would have redeposited the amount within the required 60-day period. Taxpayer's overall compliance history does not weigh against compromise.

(c) *Procedures for submission and consideration of offers.* (1) *In general.* An offer to compromise a tax liability pursuant to section 7122 must be submitted according to the procedures, and in the form and manner, prescribed by the Secretary. An offer to compromise a tax liability must be signed by the taxpayer under penalty of perjury and must contain the information prescribed or requested by the Secretary. However, taxpayers submitting offers to compromise liabilities solely on the basis of doubt as to liability will not be required to provide financial statements.

(2) *When offers become pending and return of offers.* An offer to compromise becomes pending when it is accepted for processing. If an offer accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the offer should be accepted, the IRS will request the taxpayer to provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable time period after such a request, the IRS may return the offer to the taxpayer. The IRS may also return an offer to compromise a tax liability if it determines that the offer was submitted solely to delay collection or was otherwise nonprocessable. An offer returned following acceptance for processing is deemed pending only for the period between the date the offer is accepted for processing and the date the IRS returns the offer to the taxpayer. See paragraphs (e)(5)(ii) and (f)(2)(iv) of this temporary regulation for rules regarding the effect of such returns of offers.

(3) *Withdrawal.* An offer to compromise a tax liability may be withdrawn by the taxpayer or the taxpayer's representative at any time prior to the IRS' acceptance of the offer to compromise. An offer will be considered withdrawn upon the IRS' receipt of written notification of the withdrawal of the offer by personal delivery, or by certified mail, or upon issuance of a letter by the IRS confirming the taxpayer's intent to withdraw the offer.

(d) *Acceptance of an offer to compromise a tax liability.* (1) An offer to compromise has not been accepted until the IRS issues a written notification of acceptance to the taxpayer or the taxpayer's representative.

(2) As additional consideration for the acceptance of an offer to compromise, the IRS may request that taxpayer enter into any collateral agreement or post any security which is deemed necessary for the protection of the interests of the United States.

(3) Offers may be accepted when they provide for payment of compromised amounts in one or more equal or unequal installments.

(4) If the final payment on an accepted offer to compromise is contingent upon the immediate and simultaneous release of a tax lien in whole or in part, such payment must be made in accordance with the forms, instructions, or procedures prescribed by the Secretary.

(5) Acceptance of an offer to compromise will conclusively settle the liability of the taxpayer specified in the offer. Neither the taxpayer nor the Government will, following acceptance of an offer to compromise, be permitted to reopen the case except in instances where–

(i) False information or documents are supplied in conjunction with the offer;

(ii) The ability to pay and/or the assets of the taxpayer are concealed; or

(iii) A mutual mistake of material fact sufficient to cause the offer agreement to be reformed or set aside is discovered.

(6) *Opinion of Chief Counsel.* Except as otherwise provided in this paragraph (d)(6), if an offer to compromise is accepted, there will be placed on file the opinion of the Chief Counsel for the IRS with respect to such compromise, along with the reasons therefor. However, no such opinion will be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $50,000. Also placed on file will be a statement of—

(i) The amount of tax assessed;

(ii) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed; and

(iii) The amount actually paid in accordance with the terms of the compromise.

(e) *Rejection of an offer to compromise.* (1) An offer to compromise has not been rejected until the IRS issues a written notice to the taxpayer or his representative, advising of the rejection, the reason(s) for rejection, and the right to an appeal.

(2) The IRS may not notify a taxpayer or taxpayer's representative of the rejection of an offer to compromise until an independent administrative review of the proposed rejection is completed.

(3) *Low income taxpayers.* No offer to compromise received from a low income taxpayer may be rejected solely on the basis of the amount of the offer without evaluating whether that offer meets the criteria in paragraph (b) of this section. For purposes of this paragraph (e)(3), a low income taxpayer is a taxpayer who falls at or below the dollar criteria established by the poverty guidelines updated annually in the **Federal Register** by the U.S. Department of Health and Human Services under authority of section 673(2) of the Omnibus Budget Reconciliation Act of 1981 or such other measure that is adopted by the Secretary.

(4) *Offers based upon doubt as to liability.* Offers submitted on the basis of doubt as to liability cannot be rejected solely because the IRS is unable to locate the taxpayer's return or return information for verification of the liability.

(5) *Appeal of rejection of an offer in compromise.* (i) *In general.* The taxpayer may administratively appeal a rejection of an offer to compromise to the IRS Office of Appeals (Appeals) if, within the 30-day period commencing the day after the date on the letter of rejection, the taxpayer requests such an administrative review in the manner provided by the Secretary.

(ii) *Offer to compromise returned following a determination that the offer was nonprocessable, a failure by the taxpayer to provide requested information, or a determination that the offer was submitted for purposes of delay.* Where a determination is made to return offer documents because the offer to compromise was nonprocessable, because the taxpayer failed to

provide requested information, or because the IRS determined that the offer to compromise was submitted solely for purposes of delay under paragraph (c)(2) of this section, the return of the offer does not constitute a rejection of the offer for purposes of this provision and does not entitle the taxpayer to appeal the matter to Appeals under the provisions of this section (e)(5) of this temporary regulation. However, if the offer is returned because the taxpayer failed to provide requested financial information, the offer will not be returned until an independent administrative review of the proposed return is completed.

(f) *Effect of offer to compromise on collection activity.* (1) *Offers submitted prior to and not pending on or after December 31, 1999.* For offers to compromise submitted prior to and not pending on or after December 31, 1999, the submission of an offer to compromise will not automatically operate to stay the collection of any liability. Enforcement of collection may, however, be deferred if the interests of the United States will not be jeopardized thereby.

(2) *Offers pending on or made on or after December 31, 1999.* (i) *In general.* For offers pending on or made on or after December 31, 1999, the IRS will not make any levies to collect the liability that is the subject of the compromise during the period the IRS is evaluating whether such offer will be accepted or rejected, for 30 days immediately following the rejection of the offer, and for any period when a timely filed appeal from the rejection is being considered by Appeals.

(ii) *Revised offers submitted following rejection.* If, following the rejection of an offer to compromise pending on or made on or after December 31, 1999, the taxpayer makes a good faith revision of that offer and submits the revised offer within 30 days after the date of rejection, the IRS will not levy to collect the liability that is the subject of the revised offer to compromise while the IRS is evaluating whether to accept or reject the revised offer.

(iii) *Jeopardy.* The IRS may levy to collect the liability that is the subject of an offer to compromise during the period the IRS is evaluating whether that offer will be accepted if it determines that collection of the liability is in jeopardy.

(iv) *Offers to compromise determined by IRS to be nonprocessable or submitted solely for purposes of delay.* The IRS may levy to collect the liability that is the subject of an offer to compromise at any time after it determines, under paragraph (c)(2) of this section, that a pending offer did not contain sufficient information to permit evaluation of whether the offer should be accepted, that the offer was submitted solely to delay collection, or that the offer was otherwise nonprocessable.

(v) *Offsets under section 6402.* Notwithstanding the evaluation and processing of an offer to compromise, the IRS may, in accordance with section 6402, credit any overpayments made by the taxpayer against a liability that is the subject of an offer to compromise and may offset such overpayments against other liabilities owed by the taxpayer to the extent authorized by section 6402.

(g) *Deposits.* Sums submitted with an offer to compromise a liability or during the pendency of an offer to compromise are considered deposits and will not be applied to the liability until the offer is accepted unless the taxpayer provides written authorization for application of the payments. If an offer to compromise is withdrawn, is determined to be nonprocessable, or is submitted solely for purposes of delay and returned to the taxpayer, any amount tendered with the offer, including all installments paid on the offer, will be refunded without interest. If an offer is rejected, any amount tendered with the offer, including all installments paid on the offer, will be refunded, without interest, after the conclusion of any review sought by the taxpayer with Appeals. Refund will not be required if the taxpayer has agreed in writing that amounts tendered pursuant to the offer may be applied to the liability for which the offer was submitted.

(h) *Statute of limitations.* (1) *Offers submitted prior to and not pending on or after December 31, 1999.* For offers to compromise submitted prior to and not pending on or after December 31, 1999, —

(i) if the 10-year period specified in section 6502(a) will expire prior to December 31, 2002, and

(ii) payments due under the agreement are scheduled to be made after the date upon which the 10-year period specified in section 6502(a) will expire — no offer will be accepted unless the taxpayer executes a consent to extend the statutory period of limitations on the collection of the liability involved until the date one year subsequent to the date of the last scheduled payment or until December 31, 2002, whichever is earlier.

(2) *Offers pending on or made on or after December 31, 1999.* For offers pending on or made on or after December 31, 1999, the statute of limitations on collection will be suspended while collection is prohibited under paragraph (f)(2) of this section.

(3) For any offer to compromise, the IRS may continue to require, where appropriate, the extension of the statute of limitations on assessment. However, in any case where waiver of the running of the statutory period of limitations on assessment is sought, the taxpayer must be notified of the right to refuse to extend the period of limitations or to limit the extension to particular issues or particular periods of time.

(i) *Inspection with respect to accepted offers to compromise.* For provisions relating to the inspection of returns and accepted offers to compromise, see section 6103(k)(1).

(j) *Effective date.* Except as otherwise provided, this section applies to offers to compromise submitted on or after **July 21, 1999,** through **July 19, 2002.**

Charles O. Rossotti,
Commissioner of Internal Revenue.

Approved July 14, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 19, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 21, 1999, 64 F.R.39020)

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Compromises

REG–116991–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In T.D. 8829, on page 235, the IRS is issuing temporary regulations relating to the compromise of tax liabilities. These regulations provide additional guidance regarding the compromise of internal revenue taxes. The temporary regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998 and the Taxpayer bill of Rights II. The text of the temporary regulations also serves as the text of these proposed regulations.

DATE: Written or electronically generated comments and requests for a public hearing must be received by **October 19, 1999.**

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–116991–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–116991–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Carol A. Campbell, (202) 622-3620 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in T.D. 8829 amend the Procedure and Administration Regulations (26 CFR part 301) under section 7122 of the Internal Revenue Code. The temporary regulations reflect the amendment of section 7122 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 ("RRA 1998") Public Law, 105–206, (112 Stat. 685, 764) and by section 503(a) of Taxpayer Bill of Rights II Public Law 104-168, (110 Stat. 1452, 1461).

The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805 (f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronically generated comments that are submitted timely to the IRS. The IRS generally requests any comments on the clarity of the proposed rule and how it may be made easier to understand.

Section 3462 of RRA 1998 and its legislative history provide for the consideration of factors such as equity, hardship, and public policy in the compromise of tax cases, if such consideration would promote effective tax administration. The legislative history also states that the IRS should use this new compromise authority "to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayerís liability." H. Conf. Rep. 599, 105th Cong., 2d Sess. 289 (1998). The text of the temporary regulation provides the authority to compromise cases involving issues of equity, hardship, and public policy, if such a compromise would promote effective tax administration. The temporary regulation provides factors to be considered and examples of cases that could be compromised under this authority when collection of the full amount of the tax liability would create economic hardship. The temporary regulation also provides limited examples of cases that could be compromised when the facts and circumstances presented indicate that collection of the full tax liability would be detrimental to voluntary compliance. The temporary regulation does not contain examples of longstanding cases that could be compromised to promote effective tax administration when penalties and interest have accumulated as the result of delay by the Service in determining the tax liability.

The public is specifically encouraged to make comments or provide examples regarding the particular types of cases or situations in which the Secretaryís authority to compromise should be used because: (1) collection of the full amount of tax liability would be detrimental to voluntary compliance or (2) IRS delay in determining the tax liability has resulted in the accumulation of significant interest and penalties. In formulating comments regarding delay in interest and penalty cases, consideration should be given to the possible interplay between cases compromised under this provision and the relief accorded taxpayers under I.R.C. § 6404(e).

All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by a person that

timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Carol A. Campbell, Office of the Assistant Chief Counsel (General Litigation) CC:EL:GL, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Paragraph 2. Section 301. 7122–1 is added to read as follows:

§ 301.7122–1 Compromises.

[The text of this proposed section is the same as the text of § 301.7122–1T published in T.D. 8829, on page 235.]

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 19, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 21, 1999, 64 F.R. 39106)

Boyd Gaming Corporation v. Commissioner

Announcement 99–77

The Service (1) acquiesces in the opinion, (2) withdraws proposed training materials relating primarily to the application of section 119 of the Internal Revenue Code to employer-provided meals in the hospitality industry, and (3) terminates the settlement initiative related to this issue.

The Internal Revenue Service (Service) announces three actions as a result of the opinion of the United States Court of Appeals for the Ninth Circuit in *Boyd Gaming Corporation v. Comm'r,* ___ F.3d ___ (9th Cir. May 12, 1999), reversing T.C. Memo 1997–445 T.C. Dkt. Nos. 3433–95, 3434–95 (1997).

First, the Solicitor General has decided not to file a petition for a writ of certiorari with the United States Supreme Court with respect to the Ninth Circuit's opinion. Accordingly, the Service announces today that it acquiesces in the Ninth Circuit's opinion in *Boyd Gaming Corporation.* The acquiescence will appear in 1999–32 I.R.B. (August 9, 1999), and a copy of the Action on Decision memorandum in support of that acquiescence accompanies this announcement.

Second, the Service withdraws the proposed training materials described in Announcement 98–77, 1998–34 I.R.B. 30. See also Announcement 98-100, 1998–46 I.R.B. 42. These materials relate primarily to the application of section 119 of the Internal Revenue Code to meals provided to employees in the hospitality industry.

Finally, the Service terminates the settlement initiative relating to employee meals described in Announcement 98–78, 1998–34 I.R.B. 30. Pending cases involving this issue will be resolved on the basis of their particular facts in light of the Ninth Circuit's opinion in *Boyd Gaming Corporation* and the Service's acquiescence in that opinion.

The principal author of this announcement is Thomas Burger, Director, Office of Employment Tax Administration and Compliance (OETAC). For further information regarding this announcement contact Mr. Burger at (202) 622-3650 (not a toll-free call).

ACTION ON DECISION

Subject: Boyd Gaming Corporation v. Commissioner, __F.3d__ (9th Cir. 1999), rev'g T.C. Memo. 1997–445 T.C. Dkt. Nos. 3433–95, 3434–95

Issue: Whether a meal furnished by the taxpayer/employer on its business premises to an employee is furnished for "the convenience of the employer" within the meaning of that phrase in section 119 of the Internal Revenue Code.

Discussion: Section 119 of the Internal Revenue Code provides that an employee's gross income does not include the value of any meal furnished to him in kind by or on behalf of his employer for the convenience of the employer if the meal is furnished on the employer's business premises. Treas. Reg. § 1.119–1(a)-(2) provides that a meal is furnished for "the convenience of the employer" if it is furnished for a substantial noncompensatory business reason of the employer. Whether an employer-provided meal is furnished for "the convenience of the employer" is important to the employer for federal tax purposes because the interplay of sections 119, 132, and 274 of the Internal Revenue Code determines whether the employer can fully deduct the cost of the meal.

During the years in issue, the taxpayer furnished free meals on its business premises to all of its employees, most of whom were required to stay on the taxpayer's business premises during their working hours primarily because of the particular security concerns of the casino industry. The taxpayer argued that, because its employees were required to remain on its business premises during their working hours, the meals it provided to its employees were provided for a substantial noncompensatory business reason.

The Tax Court held that the taxpayer's stay-on-the-business-premises requirement did not satisfy the convenience-of-the-employer requirement of section 119, determining that there must be a "closer and better documented connection between the necessities of the employer's business and the furnishing of free meals."

The Ninth Circuit reversed the Tax Court decision. The Ninth Circuit found that the taxpayer's particular security and other business-related concerns provided sufficient justification for its policy of requiring employees to stay on the employer's business premises to satisfy "the convenience of the employer" test of section 119. Specifically, the Ninth Circuit stated that –

> Boyd was required to and did support its closed campus policy with adequate evidence of legitimate business reasons. While reasonable minds might differ regarding whether a "stay-on-the-premises" policy is necessary for

security and logistics, the fact remains that the casinos here operate under this policy. Given the credible and uncontradicted evidence regarding the [business] reasons underlying the "stay-on-the-premises" policy, it is inappropriate to second guess these reasons or to substitute a different business judgment for that of Boyd.

In light of the Ninth Circuit's opinion, the Service will not challenge whether meals provided to employees of casino businesses similar to that operated by Boyd Gaming meet the section 119 "convenience of the employer" test where the employer's business policies and practices would otherwise preclude employees from obtaining a proper meal within a reasonable meal period. A bona fide and enforced policy that requires employees to stay on the employer's business premises during their normal meal period is only one example of the type of business practice that could justify the employer's providing of meals that would qualify for section 119 treatment. Another example could be a practice requiring "check-out" procedures for employees leaving the premises in order to address the same type of security concerns that were relevant in Boyd Gaming where these procedures have the same practical effect.

More generally, in applying section 119 and Treas. Reg. § 1.119–1, the Service will not attempt to substitute its judgment for the business decisions of an employer as to what specific business policies and practices are best suited to addressing the employer's business concerns. By the same token, to paraphrase the Ninth Circuit, "it would not [be] enough for [an employer] to wave a 'magic wand' and say it had a policy in order [for meals to qualify under section 119]." Thus, the Service will consider whether the policies decided upon by the employer are reasonably related to the needs of the employer's business (apart from a desire to provide additional compensation to its employees) and whether these policies are in fact followed in the actual conduct of the business. If such reasonable procedures are adopted and applied, and they preclude employees from obtaining a proper meal off the employer's business premises during a reasonable meal period, section 119 will apply.

Recommendation: Acquiescence

Reviewer: Paul C. Feinberg,
Special Counsel.

Approved: Stuart L. Brown,
Chief Counsel.

By: Nancy J. Marks,
Acting Associate Chief Counsel, (Employee Benefits and Exempt Organizations).

THIS DOCUMENT IS NOT TO BE RELIED UPON OR OTHERWISE CITED AS PRECEDENT BY TAXPAYERS

Internal Revenue Service to Make Litigation Guideline Memoranda Available for Public Inspection

Announcement 99–81

On July 22, 1999, the Internal Revenue Service (IRS) will make, among other documents, Litigation Guideline Memoranda (LGMs), issued between January 1, 1986, and October 20, 1998, available for public inspection. Section 3509(d)(2)(A) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105–206, required that certain types of "Chief Counsel Advice" be made available for public inspection at this time. In general, Chief Counsel Advice is advice about the tax laws written by the National Office of Chief Counsel to field offices, including District Counsel, Examination and Appeals.

As reflected in Chief Counsel Notice N(32)210–1 (April 18, 1988) LGMs "provide information and instruction relating to litigating procedures and methods, and standards and criteria on issues and matters of significant interest to litigating attorneys in the Office of Chief Counsel." However, "each [LGM] represents the litigating position criteria and procedures of the Office of Chief Counsel as of the date of issuance and may not represent the current position." Because some of the LGMs do not represent current Chief Counsel position, they may have been designated internally as "obsolete." This designation will not necessarily be apparent on the face of the document. Despite the fact that the Chief Counsel attorneys no longer follow the guidance and instructions set forth in obsolete LGMs, all LGMs issued between 1986-1998 are being made publicly available. It is anticipated that the IRS will make available to the public a Title Index that identifies which LGMs are current and those that have been obsoleted.

Pursuant to § 3509 of RRA 98, Congress has authorized the IRS to delete taxpayer identifying details and information that is exempt from public disclosure under the Freedom of Information Act (FOIA). *See* § 6110(i)(3). The FOIA deletions will be made only if it is determined that disclosure might "seriously impede or nullify IRS activities in carrying out a responsibility or function;" for example, jeopardize an ongoing investigation or judicial proceeding or that would be harmful to other interests specified in the FOIA. IRM 1230, Internal Management Document System Handbook, at text 293(2). After the documents have been made available to the public, the correctness of the deletion of any information may be challenged under section 6110.

Documents released under this process will be found in the Freedom of Information Room, 1111 Constitution Ave., NW, Washington, DC 20224, where they may be read and copied by the public during the hours 9:00 A.M. to 4:00 P.M.

The public is cautioned that LGMs may not be used or cited as precedent. *See* § 6110(k)(3).

The principal author of this announcement is Andrea Tucker of the Office of the Associate Chief Counsel (Domestic). For further information regarding this announcement contact Andrea Tucker on (202) 622-4540 (not a toll-free call).

Recovery Period for Certain Personal Property Used in Rental Real Estate Activities; Correction

Announcement 99–82

The 1998 instructions for **Form 4562,** Depreciation and Amortization, and **Publication 527**, Residential Rental Property, classify certain personal property used in a rental real estate activity (appliances,

carpeting, furniture, etc.) as 7-year property. The correct classification is 5-year property. This property is included in Asset Class 57.0, Distributive Trades and Services (see Rev. Proc. 87–56, 1987–2 C.B. 674). Therefore, the correct recovery period to be used for the regular tax is 5 years under the General Depreciation System (GDS) and 9 years under the Alternative Depreciation System (ADS).

When using a 5-year recovery period for this property for the regular tax, any alternative minimum tax (AMT) adjustment generally must be figured using a 9-year recovery period. However, if the property was placed in service after 1998, the same recovery period applies for both the regular tax and the AMT.

The action, if any, to be taken is determined for each property based on when the property was placed in service.

- For property placed in service during any tax year for which a return has not yet been filed, taxpayers must use a 5-year recovery period under GDS (9 years under ADS). For the AMT, taxpayers must use a 9-year recovery period for property placed in service before 1999.
- For property placed in service during the most recent tax year for which a tax return has been filed, the taxpayer may do either of the following:

  1. Continue to depreciate the property using a 7-year recovery period under GDS (12 years under ADS). For the AMT, continue using a 12- year recovery period for property placed in service before 1999.

  2. File an amended return for that year to change the recovery period from 7 years to 5 years under GDS (12 years to 9 years under ADS). For the AMT, use a 9-year recovery period on that amended return for property placed in service before 1999.
- For property placed in service during any tax year prior to the most recent tax year for which a tax return has been filed, the taxpayer may do either of the following:

  1. Continue to depreciate the property using a 7-year recovery period under GDS (12 years under ADS). For the AMT, continue using a 12- year recovery period for property placed in service before 1999.

  2. File **Form 3115,** Application for Change in Accounting Method, to change to a 5-year recovery period under GDS (9 years under ADS). Also use Form 3115 to change to a 9-year recovery period for the AMT for property placed in service before 1999. The change is automatic and no user fee is required, but Form 3115 must be filed. See Rev. Proc. 98–60, 1998–51 I.R.B. 16, for details on how to make the change and file Form 3115.

You can obtain Form 3115 and its separate instructions by telephone or by using IRS electronic information services.

Approved July 20, 1999.

Sheldon D. Schwartz,
National Director, Tax Forms and Publications Division.

Request by–	Number or Address
Telephone	1-800-TAX-FORM (1-800-829-3676)
Personal computer: World Wide Web File Transfer Protocol Telnet	 www.irs.ustreas.gov ftp.irs.ustreas.gov iris.irs.ustreas.gov
Direct Dial (by modem)	703-321-8020

Foundations Status of Certain Organizations

Announcement 99–83

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Center for Art and Earth Inc., New York, NY
George A. Boyce Military Museum, Tempe, AZ
Help Ourselves Project, Philadelphia, PA
Medcetera Education Foundation, Inc., Bellaire, TX
Memorial Neighborhood Health Centers Inc., South Bend, IN
Moose-Willow Sportsman Club, Hill City, MN
United States Amateur Basketball Association Inc., Ft. Worth, TX
United States Army Command and General Staff College Alumni, Ft. Leavenworth, KS
United States Coalition for Education for All Inc., Arlington, VA
United States Medical Triathlon Association Inc., Roanoke, VA
United States Water Fitness, Boynton Beach, FL
United Victim Recovery Service, Toledo, OH
United Way of Scott County Indiana Inc., Scottsburg, IN
Unity Community Center of South Jersey Incorporated, Camden, NJ
Unity to Assist Humanity Alliance, Salt, Lake City, UT
Universal Awareness Association Inc., Phoenix, AZ
Universal Community & Housing Development Corporation, Detroit, MI
Universal Ministries Inc., Pittsburgh, PA
University Ophthalmic Consultants of Washington PC, Washington, DC
Unlimited Senior Housing Inc., Uniontown, PA
Upper Michigan Central Model RR Club, Wells, MI
Upper Rio FM Society Inc., Albuquerque, NM
Villa D Ames Organization Intent on Changing Its Environment, Marrero, LA
Upstreet Educational Media Inc., Scottsdale, AZ
Upward Movement Nutritional Service,

Houston, TX
Urban Agriculture Network, Washington, DC
Urban Christian Ministries Inc., Arlington Heights, IL
Urban Genesis Inc., Philadelphia, PA
Urban Harvest Ministries Inc., Beaumont, TX
Urban Life Challenge Inc., Paterson, NJ
Urban Ministries of Springfield Inc., Jacksonville, FL
Urban Shelters of America Inc., Chicago, IL
Urban Vision Inc., Richmond, VA
USA Compete Inc. A Non-Profit Corporation, Greeley, CO
USA Karate Federation of New Mexico, Albuquerque, NM
Utah Harvest, Sandy, UT
Utah Head and Spinal Cord Injury Prevention Program, Salt Lake City, UT
Utah Taxpayers Legal Foundation, Salt Lake City, UT
Ute Pass Field of Dreams Inc., Cascade, CO
Uvalde Youth Rodeo Club, Uvalde, TX
VIPs Performing Dance Company Inc., Wilmington, NC
Valley Christian Radio Inc., Littleton, CO
Valley Youth Athletic Parks Boosters Inc., Lucasville, OH
Variety Clubs of Colorado Inc., Englewood, CO
Vaut Association, Riverdale, IL
Venable Apartments Inc., Owensboro, KY
Vernon Daniels Evangelistic Association, Norman, OK
Vestavia Hills Chamber of Commerce Foundation, Birmingham, AL
Vet-Group Inc., W. Monroe, LA
Veteran Information and Service Center, Columbus, OH
Veterans Action Force USA Inc., Tucker, GA
Veterans Foodlocker and Relief Fund, Lisbon, OH
Veterans Support Task Force Inc., Madison, WI
Victim Protection Services, Denver, CO
Victims of Choice & Abortions Legacy Inc., Snellville, GA
Victorious Living Foundation Inc., Broken Arrow, OK
Victory Museum Foundation Inc., Hinesville, GA
Victory Videos Inc., Florence, KY
Video Portrait Society of America Inc., Denver, CO
Video Vista of New York Ltd., New York, NY
Villa Vista Nonprofit Housing Corporation, Saginaw, MI
Village Association of Batavia Inc., Cincinnati, OH
Village Puppet Theatre Inc., Covington, KY
Vincennes Area Youth Adult Ministries Inc., Vincennes, IN
Vinita Unlimited Inc., Vinita, OK
Virginia Association of Black Women Attorneys, Midlothian, VA
Virginia Caring Program Inc., Richmond, VA
Virginia Theatrical Society Inc., Chesapeake, VA
Vision International Inc., Hays, KS
Vision Music Ministries, Gastonia, NC
Visions Studio for the Creative Arts, De Soto, TX
Visions Unfolding Incorporated, Houston, TX
Vocational Technical Educational Foundation of Delaware, Woodside, DE
Voice for Life, Colorado Springs, CO
Voice of Freedom Inc., Washington, DC
Voice of Triumph Ministries Inc., Tucson, AZ
Voices for Life, Houston, TX
Volunteer Center of the Lowcountry Inc., Charleston, SC
Volunteer Emergency Services Support Group, Hernando, MS
Volunteer Firemens Association, Calumet, OK
Volunteer for AIDS Information and Service, Dallas, TX
Volusia Surf Lifesaving Association Inc., Daytona Beach, FL
Voters Against Sexual Abuse Inc., Grand Rapids, MI
Walker Mill Towne Affordable Home Ownership Corporation, Seat Pleasant, MD
We Stay-Nos Quedamos Inc., Bronx, NY
West Bank Safety Center, Minneapolis, MN
World Outreach International, Detroit, MI
Yenping Association Inc., New York, NY
Zachary & Elizabeth M. Fisher Medical Foundation, Inc., New York, NY
Zichron Chaim Shlomo, Passaic, NJ

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 472.—Last-in, First-out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The June 1999 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, June 30, 1999.

Rev. Rul. 99-34

The following Department Store Inventory Price Indexes for June 1999 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, 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, June 30, 1999.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

Bureau of Labor Statistics, Department Store Inventory Price Indexes By Department Groups
(January 1941 = 100, unless otherwise noted)

Groups	June 1998	June 1999	Percent Change from June 1998 to June 1999[1]
1. Piece Goods	513.9	555.1	8.0
2. Domestics and Draperies	618.6	630.1	1.9
3. Women's and Children's Shoes	659.3	645.1	-2.2
4. Men's Shoes	906.7	876.9	-3.3
5. Infants' Wear	623.1	610.1	-2.1
6. Women's Underwear	567.7	561.4	-1.1
7. Women's Hosiery	308.3	322.8	4.7
8. Women's and Girls' Accessories	536.2	549.3	2.4
9. Women's Outerwear and Girls' Wear	410.0	392.0	-4.4
10. Men's Clothing	616.6	624.1	1.2
11. Men's Furnishings	599.1	630.4	5.2
12. Boys' Clothing and Furnishings	494.6	488.9	-1.2
13. Jewelry	970.3	961.2	-0.9
14. Notions	776.0	747.4	-3.7
15. Toilet Articles and Drugs	948.5	968.8	2.1
16. Furniture and Bedding	689.3	682.9	-0.9
17. Floor Coverings	604.0	602.7	-0.2
18. Housewares	818.6	801.4	-2.1
19. Major Appliances	236.7	235.7	-0.4
20. Radio and Television	71.9	66.3	-7.8
21. Recreation and Education[2]	104.8	98.7	-5.8
22. Home Improvements[2]	133.1	127.6	-4.1
23. Auto Accessories[2]	107.2	106.7	-0.5
Groups 1 - 15: Soft Goods	600.1	599.9	0.0
Groups 16 - 20: Durable Goods	463.6	452.2	-2.5
Groups 21 - 23: Misc. Goods[2]	108.9	104.1	-4.4
Store Total[3]	550.7	545.0	-1.0

1 Absence of a minus sign before percentage change in this column signifies price increase.
2 Indexes on a January 1986=100 base.
3 The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

Drafting Information

The principal author of this revenue ruling is Richard C. Farley, Jr. of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Farley on (202) 622-4970 (not a toll-free call).

Part IV. Items of General Interest

Employee Stock Ownership Plans; Section 411(d)(6) Protected Benefits; Qualified Retirement Plan Benefits; Correction

Announcement 99–84

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains corrections to T.D. 8806, 1999–6 I.R.B. 4, final regulations which were published in the **Federal Register** on Friday, January 8, 1999, (64 F.R. 1125), relating to employee stock ownership plans and protected benefits under section 411(d)(6) and qualified retirement plan benefits.

DATES: This correction is effective January 8, 1999.

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to this correction are under section 411 of the Internal Revenue Code.

Need for Correction

On January 8, 1999, final regulations (T.D. 8806, 1999–6 I.R.B. 4) were published in the **Federal Register** (64 F.R. 1125). These regulations inadvertently amended §1.411(d)–4 Q&A–2(d)(2)(ii) instead of §1.411(d)–4 Q&A–2(d)(1)(ii). This document is correcting this amendment by providing the correct language for §1.411(d)–4 Q&A–2(d)(1)(ii) and restoring the language for §1.411(d)–4 Q&A–2(d)(2)(ii).

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Correction of Publication

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendments:

PART 1 — INCOME TAXES

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

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

§1.411(d)–4 [Corrected]

Par. 2. Section 1.411(d)–4 Q&A–2 is amended by:

1. Removing paragraph (d)(1)(ii).
2. Redesignating paragraph (d)(2)(ii) as paragraph (d)(1)(ii).
3. Adding paragraph (d)(2)(ii).

The addition reads as follows:

§1.411(d)–4 Section 411(d)(6) protected benefits.

* * * * *

Q-2: ***

A-2: ***

(d) ***

(2) ***

(ii) *ESOP investment requirement.* Except as provided in paragraph (d)(2)(iii) of this Q&A–2, benefits provided by employee stock ownership plans will not be eligible for the exceptions in paragraph (d)(1) of this Q&A–2 unless the benefits have been held in a tax credit employee stock ownership plan (as defined in section 409 (a)) or an employee stock ownership plan (as defined in section 4975 (e)(7)) subject to section 409 (h) for the five-year period prior to the exercise of employer discretion or any amendment affecting such benefits and permitted under paragraph (d)(1) of this Q&A–2. For purposes of the preceding sentence, if benefits held under an employee stock ownership plan are transferred to a plan that is an employee stock ownership plan at the time of transfer, then the consecutive periods under the transferor and transferee employee stock ownership plans may be aggregated for purposes of meeting the five-year requirement. If the benefits are held in an employee stock ownership plan throughout the entire period of their existence, and such total period of existence is less than five years, then such lesser period may be substituted for the five year requirement.

* * * * *

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on July 19, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 20, 1999, 64 F.R. 38825)

Foundations Status of Certain Organizations

Announcement 99–85

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Lingua Africa Inc., Dallas, TX
Lion P A W Booster Club, Riverside, CA
Lions Club of Chanhassen Foundation, Chanhassen, MN
Literacy Volunteers of Coconino County, Flagstaff, AZ
Lithuanian Orphanage Fund Inc., Torrington, CT
Little Jewels Day Care Inc., Brooklyn, NY
Little Rock Wind Symphony Inc., Little Rock AR
Littlefield Historic Preservation Inc., Littlefield, TX
Live Poets Society, Washington, ME
Long Island Toy Lending Center for Children With Disabilities Inc., Farmingdale, NY
Louisiana Assistance Program Inc., Grambling, LA
Louisiana Development Partnerships Inc., Baton Rouge, LA
Loving Food Resources, Asheville, NC

Luzerne County Cultural Council Inc., Wilkes Barre, PA
Madison County Step Ahead Council Inc., Anderson, IN
Magnet Schools of Texas Inc., Bryan, TX
Main Street Singers Student Parent Group, Los Altos, CA
Main Street Watsonville, Watsonville, CA
Maine Bioethics Network, Bar Harbor, ME
Maine Education Council for Aviation Aerospace, Falmouth, ME
Manchester United Soccer Club Inc., Manchester, NH
Mandarin Middle School Band Booster Inc., Jacksonville, FL
Manhattan Wind Quintet, New York, NY
Manna Ministry, Indianapolis, IN
Marina High School Educational Foundation, Huntington Beach, CA
Mary Lee Maintenance Inc., Austin, TX
Maryland Alliance Against Family Violence, Baltimore, MD
Mayor Smiths Private Sector Survey Inc., Boca Raton, FL
Meacham Park Community Resource Center, Kirkwood, MO
Med Traum Inc., Thayer, MO
Medicine Horse Riding Center, Minneapolis, MN
Megumi PTA 6 15 10, Tacoma, WA
Mid-America Artists Showcase Inc., Witchita, KS
Middlesex Health Services Inc., Middlesex, NC
Midway Fellowship Club, Chicago, IL
Midwest Badminton Association, Mount Prospect, IL
Midwest Nursing Research Society Inc., Indianapolis, IN
Millcreek-West Unity Area Foundation Inc., W Unity, OH
Minerva International Inc., Scottsdale, AZ
Minnesota, DBAE Consortium, St. Paul, MN
Mississippi County Arkansas Rape Crisis Inc., Blytheville, AR
Missouri 1st Vote Foundation, Jefferson City, MO
Mobile Pregnancy Unit Inc., Port St. Lucie, FL
Monsignor Neagle Apartments Inc., Boston, MA
Moon Lake Lodge and Gardens Inc., New Port Richey, FL
Morrison County Volunteer Network, Little Falls, MN
Mount Pleasant Residence Council, New Britain, CT
Moving On Coalition, Columbia, MO
Murray County Family Circle Inc., Chatsworth, GA
Murrow Media Foundation Inc., Brooklyn, NY
Muse Theatre Inc., New York, NY
Museo Guadalupe Aztlan, Houston, TX
Music Ministers of Jesus Inc., Orange Park, FL
Nabs New York, New York, NY
Naranja Residence Association Inc., Miami, FL
Nashville Vietnamese Veterans Association, Nashville, TN
National Association of Mothers Centers Inc., Hempstead, NY
National Black Science Student Alumni Group Inc., Brooklyn, NY
National Council on Alcoholism & Drug Dependence, Palm Springs, CA
National Educational Consortium Inc., Kensington, MD
National Educational Resource Institute, New Rochelle, NY
National Parents Outreach Network, Clemmons, NC
Neodata Employee Disaster Fund, Des Moines, IA
New Choices Program Inc., Dayton, OH
New City Trust Inc., Homestead, FL
New Hampshire Feminist Connection, Concord, NH
New Life Center, Lexington, SC
New Life Residential Center Inc., Hamburg, NY
New Urban Vision Inc., Philadelphia, PA
New Visions Economic Development Corporation, Homestead, FL
New Water Foundation, Wheaton, IL
Newark Neighborhood Inc., Newark, NJ
Newberry County Commission on Alcohol and Drug Abuse, Newberry, SC
Newburyport Youth Basketball League Inc., Newburyport, MA
Newton Education Foundation Inc., Covington, GA
NIA Investment Corporation, Dover, DE
Night of Stars Inc., Fort Myers, FL
Noel Singers Brooklyn Youth Arts Ensemble Inc., Brooklyn, NY
Norfolk Community Trust Exempt Fund, Norfolk, VA
North Alabama Center for Educational Excellence Inc., Huntsville, AL
North Alabama Childrens Charity Inc., Fort Payne, AL
North American Youth Hockey Foundation, Inc., Melville, NY
North Central District Aids Coalition Inc., Bellefonte, PA
North East Central Durham Economic Reinvestment Inc., Durham, NC
North-Tartan A A U Girls Basketball Booster Club, Oakdale, MN
North Texas Express Soccer Club Inc., Richardson, TX
Northern Educational Partnership, Presque Isle, ME
Northern Virginia Choral Alliance, Annandale, VA
Northwest Alumnae Association, Seattle, WA
Northwest Genesis Community, Beaverton, OR
Northwest Worklink Inc. Chicago, IL
NTSW Foundation, Skokie, IL
NVCSS Wilshire Drive Housing Inc., Redding, CA
Oak Leaf Club Inc., Iola, KS
Oak View Parent Teacher Organization, Fort Wayne, IN
Oceanside Rotary Charities Inc., Neptune Beach, FL
Oklahoma Crime Victims Centre Inc., Shawnee, OK
Oklahoma Entertainment Hall of Fame Foundation, Tulsa, OK
Olympia Foundation for Education, Stanford, IL
On a Mission, Pittsburgh, PA
Oncara, Brandon, VT
Onesimus Evangelistic Ministries Inc., Orlando, FL
Oneway Productions Inc., Grand Prairie, TX
Operation Win Inc., Houston, TX
Orange High Gradnite 93, Orange, CA
Oro Grande Elementary School Parent-Teacher Advisory Committee, Lake Havasu City, AZ
Ouachita County Youth Aid, Camden, AR
Ourpeople Entrepreneur Center, New York, NY
Outside Chance of Georgia Inc., Marietta, GA
P T Barnum Tenants Association Inc., Bridgeport, CT
Outdoor School Partners & Alumni Assisting With Longterm Support, Hillsboro, OR
Paducah-McCracken County Pride Inc., Paducah, KY

Paducah Tilghman High School Band Booster Association, Paducah, KY
Pamlico Hurricanes Booster Club Inc., Oriental, NC
Parent Involvement Project Inc., Springfield, MA
Parents Advocating Challenging Education, Colorado Springs, CO
Parkway Child Care Inc., Greenwich, CT
Pendergrass Institute for the Musical and Performing Arts, Penn Valley, PA
Penn Manor Community Center Foundation, Lancaster, PA
Pennington Music Festival Inc., Pennington, NJ
Penobscot Valley Ice Sports Inc., Brewer, ME
People Rededicated in Downtown Efforts Inc., Spruce Pine, NC
People United Exclusively by Long Term Objectives, Dixon, CA
Perry County Casa, New Bloomfield, PA
PHS Renaissance Booster Club, Parsons, KS
Piedmont Triad Center for Advanced Manufacturing Inc., Greensboro, NC
Planet Earths Environment Inc., Upland, CA
Pocomoke Occohannock Tribal Association Inc., Salisbury, MD
Poly-Band Boosters Corp, Riverside, CA
Positive Vision Theater, Columbus, OH
Positively HIV Inc., Lemoyne, PA
Prevent Autism Now, Leominster, MA
Prevention Point Philadelphia Inc., Philadelphia, PA
Prism Group Inc., East Windsor, NJ
Project Big Heart Association Inc., Culpeper, VA
Project Stamp Inc., Atlanta, GA
Project Success Through Opportunity Achievement and Responsibility, Greenville, NC
Project Unicycle Inc., Brooklyn, NY
Promoting a Drug Free Community in Posey County Inc., Mt. Vernon, IN
Prospect Hall Athletic Association, Frederick, MD
Psychobioenergy Foundation Inc., New York, NY
Public Defender Services of Knox County, Knoxville, TN
Quality Care for Kids, Novato, CA
Quality Educational Scholastic Trust Inc., Pittsfield, MA
Quaystone Concert Series Inc., Marquette, MI
Queens College Alumni Association-New York Chapter, Brooklyn, NY
Queens Parents Resource Center Inc., Queens Village, NY
Quest South Florida Inc., Miami, FL
Queue Theatre Company Inc., Marion, NY
Quincy Child Development Center, Quincy, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Fringe benefits aircraft valuation formula. For purposes of section 1.61–21(g) of the Income Tax Regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL), cents-per-mile rates, and terminal charges in effect for the second half of 1999 are set forth.

Rev. Rul. 99–33

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the periods during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semiannually.

The following chart sets forth the terminal charges and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
7/1/99-12/31/99	$32.41	Up to 500 miles = $.1773 per mile
		501–1500 miles = $.1352 per mile
		Over 1500 miles = $.1300 per mile

DRAFTING INFORMATION

The principle author of this revenue is Kathleen Edmondson of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). For further information regarding this revenue ruling, contact Ms. Edmondson on (202) 622-6080 (not a toll-free call).

Section 367.—Foreign Corporations

26 CFR 1.367(e)–1: Distributions described in section 367(e)(1).

T.D. 8834

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Treatment of Distributions to Foreign Persons Under Sections 367(e)(1) and 367(e)(2)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document amends the Income Tax Regulations by removing temporary regulations on the treatment of distributions to foreign persons under section 367(e) of the Internal Revenue Code and adding final regulations under section 367(e). These final regulations are necessary to implement section 367(e)(1) and (2), as added to the Internal Revenue Code by the Tax Reform Act of 1986, which affects U.S. corporations.

DATES: These regulations are effective August 9, 1999.

FOR FURTHER INFORMATION CONTACT: Guy A. Bracuti, 202-622-3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this final rule has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1487.

The collections of information in this regulation are in §§1.367(e)–1(d)(2), 1.367(e)–1(d)(3), 1.367(e)–2(b)(2), and 1.6038B–1(e). This information is required to obtain certain exemptions from taxation and to satisfy other information reporting requirements imposed by the Internal Revenue Code (Code). This information will be used by the **Internal Revenue Service** to verify whether a taxpayer is entitled to an exemption from income tax. The likely respondents are large corporations.

Comments on the collections of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by October 8, 1999.

Comments are specifically requested concerning: Whether the collections of information are necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility; The accuracy of the estimated burden associated with the collection of information (see below); How the quality, utility, and clarity of the information to be collected may be enhanced; How the burden of complying with the collections of information may be minimized, including through the application of automated collection techniques or

other forms of information technology; and Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information. The estimated total annual reporting and/or recordkeeping burden is 2,471 hours. The estimated average annual burden hours per respondent and/or recordkeeper is 11 hours. The estimated number of respondents and/or recordkeepers is 217. The estimated annual frequency of responses is once.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 367(e)(1) amended the Code by providing regulatory authority to tax gain on a domestic distributing corporation's section 355 distribution of stock or securities to foreign persons. Section 367(e)(2) amended the Code by requiring a liquidating corporation to recognize gain (or loss) attributable to property distributed in a section 332 liquidation to a foreign parent corporation, except to the extent regulations provide otherwise.

On January 16, 1990, temporary regulations under section 367(e)(1) and (2) were published in the **Federal Register** (55 F.R. 1406 [T.D. 8280, 1990–1 C.B. 80]). A cross-referenced Notice of Proposed Rulemaking was published on that same date under RIN 1545–AL35 (55 F.R. 1472 [1990–1 C.B. 678]). The temporary regulations were proposed and issued to implement section 367(e) of the Internal Revenue Code of 1986 (Code), as amended by sections 631(d)(1) and 1810(g) of the Tax Reform Act of 1986 (100 Stat. 2085, 2272, Public Law 99–514 [1986-3 C.B.]). On January 25, 1993, final regulations under section 367(e)(1) were published in the **Federal Register** (58 F.R. 5927 [T.D. 8472, 1993-1 C.B. 51]). RIN 1545–AL35 was thereby closed. The preamble of T.D. 8472 stated that final regulations under section 367(e)(2) would be promulgated in a separate Treasury decision and that taxpayers could apply the provisions contained in §1.367(e)–2T to distributions occurring on or after January 16, 1993, and prior to the date that is 30 days after final regulations under section 367(e)(2) are published in the **Federal Register.** The final regulations under section 367(e)(1) were removed and replaced with temporary regulations that were published in the **Federal Register** on August 14, 1996 (61 F.R. 42165 [T.D. 8682, 1996–2 C.B. 12]). A cross-referenced Notice of Proposed Rulemaking was published on August 14, 1996 under RIN 1545–AU22 (61 F.R. 42217). A new RIN (RIN 1545-AX30) has been issued under which the section 367(e)(2) proposed regulations will be finalized.

No significant comments were received with respect to the 1996 Notice of Proposed Rulemaking with respect to section 367(e)(1). Comments were received with respect to the 1990 Notice of Proposed Rulemaking with respect to sections 367(e)(1) and 367(e)(2). No hearings were held on either Notice of Proposed Rulemaking.

Explanation of Revisions and Summary of Comments

I. *Overview*

These final regulations address the tax consequences of a distribution by a domestic corporation of its subsidiary's stock to foreign shareholders in a transaction described in section 355 (outbound section 355 distribution), a liquidation of a domestic corporation into a foreign parent corporation in a transaction described in section 332 (outbound liquidation), and a liquidation of a foreign corporation into a foreign parent corporation in a transaction described in section 332 (foreign-to-foreign liquidation).

Section 367(e) grants the Secretary authority to provide the extent to which a distributing corporation in an outbound section 355 distribution or liquidation or foreign-to-foreign liquidation may obtain the benefit of nonrecognition treatment when it makes the distribution to a foreign shareholder. The purpose of section 367 is to prevent the inappropriate avoidance of U.S. tax that can arise from the application of nonrecognition provisions in the cross-border context.

A. *Outbound section 355 distributions*

Section 367(e)(1) provides that a distribution under section 355 (or so much of section 356 as relates to section 355) by a U.S. corporation to its foreign shareholders is accorded nonrecognition treatment except to the extent provided in regulations. Section 1.367(e)–1 provides the circumstances under which such a distribution is taxable.

The legislative history to section 367(e)(1) provides that "transfers of stock by domestic corporations to foreign persons pursuant to Code section 355 . . . will give rise to the recognition of gain under Code section 367(e), to the extent provided in regulations. The committee expects that the Secretary will carefully consider the extent to which it is appropriate, in view of the purpose of section 367(e), to require the recognition of gain upon the transfer of the stock of a domestic corporation to foreign persons under section 355." H.R. Rep. 426, 99th Cong., 1st Sess. 931 (1985); S. Rep. 313, 99th Cong., 2nd Sess. 950 (1986).

The temporary regulations under section 367(e)(1) provide a general rule that a domestic distributing corporation is taxed on a distribution of controlled stock to foreign shareholders, regardless of whether the controlled corporation is a domestic corporation or a foreign corporation. Several exceptions are provided in the current temporary regulations in the case of an outbound distribution of stock of a domestic controlled corporation.

Consistent with the legislative history above and the temporary regulations, the final regulations continue to provide that an outbound section 355 distribution of a foreign controlled corporation is taxable to the distributing corporation. See also sections 367(b) and 1248(f) of the Code. In the case of an outbound section 355 distribution of a domestic controlled corporation, however, the final regulations amend the temporary regulations by providing that the distributing corporation shall obtain the benefit of nonrecognition treatment. In weighing the administrative burdens to taxpayers and the Government in connection with rules requiring gain recognition agreements and similar arrangements, the IRS and Treasury believe that adequate protections are in place to protect the policies of section

367(e)(1). Specifically, significant protections are provided in sections 355(d) and (e) and the device and continuity of interest requirements of section 355.

B. *Outbound and foreign-to-foreign liquidations*

Generally, a liquidating corporation does not recognize gain or loss on a distribution in complete liquidation into a parent corporation that meets the ownership requirements of section 332(b). See Section 337(a) of the Code. Section 367(e)(2) provides that a section 332 liquidation into a foreign parent is taxed to the liquidating corporation, except to the extent provided in regulations. Section 1.367(e)–2 provides the circumstances under which gain or loss on assets distributed in a section 332 liquidation into a foreign parent is not currently recognized.

Section 332 was enacted in 1935 to encourage the simplification of corporate structures and was retained in 1986 as an exception to the repeal of the General Utilities doctrine. Consistent with the policies of section 332, the final regulations generally tax the distribution of assets in an outbound liquidation but provide exceptions for assets over which the United States retains adequate taxing jurisdiction. The final regulations retain the exceptions in the proposed regulations for a distribution of assets used in the conduct of a U.S. trade or business and for a distribution of a U.S. real property interest (USRPI). In addition, the final regulations provide a new exception for a distribution of stock of a domestic subsidiary that is 80 percent owned by vote and value directly by the liquidating corporation.

In a foreign-to-foreign liquidation, the final regulations generally adopt the rules provided in the proposed regulations. Thus, the regulations generally provide that the liquidation is not taxable, except to the extent that assets used in a U.S. trade or business are distributed and not used in a U.S. trade or business over the subsequent ten-year period. The ten-year period (which is also used in the U.S. trade or business exception for outbound liquidations) supplements the principles contained in section 864(c)(7). The regulations also tax a distribution of assets that had formerly been used in the conduct of a U.S. trade or business by the liquidating corporation.

II. *Details of Provisions*

A. *Outbound section 355 distributions*

The final regulations amend the rule in the temporary regulations and do not require gain recognition on an outbound section 355 distribution of the stock or securities of a domestic corporation. The final regulations continue to require gain recognition on an outbound section 355 distribution of the stock or securities of a foreign corporation.

Where gain recognition is required, the final regulations amend the rules for determining the residency status of distributees of stock or securities in an outbound section 355 distribution. A distributee is presumed to be a person who is not a qualified U.S. person (i.e., a person that is not a U.S. citizen, resident, or corporation), except to the extent that the distributing corporation certifies that the distributee is a qualified U.S. person. A publicly traded distributing corporation may use a reasonable analysis with respect to distributees who are not five percent shareholders of publicly traded stock to demonstrate the number of distributees that are qualified U.S. persons. A reasonable analysis includes a determination of the actual number of distributees that are qualified U.S. persons or a reasonable statistical analysis of shareholder records and other relevant information. The final regulations also broaden the look-through rule in the temporary regulations for determining the identity of the distributees of stock or securities of a controlled corporation received by a partnership, trust or estate to include stock or securities received by a disregarded entity.

Section 1.367(e)–1 is applicable to distributions occurring in taxable years ending after August 8, 1999.

B. *Outbound and foreign-to-foreign liquidations*

1. *General Rule*

The final regulations under section 367(e)(2) contain two sets of rules, depending upon whether the liquidating corporation is domestic or foreign. The final regulations retain the rules of the proposed regulations with respect to foreign-to-foreign liquidations with only minor modification.

In the case of an outbound liquidation, a domestic liquidating corporation is generally required to recognize gain (or loss) on the distributed assets. In determining the amount of gain or loss recognized under the general rule, the proposed regulations contain an anti-netting rule and an anti-stuffing rule that limit the domestic liquidating corporation's ability to recognize losses.

Several commentators criticized the anti-netting rule contained in the proposed regulations as overly broad because the rule prohibits the netting of ordinary losses against capital gains. The final regulations take this into account and allow the netting of ordinary or capital losses against ordinary or capital gains to the same extent allowed under general rules of the Code, including section 1211.

Commentators also questioned the propriety of the anti-stuffing rule in the proposed regulations and argued that the anti-stuffing rules contained in section 336(d) and the loss limitation rules of section 382 should sufficiently address loss trafficking concerns. The anti-stuffing rule contained in the proposed regulations disallows the recognition of losses attributable to property acquired in capital contributions, section 332 liquidations, and exchanges under sections 351 and 361 within five years of the distribution.

The IRS and Treasury do not believe that sections 336(d) and 382 alone adequately address the Government's loss trafficking concerns. For example, neither section 336(d) nor 382 would limit a liquidating corporation's ability to recognize a loss that is acquired in a reorganization among affiliates even though the loss could not have been recognized if those corporations were liquidated individually. The anti-stuffing rule in the proposed regulations also does not adequately protect against the use of losses to offset gains where the loss corporation acquires the gain property.

After considering the issue, the Treasury and the IRS have amended the anti-stuffing rule in the final regulations to limit the recognition of built-in gains and losses attributable to property received by the domestic liquidating corporation in a reorganization or liquidation occurring within two years prior to the distribution. Sections 336(d) and 382 also limit loss recognition in applicable circumstances.

Comments also requested clarification on the treatment of a distribution of an in-

terest in a publicly traded partnership (PTP). The final regulations provide that an interest in a PTP that is treated as a corporation under section 7704(a) shall be treated in the same manner as stock.

The final regulations retain the look-through rule for a domestic liquidating corporation's distribution of a partnership interest to its foreign parent. The look-through rule provides that, for purposes of the regulation, a domestic liquidating corporation is treated as distributing its proportionate share of the partnership property. The Treasury and the IRS hereby request comments on the proper method of calculating such gain or loss and reserve a section in the final regulations with respect to this issue. Comments should consider the application of similar rules in other cross-border contexts, such as Treas. Reg. §1.367(a)–1T(c)(3).

2. Exceptions to General Rule

The proposed regulations contain exceptions to the general gain recognition rule for the distribution of property used in a U.S. trade or business and the distribution of a USRPI. The final regulations retain the two exceptions with some modifications and add an additional exception for stock of a domestic subsidiary corporation.

Under the proposed regulations, a domestic liquidating corporation does not recognize gain (or loss) on the distribution of property used in a U.S. trade or business, if: (1) the foreign parent is not a controlled foreign corporation; (2) the foreign parent continues to use the property in a U.S. trade or business for a ten-year period following the distribution of such property; and (3) the domestic liquidating corporation and the foreign parent attach a statement to their U.S. income tax returns for the year of distribution. If within the ten-year period following a distribution, the property ceases to be used in the foreign parent's U.S. trade or business other than by a disposition, then the foreign parent is required to file an amended U.S. income tax return on behalf of the domestic liquidating corporation and recognize gain thereon. If the foreign parent disposes of such property, then the foreign parent recognizes gain (or loss) on its U.S. income tax return for the year of disposition in lieu of the domestic liquidating corporation recognizing gain on an amended return for the year of distribution. Also, under the proposed regulations, gain recognition is not triggered on involuntary conversions of such property under section 1033, like-kind exchanges of such property under section 1031, and the abandonment of obsolete or worthless property.

The final regulations modify the U.S. trade or business property exception in response to comments in several respects. First, the final regulations make the exception available to a domestic liquidating corporation that liquidates into a controlled foreign corporation. Second, the final regulations no longer require that the foreign parent file an amended return on behalf of the liquidating corporation when property ceases to be used in the conduct of a U.S. trade or business (whether by disposition or otherwise), provided that the foreign parent properly recognizes gain (or loss in the case of a disposition) as if the property had been sold for fair market value at the time the property ceases to be used in the conduct of a U.S. trade or business. Third, the final regulations expand the types of dispositions that will not trigger gain recognition. U.S. trade or business property may be transferred to another person without gain recognition, if the transfer is a disposition normally entitled to nonrecognition under the Code and the transferor and transferee satisfy various procedural requirements.

The final regulations retain the exception for a distribution of a USRPI contained in the proposed regulation with only minor modification.

The final regulations add a new exception that allows for nonrecognition of gain on a distribution of stock of a domestic subsidiary that is 80 percent owned (by vote and value) directly by the domestic liquidating corporation, provided that the liquidation does not have as a principal purpose the avoidance of U.S. tax on a subsequent disposition of the domestic subsidiary.

3. General Anti-abuse Rule

The final regulations contain a new anti-abuse rule that allows the Commissioner to require the liquidating corporation to recognize gain (or treat the liquidating corporation as if it had recognized loss) on the distribution of property pursuant to the liquidation if a principal purpose of the liquidation is the avoidance of U.S. tax. The rule would apply, for example, if a principal purpose of a liquidation is the distribution of a domestic liquidating corporation's earnings and profits without a U.S. withholding tax. In certain circumstances, the Service is also concerned about a liquidation of a domestic corporation into a U.S. branch of a foreign corporation in a manner that facilitates the avoidance of U.S. tax, including the inappropriate use of attributes such as net operating losses. Liquidations used to facilitate the avoidance of tax may be challenged under existing law. The Treasury and the IRS hereby solicit comments, however, as to other measures that should be taken to adequately address such transactions, including the more specific identification of the conditions under which liquidated property, particularly securities and other financial instruments, may be considered to be used in a U.S. trade or business.

4. Effective Date

Section 1.367(e)–2 is applicable to distributions occurring 30 days after August 9, 1999 or, if a taxpayer elects, to distributions in taxable years ending after August 8, 1999. In addition, taxpayers may rely on the principles contained in the temporary regulations issued under section 367(e)(2) on January 16, 1990 for distributions occurring prior to 30 days after August 9, 1999.

C. *Section 6038B*

The regulations under section 6038B are also revised to require reporting for transactions described in section 367(e)(1) and (2) in accordance with the final regulations under section 367(e)(1) and (2).

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collections of information contained in this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the number of section 367(e) distributions that require

reporting under these regulations is estimated to be only 400 per year. Moreover, because these regulations will primarily affect large multinational corporations, it is estimated that out of the 400 transactions very few, if any, will involve small entities. Thus, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact of the proposed regulations on small business.

Drafting Information

The principal author of these regulations is Guy A. Bracuti of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for 1.367(e)–1T and by adding entries in numerical order to read in part as follows:

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

Section 1.367(e)–1 also issued under 26 U.S.C. 367(e)(1).

Section 1.367(e)–2 also issued under 26 U.S.C. 367(e)(2). * * *

§1.367(e)–0T through §1.367(e)–2T [Removed]

Par. 2. Sections 1.367(e)–0T, 1.367(e)–1T, and 1.367(e)–2T are removed.

Par. 3. Sections 1.367(e)–0, 1.367(e)–1, and 1.367(e)–2 are added to read as follows:

§1.367(e)–0 Outline of §§1.367(e)–1 and 1.367(e)–2.

This section lists captioned paragraphs contained in §§1.367(e)–1 and 1.367(e)–2 as follows:

§1.367(e)–1 Distributions described in section 367(e)(1).

(a) Purpose and scope.
(b) Gain recognition.
(1) General rule.
(2) Stock owned through partnerships, disregarded entities, trusts, and estates.
(3) Gain computation.
(4) Treatment of distributee.
(c) Nonrecognition of gain.
(d) Determining whether distributees are qualified U.S. persons.
(1) General rule—presumption of foreign status.
(2) Non-publicly traded distributing corporations.
(3) Publicly traded distributing corporations.
(i) Five percent shareholders.
(ii) Other distributees.
(4) Qualified exchange or other market.
(e) Reporting under section 6038B.
(f) Effective date.

§1.367(e)–2 Distributions described in section 367(e)(2).

(a) Purpose and scope.
(1) In general.
(2) Nonapplicability of section 367(a).
(b) Distribution by a domestic corporation.
(1) General rule.
(i) Recognition of gain and loss.
(ii) Operating rules.
(A) General rule.
(B) Overall loss limitation.
(*1*) Overall loss limitation rule.
(*2*) Example.
(C) Special rules for built-in gains and losses attributable to property received in liquidations and reorganizations.
(iii) Distribution of partnership interest.
(A) General rule.
(B) Gain or loss calculation. [Reserved]
(C) Basis adjustments.
(D) Publicly traded partnerships.
(2) Exceptions.
(i) Distribution of property used in a U.S. trade or business.
(A) Conditions for nonrecognition.
(B) Qualifying property.
(C) Required statement.
(*1*) Declaration and certification.
(*2*) Property description.
(*3*) Distributee identification.
(*4*) Treaty benefits waiver.
(*5*) Statute of limitations extension.
(D) Failure to file statement.
(E) Operating rules.
(*1*) Gain or loss recognition by the foreign distributee corporation.
(*i*) Taxable dispositions.
(*ii*) Other triggering events.
(*2*) Gain recognition by the domestic liquidating corporation.
(*i*) General rule.
(*ii*) Amended return.
(*iii*) Interest.
(*iv*) Joint and several liability.
(*3*) Schedule for property no longer used in a U.S. trade or business.
(*4*) Nontriggering events.
(*i*) Conversions, certain exchanges, and abandonment.
(*ii*) Amendment to Master Property Description
(*5*) Nontriggering transfers to qualified transferees.
(ii) Distribution of certain U.S. real property interests.
(iii) Distribution of stock of domestic subsidiary corporations.
(A) Conditions for nonrecognition.
(B) Exceptions when the liquidating corporation is a U.S. real property holding corporation.
(C) Anti-abuse rule.
(D) Required statement.
(3) Other consequences.
(i) Distributee basis in property.
(ii) Reporting under section 6038B.
(iii) Other rules.
(c) Distribution by a foreign corporation.
(1) General rule—gain and loss not recognized.
(2) Exceptions.
(i) Property used in a U.S. trade or business.
(A) General rule.
(B) Ten-year active U.S. business exception.
(C) Required statement.
(D) Operating rules.
(ii) Property formerly used in a U.S. trade or business.
(3) Other consequences.
(i) Distributee basis in property.
(ii) Other rules.
(d) Anti-abuse rule.
(e) Effective date.

§1.367(e)–1 Distributions described in section 367(e)(1).

(a) *Purpose and scope.* This section provides rules for recognition (and nonrecognition) of gain by a domestic corporation (distributing corporation) on a distribution of stock or securities of a corporation (controlled corporation) to foreign persons that is described in section 355. Paragraph (b) of this section contains the general rule that gain is recognized on the distribution to the extent stock or securities of controlled are distributed to foreign persons. Paragraph (c) of this section provides an exception to the gain recognition rule for distributions of stock or securities of a domestic corporation. Paragraph (d) of this section contains rules for determining whether distributees of stock or securities in a section 355 distribution are qualified U.S. persons. Paragraph (e) of this section cross-references section 6038B for certain reporting obligations. Finally, paragraph (f) of this section specifies the effective date of this section.

(b) *Gain recognition*—(1) *General rule.* If a domestic corporation makes a distribution of stock or securities of a corporation that qualifies for nonrecognition under section 355 to a person who is not a qualified U.S. person, then, except as provided in paragraph (c) of this section, the distributing corporation shall recognize gain (but not loss) on the distribution under section 367(e)(1). A distributing corporation shall not recognize gain under this section with respect to a section 355 distribution to a qualified U.S. person. For purposes of this section, a qualified U.S. person is—

(A) A citizen or resident of the United States; or

(B) A domestic corporation.

(2) *Stock owned through partnerships, disregarded entities, trusts, and estates.* For purposes of this section, distributing corporation stock or securities owned by or for a partnership (whether foreign or domestic) are owned proportionately by its partners. A partner's proportionate share of the stock or securities of the distributing corporation shall be equal to the partner's distributive share of the gain that would have been recognized had the partnership sold the stock or securities (at a taxable gain) immediately before the distribution. The partner's distributive share of gain shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder. For purposes of this section, stock or securities owned by or for an entity that is disregarded as an entity (disregarded entity) under §1.7701–3(b)(1)(ii) or (b)(2)(i)(C) are owned directly by the owner of such disregarded entity. For purposes of this section, stock or securities owned by or for a trust or estate (whether foreign or domestic) are owned proportionately by the persons who would be treated as owning such stock or securities under section 318(a)(2)(A) and (B). In applying section 318(a)(2)(B)(i), if a trust includes interests that are not actuarially ascertainable, all such interests shall be considered to be owned by foreign persons. In a case where an interest holder in a partnership, a disregarded entity, trust, or estate that (directly or indirectly) owns stock of the distributing corporation is itself a partnership, disregarded entity, trust, or estate, the rules of this paragraph (b)(2) apply to such interest holder.

(3) *Gain computation.* Gain recognized under paragraph (b)(1) of this section shall be equal to the excess of the fair market value of the stock or securities distributed to persons who are not qualified U.S. persons (determined as of the time of the distribution) over the distributing corporation's adjusted basis in the stock or securities distributed to such distributees. For purposes of the preceding sentence, the distributing corporation's adjusted basis in each unit of each class of stock or securities distributed to a distributee shall be equal to the distributing corporation's total adjusted basis in all of the units of the respective class of stock or securities owned immediately before the distribution, divided by the total number of units of the class of stock or securities owned immediately before the distribution.

(4) *Treatment of distributee.* If the distribution otherwise qualifies for nonrecognition under section 355, each distributee shall be considered to have received stock or securities in a distribution qualifying for nonrecognition under section 355, even though the distributing corporation may recognize gain on the distribution under this section. Thus, the distributee shall not be considered to have received a distribution described in section 301 or a distribution in an exchange described in section 302(b) upon the receipt of the stock or securities of the controlled corporation, and the domestic distributing corporation shall have no withholding responsibilities under section 1441. Except where section 897(e)(1) and the regulations thereunder cause gain to be recognized by the distributee, the basis of the distributed domestic or foreign corporation stock in the hands of the foreign distributee shall be the basis of the distributed stock determined under section 358 without any increase for any gain recognized by the domestic corporation on the distribution.

(c) *Nonrecognition of gain.* A domestic distributing corporation shall not recognize gain under paragraph (b)(1) of this section on the distribution of stock or securities of a domestic corporation.

(d) *Determining whether distributees are qualified U.S. persons*—(1) *General rule—presumption of foreign status.* Except as provided in paragraphs (d)(2) and (3) of this section, all distributions of stock or securities in a distribution described in paragraph (b)(1) of this section are presumed to be to persons who are not qualified U.S. persons, as defined in paragraph (b)(1) of this section.

(2) *Non-publicly traded distributing corporations.* If the class of stock or securities of the distributing corporation (in respect to which stock or securities of the controlled corporation are distributed) is not regularly traded on a qualified exchange or other market (as defined in paragraph (d)(4) of this section), then the distributing corporation may only rebut the presumption contained in paragraph (d)(1) of this section by identifying the qualified U.S. persons to which controlled corporation stock or securities were distributed and by certifying the amount of stock or securities that were distributed to the qualified U.S. persons.

(3) *Publicly traded distributing corporations.* If the class of stock or securities of the distributing corporation (in respect to which stock or securities of the controlled corporation are distributed) is regularly traded on a qualified exchange or other market (as defined in paragraph (d)(4) of this section), then the distributing corporation may only rebut the presumption contained in paragraph (d)(1) of this section as described in this paragraph (d)(3).

(i) *Five percent shareholders.* A publicly traded distributing corporation may only rebut the presumption contained in paragraph (d)(1) of this section with respect to distributees that are five percent shareholders of the class of stock or securities of the distributing corporation (in respect to which stock or securities of the controlled corporation are distributed) by identifying the qualified U.S. persons to which controlled corporation stock or securities were distributed and by certifying the amount of stock or securities that were distributed to the qualified U.S. persons. A five percent shareholder is a distributee who is required under U.S. securities laws to file with the Securities and Exchange Commission (SEC) a Schedule 13D or 13G under 17 CFR 240.13d–1 or 17 CFR 240.13d–2, and provide a copy of same to the distributing corporation under 17 CFR 240.13d–7.

(ii) *Other distributees.* A distributing corporation that has made a distribution described in paragraph (d)(3) of this section may rebut the presumption contained in paragraph (d)(1) of this section with respect to distributees that are not five percent shareholders (as defined in this paragraph (d)(3)) by relying on and providing a reasonable analysis of shareholder records and other relevant information that demonstrates a number of distributees that are qualified U.S. persons. Taxpayers may rely on such analysis, unless it is subsequently determined that there are actually fewer distributees who are qualified U.S. persons than were demonstrated in the analysis.

(4) *Qualified exchange or other market.* For purposes of paragraph (d) of this section, the term qualified exchange or other market means, for any taxable year—

(i) A national securities exchange which is registered with the SEC or the national market system established pursuant to section 11A of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) A foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located and which has the following characteristics—

(A) The exchange has trading volume, listing, financial disclosure, and other requirements designed to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors; and the laws of the country in which the exchange is located and the rules of the exchange ensure that such requirements are actually enforced; and

(B) The rules of the exchange ensure active trading of listed stocks.

(e) *Reporting under section 6038B.* See the regulations under section 6038B for reporting requirements for distributions under this section.

(f) *Effective date.* This section shall be applicable to distributions occurring in taxable years ending after August 8, 1999.

§1.367(e)–2 Distributions described in section 367(e)(2).

(a) *Purpose and scope*—(1) *In general.* This section provides rules requiring gain and loss recognition by a corporation on its distribution of property to a foreign corporation in a complete liquidation described in section 332. Paragraph (b)(1) of this section contains the general rule that gain and loss are recognized when a domestic corporation makes a distribution of property in complete liquidation under section 332 to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the domestic corporation. Paragraph (b)(2) of this section provides the only exceptions to the gain and loss recognition rule of paragraph (b)(1) of this section. Paragraph (b)(3) of this section refers to other consequences of distributions described in paragraphs (b)(1) and (2) of this section. Paragraph (c)(1) of this section contains the general rule that gain and loss are not recognized when a foreign corporation makes a distribution of property in complete liquidation under section 332 to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the foreign liquidating corporation. Paragraph (c)(2) of this section provides the only exceptions to the nonrecognition rule of paragraph (c)(1) of this section. Paragraph (c)(3) of this section refers to other consequences of distributions described in paragraphs (c)(1) and (2) of this section. Paragraph (d) of this section contains an anti-abuse rule. Finally, paragraph (e) of this section specifies the effective date for the rules of this section. The rules of this section are issued pursuant to the authority conferred by section 367(e)(2).

(2) *Nonapplicability of section 367(a).* Section 367(a) shall not apply to a complete liquidation described in section 332 by a domestic liquidating corporation into a foreign corporation that meets the stock ownership requirements of section 332(b).

(b) *Distribution by a domestic corporation*—(1) *General rule*—(i) *Recognition of gain and loss.* If a domestic corporation (domestic liquidating) makes a distribution of property in complete liquidation under section 332 to a foreign corporation (foreign distributee) that meets the stock ownership requirements of section 332(b) with respect to stock in the domestic liquidating corporation, then–

(A) Pursuant to section 367(e)(2), section 337(a) and (b)(1) shall not apply; and

(B) The domestic liquidating corporation shall recognize gain or loss on the distribution of property to the foreign distributee, except as provided in paragraph (b)(2) of this section.

(ii) *Operating rules*—(A) *General rule.* Except as provided in paragraphs (b)(1)-(ii)(B) and (C) of this section, the rules contained in section 336 will apply to the gain and loss recognized pursuant to this section.

(B) *Overall loss limitation*—*(1) Overall loss limitation rule.* Loss in excess of gain from the distribution shall not be recognized. If realized losses exceed recognized losses, the losses shall be recognized on a pro rata basis with respect to the realized loss attributable to each distributed loss asset in the category of assets (i.e., capital or ordinary) to which the realized but unrecognized loss relates. For additional limitations on the recognition of losses, see, e.g., section 1211.

(2) *Example.* The following example illustrates the overall loss limitation rule, the pro rata loss allocation method, and the general capital loss limitation rule in section 1211(a):

Example. F, a foreign corporation, owns all stock of US1, a domestic corporation. US1 owns the following capital assets: Asset A, which has a fair market value of $100 and an adjusted basis of $40; Asset B, which has a fair market value of $60 and an adjusted basis of $80; and, Asset C, which has a fair market value of $40 and an adjusted basis of $100. US1 also owns the following business assets that

will generate ordinary income (or loss) upon disposition: Asset D, which has a fair market value of $100 and an adjusted basis of $40; Asset E, which has a fair market value of $60 and an adjusted basis of $100; and, Asset F, which has a fair market value of $40 and an adjusted basis of $80. US1 liquidates into F and distributes all assets to F in liquidation. None of the assets qualify for nonrecognition under paragraph (b)(2) of this section. US1's total realized capital loss is $80, but it may only recognize $60 of that loss. See section 1211(a). US1's total realized ordinary loss is $80, but it may only recognize $60 of that loss. See paragraph (b)(1)(ii)(B)(*1*) of this section. US1 will allocate $45 (60 × .75) of the recognized capital loss to Asset B and will allocate the remaining $15 (60 × .25) of recognized capital loss to Asset C. See paragraph (b)(1)(ii)(B)(*1*) of this section. US1 will allocate $30 (60 × .50) of the recognized ordinary loss to Asset E and will allocate the remaining $30 (60 × .50) to Asset F. See paragraph (b)(1)(ii)(B)(*1*) of this section.

(C) *Special rules for built-in gains and losses attributable to property received in liquidations and reorganizations.* Built-in losses attributable to property received in a transaction described in sections 332 or 361 (during the two-year period ending on the date of the distribution in liquidation covered by this section) shall not offset gain from property not received in the same transaction. Built-in gains attributable to property received in a transaction described in sections 332 or 361 (during the two-year period ending on the date of the distribution in liquidation covered by this section) shall not offset loss from property not received in the same transaction. Built-in gain or loss is that amount of gain or loss on property that existed at the time the domestic liquidating corporation acquired such property. See sections 336(d) and 382 for additional limitations on the recognition of losses.

(iii) *Distribution of partnership interest*—(A) *General rule.* If a domestic corporation distributes a partnership interest (whether foreign or domestic) in a distribution described in paragraph (b)(1)(i) of this section, then for purposes of applying this section the domestic liquidating corporation shall be treated as having distributed a proportionate share of partnership property. Accordingly, the applicability of the recognition rules of paragraphs (b)(1)(i) and (ii) of this section, and of any exception to recognition provided in this section shall be determined with reference to the partnership property, rather than to the partnership interest itself. Where the partnership property includes an interest in a lower-tier partnership, the applicability of any exception with respect to the interest in the lower-tier partnership shall be determined with reference to the lower-tier partnership property. In the case of multiple tiers of partnerships, the applicability of an exception shall be determined with reference to the property of each partnership, applying the rule contained in the preceding sentence. A domestic liquidating corporation's proportionate share of partnership property shall be determined under the rules and principles of sections 701 through 761 and the regulations thereunder.

(B) *Gain or loss calculation.* [Reserved]

(C) *Basis adjustments.* The foreign distributee corporation's basis in the distributed partnership interest shall be equal to the domestic liquidating corporation's basis in such partnership interest immediately prior to the distribution, increased by the amount of gain and reduced by the amount of loss recognized by the domestic liquidating corporation on the distribution of the partnership interest. Solely for purposes of sections 743 and 754, the foreign distributee corporation shall be treated as having purchased the partnership interest for an amount equal to the foreign corporation's adjusted basis therein.

(D) *Publicly traded partnerships.* The distribution by a domestic liquidating corporation of an interest in a publicly traded partnership that is treated as a corporation for U.S. income tax purposes under section 7704(a) shall not be subject to the rules of paragraphs (b)(1)(iii)(A) and (B) of this section. Instead, the distribution of such an interest shall be treated in the same manner as a distribution of stock. Thus, a transfer of an interest in a publicly traded partnership that is treated as a U.S. corporation for U.S. income tax purposes shall be treated in the same manner as stock in a domestic corporation, and a transfer of an interest in a publicly traded partnership that is treated as a foreign corporation for U.S. income tax purposes shall be treated in the same manner as stock in a foreign corporation.

(2) *Exceptions*—(i) *Distribution of property used in a U.S. trade or business*—(A) *Conditions for nonrecognition.* A domestic liquidating corporation shall not recognize gain or loss under paragraph (b)(1) of this section on its distribution of property (including inventory) used by the domestic liquidating corporation in the conduct of a trade or business within United States, if—

(*1*) The foreign distributee corporation, immediately thereafter and for the ten-year period beginning on the date of the distribution of such property, uses the property in the conduct of a trade or business within the United States;

(*2*) The domestic liquidating corporation attaches the statement described in paragraph (b)(2)(i)(C) of this section to its U.S. income tax returns for the taxable years that include the distributions in liquidation; and

(*3*) The foreign distributee corporation attaches a copy of the property description contained in paragraph (b)(2)(i)-(C)(2) of this section to its U.S. income tax return for the tax year that includes the date of distribution.

(B) *Qualifying property.* Property is used by the foreign distributee corporation in the conduct of a trade or business in the United States within the meaning of this paragraph (b)(2)(i) only if all income from the use of the property and all income or gain from the sale or exchange of the property would be subject to taxation under section 882(a) as effectively connected income. Also, stock held by a dealer as inventory or for sale in the ordinary course of its trade or business shall be treated as inventory and not as stock in the hands of both the domestic liquidating corporation and the distributee foreign corporation. Notwithstanding the foregoing, the exception provided in this paragraph (b)(2)(i) shall not apply to intangibles described in section 936(h)(3)(B).

(C) *Required statement.* The statement required by paragraph (b)(2)(i)(A) of this section shall be entitled "Required Statement under §1.367(e)–2(b)(2)(i)" and shall be prepared by the domestic liquidating corporation and signed under penalties of perjury by an authorized officer of the domestic liquidating corporation and by an authorized officer of the foreign distributee corporation. The statement shall contain the following items:

(*1*) *Declaration and certification.* A declaration that the distribution to the foreign distributee corporation is one to which the rules of this paragraph (b)(2)(i) apply and a certification that the domestic liquidating corporation and the foreign

distributee corporation agree to all of the terms and conditions set forth in this paragraph (b)(2)(i).

(*2*) *Property description.* A description of all property distributed by the domestic liquidating corporation (irrespective of whether the property qualifies for nonrecognition). Such description shall be entitled "Master Property Description" and shall identify the property that continues to be used by the foreign distributee corporation in the conduct of a trade or business within the United States, including the location, adjusted basis, estimated fair market value, a summary of the method (including appraisals if any) used for determining such value, and the date of distribution of such items of property. The description shall also identify the property excepted from gain recognition under paragraphs (b)(2)(ii) and (iii) of this section.

(*3*) *Distributee identification.* An identification of the foreign distributee corporation, including its name and address, taxpayer identification number, residence, and place of incorporation.

(*4*) *Treaty benefits waiver.* With respect to property entitled to nonrecognition pursuant to this paragraph (b)(2)(i), a declaration by the foreign distributee corporation that it irrevocably waives any right under any treaty (whether or not currently in force at the time of the liquidation) to sell or exchange any item of such property without U.S. income taxation or at a reduced rate of taxation, or to derive income from the use of any item of such property without U.S. income taxation or at a reduced rate of taxation.

(*5*) *Statute of limitations extension.* An agreement by the domestic liquidating corporation and the foreign distributee corporation to extend the statute of limitations on assessments and collections (under section 6501) with respect to the domestic liquidating corporation on the distribution of each item of property until three years after the date on which all such items of property have ceased to be used in a trade or business within the United States, but in no event shall the extension be for a period longer than 13 years from the filing of the original U.S. income tax return for the taxable year of the last distribution of any such item of property. The agreement to extend the statute of limitation shall be executed on a Form 8838, "Consent to Extend the Time to Assess Tax Under Section 367—Gain Recognition Agreement."

(D) *Failure to file statement.* If a domestic liquidating corporation that would otherwise qualify for nonrecognition on the distribution of property under this paragraph (b)(2)(i) fails to file the statement described in paragraph (b)(2)(i)(C) of this section or files a statement that does not comply with the requirements of paragraph (b)(2)(i)(C) of this section, the Commissioner may treat the domestic liquidating corporation as if it had claimed nonrecognition under this paragraph (b)(2)(i) and met all the requirements of paragraph (b)(2)(i)(C) of this section, if such treatment is necessary to prevent the domestic liquidating corporation or the foreign distributee corporation from otherwise deriving a tax benefit by such failure.

(E) *Operating rules.* By the domestic liquidating corporation's claiming nonrecognition under this paragraph (b)(2)(i) and filing a statement described in paragraph (b)(2)(i)(C) of this section, the domestic liquidating corporation and the foreign distributee corporation agree to be subject to the rules of this paragraph (b)(2)(i)(E).

(*1*) *Gain or loss recognition by the foreign distributee corporation—(i) Taxable dispositions.* If, within the ten-year period from the date of a distribution of qualifying property, the foreign distributee corporation disposes of any qualifying property in a transaction subject to tax under section 882(a), then the foreign distributee corporation shall recognize such gain (or loss) and properly report it on a timely filed U.S. income tax return. If the foreign distributee corporation recognizes gain (or loss) under this paragraph (b)(2)(i)(E)(*1*)(*i*) and properly reports such gain (or loss) on its U.S. income tax return, then the domestic liquidating corporation shall not recognize gain attributable to such property under paragraph (b)(2)(i)(E)(*2*) of this section.

(*ii*) *Other triggering events.* If, within the ten-year period from the date of distribution, any qualifying property ceases to be used by the foreign distributee corporation in the conduct of a trade or business in the United States (other than by reason of a taxable disposition described in paragraph (b)(2)(i)(E)(*1*)(*i*) of this section, a nontriggering event described in paragraph (b)(2)(i)(E)(*4*) of this section, or a nontriggering transfer described in paragraph (b)(2)(i)(E)(*5*) of this section), then the foreign distributee corporation shall recognize gain (but not loss) attributable to such property and properly report it on a timely filed U.S. income tax return. If the foreign distributee corporation properly reports gain under this paragraph (or if such qualified property is not gain property on the date that it ceases to be used in the foreign distributee corporation's U.S. trade or business), then the domestic liquidating corporation shall not recognize gain attributable to such property under paragraph (b)(2)(i)(E)(*2*) of this section. The gain recognized under this paragraph (b)(2)(i)(E)(*1*)(*ii*) shall be an amount equal to the fair market value of the property on the date it ceases to be used in the foreign distributee corporation's U.S. trade or business less the foreign distributee corporation's adjusted basis in such property.

(2) *Gain recognition by the domestic liquidating corporation—(i) General rule.* If, within the ten-year period from the date of distribution, any qualifying property described in paragraph (b)(2)(i)-(B) of this section ceases to be used by the foreign distributee corporation (or a qualifying transferee described in paragraph (b)(2)(i)(E)(*5*) of this section) in the conduct of a trade or business in the United States for any reason (including but not limited to the sale or exchange of such property or the removal of the property from conduct of the trade or business), then, except to the extent gain (or loss) is recognized under paragraph (b)(1)(i)(E)-(*1*) of this section, the domestic liquidating corporation shall recognize the gain (but not loss) realized but not recognized upon the initial distribution of such item of property. The domestic liquidating corporation shall recognize gain pursuant to this paragraph (b)(2)(i)(E)(*2*)(*i*) on the amended U.S. income tax return described in paragraph (b)(2)(i)(E)(*2*)(*ii*) of this section.

(*ii*) *Amended return.* If gain recognition is required pursuant to paragraph (b)(2)(i)(E)(*2*)(*i*) of this section, the foreign distributee corporation shall file an amended U.S. income tax return on behalf of the domestic liquidating corporation for the year of the distribution of such item of property. On the amended return,

the domestic liquidating corporation may use any losses (or credits) existing in the year of the distribution to offset the gain recognized pursuant to paragraph (b)(2)(i)(E)(2)(*i*) of this section (or the tax thereon), provided that the losses (or credits) were otherwise available in the year distribution and were not used in another year. The amended return shall be filed no later than the due date (including extensions) for the return of the foreign distributee corporation for the taxable year in which the property ceases to be used by the foreign distributee corporation in the conduct of a trade or business in the United States.

(*iii*) *Interest.* If the domestic liquidating corporation owes additional tax pursuant to paragraph (b)(2)(i)(E)(2)(*i*) of this section for the year of liquidation, then interest must be paid on that amount at the rates determined under section 6621. The interest due will be calculated from the due date of the domestic liquidating corporation's U.S. income tax return for the year of the distribution to the date on which the additional tax for that year is paid.

(*iv*) *Joint and several liability.* The foreign distributee corporation shall be jointly and severally liable for any tax owed by the domestic liquidating corporation as a result of the application of this section, and shall succeed to the domestic liquidating corporation's agreement to extend the statute of limitations on assessments and collections under section 6501.

(*3*) *Schedule for property no longer used in a U.S. trade or business.* If qualifying property (other than inventory) ceases to be used by the foreign distributee corporation in the conduct of a U.S. trade or business in the ten-year period beginning on the date of distribution of such property from the domestic liquidating corporation to the foreign distributee corporation, then the foreign distributee corporation shall list on a separate schedule (attached to its U.S. income tax return for the year of cessation) all such qualifying property. For purposes of this paragraph (b)(2)(i)(E)(*3*), property ceases to be used in a U.S. trade or business whenever such property is sold, exchanged, or otherwise removed from the U.S. trade or business, irrespective of whether the domestic liquidating corporation filed an amended return under paragraph (b)(2)(i)(E)(2) of this section, and irrespective of whether the property ceases to be used in the foreign distributee corporation's U.S. trade or business by virtue of a nontriggering event described in paragraph (b)(2)(i)(E)(*4*) of this section or a nontriggering transfer described in paragraph (b)(2)(i)(E)(*5*) of this section.

(4) *Nontriggering events—(i) Conversions, certain exchanges, and abandonment.* Gain (or loss) under this paragraph (b)(2)(i)(E) shall not be triggered if qualifying property described in paragraph (b)(2)(i)(B) of this section is involuntarily converted into, or exchanged for, similar qualifying property used in the conduct of a trade or business in the United States, to the extent such conversion or exchange qualifies for nonrecognition under sections 1033 or 1031. Also, the abandonment or disposal of worthless or obsolete property shall not trigger gain (or loss) under this paragraph (b)(2)(i)(E).

(*ii*) *Amendment to Master Property Description.* If the foreign distributee corporation acquires replacement property by virtue of a conversion or exchange of the qualifying property under this paragraph (b)(2)(i)(E)(*4*), then the foreign distributee corporation shall attach to its U.S. income tax return for the year of the acquisition such replacement property a schedule entitled "Amendment to Master Property Description Required by §1.367(e)–2(b)(2)(i)" that lists the replacement property and the property being replaced.

(*5*) *Nontriggering transfers to qualified transferees.* Gain (or loss) under this paragraph (b)(2)(i)(E) will not be triggered if qualifying property described in paragraph (b)(2)(i)(B) of this section is transferred to another person (qualified transferee) in a transaction qualifying for nonrecognition under the Internal Revenue Code (other than transactions described in paragraphs (b)(2)(i)(E)(4)(i) and (c)(1) of this section), if–

(*i*) The qualified transferee (and all other subsequent qualified transferees), immediately thereafter and for the ten-year period beginning on the date of the initial distribution of such qualifying property from the domestic liquidating corporation to the foreign distributee corporation, uses the property in the conduct of a trade or business in the United States;

(*ii*) The foreign distributee corporation (or its successor in interest) prepares and attaches to its U.S. income tax return for the year of transfer a statement entitled "Required Statement under §1.367(e)–2(b)(2)(i)(E)(5) for Property Transferred to a Qualified Transferee" that is signed under penalties of perjury by an authorized officer of the foreign distributee corporation and by a person similarly authorized by the qualified transferee;

(*iii*) The statement described in paragraph (b)(2)(i)(E)(*5*)(*ii*) of this section shall contain a description of all qualifying property transferred by the foreign distributee corporation (or qualified transferee) to the qualified transferee (or subsequent qualified transferee);

(*iv*) The statement described in paragraph (b)(2)(i)(E)(5)(*ii*) of this section shall also contain an identification of the qualified transferee (or subsequent qualified transferee), including its name and address, taxpayer identification number, residence, and place of incorporation (if applicable);

(*v*) The statement described in paragraph (b)(2)(i)(E)(*5*)(*ii*) of this section shall also contain a declaration by the qualifying transferee (or subsequent qualifying transferee) that it irrevocably waives any right under any treaty (whether or not currently in force at the time of the liquidation) to sell or exchange any item of such property without U.S. income taxation or at a reduced rate of taxation, or to derive income from the use of any item of such qualifying property without U.S. income taxation or at a reduced rate of taxation; and

(*vi*) A declaration that the transfer to the qualifying transferee (or subsequent qualifying transferee) is one to which the rules of this paragraph (b)(2)(i)(E)(*5*) apply and a certification that the foreign distributee corporation (or its successor in interest) and the qualifying transferee (or subsequent qualifying transferee) agree to all of the terms and conditions set forth in paragraph (b)(2)(i)(E)(*1*) of this section, replacing "foreign distributee corporation" with "qualifying transferee" and replacing references to "section 882(a)" with "section 871(b)" (as the case may be).

(ii) *Distribution of certain U.S. real property interests.* A domestic liquidating corporation shall not recognize gain (or loss) under paragraph (b)(1) of this sec-

tion on the distribution of a U.S. real property interest (other than stock in a former U.S. real property holding corporation that is treated as a U.S. real property interest for five years under section 897(c)(1)(A)(ii)). If property distributed by the domestic liquidating corporation is a U.S. real property interest that qualifies for nonrecognition under this paragraph (b)(2)(ii) in addition to nonrecognition provided by paragraph (b)(2)(i) of this section, then the domestic liquidating corporation shall secure nonrecognition pursuant to this paragraph (b)(2)(ii) and not pursuant to the provisions of paragraph (b)(2)(i) of this section.

(iii) *Distribution of stock of domestic subsidiary corporations*—(A) *Conditions for nonrecognition.* A domestic liquidating corporation shall not recognize gain or loss under paragraph (b)(1) of this section on a distribution of stock of an 80 percent domestic subsidiary corporation, if the domestic liquidating corporation attaches a statement described in paragraph (b)(2)(iii)(D) of this section to its U.S. income tax return for the year of the distribution of such stock. For purposes of this paragraph (b)(2)(iii), a corporation is an 80 percent domestic subsidiary corporation, if—

(*1*) The subsidiary corporation is a domestic corporation (but not a foreign corporation that has made an election under section 897(i) to be treated as a U.S. corporation for purposes of section 897);

(*2*) The domestic liquidating corporation owns (directly) at least 80 percent of the total voting power of the stock of such corporation; and

(*3*) The domestic liquidating corporation owns (directly) at least 80 percent of the total value of all stock of such corporation.

(B) *Exceptions when the liquidating corporation is a U.S. real property holding corporation.* If the domestic liquidating corporation is a U.S. real property holding corporation (as defined in section 897(c)(2)) at the time of liquidation (or was a U.S. real property holding corporation with respect to the foreign distributee corporation during the five year period ending on the date of liquidation), then the exception in paragraph (b)(2)(iii)(A) of this section shall apply only to the distribution of stock of an 80 percent domestic subsidiary corporation that is a U.S. real property holding corporation (as defined in section 897(c)(2)) at the time of the liquidation and immediately thereafter.

(C) *Anti-abuse rule.* (*1*) The exception in paragraph (b)(2)(iii)(A) of this section shall not apply, if a principal purpose of the distribution of the 80 percent domestic subsidiary corporation's stock is the avoidance of U.S. tax that would have been imposed on the domestic liquidating corporation's disposition of such stock (directly or indirectly) to an unrelated party. A distribution may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes (taken together or separately).

(*2*) For purposes of paragraph (b)(2)-(iii)(C)(*1*) of this section, a distribution of stock of the 80 percent domestic subsidiary corporation will be deemed to have been made pursuant to a plan, one of the principal purposes of which was the avoidance of U.S. tax, if the foreign distributee corporation disposes of any such stock within two years of such distribution. The rule in this paragraph (b)(2)-(iii)(C)(*2*) will not apply if the foreign distributee corporation can demonstrate to the satisfaction of the Commissioner that a principal purpose of the liquidation was not the avoidance of U.S. tax.

(D) *Required statement.* The statement required by paragraph (b)(2)(iii)(A) of this section shall be entitled "Required Statement under §1.367(e)–2(b)(2)(iii) for Stock of 80 Percent Domestic Subsidiary Corporations" and shall be prepared by the domestic liquidating corporation and shall be signed under penalties of perjury by an authorized officer of the domestic liquidating corporation and by an authorized officer of the foreign distributee corporation. The required statement shall contain a certification that states that if the foreign distributee corporation disposes of any stock subject to paragraph (b)(2)(iii)(A) of this section in a transaction described in paragraph (b)(2)(iii)(C) of this section, then the domestic liquidating corporation shall recognize all realized gain attributable to such stock at the time of distribution, and the domestic liquidating corporation (or the foreign distributee corporation on behalf of the domestic liquidating corporation) shall file a U.S. income tax return (or amended U.S. income tax return, as the case may be) for the year of distribution reporting the gain attributable to such stock.

(3) *Other consequences*—(i) *Distributee basis in property.* The foreign distributee corporation's basis in property subject to this paragraph (b) shall be the same as the domestic liquidating corporation's basis in such property immediately before the liquidation, increased by any gain, or reduced by any loss recognized by the domestic liquidating corporation on such property pursuant to paragraph (b)(1) of this section. In no case, however, will the foreign distributee corporation's adjusted basis in distributed property exceed the fair market value of such property at the time of liquidation.

(ii) *Reporting under section 6038B.* Section 6038B and the regulations thereunder apply to a domestic liquidating corporation's transfer of property to a foreign distributee corporation under section 367(e)(2).

(iii) *Other rules.* For other rules that may be applicable, see sections 1248, 897, and 381.

(c) *Distribution by a foreign corporation*—(1) *General rule—gain and loss not recognized.* If a foreign corporation (foreign liquidating) makes a distribution of property in complete liquidation under section 332 to a foreign corporation (foreign distributee) that meets the stock ownership requirements of section 332(b) with respect to stock in the foreign liquidating corporation, then, except as provided in paragraph (c)(2) of this section, section 337(a) and (b)(1) shall apply and the foreign liquidating corporation shall not recognize gain (or loss) on the distribution under section 367(e)(2). If a foreign liquidating corporation distributes a partnership interest (whether foreign or domestic), then such corporation shall be treated as having distributed a proportionate share of partnership property in accordance with the principles of paragraph (b)(1)(iii) of this section.

(2) *Exceptions*—(i) *Property used in a U.S. trade or business*—(A) *General rule.* A foreign liquidating corporation (including a corporation that has made an effective election under section 897(i)) that makes a distribution described in paragraph (c)(1) of this section shall recognize gain on the distribution of qualified prop-

erty, as described in paragraph (b)(2)-(i)(B) of this section (other than U.S. real property interests), that is used by the foreign liquidating corporation in the conduct of a trade or business within the United States at the time of distribution.

(B) *Ten-year active U.S. business exception.* A foreign liquidating corporation shall not recognize gain under paragraph (c)(2)(i)(A) of this section, if—

(*1*) The foreign distributee corporation, immediately thereafter and for the ten-year period beginning on the date of the distribution of such property, uses the property in the conduct of a trade or business in the United States;

(*2*) The foreign distributee corporation is not entitled to benefits under a comprehensive income tax treaty (this requirement shall apply only if the foreign liquidating corporation (or predecessor corporation) was not entitled to benefits under a comprehensive income tax treaty); and

(*3*) The foreign liquidating corporation and foreign distributee corporation attach the statement described in paragraph (c)(2)(i)(C) of this section to their U.S. income tax returns for their taxable years that include the distribution.

(C) *Required statement.* The statement required by paragraph (c)(2)(i)(B)(3) of this section shall be entitled "Required Statement under §1.367(e)–2(c)(2)(i)," shall be prepared by foreign liquidating corporation, shall be signed under penalties of perjury by an authorized officer of the foreign liquidating corporation and by an authorized officer of the foreign distributee corporation, and shall be identical to the statement described in paragraph (b)(2)(i)(C) of this section, except that "§1.367(e)–2(c)(2)(i)(B)" shall be substituted for references to "§1.367(e)–2(b)-(2)(i)" and "foreign liquidating corporation" shall be substituted for "domestic liquidating corporation" each time it appears. References in the rules of paragraph (b)(2)(i)(C) of this section to various rules in paragraph (b) of this section shall be applied as if such references were to this paragraph (c). However, the statement described in this paragraph (c)(2)-(i)(C) shall be modified as follows:

(*1*) The foreign distributee corporation shall not be required to waive its income tax treaty benefits as required by §1.367(e)–2(b)(2)(i)(C)(*4*), unless—

(*i*) The foreign liquidating corporation was required to waive its treaty benefits under paragraph (b)(2)(i)(C)(4) of this section in connection with the distribution of such property in a prior liquidation distribution subject to the provisions of this section; or

(*ii*) The foreign distributee corporation is entitled benefits under a treaty to which the foreign liquidating corporation was not entitled.

(*2*) If the foreign distributee is required to waive treaty benefits because of paragraph (c)(2)(i)(C)(*1*)(*ii*) of this section, then the foreign distributee shall only be required to waive benefits that were not available to the foreign liquidating corporation (or a predecessor corporation) prior to liquidation.

(*3*) The property description described in paragraph (b)(2)(i)(C)(*2*) of this section shall include only the qualified U.S. trade or business property described in paragraph (c)(2)(i) of this section.

(D) *Operating rules.* By the foreign liquidating corporation's claiming nonrecognition under paragraph (c)(2)(i)(B) of this section and filing a statement described in paragraph (c)(2)(i)(C) of this section, the foreign liquidating corporation and the foreign distributee corporation agree to be subject to the rules of paragraph (c)(2)(i) of this section, as well as the rules of paragraphs (b)(2)(i)(D) and (E) of this section. In applying the rules of paragraphs (b)(2)(i)(D) and (E) of this section, "foreign liquidating corporation" shall be used instead of "domestic liquidating corporation" each time it appears. References in the rules of paragraphs (b)(2)(i)(D) and (E) of this section to various rules in paragraph (b) of this section shall be applied as if such references were to this paragraph (c).

(ii) *Property formerly used in a United States trade or business.* A foreign liquidating corporation that makes a distribution described in paragraph (c)(1) of this section shall recognize gain (but not loss) on the distribution of property (other than U.S. real property interests) that had ceased to be used by the foreign liquidating corporation in the conduct of a U.S. trade or business within the ten-year period ending on the date of distribution and that would have been subject to section 864(c)(7) had it been disposed. Section 864(c)(7) shall govern the treatment of any gain recognized on the distribution of assets described in this paragraph as income effectively connected with the conduct of a trade or business within the United States.

(3) *Other consequences*—(i) *Distributee basis in property.* The foreign distributee corporation's basis in property subject to this paragraph (c) shall be the same as the foreign liquidating corporation's basis in such property immediately before the liquidation, increased by any gain, or reduced by any loss recognized by the foreign liquidating corporation on such property, pursuant to paragraph (c)(2) of this section. In no event, however, will the foreign distributee corporation's adjusted basis in distributed property exceed the fair market value of such property at the time of liquidation.

(ii) *Other rules.* For other rules that may apply, see sections 367(b) and 381.

(d) *Anti-abuse rule.* The Commissioner may require either a domestic liquidating corporation or a foreign liquidating corporation to recognize gain on a distribution in liquidation described in paragraph (b) or (c) of this section (or treat the liquidating corporation as if it had recognized loss on a distribution in liquidation), if a principal purpose of the liquidation is the avoidance of U.S. tax (including, but not limited to, the distribution of a liquidating corporation's earnings and profits with a principal purpose of avoiding U.S. tax). A liquidation may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes (taken together or separately).

(e) *Effective date.* This section shall be applicable to distributions occurring 30 days after August 9, 1999 or, if taxpayer so elects, to distributions in taxable years ending after August 8, 1999.

Par. 4. Section 1.6038B-1 is amended by revising the fourth sentence of paragraph (a), the first sentence of paragraph (b)(1)(i), and paragraphs (d), (e), and (g) to read as follows:

§1.6038B–1 Reporting of certain transactions to foreign corporations.

(a) * * * Section 1.6038B-1(e) describes the filing requirements for property transfers described in section 367(e). * * *

(b) *Time and manner of reporting*—(1) *In general*—(i) *Reporting procedure.* Ex-

cept for stock or securities qualifying under the special reporting rule of paragraph (b)(2) of this section, or cash, which is subject to special rules contained in paragraph (b)(3) of this section, any U.S. person that makes a transfer described in section 6038B(a)(1)(A), 367(d), or 367(e), is required to report pursuant to section 6038B and the rules of this section and must attach the required information to Form 926, "Return by Transferor of Property to a Foreign Corporation." * * *

* * * * *

(d) [Reserved]. For further guidance, see §1.6038B–1T(d).

(e) *Transfers subject to section 367(e)*—(1) *In general.* If a domestic corporation (distributing corporation) makes a distribution described in section 367(e)(1) or section 367(e)(2), the distributing corporation must comply with the reporting requirements of this paragraph (e). Unless otherwise provided in this section, a distributing corporation making a distribution described in sections 367(e)(1) or 367(e)(2) must file a Form 926, "Return by a U.S. Transferor of Property to a Foreign Corporation (under section 367)," as amended and modified by this section.

(2) *Reporting requirements for section 367(e)(1) distributions of domestic controlled corporations.* A domestic distributing corporation making a distribution of the stock or securities of a domestic corporation under section 355 is not required to file a Form 926, as described in paragraph (e)(1) of this section, and shall have no other reporting requirements under section 6038B.

(3) *Reporting requirements for section 367(e)(1) distributions of foreign controlled corporations.* If the distributing corporation makes a section 355 distribution of the stock or securities of a foreign controlled corporation to distributee shareholders who are not qualified U.S. persons, as defined in §1.367(e)–1(b)(1), then the distributing corporation shall complete Part 1 of the Form 926 and attach a signed copy of such form to its U.S. income tax return for the year of the distribution. The distributing corporation shall also attach to its U.S. income tax return for the year of distribution a statement signed under the penalties of perjury entitled, "Addendum to Form 926." The addendum shall contain a brief description of the transaction, state the number of shares distributed to distributees who are not qualified U.S. persons (applying the rules contained in §1.367(e)–1(d)), and state the basis and fair market value of the distributed stock or securities (including a list stating the amounts that were distributed to distributees who were not qualified U.S. persons and distributees who were qualified U.S. persons).

(4) *Reporting rules for section 367(e)(2) distributions by domestic liquidating corporations.* If the distributing corporation makes a distribution of property in complete liquidation under section 332 to a foreign distributee corporation that meets the stock ownership requirements of section 332(b) with respect to the stock of the distributing corporation, then the distributing corporation shall complete a Form 926 and attach a signed copy of such form to its U.S. income tax return for the year of the distribution. The property description contained in Part III of the Form 926 shall contain a description of all property distributed by the liquidating corporation (regardless of whether the property qualifies for nonrecognition). The description shall also identify the property excepted from gain recognition under §1.367(e)–2(b)(2)(ii) and (iii). If the distributing corporation distributes property that will be used by the foreign distributee corporation in a U.S. trade or business and the distributing corporation does not recognize gain on such distribution under §1.367(e)–2(b)(2)(i), then the distributing corporation may satisfy the requirements of this section by completing Part 1 of the Form 926, noting thereon that the information required by the Form 926 is contained in the statement required by §1.367(e)–2(b)(2)(i)(C)(2), and attaching a signed copy of the Form 926 to its U.S. income tax return for the year of the distribution.

* * * * *

(g) *Effective dates.* This section applies to transfers occurring on or after July 20, 1998, except paragraph (e) of this section, which applies to transfers that are subject to §§1.367(e)–1(f) and 1.367(e)–2(e). See §1.6038B–1T for transfers occurring prior to July 20, 1998. See also §1.6038B–1T(e) in effect prior to August 9, 1999, (as contained in 26 CFR part 1 revised April 1, 1999) for transfers described in section 367(e) that are not subject to §§1.367(e)–1(f) and 1.367(e)–2(e).

Par. 5. Section 1.6038B–1T is amended by revising the section heading, revising paragraph (e) and revising the first sentence of paragraph (g), to read as follows.

§1.6038B–1T Reporting of certain transactions to foreign corporations (temporary).

* * * * *

(e) [Reserved] For further guidance, see §1.6038B–1(e).

* * * * *

(g) *Effective date.* This section applies to transfers occurring after December 31, 1984. * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, paragraph (b) is amended in the table by removing the entries for 1.367(e)–1T and 1.367(e)–2T, revising the entry for 1.6038B–1, and adding entries in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.367(e)–1	1545–1487
1.367(e)–2	1545–1487
* * * * *	
1.6038B–1	1545–1487 1545–1615
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved 7/29/1999.

Donald C. Lubbick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 6, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 9, 1999, 64 F.R. 43072)

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

This revenue procedure addresses secondary adjustments under section 482 of the Internal Revenue Code. See Rev. Proc. 99–32, page 296.

Section 643.—Definitions Applicable to Subparts A, B, C, and D

26 CFR 1.643(h)–1: Distribution by certain foreign trusts through intermediaries.

T.D. 8831

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Inbound Grantor Trusts With Foreign Grantors

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations implementing sections 672(f) and 643(h) of the Internal Revenue Code, as amended by the Small Business Job Protection Act of 1996, which relate to the application of the grantor trust rules to certain trusts established by foreign persons. These regulations affect primarily U.S. persons who are beneficiaries of trusts established by foreign persons. This document also contains temporary regulations defining the term *grantor* for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code. The text of these temporary regulations serves as the text of the proposed regulations set forth in the notice of proposed rulemaking published in REG–252487–96, on page 303.

DATES: *Effective Date:* These regulations are effective August 10, 1999.

Applicability Dates: For dates of applicability of §1.643(h)–1, see §1.643(h)–1(h). For dates of applicability of §1.671–2T(e), see §1.671–2T(e)(7). For dates of applicability of §§1.672(f)–1 through 1.672(f)–5, see §§1.672(f)–1(c), 1.672(f)–2(e), 1.672(f)–3(e), 1.672(f)–4(h), and 1.672(f)–5(c).

FOR FURTHER INFORMATION CONTACT: M. Grace Fleeman (202) 622-3880 concerning the regulations generally, and James A. Quinn (202) 622-3060 concerning §1.671–2T(e) and §1.672(f)–1 (not toll-free numbers).

SUPPLEMENTARY INFORMATION

Background

On June 5, 1997 (62 F.R. 37819) Treasury and the IRS published a notice of proposed rulemaking (REG–252487–96) under sections 643(h), 671, 672(f), and 7701 of the Internal Revenue Code (Code). Comments responding to the notice were received and a public hearing was held on August 27, 1997. After consideration of the comments, the proposed regulations under sections 643(h) and 672(f) are adopted as final regulations as revised by this Treasury decision. The proposed regulations under section 671 are issued as revised by this Treasury decision as temporary regulations. The revisions are discussed below. The proposed regulations under section 7701 are withdrawn. The temporary regulations under section 671 are also being issued as proposed regulations published in REG–252487–96, on page 303.

Explanation of Provisions and Revisions

1. *Comments and Changes to §1.643(h)–1: Distributions by Certain Foreign Trusts Through Intermediaries*

Under the proposed regulations, any amount that was derived, directly or indirectly, by a U.S. person from a foreign trust through an intermediary generally was deemed to have been transferred directly by the foreign trust to the U.S. person if any one of three specified conditions was satisfied. In cases where the transfer from the intermediary to the U.S. person did not occur in the same taxable year of the U.S. person as the transfer from the foreign trust to the intermediary, the proposed regulations looked to generally applicable agency principles to determine when the transfer to the U.S. person was deemed to occur.

Commenters said the proposed rules were too broad and could reach virtually any transfer made to a U.S. person by any person who has received a distribution from a foreign trust. They suggested that the basic requirement for treating a transfer to a U.S. person as a transfer directly from a foreign trust should be the existence of an intention to avoid U.S. tax. Alternatively, they said there should at least be a time limitation so that the rule would not apply to a transfer of property received from a foreign trust more than, for example, one year before the transfer to the U.S. person. In addition, they said the proposed rule relying on generally applicable agency principles for determining whether an intermediary is the agent of the foreign trust or of the U.S. person would be difficult to apply because different countries have different laws and the U.S. person should be taxed prior to receipt only if the intermediary is clearly a nominee or agent for the U.S. person.

In response to the comments, the final regulations treat any property (including cash) that is transferred to a U.S. person by an intermediary who has received property from a foreign trust as property transferred directly by the foreign trust to the U.S. person if the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax. A transfer of property will be deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax if all of certain specified factors are present. However, the Commissioner may find that a transfer was made pursuant to a plan one of the principal purposes of which was the avoidance of U.S. tax whether or not any of the specified factors is present.

The factors that will cause a transfer to be deemed to have been made pursuant to

a plan one of the principal purposes of which was the avoidance of U.S. tax are the following: (i) the U.S. person is related to a grantor of the foreign trust or has another relationship with a grantor of the foreign trust that establishes a reasonable basis for concluding that the grantor of the foreign trust would make a gratuitous transfer to the U.S. person; (ii) the U.S. person receives from the intermediary, within the period beginning twenty-four months before and ending twenty-four months after the intermediary's receipt of property from the foreign trust, either the property the intermediary received from the foreign trust, proceeds from such property, or property in substitution for such property; and (iii) the U.S. person cannot demonstrate to the satisfaction of the Commissioner that (A) the intermediary has a relationship with the U.S. person that establishes a reasonable basis for concluding that the intermediary would make a gratuitous transfer to the U.S. person, (B) the intermediary acted independently of the grantor and the trustee, (C) the intermediary is not an agent of the U.S. person under generally applicable U.S. agency principles, and (D) the U.S. person timely complied with the reporting requirement of section 6039F, if applicable, if the intermediary is a foreign person. See Notice 97-34 (1997-1 C.B. 422).

The final regulations also have been modified with respect to the application of generally applicable agency principles. Under the final regulations, property is treated as transferred to the U.S. person in the year it is actually transferred to the U.S. person by the intermediary unless the Commissioner determines, or the taxpayer can demonstrate to the satisfaction of the Commissioner, that the intermediary is an agent of the U.S. person under generally applicable agency principles, in which case the property will be treated as transferred to the U.S. person by the trust in the year the property was transferred to the intermediary by the trust. As a corollary, the final regulations provide that the fair market value of the property is determined as of the date of the transfer to the U.S. person, unless the intermediary is treated as an agent of the U.S. person, in which case the fair market value will be determined as of the date of the transfer to the intermediary. Examples illustrate the effect of changes in the fair market value between the date of the transfer to the intermediary and the date of the transfer to the U.S. person.

The final regulations clarify that they apply only to gratuitous transfers. They also clarify that if property is treated as transferred directly by a foreign trust to a U.S. person pursuant to the regulations, the same property will not be taken into account in computing the gross income of the intermediary (if such property would otherwise be required to be so taken into account).

The final regulations under section 643(h) are applicable to transfers made to U.S. persons after August 10, 1999.

2. *Comments and Changes to §1.671- 2(e): Definition of Grantor*

The proposed regulations provided a definition of grantor for purposes of part I of subchapter J, chapter 1 of the Code. This document replaces the proposed regulations with temporary regulations that are effective August 10, 1999. These temporary regulations are also being issued as proposed regulations published elsewhere in this issue of the **Federal Register.** In accordance with section 7805(e)(2), the temporary regulations will expire before August 12, 2002.

Under the original proposed regulations, a grantor was defined to include any person to the extent such person either (i) creates a trust or (ii) directly or indirectly makes a gratuitous transfer to a trust. Commenters questioned why a nominal creator who has made no transfer to a trust should be treated as a grantor and asked for an explanation of the tax significance of such treatment.

Treating a nominal creator as a grantor ensures that someone will be responsible for reporting the creation of a foreign trust by a U.S. person even if the trust is not immediately funded. See section 6048(a)(3)(A)(i) and (a)(4)(A). At the same time, Treasury and the IRS believe that an accommodation grantor, such as an attorney who creates a trust on behalf of a client, (although a grantor) should not be treated as an owner of the trust. Accordingly, the temporary regulations provide that a person who either creates a trust, or funds a trust with an amount that is directly repaid to such person within a reasonable period of time, but who makes no other transfers to the trust that constitute gratuitous transfers, will not be treated as an owner of any portion of the trust under sections 671 through 677 or 679.

Commenters also questioned a provision in the proposed regulations that treated a distribution from one trust to another trust that is a beneficiary of the first trust as a gratuitous transfer, with the result that the first trust was a grantor of the second trust. Under the temporary regulations, if a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally is treated as the grantor of the transferee trust. However, if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, such person is treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of part I, subchapter J, chapter 1 of the Code. (These rules do not affect the determination of whether or not the gratuitous transfer from the transferor trust is a distribution subject to sections 651 or 661.)

The proposed regulations provided that a person who acquires an interest in a fixed investment trust from a grantor of the trust also will be treated as a grantor of the trust. In response to comments received, the temporary regulations extend the same treatment to persons who acquire an interest in a liquidating trust or an environmental remediation trust.

The temporary regulations include a new section that applies to gratuitous transfers to trusts by partnerships and corporations. If the transfer is entered into for a business purpose of the partnership or corporation, the partnership or corporation, as the case may be, generally is treated as the grantor of the trust. However, if the transfer is not entered into for a business purpose of the partnership or corporation — for example, if it is for the personal purposes of one or more of the partners or shareholders — the transfer is treated as a constructive distribution to such partners or shareholders under federal tax principles, and the partners or shareholders, as the case may be, are treated as the grantors of the trust. See, for example, *Epstein v. Commissioner,* 53

T.C. 459 (1969), acq. on another issue, 1970–2 C.B. xix.

Commenters asked for guidance concerning the identification of the grantor when the property contributed to the trust is jointly owned. These temporary regulations do not provide specific guidance on the treatment of joint owners that contribute property to a trust. Treasury and the IRS invite comments with specific examples of areas that may need clarification, such as, for example, the treatment of community property or the joint ownership of property by noncitizen spouses.

3. *Comments and Changes to §1.672(f)–1: Foreign Persons Not Treated as Owners*

The proposed regulations prescribed a two-step analysis for implementing the general rule of section 672(f). First, the grantor trust rules other than section 672(f) (the basic grantor trust rules) were applied to determine the worldwide amount and the U.S. amount. Then, the trust was treated as partially or wholly owned by a foreign person based on an annual year-end comparison of the worldwide amount and the U.S. amount. Commenters suggested that the two-step analysis was unnecessarily complex and questioned whether it might produce results that were unintended or inconsistent with the statute.

In response to these concerns, the final regulations provide that the grantor trust rules other than section 672(f) must be applied first to determine whether, under such rules, any portion of the trust would be treated as owned by a person other than a U.S. citizen or resident or domestic corporation. The determination of the portion of the trust that is treated as owned by a grantor or other person is to be made based on the terms of the trust and the application of the grantor trust rules as found in §1.671–1 et seq. If it is determined that any portion of the trust would be treated as owned by a person other than a U.S. citizen or resident or domestic corporation, such person will be treated as the owner of such portion only if such person is a foreign corporation described in §1.672(f)–2(a) or if such portion of the trust qualifies for one of the exceptions in §1.672(f)–3.

The final regulations under the general rule are generally applicable to taxable years of a trust beginning after August 10, 1999.

4. *Comments and Changes to §1.672(f)–2: Certain Foreign Corporations*

Under the proposed regulations, a controlled foreign corporation (CFC) that created or funded a trust was treated as a domestic corporation for purposes of section 672(f) only to the extent the trust's income was subpart F income that was currently taken into account in computing the gross income of a U.S. citizen, U.S. resident, or domestic corporation. There were similar rules for passive foreign investment companies (PFICs) and foreign personal holding companies (FPHCs). Commenters questioned whether the proposed rules were consistent with the statutory antideferral regime and the legislative history. There also were suggestions that the proposed rules should not apply where a CFC is wholly owned, directly or indirectly, by U.S. shareholders. In addition, there were requests for simplification of the rules pertaining to annual fluctuations in the portion of a trust that is treated as owned by the grantor.

In response to the comments, Treasury and the IRS have developed rules that are narrowly targeted to potentially abusive situations and therefore are not inconsistent with the antideferral regime. Under the final regulations, if the owner of a trust upon application of the grantor trust rules without regard to section 672(f) is a CFC, PFIC, or FPHC, the CFC, PFIC, or FPHC, as the case may be, will be treated as a domestic corporation for purposes of applying the general rule of §1.672(f)–1. Consequently, a CFC, PFIC, or FPHC generally will be treated as an owner of a trust if it would be so treated under sections 671 through 678 without regard to section 672(f). A CFC, PFIC, or FPHC will be treated as a domestic corporation solely for purposes of applying the general rule of §1.672(f)–1. Thus, a CFC, PFIC, or FPHC will be treated as a foreign corporation for purposes of §1.672(f)–4, which is discussed below in part 6 of this explanation.

If a trust to which a CFC, PFIC, or FPHC has made a gratuitous transfer makes a gratuitous transfer to a U.S. person, the CFC, PFIC, or FPHC, as the case may be, will be treated as a foreign corporation for purposes of determining how the transfer will be treated in the hands of the U.S. person, and the rules of §1.672(f)–4(c) will apply. If a trust that a CFC, PFIC, or FPHC is treated as owning under section 678 makes a gratuitous transfer to a U.S. person, the rules of §1.672(f)–4(c) will apply as if the CFC, PFIC, or FPHC had made a gratuitous transfer to the trust.

The final regulations for CFCs, PFICs, and FPHCs are generally applicable to taxable years of shareholders of CFCs, PFICs, and FPHCs beginning after August 10, 1999 and taxable years of CFCs, PFICs, and FPHCs ending with or within such taxable years of the shareholders.

5. *Comments and Changes to §1.672(f)–3: Exceptions To General Rule*

A. Certain Revocable Trusts

Under the proposed regulations, the general rule of §1.672(f)–1(a) did not apply to any portion of a trust if the power to revest absolutely in the grantor title to such portion was exercisable solely by the grantor without the approval or consent of any other person for a period or periods aggregating 183 days or more during the taxable year of the trust. The 183-day rule is targeted at potentially abusive situations in which a power to revest is so limited that it is not likely to be exercised.

In response to comments received, the final regulations clarify that if the first or last taxable year of the trust is less than 183 days, the revocable trust exception will apply if the grantor has a power to revest on each day of the first or last taxable year (including the year of the grantor's death), as the case may be. The final regulations also clarify that, consistent with the principle that statutory exceptions should be construed narrowly, if a trust fails to qualify for the revocable trust exception in a particular year, the exception cannot apply in a later year even if the requirements would otherwise be satisfied in such later year.

Commenters asked whether the revocable trust exception continues to apply if the grantor becomes incapacitated. The final regulations provide that the exception will continue to apply if, but only if, there is a guardian or other person who has unrestricted authority to exercise the necessary power on the grantor's behalf.

Some commenters disagreed with the result in §1.672(f)–3(a)(4) *Example 3* of the proposed regulations, which concluded that the revocable trust exception does not apply where the grantor of the trust can replace the trustee, who is not a related or subordinate party, at any time for any reason. They said the example was inconsistent with the existing grantor trust rules. See, e.g., §1.674(d)–2(a). After careful consideration, Treasury and the IRS have concluded that Example 3 is consistent with the purposes of section 672(f) and should be retained.

Commenters raised a number of issues concerning the grandfather rules in §1.672(f)–3(a)(2) and (b)(4) of the proposed regulations for certain trusts that were in existence on September 19, 1995. In response to the comments, the final regulations confirm that physical separation of amounts that were gratuitously transferred to the trust after September 19, 1995, is not required. The final regulations further provide that initial separate accountings may be prepared at any time up until the due date (including extensions) for the tax return for the first taxable year of the trust beginning after August 10, 1999. In response to requests for more specific guidance, the final regulations provide that the grandfather rules apply only if any amounts that were gratuitously transferred to the trust after September 19, 1995, are treated as a separate portion of the trust that is accounted for under the rules of §1.671–3(a)(2).

B. Certain Trusts that Can Distribute Only to the Grantor or the Spouse of the Grantor

Under the proposed regulations, the general rule of §1.672(f)–1 did not apply if the only amounts distributable from a trust (or portion of a trust) during the lifetime of the grantor were amounts distributable to the grantor or the grantor's spouse. Treasury and the IRS contemplate that the fact that the grantor and his or her spouse might someday divorce or legally separate will be disregarded for purposes of determining whether the exception is applicable.

Under the proposed regulations, amounts distributable in discharge of a legal obligation of the grantor or the grantor's spouse generally were treated as amounts distributable to the grantor or the grantor's spouse. Commenters said these proposed rules were inconsistent with the manner in which distributions in discharge of obligations are treated in regulations promulgated under other provisions of the Code. For example, under sections 677(a) and 662(a)(2), there is no exception for obligations to family members that are not based on full and adequate consideration in money or money's worth. Commenters also said the proposed rules were likely to exclude most trusts from qualification for the exception because, in most jurisdictions, a trust provision that permits distributions to a particular person is construed to permit distributions to be made in satisfaction of that person's obligations, regardless of the source of the obligations.

Treasury and the IRS believe it is neither necessary nor appropriate for the regulations promulgated under the statutory exceptions to section 672(f) to be consistent with the regulations promulgated under other provisions of part I of subchapter J, chapter 1 of the Code. Section 672(f) reflects a policy determination that foreign persons should not be allowed "to affirmatively use the domestic anti-abuse rules concerning grantor trusts" to avoid U.S. tax on trust income distributed to U.S. beneficiaries. Dept. of the Treasury, General Explanations of the Administration's Revenue Proposals, at 12 (1995). Section 672(f) operates to implement that policy determination by providing that the grantor trust rules generally do not apply where their effect would be to treat a foreign person as the owner of any portion of a trust. S. Rep. No. 35, 104th Cong., 1st Sess. 161 (1995). The exceptions in section 672(f)(2) must be interpreted narrowly to preserve the primary operation of the general rule. See, for example, *Commissioner v. Clark,* 489 U.S. 726, 739 (1989) ("In construing provisions . . . in which a general statement of policy is qualified by an exception, we usually read the exception narrowly in order to preserve the primary operation of the provision.").

The final regulations continue to provide that a trust will not fail to qualify for the exception solely because amounts are distributable from the trust in discharge of a legal obligation of the grantor (or grantor's spouse). An obligation to a related person is not generally treated as a legal obligation unless it was contracted bona fide and for adequate and full consideration in money or money's worth. However, obligations to support certain individuals will be treated as legal obligations if the individual is either permanently and totally disabled or less than 19 years old. The final regulations expand the list of potentially eligible individuals to include certain individuals who are members of the grantor's (or grantor's spouse's) household and have as their principal place of abode the grantor's (or grantor's spouse's) home, but are not related to the grantor (or grantor's spouse) through one of the relationships listed in section 152(a)(1) through (8). The fact that amounts might become distributable from a trust to support an individual who is not described in the regulations will be disregarded if, at the time the applicability of the exception is being determined, the potential obligation is not reasonably expected to arise under the facts and circumstances.

Some commenters said the limitation in proposed §1.672(f)–3(b)(2)(ii) for legal obligations to related persons is not needed in the case of reinsurance trusts because, regardless of the sufficiency of the consideration for the reinsurance, the funds in a reinsurance trust can be utilized only to satisfy the legal obligations of the reinsurer (or will be distributed to the reinsurer). In addition, commenters pointed out that there already are other provisions, such as sections 482 and 845, that apply to related-party reinsurance arrangements.

The final regulations reserve on the application of the related-party rule to reinsurance trusts. Treasury and the IRS are looking carefully at this area, and they invite additional comments.

Commenters raised a number of issues concerning the grandfather rules in §1.672(f)–3(b)(4) of the proposed regulations. These issues are discussed above in connection with the grandfather rules under §1.672(f)–3(a)(2) of the proposed regulations.

C. Compensatory Trusts

The proposed regulations listed categories of trusts that constitute compensatory trusts, without regard to whether any portion of a particular trust would ever be treated as owned by the grantor or another person under the grantor trust

rules. Treasury and the IRS are concerned that some taxpayers may find such a comprehensive list confusing. Accordingly, the final regulations provide that the trusts to which the compensatory trust exception applies are those to which the application of section 672(f) is likely to be relevant: (i) nonexempt employees' trusts described in section 402(b) and (ii) so-called "rabbi" trusts. Treasury and the IRS believe the issue of whether tax-exempt compensatory trusts can be treated as owned by a foreign person is moot because there are special statutory rules that govern those trusts.

Treasury and the IRS contemplate that a nonexempt employees' trust described in section 402(b) will be treated as owned by a beneficiary of the trust only to the extent provided in regulations section 1.402(b)–1(b)(6). See also proposed regulations §1.671–1(g) and §1.671–1(h), which were published in the **Federal Register** (61 F.R. 50778) on September 27, 1996, for proposed rules describing when an employer will be treated as an owner of any portion of a nonexempt employees' trust described in section 402(b) that is part of a deferred compensation plan.

The final regulations also provide that the Commissioner may designate additional categories of trusts to which the compensatory trust exception applies.

6. *Comments and Changes to §1.672(f)–4: Recharacterization of Purported Gifts*

The proposed regulations provided that a U.S. donee generally must treat a purported gift from a foreign corporation as a distribution from the foreign corporation unless the U.S. donee can establish that a U.S. citizen or resident alien is a shareholder of the transferor and that the U.S. citizen or resident took the amount into account for U.S. tax purposes and subsequently made a gift to the U.S. donee. Similar rules were proposed for purported gifts from partnerships (whether domestic or foreign). There were exceptions for charitable contributions to donees described in section 170(c) and for purported gifts that did not exceed $10,000.

Section 1.672(f)–4(c) of the proposed regulations provided rules for gratuitous transfers to U.S. donees from trusts created by partnerships or foreign corporations. Under the proposed regulations, if the partnership or foreign corporation was treated as the owner of the trust under the grantor trust rules, the transfer was treated as a purported gift from the partnership or foreign corporation. If the partnership or foreign corporation was not treated as the owner of the trust, the transfer was treated as an accumulation distribution from the trust unless the resulting U.S. tax liability was less than the U.S. tax that would be due if the transfer were treated as a purported gift from the partnership or foreign corporation.

Commenters said the proposed regulations were overly broad and exceeded the scope of the regulatory authority granted by Congress. They suggested that a purported gift from a partnership or foreign corporation should be treated as a deemed distribution to the partner or shareholder followed by a deemed transfer to the U.S. donee. Commenters also suggested that purported gifts should not be recharacterized as taxable distributions unless it appeared, based on all the facts and circumstances, that the partnership or foreign corporation was being used principally as a device to avoid U.S. tax.

Treasury and the IRS believe the basic approach taken by the proposed regulations is both necessary and appropriate to prevent the avoidance of the purposes of section 672(f). See Code section 672(f)(4) and (6). A rule that would recharacterize purported gifts only in situations where the partnership or foreign corporation was being used principally as a device to avoid U.S. tax would be unadministrable. It would place a nearly insurmountable burden on the IRS to obtain information, much of it outside the United States, and to establish that the partnership or foreign corporation was being used to avoid U.S. tax. Further, individuals do not normally receive gifts from partnerships and corporations. See, for example, *Commissioner v. Duberstein*, 363 U.S. 278 (1960).

The final regulations leave the basic approach essentially unaltered, but expand the number of exceptions to the general rule. They retain the exception for cases where the U.S. donee can establish that a U.S. citizen or resident alien treated (and reported) the purported gift for U.S. tax purposes as a distribution from the partnership or foreign corporation and a subsequent gift to the donee. In response to the commenters' concerns, they provide an additional exception for cases where the U.S. donee can establish that a nonresident alien individual treated and reported the purported gift for purposes of the tax laws of the country in which the nonresident alien is resident as a distribution from the partnership or foreign corporation and a subsequent gift to the donee, provided the U.S. donee timely complied with the filing requirements of section 6039F, if applicable. Finally, they provide another new exception for purported gifts from domestic partnerships that are beneficially owned (within the meaning of §1.1441–1(c)(6)) exclusively by U.S. citizens or residents or domestic corporations.

In response to other comments, the final regulations clarify that a transfer to a U.S. donee that is a corporation will not be subject to the general rule of §1.672(f)–4(a) to the extent the donee can establish that the transfer was a contribution to capital. The final regulations also expand the scope of the charitable contribution exception to include a transfer from a transferor that has received a ruling or determination letter from the Internal Revenue Service recognizing its exempt status under section 501(c)(3), provided that the transfer was made pursuant to the transferor's exempt purpose, the ruling or determination letter has not been revoked or modified, and there has been no material change, inconsistent with exemption, in the character, purpose, or method of operation of the organization.

The final regulations revise the rules for gratuitous transfers to U.S. donees from trusts to which partnerships or foreign corporations have made gratuitous transfers. The revisions reflect the fact that, under U.S. domestic law principles, the partners or shareholders might be treated as grantors of the trust. See §1.671–2T(e)(4).

The final regulations also clarify that if the transferring partnership or foreign corporation receives some consideration from the U.S. donee, but the consideration is less than the fair market value of the property transferred, only the excess will be treated as a purported gift. Further, no portion will be treated as a purported gift if the U.S. donee can establish that the U.S. donee is neither related to a

partner or shareholder of the transferor within the meaning of §1.643(h)–1(e) nor has another relationship with a partner or shareholder of the transferor such that there is a reasonable basis for concluding that the partner or shareholder would make a gratuitous transfer to the U.S. donee.

Commenters said the proposed regulations overturned an early Supreme Court decision, *Bogardus v. Commissioner,* 302 U.S. 34 (1937), which treated certain payments by an acquiring corporation in a reorganization that were paid at the instigation of former shareholders of the target corporation to employees and former employees of the target corporation as nontaxable gifts rather than as compensation. The result in *Bogardus* might well be different today under section 102(c)(1) (enacted in 1986), which provides that the exclusion from gross income for the value of property acquired by gift does not apply to any amount transferred by or for an employer to, or for the benefit of, an employee. Further, and more importantly, the payor corporation in *Bogardus* was a domestic corporation that did not treat the payments as a deductible expense and there was no avoidance of U.S. tax. Thus, *Bogardus* is distinguishable on its facts from a situation where a foreign corporation transfers property to a U.S. person who treats the transfer as a gift or bequest and there will be avoidance of U.S. tax if the purported gift is not recharacterized.

The final regulations for purported gifts are generally applicable to transfers made after August 10, 1999 by partnerships or foreign corporations, or by trusts to which partnerships or foreign corporations made gratuitous transfers after August 10, 1999.

7. *Comments and Changes to §1.672(f)–5: Special Rules*

Section 1.672(f)–5(b) of the proposed regulations provided that, for purposes of §1.672(f)–1, where the taxable year of a trust was different from the taxable year of a person who was taking an amount into account, the amount was taken into account for the taxable year of the person that included the last day of the taxable year of the trust. This rule was deleted from the final regulations, because it is no longer needed in light of the revisions to §1.672(f)–1, which are described above in part 3 of this explanation.

Section 1.672(f)–5(c) of the proposed regulations provided that, for purposes of §1.672(f)–4, a wholly owned business entity must be treated as a corporation, separate from its single owner. Absent this rule, an entity having a single owner could avoid the purported gift rule by electing to be disregarded, with the result that the purported gift would be received from the owner of the entity, rather than from the entity itself. The final regulations clarify that this special rule (renumbered as §1.672(f)–5(b)) applies solely for purposes of §1.672(f)–4. Thus, it does not apply for purposes of §§1.672(f)–1 through 1.672(f)–3 or §1.672(f)–5 or for purposes of any other provision of the Code or regulations.

Section 301.7701–2(c)(2)(iii) of the proposed regulations provided that, solely for purposes of applying the rules of section 672(f)(4), a wholly owned business entity will be treated as a corporation, separate from its owner. This provision, which repeated the rule in §1.672(f)–5(c) (renumbered as §1.672(f)–5(b)), is not included in the final regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on the regulation's impact on small business.

Drafting Information

The principal authors of these regulations are M. Grace Fleeman of the Office of Associate Chief Counsel (International) and James A. Quinn of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.643(h)–1 also issued under 26 U.S.C. 643(a)(7).

Section 1.671–2T also issued under 26 U.S.C. 643(a)(7) and 672(f)(6).

Section 1.672(f)–1 also issued under 26 U.S.C. 643(a)(7) and 672(f)(6).

Section 1.672(f)–2 also issued under 26 U.S.C. 643(a)(7) and 672(f)(3) and (6).

Section 1.672(f)–3 also issued under 26 U.S.C. 643(a)(7) and 672(f)(2) and (6).

Section 1.672(f)–4 also issued under 26 U.S.C. 643(a)(7) and 672(f)(4) and (6).

Section 1.672(f)–5 also issued under 26 U.S.C. 643(a)(7) and 672(f)(6). * * *

Par. 2. Section 1.643(h)–1 is added to read as follows:

§1.643(h)–1 Distributions by certain foreign trusts through intermediaries.

(a) *In general*—(1) *Principal purpose of tax avoidance.* Except as provided in paragraph (b) of this section, for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, and section 6048, any property (within the meaning of paragraph (f) of this section) that is transferred to a United States person by another person (an intermediary) who has received property from a foreign trust will be treated as property transferred directly by the foreign trust to the United States person if the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist.* For purposes of paragraph (a)(1) of this section, a transfer will be deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if the United States person–

(i) Is related (within the meaning of paragraph (e) of this section) to a grantor of the foreign trust, or has another rela-

tionship with a grantor of the foreign trust that establishes a reasonable basis for concluding that the grantor of the foreign trust would make a gratuitous transfer (within the meaning of §1.671–2T(e)(2)) to the United States person;

(ii) Receives from the intermediary, within the period beginning twenty-four months before and ending twenty-four months after the intermediary's receipt of property from the foreign trust, either the property the intermediary received from the foreign trust, proceeds from such property, or property in substitution for such property; and

(iii) Cannot demonstrate to the satisfaction of the Commissioner that—

(A) The intermediary has a relationship with the United States person that establishes a reasonable basis for concluding that the intermediary would make a gratuitous transfer to the United States person;

(B) The intermediary acted independently of the grantor and the trustee of the foreign trust;

(C) The intermediary is not an agent of the United States person under generally applicable United States agency principles; and

(D) The United States person timely complied with the reporting requirements of section 6039F, if applicable, if the intermediary is a foreign person.

(b) *Exceptions*—(1) *Nongratuitous transfers.* Paragraph (a) of this section does not apply to the extent that either the transfer from the foreign trust to the intermediary or the transfer from the intermediary to the United States person is a transfer that is not a gratuitous transfer within the meaning of §1.671–2T(e)(2).

(2) *Grantor as intermediary.* Paragraph (a) of this section does not apply if the intermediary is the grantor of the portion of the trust from which the property that is transferred is derived. For the definition of grantor, see §1.671–2T(e).

(c) *Effect of disregarding intermediary*—(1) *General rule.* Except as provided in paragraph (c)(2) of this section, the intermediary is treated as an agent of the foreign trust, and the property is treated as transferred to the United States person in the year the property is transferred, or made available, by the intermediary to the United States person. The fair market value of the property transferred is determined as of the date of the transfer by the intermediary to the United States person. For purposes of section 665(d)(2), the term taxes imposed on the trust includes any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on the intermediary with respect to the property transferred.

(2) *Exception.* If the Commissioner determines, or if the taxpayer can demonstrate to the satisfaction of the Commissioner, that the intermediary is an agent of the United States person under generally applicable United States agency principles, the property will be treated as transferred to the United States person in the year the intermediary receives the property from the foreign trust. The fair market value of the property transferred will be determined as of the date of the transfer by the foreign trust to the intermediary. For purposes of section 901(b), any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on the intermediary with respect to the property transferred will be treated as having been imposed on the United States person.

(3) *Computation of gross income of intermediary.* If property is treated as transferred directly by the foreign trust to a United States person pursuant to this section, the fair market value of such property is not taken into account in computing the gross income of the intermediary (if otherwise required to be taken into account by the intermediary but for paragraph (a) of this section).

(d) *Transfers not in excess of $10,000.* This section does not apply if, during the taxable year of the United States person, the aggregate fair market value of all property transferred to such person from all foreign trusts either directly or through one or more intermediaries does not exceed $10,000.

(e) *Related parties.* For purposes of this section, a United States person is treated as related to a grantor of a foreign trust if the United States person and the grantor are related for purposes of section 643(i)(2)(B), with the following modifications–

(1) For purposes of applying section 267 (other than section 267(f)) and section 707(b)(1), "at least 10 percent" is used instead of "more than 50 percent" each place it appears; and

(2) The principles of section 267(b)(10), using "at least 10 percent" instead of "more than 50 percent," apply to determine whether two corporations are related.

(f) *Definition of property.* For purposes of this section, the term *property* includes cash.

(g) *Examples.* The following examples illustrate the rules of this section. In each example, FT is an irrevocable foreign trust that is not treated as owned by any other person and the fair market value of the property that is transferred exceeds $10,000. The examples are as follows:

Example 1. Principal purpose of tax avoidance. FT was created in 1980 by A, a nonresident alien, for the benefit of his children and their descendants. FT's trustee, T, determines that 1000X of accumulated income should be distributed to A's granddaughter, B, who is a resident alien. Pursuant to a plan with a principal purpose of avoiding the interest charge that would be imposed by section 668, T causes FT to make a gratuitous transfer (within the meaning of §1.671–2T(e)(2)) of 1000X to I, a foreign person. I subsequently makes a gratuitous transfer of 1000X to B. Under paragraph (a)(1) of this section, FT is deemed to have made an accumulation distribution of 1000X directly to B.

Example 2. United States person unable to demonstrate that intermediary acted independently. GM and her daughter, M, are both nonresident aliens. M's daughter, D, is a resident alien. GM creates and funds FT for the benefit of her children. On July 1, 2001, FT makes a gratuitous transfer of XYZ stock to M. M immediately sells the XYZ stock and uses the proceeds to purchase ABC stock. On January 1, 2002, M makes a gratuitous transfer of the ABC stock to D. D is unable to demonstrate that M acted independently of GM and the trustee of FT in making the transfer to D. Under paragraph (a)(2) of this section, FT is deemed to have distributed the ABC stock to D. Under paragraph (c)(1) of this section, M is treated as an agent of FT, and the distribution is deemed to have been made on January 1, 2002.

Example 3. United States person demonstrates that specified conditions are satisfied. Assume the same facts as in Example 2, except that M receives 1000X cash from FT instead of XYZ stock. M gives 1000X cash to D on January 1, 2002. Also assume that M receives annual income of 5000X from her own investments and that M has given D 1000X at the beginning of each year for the past ten years. Based on this and additional information provided by D, D demonstrates to the satisfaction of the Commissioner that M has a relationship with D that establishes a reasonable basis for concluding that M would make a gratuitous transfer to D, that M acted independently of GM and the trustee of FT, that M is not an agent of D under generally applicable United States agency principles, and that D timely complied with the reporting requirements of section 6039F. FT will not be deemed under paragraph (a)(2) of this section to have made a distribution to D.

Example 4. Transfer to United States person less than 24 months before transfer to intermediary.

Several years ago, A, a nonresident alien, created and funded FT for the benefit of his children and their descendants. A has a close friend, C, who also is a nonresident alien. A's granddaughter, B, is a resident alien. On December 31, 2001, C makes a gratuitous transfer of 1000X to B. On January 15, 2002, FT makes a gratuitous transfer of 1000X to C. B is unable to demonstrate that C has a relationship with B that would establish a reasonable basis for concluding that C would make a gratuitous transfer to B or that C acted independently of A and the trustee of FT in making the transfer to B. Under paragraph (a)(2) of this section, FT is deemed to have distributed 1000X directly to B. Under paragraph (c)(1) of this section, C is treated as an agent of FT, and the distribution is deemed to have been made on December 31, 2001.

Example 5. United States person receives property in substitution for property transferred to intermediary. GM and her son, S, are both nonresident aliens. S's daughter, GD, is a resident alien. GM creates and funds FT for the benefit of her children and their descendants. On July 1, 2001, FT makes a gratuitous transfer of ABC stock with a fair market value of approximately 1000X to S. On January 1, 2002, S makes a gratuitous transfer of DEF stock with a fair market value of approximately 1000X to GD. GD is unable to demonstrate that S acted independently of GM and the trustee of FT in transferring the DEF stock to GD. Under paragraph (a)(2) of this section, FT is deemed to have distributed the DEF stock to GD. Under paragraph (c)(1) of this section, S is treated as an agent of FT, and the distribution is deemed to have been made on January 1, 2002.

Example 6. United States person receives indirect loan from foreign trust. Several years ago, A, a nonresident alien, created and funded FT for the benefit of her children and their descendants. A's daughter, B, is a resident alien. B needs funds temporarily while she is starting up her own business. If FT were to loan money directly to B, section 643(i) would apply. FT deposits 500X with FB, a foreign bank, on June 30, 2001. On July 1, 2001, FB loans 400X to B. Repayment of the loan is guaranteed by FT's 500X deposit. B is unable to demonstrate to the satisfaction of the Commissioner that FB has a relationship with B that establishes a reasonable basis for concluding that FB would make a loan to B or that FB acted independently of A and the trustee of FT in making the loan. Under paragraph (a)(2) of this section, FT is deemed to have loaned 400X directly to B on July 1, 2001. Under paragraph (c)(1) of this section, FB is treated as an agent of FT. For the treatment of loans from foreign trusts, see section 643(i).

Example 7. United States person demonstrates that specified conditions are satisfied. GM, a nonresident alien, created and funded FT for the benefit of her children and their descendants. One of GM's children is M, who is a resident alien. During the year 2001, FT makes a gratuitous transfer of 500X to M. M reports the 500X on Form 3520 as a distribution received from a foreign trust. During the year 2002, M makes a gratuitous transfer of 400X to her son, S, who also is a resident alien. M files a Form 709 treating the gratuitous transfer to S as a gift. Based on this and additional information provided by S, S demonstrates to the satisfaction of the Commissioner that M has a relationship with S that establishes a reasonable basis for concluding that M would make a gratuitous transfer to S, that M acted independently of GM and the trustee of FT, and that M is not an agent of S under generally applicable United States agency principles. FT will not be deemed under paragraph (a)(2) of this section to have made a distribution to S.

Example 8. Intermediary as agent of trust; increase in FMV. A, a nonresident alien, created and funded FT for the benefit of his children and their descendants. On December 1, 2001, FT makes a gratuitous transfer of XYZ stock with a fair market value of 85X to B, a nonresident alien. On November 1, 2002, B sells the XYZ stock to a third party in an arm's length transaction for 100X in cash. On November 1, 2002, B makes a gratuitous transfer of 98X to A's grandson, C, a resident alien. C is unable to demonstrate to the satisfaction of the Commissioner that B acted independently of A and the trustee of FT in making the transfer. Under paragraph (a)(2) of this section, FT is deemed to have made a distribution directly to C. Under paragraph (c)(1) of this section, B is treated as an agent of FT, and FT is deemed to have distributed 98X to C on November 1, 2002.

Example 9. Intermediary as agent of United States person; increase in FMV. Assume the same facts as in Example 8, except that the Commissioner determines that B is an agent of C under generally applicable United States agency principles. Under paragraph (c)(2) of this section, FT is deemed to have distributed 85X to C on December 1, 2001. C must take the gain of 15X into account in the year 2002.

Example 10. Intermediary as agent of trust; decrease in FMV. Assume the same facts as in Example 8, except that the value of the XYZ stock on November 1, 2002, is only 80X. Instead of selling the XYZ stock to a third party and transferring cash to C, B transfers the XYZ stock to C in a gratuitous transfer. Under paragraph (c)(1) of this section, FT is deemed to have distributed XYZ stock with a value of 80X to C on November 1, 2002.

Example 11. Intermediary as agent of United States person; decrease in FMV. Assume the same facts as in Example 10, except that the Commissioner determines that B is an agent of C under generally applicable United States agency principles. Under paragraph (c)(2) of this section, FT is deemed to have distributed XYZ stock with a value of 85X to C on December 1, 2001.

(h) *Effective date.* The rules of this section are applicable to transfers made to United States persons after August 10, 1999.

Par. 3. In §1.671–2, paragraph (e) is revised to read as follows:

§1.671–2 Applicable principles.

* * * * *

(e) [Reserved] For further guidance, see §1.671–2T(e).

Par. 4. Section 1.671–2T is added to read as follows:

§1.671–2T Applicable principles (temporary).

(a) through (d) [Reserved] For further guidance, see §1.671–2(a) through (d).

(e)(1) For purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of paragraph (e)(2) of this section) of property to a trust. For purposes of this section, the term *property* includes cash. If a person creates or funds a trust on behalf of another person, both persons are treated as grantors of the trust. (See section 6048 for reporting requirements that apply to grantors of foreign trusts.) However, a person who creates a trust but makes no gratuitous transfers to the trust is not treated as an owner of any portion of the trust under sections 671 through 677 or 679. Also, a person who funds a trust with an amount that is directly reimbursed to such person within a reasonable period of time and who makes no other transfers to the trust that constitute gratuitous transfers is not treated as an owner of any portion of the trust under sections 671 through 677 or 679. See also §1.672(f)–5(a).

(2)(i) A gratuitous transfer is any transfer other than a transfer for fair market value. A transfer of property to a trust may be considered a gratuitous transfer without regard to whether the transfer is treated as a gift for gift tax purposes.

(ii) For purposes of this paragraph (e), a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust. For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the property of, or for the services rendered by, the trust. For purposes of this determination, an interest in the trust is not property received from the trust. In addition, a person will not be treated as making a transfer for fair market value merely because the transferor recognizes gain on the transaction. See, for example, section 684 regarding the recognition of gain on certain transfers to foreign trusts.

(iii) For purposes of this paragraph (e), a gratuitous transfer does not include a distribution to a trust with respect to an interest held by such trust in either a trust described in paragraph (e)(3) of this section or an entity other than a trust. For example, a distribution to a trust by a corporation with respect to its stock described in section 301 is not a gratuitous transfer.

(3) A grantor includes any person who acquires an interest in a trust from a grantor of the trust if the interest acquired is an interest in certain investment trusts described in §301.7701–4(c) of this chapter, liquidating trusts described in §301.7701-4(d) of this chapter, or environmental remediation trusts described in §301.7701–4(e) of this chapter.

(4) If a gratuitous transfer is made by a partnership or corporation to a trust and is for a business purpose of the partnership or corporation, the partnership or corporation will generally be treated as the grantor of the trust. For example, if a partnership makes a gratuitous transfer to a trust in order to secure a legal obligation of the partnership to a third party unrelated to the partnership, the partnership will be treated as the grantor of the trust. However, if a partnership or a corporation makes a gratuitous transfer to a trust that is not for a business purpose of the partnership or corporation but is, e.g., for the personal purposes of one or more of the partners or shareholders, the gratuitous transfer will be treated as a constructive distribution to such partners or shareholders under federal tax principles and the partners or the shareholders will be treated as the grantors of the trust. For example, if a partnership makes a gratuitous transfer to a trust that is for the benefit of a child of a partner, the gratuitous transfer will be treated as a distribution to the partner under section 731 and a subsequent gratuitous transfer by the partner to the trust.

(5) If a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust. However, if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, then such person will be treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust under subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code.

(6) The following examples illustrate the rules of this paragraph (e). Unless otherwise indicated, all trusts are domestic trusts and all other persons are United States persons. The examples are as follows:

Example 1. A creates and funds a trust, T, for the benefit of her children. B subsequently makes a gratuitous transfer to T. Under paragraph (e)(1) of this section, both A and B are grantors of T.

Example 2. A makes an investment in a fixed investment trust, T, that is classified as a trust under §301.7701–4(c)(1) of this chapter. A is a grantor of T. B subsequently acquires A's entire interest in T. Under paragraph (e)(3) of this section, B is a grantor of T with respect to such interest.

Example 3. A, an attorney, creates a foreign trust, FT, on behalf of A's client, B, and transfers $100 to FT out of A's funds. A is reimbursed by B for the $100 transferred to FT. The trust instrument states that the trustee has discretion to distribute the income or corpus of FT to B, and B's children. Both A and B are treated as grantors of FT under paragraph (e)(1) of this section. In addition, B is treated as the owner of the entire trust under section 677. Because A is reimbursed for the $100 transferred to FT on behalf of B, A is not treated as transferring any property to FT. Therefore, A is not an owner of any portion of T under sections 671 through 677 regardless of whether A retained any power over or interest in T described in sections 673 through 677. A also is not treated as an owner of any portion of T under section 679. Both A and B are responsible parties for purposes of the reporting requirements in section 6048.

Example 4. A creates and funds a trust, T. A is not treated as an owner of any portion of the trust under subpart E. B holds an unrestricted power, exercisable solely by B, to withdraw certain amounts contributed to the trust before the end of the calendar year and to vest those amounts in B. B is treated as an owner of the portion of T that is subject to the withdrawal power under section 678(a)(1). However, B is not a grantor of T under paragraph (e)(1) of this section because B neither created T nor made a gratuitous transfer to T.

Example 5. A transfers cash to a trust, T, through a broker, in exchange for units in T. The units in T are not property for purposes of determining whether A has received fair market value under paragraph (e)(2)(ii) of this section. Therefore, A has made a gratuitous transfer to T, and, under paragraph (e)(1) of this section, A is a grantor of T.

Example 6. A borrows cash from T, a trust. A has not made any gratuitous transfers to T. Arm's length interest payments by A to T will not be treated as gratuitous transfers under paragraph (e)(2)(ii) of this section. Therefore, under paragraph (e)(1) of this section, A is not a grantor of T with respect to the interest payments.

Example 7. A, B's brother, creates a trust, T, for B's benefit and contributes $50,000 to T. The trustee invests the $50,000 in stock of Company X. C, B's uncle, sells property with a fair market value of $1,000,000 to T in exchange for the stock when it has appreciated to a fair market value of $100,000. Under paragraph (e)(2)(ii) of this section, the $900,000 excess value is a gratuitous transfer by C. Therefore, under paragraph (e)(1) of this section, A is a grantor with respect to the portion of the trust valued at $100,000, and C is a grantor of T with respect to the portion of the trust valued at $900,000. In addition, A or C or both will be treated as the owners of the respective portions of the trust of which each person is a grantor if A or C or both retain powers over or interests in such portions under sections 673 through 677.

Example 8. G creates and funds a trust, T1, for the benefit of G's children and grandchildren. After G's death, under authority granted to the trustees in the trust instrument, the trustees of T1 transfer a portion of the assets of T1 to another trust, T2, and retain a power to revoke T2 and revest the assets of T2 in T1. Under paragraphs (e)(1) and (5) of this section, G is the grantor of T1 and T2. In addition, because the trustees of T1 have retained a power to revest the assets of T2 in T1, T1 is treated as the owner of T2 under section 678(a).

Example 9. G creates and funds a trust, T1, for the benefit of B. G retains a power to revest the assets of T1 in G within the meaning of section 676. Under the trust agreement, B is given a general power of appointment over the assets of T1. B exercises the general power of appointment with respect to one-half of the corpus of T1 in favor of a trust, T2, that is for the benefit of C, B's child. Under paragraph (e)(1) of this section, G is the grantor of T1, and under paragraphs (e)(1) and (5) of this section, B is the grantor of T2.

(7) The rules of this section are applicable to any transfer to a trust, or transfer of an interest in a trust, on or after August 10, 1999. In accordance with section 7805(e)(2), the rules of this section will expire before August 12, 2002.

Par. 5. Sections 1.672(f)–1, 1.672(f)–2, 1.672(f)–3, 1.672(f)–4, and 1.672(f)–5 are added to read as follows:

§1.672(f)–1 Foreign persons not treated as owners.

(a) *General rule*—(1) *Application of the general rule.* Section 672(f)(1) provides that subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code (the grantor trust rules) shall apply only to the extent such application results in an amount (if any) being currently taken into account (directly or through one or more entities) in computing the income of a citizen or resident of the United States or a domestic corporation. Accordingly, the grantor trust rules apply to the extent that any portion of the trust, upon application of the grantor trust rules without regard to section 672(f), is treated as owned by a United States citizen or resident or do-

mestic corporation. The grantor trust rules do not apply to any portion of the trust to the extent that, upon application of the grantor trust rules without regard to section 672(f), that portion is treated as owned by a person other than a United States citizen or resident or domestic corporation, unless the person is described in §1.672(f)–2(a) (relating to certain foreign corporations treated as domestic corporations), or one of the exceptions set forth in §1.672(f)–3 is met, (relating to: trusts where the grantor can revest trust assets; trusts where the only amounts distributable are to the grantor or the grantor's spouse; and compensatory trusts). Section 672(f) applies to domestic and foreign trusts. Any portion of the trust that is not treated as owned by a grantor or another person is subject to the rules of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code.

(2) *Determination of portion based on application of the grantor trust rules.* The determination of the portion of a trust treated as owned by the grantor or other person is to be made based on the terms of the trust and the application of the grantor trust rules and section 671 and the regulations thereunder.

(b) *Example.* The following example illustrates the rules of this section:

Example. (i) A, a nonresident alien, funds an irrevocable domestic trust, DT, for the benefit of his son, B, who is a United States citizen, with stock of Corporation X. A's brother, C, who also is a United States citizen, contributes stock of Corporation Y to the trust for the benefit of B. A has a reversionary interest within the meaning of section 673 in the X stock that would cause A to be treated as the owner of the X stock upon application of the grantor trust rules without regard to section 672(f). C has a reversionary interest within the meaning of section 673 in the Y stock that would cause C to be treated as the owner of the Y stock upon application of the grantor trust rules without regard to section 672(f). The trustee has discretion to accumulate or currently distribute income of DT to B.

(ii) Because A is a nonresident alien, application of the grantor trust rules without regard to section 672(f) would not result in the portion of the trust consisting of the X stock being treated as owned by a United States citizen or resident. None of the exceptions in §1.672(f)–3 applies because A cannot revest the X stock in A, amounts may be distributed during A's lifetime to B, who is neither a grantor nor a spouse of a grantor, and the trust is not a compensatory trust. Therefore, pursuant to paragraph (a)(1) of this section, A is not treated as an owner under subpart E of part I, subchapter J, chapter 1 of the Internal Revenue Code, of the portion of the trust consisting of the X stock. Any distributions from such portion of the trust are subject to the rules of subparts A through D (641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code.

(iii) Because C is a United States citizen, paragraph (a)(1) of this section does not prevent C from being treated under section 673 as the owner of the portion of the trust consisting of the Y stock.

(c) *Effective date.* The rules of this section are applicable to taxable years of a trust beginning after August 10, 1999.

§1.672(f)–2 Certain foreign corporations.

(a) *Application of general rule.* Subject to the provisions of paragraph (b) of this section, if the owner of any portion of a trust upon application of the grantor trust rules without regard to section 672(f) is a controlled foreign corporation (as defined in section 957), a passive foreign investment company (as defined in section 1297), or a foreign personal holding company (as defined in section 552), the corporation will be treated as a domestic corporation for purposes of applying the rules of §1.672(f)–1.

(b) *Gratuitous transfers to United States persons*—(1) *Transfer from trust to which corporation made a gratuitous transfer.* If a trust (or portion of a trust) to which a controlled foreign corporation, passive foreign investment company, or foreign personal holding company has made a gratuitous transfer (within the meaning of §1.671–2T(e)(2)), makes a gratuitous transfer to a United States person, the controlled foreign corporation, passive foreign investment company, or foreign personal holding company, as the case may be, is treated as a foreign corporation for purposes of §1.672(f)–4(c), relating to gratuitous transfers from trusts (or portions of trusts) to which a partnership or foreign corporation has made a gratuitous transfer.

(2) *Transfer from trust over which corporation has a section 678 power.* If a trust (or portion of a trust) that a controlled foreign corporation, passive foreign investment company, or foreign personal holding company is treated as owning under section 678 makes a gratuitous transfer to a United States person, the controlled foreign corporation, passive foreign investment company, or foreign personal holding company, as the case may be, is treated as a foreign corporation that had made a gratuitous transfer to the trust (or portion of a trust) and the rules of §1.672(f)–4(c) apply.

(c) *Special rules for passive foreign investment companies*—(1) *Application of section 1297.* For purposes of determining whether a foreign corporation is a passive foreign investment company as defined in section 1297, the grantor trust rules apply as if section 672(f) had not come into effect.

(2) *References to renumbered Internal Revenue Code section.* For taxable years of shareholders beginning on or before December 31, 1997, and taxable years of passive foreign investment companies ending with or within such taxable years of the shareholders, all references in this §1.672(f)–2 to section 1297 are deemed to be references to section 1296.

(d) *Examples.* The following examples illustrate the rules of this section. In each example, FT is an irrevocable foreign trust, and CFC is a controlled foreign corporation. The examples are as follows:

Example 1. Application of general rule. CFC creates and funds FT. CFC is the grantor of FT within the meaning of §1.671–2T(e). CFC has a reversionary interest in FT within the meaning of section 673 that would cause CFC to be treated as the owner of FT upon application of the grantor trust rules without regard to section 672(f). Under paragraph (a) of this section, CFC is treated as a domestic corporation for purposes of applying the general rule of §1.672(f)–1. Thus, §1.672(f)–1 does not prevent CFC from being treated as the owner of FT under section 673.

Example 2. Distribution from trust to which CFC made gratuitous transfer. A, a nonresident alien, owns 40 percent of the stock of CFC. A's brother B, a resident alien, owns the other 60 percent of the stock of CFC. CFC makes a gratuitous transfer to FT. FT makes a gratuitous transfer to A's daughter, C, who is a resident alien. Under paragraph (b)(1) of this section, CFC will be treated as a foreign corporation for purposes of §1.672(f)–4(c). For further guidance, see §1.672(f)–4(g) *Example 2* through *Example 4.*

(e) *Effective date.* The rules of this section are generally applicable to taxable years of shareholders of controlled foreign corporations, passive foreign investment companies, and foreign personal holding companies beginning after August 10, 1999, and taxable years of controlled foreign corporations, passive foreign investment companies, and foreign personal holding companies ending with or within such taxable years of the shareholders.

§1.672(f)–3 Exceptions to general rule.

(a) *Certain revocable trusts*—(1) *In general.* Subject to the provisions of paragraph (a)(2) of this section, the general rule of §1.672(f)–1 does not apply to any portion of a trust for a taxable year of the trust if the power to revest absolutely in the grantor title to such portion is exercisable solely by the grantor (or, in the event of the grantor's incapacity, by a guardian or other person who has unrestricted authority to exercise such power on the grantor's behalf) without the approval or consent of any other person. If the grantor can exercise such power only with the approval of a related or subordinate party who is subservient to the grantor, such power is treated as exercisable solely by the grantor. For the definition of *grantor*, see §1.671–2T(e). For the definition of *related or subordinate party*, see §1.672(c)–1. For purposes of this paragraph (a), a related or subordinate party is subservient to the grantor unless the presumption in the last sentence of §1.672(c)–1 is rebutted by a preponderance of the evidence. A trust (or portion of a trust) that fails to qualify for the exception provided by this paragraph (a) for a particular taxable year of the trust will be subject to the general rule of §1.672(f)–1 for that taxable year and all subsequent taxable years of the trust.

(2) *183-day rule.* For purposes of paragraph (a)(1) of this section, the grantor is treated as having a power to revest for a taxable year of the trust only if the grantor has such power for a total of 183 or more days during the taxable year of the trust. If the first or last taxable year of the trust (including the year of the grantor's death) is less than 183 days, the grantor is treated as having a power to revest for purposes of paragraph (a)(1) of this section if the grantor has such power for each day of the first or last taxable year, as the case may be.

(3) *Grandfather rule for certain revocable trusts in existence on September 19, 1995.* Subject to the rules of paragraph (d) of this section (relating to separate accounting for gratuitous transfers to the trust after September 19, 1995), the general rule of §1.672(f)–1 does not apply to any portion of a trust that was treated as owned by the grantor under section 676 on September 19, 1995, as long as the trust would continue to be so treated thereafter. However, the preceding sentence does not apply to any portion of the trust attributable to gratuitous transfers to the trust after September 19, 1995.

(4) *Examples.* The following examples illustrate the rules of this paragraph (a):

Example 1. Grantor is owner. FP1, a foreign person, creates and funds a revocable trust, T, for the benefit of FP1's children, who are resident aliens. The trustee is a foreign bank, FB, that is owned and controlled by FP1 and FP2, who is FP1's brother. The power to revoke T and revest absolutely in FP1 title to the trust property is exercisable by FP1, but only with the approval or consent of FB. The trust instrument contains no standard that FB must apply in determining whether to approve or consent to the revocation of T. There are no facts that would suggest that FB is not subservient to FP1. Therefore, the exception in paragraph (a)(1) of this section is applicable.

Example 2. Death of grantor. Assume the same facts as in Example 1, except that FP1 dies. After FP1's death, FP2 has the power to withdraw the assets of T, but only with the approval of FB. There are no facts that would suggest that FB is not subservient to FP2. However, the exception in paragraph (a)(1) of this section is no longer applicable, because FP2 is not a grantor of T within the meaning of §1.671–2T(e).

Example 3. Trustee is not related or subordinate party. Assume the same facts as in Example 1, except that neither FP1 nor any member of FP1's family has any substantial ownership interest or other connection with FB. FP1 can remove and replace FB at any time for any reason. Although FP1 can replace FB with a related or subordinate party if FB refuses to approve or consent to FP1's decision to revest the trust property in himself, FB is not a related or subordinate party. Therefore, the exception in paragraph (a)(1) of this section is not applicable.

Example 4. Unrelated trustee will consent to revocation. FP, a foreign person, creates and funds an irrevocable trust, T. The trustee is a foreign bank, FB, that is not a related or subordinate party within the meaning of §1.672(c)-1. FB has the discretion to distribute trust income or corpus to beneficiaries of T, including FP. Even if FB would in fact distribute all the trust property to FP if requested to do so by FP, the exception in paragraph (a)(1) of this section is not applicable, because FP does not have the power to revoke T.

(b) *Certain trusts that can distribute only to the grantor or the spouse of the grantor*—(1) *In general.* The general rule of §1.672(f)–1 does not apply to any trust (or portion of a trust) if at all times during the lifetime of the grantor the only amounts distributable (whether income or corpus) from such trust (or portion thereof) are amounts distributable to the grantor or the spouse of the grantor. For purposes of this paragraph (b), payments of amounts that are not gratuitous transfers (within the meaning of §1.671–2T(e)(2)) are not amounts distributable. For the definition of grantor, see §1.671–2T(e).

(2) *Amounts distributable in discharge of legal obligations*—(i) *In general.* A trust (or portion of a trust) does not fail to satisfy paragraph (b)(1) of this section solely because amounts are distributable from the trust (or portion thereof) in discharge of a legal obligation of the grantor or the spouse of the grantor. Subject to the provisions of paragraph (b)(2)(ii) of this section, an obligation is considered a legal obligation for purposes of this paragraph (b)(2)(i) if it is enforceable under the local law of the jurisdiction in which the grantor (or the spouse of the grantor) resides.

(ii) *Related parties*—(A) *In general.* Except as provided in paragraph (b)(2)-(ii)(B) of this section, an obligation to a person who is a related person for purposes of §1.643(h)–1(e) (other than an individual who is legally separated from the grantor under a decree of divorce or of separate maintenance) is not a legal obligation for purposes of paragraph (b)(2)(i) of this section unless it was contracted bona fide and for adequate and full consideration in money or money's worth (see §20.2043–1 of this chapter).

(B) *Exceptions*—(1) *Amounts distributable in support of certain individuals.* Paragraph (b)(2)(ii)(A) of this section does not apply with respect to amounts that are distributable from the trust (or portion thereof) to support an individual who—

(*i*) Would be treated as a dependent of the grantor or the spouse of the grantor under section 152(a)(1) through (9), without regard to the requirement that over half of the individual's support be received from the grantor or the spouse of the grantor; and

(*ii*) Is either permanently and totally disabled (within the meaning of section 22(e)(3)), or less than 19 years old.

(2) *Certain potential support obligations.* The fact that amounts might become distributable from a trust (or portion of a trust) in discharge of a potential obligation under local law to support an individual other than an individual described in paragraph (b)(2)(ii)(B)(*1*) of this section is disregarded if such potential obligation is not reasonably expected to arise under the facts and circumstances.

(3) *Reinsurance trusts.* [Reserved]

(3) *Grandfather rule for certain section 677 trusts in existence on September 19, 1995.* Subject to the rules of paragraph (d) of this section (relating to separate accounting for gratuitous transfers to the trust after September 19, 1995), the general rule of §1.672(f)–1 does not apply to any portion of a trust that was treated as owned by the grantor under section 677 (other than section 677(a)(3)) on September 19, 1995, as long as the trust would continue to be so treated thereafter. However, the preceding sentence does not apply to any portion of the trust attributable to gratuitous transfers to the trust after September 19, 1995.

(4) *Examples.* The following examples illustrate the rules of this paragraph (b):

Example 1. Amounts distributable only to grantor or grantor's spouse. H and his wife, W, are both nonresident aliens. H is 70 years old, and W is 65. H and W have a 30-year-old child, C, a resident alien. There is no reasonable expectation that H or W will ever have an obligation under local law to support C or any other individual. H creates and funds an irrevocable trust, FT, using only his separate property. H is the grantor of FT within the meaning of §1.671–2T(e). Under the terms of FT, the only amounts distributable (whether income or corpus) from FT as long as either H or W is alive are amounts distributable to H or W. Upon the death of both H and W, C may receive distributions from FT. During H's lifetime, the exception in paragraph (b)(1) of this section is applicable.

Example 2. Effect of grantor's death. Assume the same facts as in *Example 1.* H predeceases W. Assume that W would be treated as owning FT under section 678 if the grantor trust rules were applied without regard to section 672(f). The exception in paragraph (b)(1) of this section is no longer applicable, because W is not a grantor of FT within the meaning of §1.671–2T(e).

Example 3. Amounts temporarily distributable to person other than grantor or grantor's spouse. Assume the same facts as in *Example 1,* except that C (age 30) is a law student at the time FT is created and the trust instrument provides that, as long as C is in law school, amounts may be distributed from FT to pay C's expenses. Thereafter, the only amounts distributable from FT as long as either H or W is alive will be amounts distributable to H or W. Even assuming there is an enforceable obligation under local law for H and W to support C while he is in school, distributions from FT in payment of C's expenses cannot qualify as distributions in discharge of a legal obligation under paragraph (b)(2) of this section, because C is neither permanently and totally disabled nor less than 19 years old. The exception in paragraph (b)(1) of this section is not applicable. After C graduates from law school, the exception in paragraph (b)(1) still will not be applicable, because amounts were distributable to C during the lifetime of H.

Example 4. Fixed investment trust. FC, a foreign corporation, invests in a domestic fixed investment trust, DT, that is classified as a trust under §301.7701–4(c)(1) of this chapter. Under the terms of DT, the only amounts that are distributable from FC's portion of DT are amounts distributable to FC. The exception in paragraph (b)(1) of this section is applicable to FC's portion of DT.

Example 5. Reinsurance trust. A domestic insurance company, DI, reinsures a portion of its business with an unrelated foreign insurance company, FI. To satisfy state regulatory requirements, FI places the premiums in an irrevocable domestic trust, DT. The trust funds are held by a United States bank and may be used only to pay claims arising out of the reinsurance policies, which are legally enforceable under the local law of the jurisdiction in which FI resides. On the termination of DT, any assets remaining will revert to FI. Because the only amounts that are distributable from DT are distributable either to FI or in discharge of FI's legal obligations within the meaning of paragraph (b)(2)(i) of this section, the exception in paragraph (b)(1) of this section is applicable.

Example 6. Trust that provides security for loan. FC, a foreign corporation, borrows money from B, an unrelated bank, to finance the purchase of an airplane. FC creates a foreign trust, FT, to hold the airplane as security for the loan from B. The only amounts that are distributable from FT while the loan is outstanding are amounts distributable to B in the event that FC defaults on its loan from B. When FC repays the loan, the trust assets will revert to FC. The loan is a legal obligation of FC within the meaning of paragraph (b)(2)(i) of this section, because it is enforceable under the local law of the country in which FC is incorporated. Paragraph (b)(2)(ii) of this section is not applicable, because B is not a related person for purposes of §1.643(h)–1(e). The exception in paragraph (b)(1) of this section is applicable.

(c) *Compensatory trusts*—(1) *In general.* The general rule of §1.672(f)–1 does not apply to any portion of—

(i) A nonexempt employees' trust described in section 402(b), including a trust created on behalf of a self-employed individual;

(ii) A trust, including a trust created on behalf of a self-employed individual, that would be a nonexempt employees' trust described in section 402(b) but for the fact that the trust's assets are not set aside from the claims of creditors of the actual or deemed transferor within the meaning of §1.83–3(e); and

(iii) Any additional category of trust that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter).

(2) *Exceptions.* The Commissioner may, in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), designate categories of compensatory trusts to which the general rule of paragraph (c)(1) of this section does not apply.

(d) *Separate accounting for gratuitous transfers to grandfathered trusts after September 19, 1995.* If a trust that was treated as owned by the grantor under section 676 or 677 (other than section 677(a)(3)) on September 19, 1995, contains both amounts held in the trust on September 19, 1995, and amounts that were gratuitously transferred to the trust after September 19, 1995, paragraphs (a)(3) and (b)(3) of this section apply only if the amounts that were gratuitously transferred to the trust after September 19, 1995, are treated as a separate portion of the trust that is accounted for under the rules of §1.671–3(a)(2). If the amounts that were gratuitously transferred to the trust after September 19, 1995 are not so accounted for, the general rule of §1.672(f)–1 applies to the entire trust. If such amounts are so accounted for, and without regard to whether there is physical separation of the assets, the general rule of §1.672(f)–1 does not apply to the portion of the trust that is attributable to amounts that were held in the trust on September 19, 1995.

(e) *Effective date.* The rules of this section are generally applicable to taxable years of a trust beginning after August 10, 1999. The initial separate accounting required by paragraph (d) of this section must be prepared by the due date (including extensions) for the tax return of the trust for the first taxable year of the trust beginning after August 10, 1999.

§1.672(f)–4 Recharacterization of purported gifts.

(a) *In general*—(1) *Purported gifts from partnerships.* Except as provided in paragraphs (b), (e), and (f) of this section, and without regard to the existence of any trust, if a United States person (United States donee) directly or indirectly receives a purported gift or bequest (as defined in paragraph (d) of this section) from a partnership, the purported gift or bequest must be included in the United States donee's gross income as ordinary income.

(2) *Purported gifts from foreign corporations.* Except as provided in paragraphs (b), (e), and (f) of this section, and without regard to the existence of any trust, if a United States donee directly or indirectly receives a purported gift or bequest (as defined in paragraph (d) of this section) from any foreign corporation, the purported gift or bequest must be included in the United States donee's gross income as if it were a distribution from the foreign corporation. If the foreign corporation is a passive foreign investment company (within the meaning of section 1297), the rules of section 1291 apply. For purposes of section 1012, the United States donee is not treated as having basis in the stock of the foreign corporation. However, for purposes of section 1223, the United States donee is treated as having a holding period in the stock of the foreign corporation on the date of the deemed distribution equal to the weighted average of the holding periods of the actual interest holders (other than any interest holders who treat the portion of the purported gift attributable to their interest in the foreign corporation in the manner described in paragraph (b)(1) of this section). For purposes of section 902, a United States donee that is a domestic corporation is not treated as owning any voting stock of the foreign corporation.

(b) *Exceptions*—(1) *Partner or shareholder treats transfer as distribution and gift.* Paragraph (a) of this section does not apply to the extent the United States donee can demonstrate to the satisfaction of the Commissioner that either—

(i) A United States citizen or resident alien individual who directly or indirectly holds an interest in the partnership or foreign corporation treated and reported the purported gift or bequest for United States tax purposes as a distribution to such individual and a subsequent gift or bequest to the United States donee; or

(ii) A nonresident alien individual who directly or indirectly holds an interest in the partnership or foreign corporation treated and reported the purported gift or bequest for purposes of the tax laws of the nonresident alien individual's country of residence as a distribution to such individual and a subsequent gift or bequest to the United States donee, and the United States donee timely complied with the reporting requirements of section 6039F, if applicable.

(2) *All beneficial owners of domestic partnership are United States citizens or residents or domestic corporations.* Paragraph (a)(1) of this section does not apply to a purported gift or bequest from a domestic partnership if the United States donee can demonstrate to the satisfaction of the Commissioner that all beneficial owners (within the meaning of §1.1441–1(c)(6)) of the partnership are United States citizens or residents or domestic corporations.

(3) *Contribution to capital of corporate United States donee.* Paragraph (a) of this section does not apply to the extent a United States donee that is a corporation can establish that the purported gift or bequest was treated for United States tax purposes as a contribution to the capital of the United States donee to which section 118 applies.

(4) *Charitable transfers.* Paragraph (a) of this section does not apply if either—

(i) The United States donee is described in section 170(c); or

(ii) The transferor has received a ruling or determination letter, which has been neither revoked nor modified, from the Internal Revenue Service recognizing its exempt status under section 501(c)(3), and the transferor made the transfer pursuant to an exempt purpose for which the transferor was created or organized. For purposes of the preceding sentence, 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.

(c) *Certain transfers from trusts to which a partnership or foreign corporation has made a gratuitous transfer*—(1) *Generally treated as distribution from partnership or foreign corporation.* Except as provided in paragraphs (c)(2) and (3) of this section, if a United States donee receives a gratuitous transfer (within the meaning of §1.671–2T(e)(2)) from a trust (or portion of a trust) to which a partnership or foreign corporation has made a gratuitous transfer, the United States donee must treat the transfer as a purported gift or bequest from the partnership or foreign corporation that is subject to the rules of paragraph (a) of this section (including the exceptions in paragraphs (b) and (f) of this section). This paragraph (c) applies without regard to who is treated as the grantor of the trust (or portion thereof) under §1.671–2T(e)(4).

(2) *Alternative rule.* Except as provided in paragraph (c)(3) of this section, if the United States tax computed under the rules of paragraphs (a) and (c)(1) of this section does not exceed the United States tax that would be due if the United States donee treated the transfer as a distribution from the trust (or portion thereof), paragraph (c)(1) of this section does not apply and the United States donee must treat the transfer as a distribution from the trust (or portion thereof) that is subject to the rules of subparts A through D (section 641 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code. For purposes of paragraph (f) of this section, the transfer is treated as a purported gift or bequest from the partnership or foreign corporation that made the gratuitous transfer to the trust (or portion thereof).

(3) *Exception.* Neither paragraph (c)(1) of this section nor paragraph (c)(2) of this section applies to the extent the United States donee can demonstrate to the satisfaction of the Commissioner that the transfer represents an amount that is, or has been, taken into account for United States tax purposes by a United States citizen or resident or a domestic corporation. A transfer will be deemed to be made first out of amounts that have not been taken into account for United States tax purposes by a United States citizen or resident or a domestic corporation, unless the United States donee can demonstrate to the satisfaction of the Commissioner that another ordering rule is more appropriate.

(d) *Definition of purported gift or bequest*—(1) *In general.* Subject to the provisions of paragraphs (d)(2) and (3) of this section, *a purported gift or bequest* for purposes of this section is any transfer of property by a partnership or foreign corporation other than a transfer for fair market value (within the meaning of §1.671–2T(e)(2)(ii)) to a person who is not a partner in the partnership or a shareholder of the foreign corporation (or to a person who is a partner in the partnership or a shareholder of a foreign corporation, if the amount transferred is inconsistent with the partner's interest in the partnership or the shareholder's interest in the

corporation, as the case may be). For purposes of this section, the term *property* includes cash.

(2) *Transfers for less than fair market value*—(i) *Excess treated as purported gift or bequest.* Except as provided in paragraph (d)(2)(ii) of this section, if a transfer described in paragraph (d)(1) of this section is for less than fair market value, the excess of the fair market value of the property transferred over the value of the property received, services rendered, or the right to use property is treated as a purported gift or bequest.

(ii) *Exception for transfers to unrelated parties.* No portion of a transfer described in paragraph (d)(1) of this section will be treated as a purported gift or bequest for purposes of this section if the United States donee can demonstrate to the satisfaction of the Commissioner that the United States donee is not related to a partner or shareholder of the transferor within the meaning of §1.643(h)–1(e) or does not have another relationship with a partner or shareholder of the transferor that establishes a reasonable basis for concluding that the transferor would make a gratuitous transfer to the United States donee.

(e) *Prohibition against affirmative use of recharacterization by taxpayers.* A taxpayer may not use the rules of this section if a principal purpose for using such rules is the avoidance of any tax imposed by the Internal Revenue Code. Thus, with respect to such taxpayer, the Commissioner may depart from the rules of this section and recharacterize (for all purposes of the Internal Revenue Code) the transfer in accordance with its form or its economic substance.

(f) *Transfers not in excess of $10,000.* This section does not apply if, during the taxable year of the United States donee, the aggregate amount of purported gifts or bequests that is transferred to such United States donee directly or indirectly from all partnerships or foreign corporations that are related (within the meaning of section 643(i)) does not exceed $10,000. The aggregate amount must include gifts or bequests from persons that the United States donee knows or has reason to know are related to the partnership or foreign corporation (within the meaning of section 643(i)).

(g) *Examples.* The following examples illustrate the rules of this section. In each example, the amount that is transferred exceeds $10,000. The examples are as follows:

Example 1. Distribution from foreign corporation. FC is a foreign corporation that is wholly owned by A, a nonresident alien who is resident in Country C. FC makes a gratuitous transfer of property directly to A's daughter, B, who is a resident alien. Under paragraph (a)(2) of this section, B generally must treat the transfer as a dividend from FC to the extent of FC's earnings and profits and as an amount received in excess of basis thereafter. If FC is a passive foreign investment company, B must treat the amount received as a distribution under section 1291. B will be treated as having the same holding period as A. However, under paragraph (b)(1)(ii) of this section, if B can establish to the satisfaction of the Commissioner that, for purposes of the tax laws of Country C, A treated (and reported, if applicable) the transfer as a distribution to himself and a subsequent gift to B, B may treat the transfer as a gift (provided B timely complied with the reporting requirements of section 6039F, if applicable).

Example 2. Distribution of corpus from trust to which foreign corporation made gratuitous transfer. FC is a foreign corporation that is wholly owned by A, a nonresident alien who is resident in Country C. FC makes a gratuitous transfer to a foreign trust, FT, that has no other assets. FT immediately makes a gratuitous transfer in the same amount to A's daughter, B, who is a resident alien. Under paragraph (c)(1) of this section, B must treat the transfer as a transfer from FC that is subject to the rules of paragraph (a)(2) of this section. Under paragraph (a)(2) of this section, B must treat the transfer as a dividend from FC unless she can establish to the satisfaction of the Commissioner that, for purposes of the tax laws of Country C, A treated (and reported, if applicable) the transfer as a distribution to himself and a subsequent gift to B and that B timely complied with the reporting requirements of section 6039F, if applicable. The alternative rule in paragraph (c)(2) of this section would not apply as long as the United States tax computed under the rules of paragraph (a)(2) of this section is equal to or greater than the United States tax that would be due if the transfer were treated as a distribution from FT.

Example 3. Accumulation distribution from trust to which foreign corporation made gratuitous transfer. FC is a foreign corporation that is wholly owned by A, a nonresident alien. FC is not a passive foreign investment company (as defined in section 1297). FC makes a gratuitous transfer of 100X to a foreign trust, FT, on January 1, 2001. FT has no other assets on January 1, 2001. Several years later, FT makes a gratuitous transfer of 1000X to A's daughter, B, who is a United States resident. Assume that the section 668 interest charge on accumulation distributions will apply if the transfer is treated as a distribution from FT. Under the alternative rule of paragraph (c)(2) of this section, B must treat the transfer as an accumulation distribution from FT, because the resulting United States tax liability is greater than the United States tax that would be due if the transfer were treated as a transfer from FC that is subject to the rules of paragraph (a) of this section.

Example 4. Transfer from trust that is treated as owned by United States citizen. Assume the same facts as in Example 3, except that A is a United States citizen. Assume that A treats and reports the transfer to FT as a constructive distribution to himself, followed by a gratuitous transfer to FT, and that A is properly treated as the grantor of FT within the meaning of §1.671–2T(e). A is treated as the owner of FT under section 679 and, as required by section 671 and the regulations thereunder, A includes all of FT's items of income, deductions, and credit in computing his taxable income and credits. Neither paragraph (c)(1) nor paragraph (c)(2) of this section is applicable, because the exception in paragraph (c)(3) of this section applies.

Example 5. Transfer for less than fair market value. FC is a foreign corporation that is wholly owned by A, a nonresident alien. On January 15, 2001, FC transfers property directly to A's daughter, B, a resident alien, in exchange for 90X. The Commissioner later determines that the fair market value of the property at the time of the transfer was 100X. Under paragraph (d)(2)(i) of this section, 10X will be treated as a purported gift to B on January 15, 2001.

(h) *Effective date.* The rules of this section are generally applicable to any transfer after August 10, 1999, by a partnership or foreign corporation, or by a trust to which a partnership or foreign corporation makes a gratuitous transfer after August 10, 1999.

§1.672(f)–5 Special rules.

(a) *Transfers by certain beneficiaries to foreign grantor*—(1) *In general.* If, but for section 672(f)(5), a foreign person would be treated as the owner of any portion of a trust, any United States beneficiary of the trust is treated as the grantor of a portion of the trust to the extent the United States beneficiary directly or indirectly made transfers of property to such foreign person (without regard to whether the United States beneficiary was a United States beneficiary at the time of any transfer) in excess of transfers to the United States beneficiary from the foreign person. The rule of this paragraph (a) does not apply to the extent the United States beneficiary can demonstrate to the satisfaction of the Commissioner that the transfer by the United States beneficiary to the foreign person was wholly unrelated to any transaction involving the trust. For purposes of this paragraph (a), the term property includes cash, and a

transfer of property does not include a transfer that is not a gratuitous transfer (within the meaning of §1.671-2T(e)(2)). In addition, a gift is not taken into account to the extent such gift would not be characterized as a taxable gift under section 2503(b). For a definition of United States beneficiary, see section 679.

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

Example 1. A, a nonresident alien, contributes property to FC, a foreign corporation that is wholly owned by A. FC creates a foreign trust, FT, for the benefit of A and A's children. FT is revocable by FC without the approval or consent of any other person. FC funds FT with the property received from A. A and A's family move to the United States. Under paragraph (a)(1) of this section, A is treated as a grantor of FT. (A may also be treated as an owner of FT under section 679(a)(4).)

Example 2. B, a United States citizen, makes a gratuitous transfer of $1 million to B's uncle, C, a nonresident alien. C creates a foreign trust, FT, for the benefit of B and B's children. FT is revocable by C without the approval or consent of any other person. C funds FT with the property received from B. Under paragraph (a)(1) of this section, B is treated as a grantor of FT. (B also would be treated as an owner of FT as a result of section 679.)

(b) *Entity characterization.* Entities generally are characterized under United States tax principles for purposes of §§1.672(f)–1 through 1.672(f)–5. See §§301.7701–1 through 301.7701–4 of this chapter. However, solely for purposes of §1.672(f)–4, a transferor that is a wholly owned business entity is treated as a corporation, separate from its single owner.

(c) *Effective date.* The rules in paragraph (a) of this section are applicable to transfers to trusts on or after August 10, 1999. The rules in paragraph (b) of this section areapplicable August 10, 1999.

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved July 23, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 5, 1999, 2:09 p.m., and published in the issue of the Federal Register for August 10, 1999, 64 F.R. 43267)

Section 809.—Reduction in Certain Deductions of Mutual Life Insurance Companies

26 CFR 1.809–9: Computation of the differential earnings rate and the recomputed differential earnings rate.

Mutual life insurance companies; differential earnings rate. The differential earnings rate for 1998 and the recomputed differential earnings rate for 1997 are set forth for use by mutual life insurance companies to compute their income tax liabilities for 1998.

Rev. Rul. 99–35

This revenue ruling contains the differential earnings rate for 1998 and the recomputed differential earnings rate for 1997. Under § 809 of the Internal Revenue Code, mutual life insurance companies use these rates in computing their Federal income tax liability for taxable years beginning in 1998. This revenue ruling also contains the figures on which the determinations of these rates are based. Notice 99–13, 1999–10 I.R.B. 26, contained tentative determinations of these rates.

Section 809(a) provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under § 808 for policyholder dividends is reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under § 808 is taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of § 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taxable year multiplied by (b) the "differential earnings rate" for that taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate" for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for that taxable year, the excess is included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for that taxable year, the excess is allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for that taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

The stock earnings rates and mutual earnings rates taken into account under § 809 generally are determined by dividing statement gain from operations by the average equity base. For this purpose, the term "statement gain from operations" means "the net gain or loss from operations required to be set forth in the annual statement, determined without regard to Federal income taxes, and . . . properly adjusted for realized capital gains and losses. . . ." *See* § 809(g)(1). The term "equity base" is defined as an amount determined in the manner prescribed by regulations equal to surplus and capital increased by the amount of nonadmitted financial assets, the excess of the amount of statutory reserves over the amount of tax reserves, the sum of certain other reserves, and 50 percent of any policyholder dividends (or other similar liability) payable in the following taxable year. *See* § 809(b)(2), (3), (4), (5) and (6). Section 1.809–10 of the Income Tax Regulations provides that the equity base includes both the asset valuation reserve and the interest maintenance reserve for taxable years ending after December 31, 1991.

Section 1.809–9(a) of the regulations provides that neither the differential earn-

ings rate under § 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under § 809(f)(3) may be less than zero.

Rev. Rul. 99–3, 1999–3 I.R.B. 4, provides that a life insurance subsidiary of a mutual holding company is not a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to §§ 808(c)(2) and 809.

For purposes of § 809, the differential earnings rate for 1998 and the rate used to calculate the recomputed differential earnings amount for 1997 (the recomputed differential earnings rate for 1997), and the figures on which these two rates are based are set forth in Table 1.

Rev. Rul. 99–35 Table 1

Determination of Rates To Be Used For Taxable Years

Beginning in 1998

Differential earnings rate for 1998	0.081
Recomputed differential earnings rate for 1997	0
Imputed earnings rate for 1997	13.813
Imputed earnings rate for 1998	16.193
Base period stock earnings rate	18.221
Current stock earnings rate for 1998	17.882
Stock earnings rate for 1995	17.087
Stock earnings rate for 1996	17.238
Stock earnings rate for 1997	19.321
Average mutual earnings rate for 1996	16.112
Average mutual earnings rate for 1997	15.566

DRAFTING INFORMATION

The principal author of this revenue ruling is Katherine A. Hossofsky of the Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact Ms. Hossofsky on (202) 622-3477 (not a toll-free number).

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.202: Closing Agreements.

Rev. Proc. 99–31

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SECTION 1. PURPOSE AND BACKGROUND

.01 *Purpose.* (1) This revenue procedure augments the Employee Plans Compliance Resolution System ("EPCRS"). It describes and illustrates many of the correction methods sponsors of qualified plans under Internal Revenue Code § 401(a) or 403(a) can use to correct failures to comply with the qualified plan rules. Among the numerous favorable comments on EPCRS, many suggested that it would be helpful to provide additional guidance on acceptable means of correction.

(2) This revenue procedure, together with the standardized correction methods described in Rev. Proc. 98–22, 1998–12 I.R.B. 11, gives plan sponsors methods (and in many cases alternative methods) they can use to correct the Operational Failures typically encountered under EPCRS. Of course, other methods of correcting the same Operational Failures might also be reasonable and appropriate. The methods described in this revenue procedure will be particularly useful for plan sponsors self-correcting Operational Failures under APRSC. The revenue procedure includes numerous examples illustrating these correction methods.

(3) The correction methods described in this revenue procedure include the following —

- For § 401(k) and § 401(m) nondiscrimination failures, in addition to the SVP correction method, a "one-to-one" correction method which combines distribution of excess contributions with an equivalent corrective contribution that typically will be less than the corrective contribution under the SVP correction method for the same failure;
- If eligible employees have been excluded from receiving employer contributions under a profit-sharing or stock bonus plan, then, in addition to the SVP correction method, improperly allocated contributions can be reallocated to the excluded eligible employees, in accordance with specified requirements;
- If an amount has been improperly forfeited under a defined contribution plan, then either a corrective contribution can be made or, in accordance with specified requirements, the improperly forfeited amount can be reallocated;
- If payments from a defined benefit plan exceeded the § 415(b) limits, the excess can be repaid to the plan or future payments can be reduced;
- If annual additions under a defined contribution plan exceeded the § 415(c) limits, then in addition to the SVP correction method, the previously paid excess can be repaid to the plan or, in the case of certain terminated employees who have received a distribution of elective deferrals, nonvested employer contributions can be forfeited;
- If amounts in excess of certain other limits have been paid, then the excesses can be repaid to the plan or, as an additional alternative in the case of a defined benefit plan, future benefit payments can be reduced;
- If contributions to a defined contribution plan have been allocated based on compensation in excess of the § 401(a)(17) limit, then the excess allocation can be reallocated to other participants or used to reduce future employer contributions or, as an additional alternative, under the Walk-in Closing Agreement Program ("Walk-in CAP"), additional plan contributions can be made for other employees;
- If hardship distributions that were not permitted under plan terms have been made, then, in accordance with specified requirements, a corrective plan

amendment can be made under Walk-in CAP; and

- If corrective contributions or allocations are made under a defined contribution plan, several alternative methods are provided for adjustments to reflect earnings.

This revenue procedure also expands the SVP correction method for the exclusion of eligible employees from elective deferrals, employee after-tax contributions, and matching contributions for a full year to include partial year exclusions, and clarifies the SVP correction method for exclusion of eligible employees from employer nonelective contributions under profit-sharing and stock bonus plans.

(4) The Service anticipates that the methods and examples described in this revenue procedure will be updated, and the methods and examples may be supplemented or expanded. In addition, the Service will continue to monitor and improve EPCRS as a whole, and accordingly, intends to revise Rev. Proc. 98–22 to reflect experience and public comments.

.02 *Background.* (1) Rev. Proc. 98–22, modified and consolidated into EPCRS the various Internal Revenue Service programs relating to correction of certain failures ("Qualification Failures"), which affect the qualification of a plan intended to be qualified under § 401(a) or 403(a) ("Qualified Plans"), or § 403(b) ("403(b) plans"). The programs consolidated into EPCRS include the Administrative Policy Regarding Self-Correction ("APRSC"), the Voluntary Compliance Resolution ("VCR") program, Walk-in CAP, and the Audit Closing Agreement Program ("Audit CAP"). Rev. Proc. 99–13, 1999–5 I.R.B. 52, modified and amplified Rev. Proc. 98–22 with respect to 403(b) plans.

(2) Section 6 of Rev. Proc. 98–22 sets forth correction principles that apply to all of the EPCRS programs. The standardized correction methods permitted under the Standardized VCR Procedure ("SVP") set forth in Appendix A of Rev. Proc. 98–22 are deemed to be reasonable and appropriate methods of correction for certain Qualification Failures that arise solely from failure to follow the terms of a plan ("Operational Failures"). Section 6.02(2) of Rev. Proc. 98–22 provides that there may be more than one reasonable and appropriate correction method for a Qualification Failure. Section 6.02(3) of Rev. Proc. 98–22 provides that corrective allocations under a defined contribution plan should be adjusted for earnings and forfeitures that would have been allocated to a participant's account if the failure had not occurred.

.03 *Overview.* (1) Section 2 of this revenue procedure describes the effect of this revenue procedure and taxpayers' ability to rely on it.

(2) Section 3 sets forth certain provisions that generally apply with respect to the correction methods and earnings adjustment methods under this revenue procedure, and assumptions that apply for purposes of the examples in this revenue procedure.

(3) Section 4 sets forth a number of reasonable and appropriate correction methods (and examples) that may be used to correct specific Operational Failures. Section 4 also clarifies and expands on certain correction methods under SVP. Consistent with section 6.02(2) of Rev. Proc. 98–22, other correction methods, different from those illustrated in this revenue procedure, may also be considered reasonable and appropriate for the same Operational Failure.

(4) Section 5 sets forth earnings adjustment methods (and examples) that may be used to adjust a corrective contribution or allocation for earnings in a defined contribution plan. Consequently, these earnings adjustment methods may be used to determine the earnings adjustments for corrective contributions or allocations under the correction methods in section 4 and under certain SVP correction methods. Other earnings adjustment methods, different from those illustrated in this revenue procedure, may also be appropriate for adjusting corrective contributions or allocations to reflect earnings.

.04 *Request for Comments.* The Service solicits comments and suggestions relating to this revenue procedure. In particular, the Service requests (1) comments on the correction methods, earnings adjustment methods, and examples described in this revenue procedure, (2) suggestions for alternative methods of correction for the Operational Failures addressed in this revenue procedure, and (3) suggestions for methods of correction for Qualification Failures not addressed in this revenue procedure (including methods for correcting failures with respect to 403(b) plans). It is requested that comments and suggestions be submitted by November 21, 1999, addressed to CC:DOM:CORP:R (Rev. Proc. 99–31), Room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand-delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Rev. Proc. 99–31), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically by using the following site: cynthia.grigsby@m1.irscounsel.treas.gov

SECTION 2. EFFECT OF THIS REVENUE PROCEDURE; RELIANCE

.01 *Effect of this Revenue Procedure.* If an Operational Failure addressed in this revenue procedure is corrected in the specific manner described in an applicable correction method set forth in this revenue procedure, the Service will treat the correction as a reasonable and appropriate correction for the Operational Failure under section 6.02(2) of Rev. Proc. 98–22. In addition, if an earnings adjustment is made to a corrective contribution or allocation under a defined contribution plan in a specific manner described in section 5 of this revenue procedure, the Service will treat the earnings adjustment as satisfying the requirement of section 6.02(3)(a) of Rev. Proc. 98–22 that corrective allocations in a defined contribution plan be adjusted for earnings.

.02 *Revenue Procedure Not Applicable to 403(b) Plans.* This revenue procedure does not apply to 403(b) plans. Accordingly, sponsors of 403(b) plans cannot rely on the correction methods under section 4 and the earnings adjustment methods under section 5. For guidance relating to 403(b) plans, see Rev. Proc. 99–13.

.03 *Reliance.* Taxpayers may rely on Rev. Proc. 98–22, as supplemented by this revenue procedure. Accordingly, if an Operational Failure addressed in this revenue procedure is corrected in accordance with the requirements of APRSC, VCR, Walk-in CAP, or Audit CAP, whichever is applicable; the eligibility requirements set forth in section 4 of Rev. Proc. 98–22 for the applicable program

are satisfied; and the Operational Failure is corrected using an applicable correction method described in this revenue procedure that otherwise satisfies section 6.02 of Rev. Proc. 98–22, then, in accordance with section 3 of Rev. Proc. 98–22, the plan will not be disqualified by reason of the Operational Failure.

.04 *Effect of Future Guidance.* The Service expects that the correction methods and earnings adjustment methods described in this revenue procedure will be updated periodically in light of experience gained and comments received. However, taxpayers will be able to continue to rely on the correction methods and earnings adjustment methods in this revenue procedure for corrections prior to the publication of future guidance.

SECTION 3. GENERALLY APPLICABLE PROVISIONS

.01 *General.* Unless otherwise specified, the provisions of this section 3 apply for purposes of the correction methods in section 4 and the earnings adjustment methods in section 5 of this revenue procedure.

.02 *Correction Should Not Violate §401(a).* As provided in Rev. Proc. 98–22, section 6.02(2)(d), the correction method used to correct an Operational Failure should not violate § 401(a). If an additional Qualification Failure is created as a result of the use of a correction method in this revenue procedure, then that Qualification Failure also must be corrected in conjunction with the use of that correction method and in accordance with the requirements of EPCRS.

.03 *Consistency Requirement.* Generally, where more than one correction method is available to correct a type of Operational Failure for a plan year (or where there are alternative ways to apply a correction method), the correction method (or alternative ways to apply the correction method) should be applied consistently in correcting all Operational Failures of that type for that plan year. Similarly, earnings adjustment methods generally should be applied consistently with respect to corrective contributions or allocations for a particular type of Operational Failure for a plan year.

.04 *Treatment of Excess Amounts.* A distribution of an Excess Amount is not eligible for the favorable tax treatment accorded to distributions from qualified plans (such as eligibility for rollover under § 402(c)). To the extent that a current or prior distribution was a distribution of an Excess Amount, that distribution is not an eligible rollover distribution. Thus, for example, if such a distribution was contributed to an individual retirement arrangement ("IRA"), the contribution is not a valid rollover contribution for purposes of determining the amount of excess contributions (within the meaning of § 4973) to the individual's IRAs. Where an Excess Amount has been distributed in connection with an Operational Failure that is being corrected using a correction method set forth in section 4, the employer must notify the recipient that (1) the Excess Amount was distributed and (2) the Excess Amount was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).

.05 *No Effect on Other Law.* In accordance with section 6.06 of Rev. Proc. 98–22, compliance under these programs has no effect on the rights of any party under any other law, including Title I of the Employee Retirement Income Security Act of 1974.

.06 *Definitions.* (1) Definitions from Rev. Proc. 98–22. The definitions set forth in section 5 of Rev. Proc. 98–22 apply for purposes of this revenue procedure.

(2) Excess Amount Defined. For purposes of this revenue procedure, an Excess Amount is (a) an Overpayment (within the meaning of section 4.05(2)), (b) an elective deferral or employee after-tax contribution returned to satisfy § 415, (c) an elective deferral in excess of the limitation of § 402(g) that is distributed, (d) an excess contribution or excess aggregate contribution that is distributed to satisfy § 401(k) or § 401(m), or (e) any similar amount required to be distributed in order to maintain plan qualification.

.07 *Assumptions for Examples.* Unless otherwise specified, for ease of presentation, the examples assume that:

(1) the plan year and the § 415 limitation year are the calendar year;

(2) the employer maintains a single plan intended to satisfy § 401(a) and has never maintained any other plan;

(3) in a defined contribution plan, the plan provides that forfeitures are used to reduce future employer contributions;

(4) the Qualification Failures are Operational Failures and the eligibility and other requirements for APRSC, VCR, Walk-in CAP, or Audit CAP, whichever applies, are satisfied; and

(5) there are no Qualification Failures other than the described Operational Failures, and if a corrective action would result in any additional Qualification Failure, appropriate corrective action is taken for that additional Qualification Failure in accordance with EPCRS.

SECTION 4. CORRECTION METHODS AND EXAMPLES

.01 *ADP/ACP Failures.*

(1) Correction Methods. (a) SVP Correction Method. Appendix A, section .03 of Rev. Proc. 98–22 sets forth the SVP correction method for a failure to satisfy the actual deferral percentage ("ADP"), actual contribution percentage ("ACP"), or multiple use test set forth in §§ 401(k)(3), 401(m)(2), and 401(m)(9), respectively.

(b) One-to-One Correction Method. (i) General. In addition to the SVP correction method, a failure to satisfy the ADP, ACP, or multiple use test may be corrected using the one-to-one correction method set forth in this section 4.01(1)(b). Under the one-to-one correction method, an excess contribution amount is determined and assigned to highly compensated employees as provided in paragraph (1)(b)(ii) below. That excess contribution amount (adjusted for earnings) is either distributed to highly compensated employees or forfeited from highly compensated employees' accounts as provided in paragraph (1)(b)(iii) below. That same dollar amount (i.e., the excess contribution amount, adjusted for earnings) is contributed to the plan and allocated to nonhighly compensated employees as provided in paragraph (1)(b)(iv) below.

(ii) Determination of the Excess Contribution Amount. The excess contribution amount for the year is equal to the excess of (A) the sum of the excess contributions (as defined in § 401(k)(8)(B)), the excess aggregate contributions (as defined in § 401(m)(6)(B)), and the amount treated as excess contributions or excess aggregate contributions under the multiple use test pursuant to § 401(m)(9) and

§ 1.401(m)–2(c) of the Income Tax Regulations for the year, as assigned to each highly compensated employee in accordance with § 401(k)(8)(C) and (m)(6)(C), over (B) previous corrections permitted under § 401(k)(8), (m)(6), and (m)(9). See Notice 97–2, 1997–1 C.B. 348.

(iii) Distributions and Forfeitures of the Excess Contribution Amount. (A) The portion of the excess contribution amount assigned to a particular highly compensated employee under paragraph (1)(b)(ii) is adjusted for earnings through the date of correction. The amount assigned to a particular highly compensated employee, as adjusted, is distributed or, to the extent the amount is forfeitable as of the close of the plan year of the failure, is forfeited. If the amount is forfeited, it is used in accordance with the plan provisions relating to forfeitures that were in effect for the year of the failure. If the amount so assigned to a particular highly compensated employee has been previously distributed, the amount is an Excess Amount within the meaning of section 3.06(2). Thus, pursuant to section 3.04, the employer must notify the employee that the Excess Amount was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).

(B) If any matching contributions (adjusted for earnings) are forfeited in accordance with § 411(a)(3)(G), the forfeited amount is used in accordance with the plan provisions relating to forfeitures that were in effect for the year of the failure.

(C) If a payment was made to an employee and that payment is a forfeitable match described in either paragraph 4.01(b)(iii)(A) or (B), then it is an Overpayment defined in section 4.05(2) that must be corrected (see section 4.05(1)).

(iv) Contribution and Allocation of Equivalent Amount. (A) The employer makes a contribution to the plan that is equal to the aggregate amounts distributed and forfeited under paragraph (1)(b)(iii)(A) (i.e., the excess contribution amount adjusted for earnings, as provided in paragraph (1)(b)(iii)(A), which does not include any matching contributions forfeited in accordance with § 411(a)(3)(G), as provided in paragraph (1)(b)(iii)(B)). The contribution must satisfy the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C).

(B)(*1*) This paragraph (1)(b)(iv)(B)(*1*) applies to a plan that uses the current year testing method described in Notice 98-1, 1998–3 I.R.B. 42. The contribution made under paragraph (1)(b)(iv)(A) is allocated to the account balances of those individuals who were either (I) the eligible employees for the year of the failure who were not highly compensated employees for that year or (II) the eligible employees for the year of the failure who were not highly compensated employees for that year and who also are not highly compensated employees for the year of correction. Alternatively, the contribution is allocated to account balances of eligible employees described in (I) or (II) of the preceding sentence, except that the allocation is made only to the account balances of those employees who are employees on a date during the year of the correction that is no later than the date of correction. Regardless of which of these four options (described in the two preceding sentences) the employer selects, the contribution is allocated to each such employee either as the same percentage of the employee's compensation for the year of the failure or as the same dollar amount for each employee. (See Examples 1, 2 and 3.) Under the one-to-one correction method, the amount allocated to the account balance of an employee (i.e., the employee's share of the total amount contributed under paragraph (1)(b)(iv)(A)) is not further adjusted for earnings and is treated as an annual addition under § 415 for the year of the failure for the employee for whom it is allocated.

(*2*) This paragraph (1)(b)(iv)(B)(*2*) applies to a plan that uses the prior year testing method described in Notice 98–1. Paragraph (1)(b)(iv)(B)(*1*) is applied by substituting "the year prior to the year of the failure" for "the year of the failure".

(2) Examples.

Example 1:

Employer A maintains a profit-sharing plan with a cash or deferred arrangement that is intended to satisfy § 401(k) ("401(k) plan") using the current year testing method described in Notice 98-1. The plan does not provide for matching contributions or employee after-tax contributions. In 1999, it was discovered that the ADP test for 1997 was not performed correctly. When the ADP test was performed correctly, the test was not satisfied for 1997. For 1997, the ADP for highly compensated employees was 9% and the ADP for nonhighly compensated employees was 4%. Accordingly, the ADP for highly compensated employees exceeded the ADP for nonhighly compensated employees by more than two percentage points (in violation of § 401(k)(3)). (The ADP for nonhighly compensated employees for 1996 also was 4%, so the ADP test for 1997 would not have been satisfied even if the plan had used the prior year testing method described in Notice 98–1.) There were two highly compensated employees eligible under the 401(k) plan during 1997, Employee P and Employee Q. Employee P made elective deferrals of $8,000, which is equal to 10% of Employee P's compensation of $80,000 for 1997. Employee Q made elective deferrals of $9,500, which is equal to 8% of Employee Q's compensation of $118,750 for 1997.

Correction:

On June 30, 1999, Employer A uses the one-to-one correction method to correct the failure to satisfy the ADP test for 1997. Accordingly, Employer A calculates the dollar amount of the excess contributions for the two highly compensated employees in the manner described in § 401(k)(8)(B). The amount of the excess contribution for Employee P is $3,200 (4% of $80,000) and the amount of the excess contribution for Employee Q is $2,375 (2% of $118,750), or a total of $5,575. In accordance with § 401(k)(8)(C), $5,575, the excess contribution amount, is assigned $2,037.50 to Employee P and $3,537.50 to Employee Q. It is determined that the earnings on the assigned amounts through June 30, 1999 are $407 and $707 for Employees P and Q, respectively. The assigned amounts and the earnings are distributed to Employees P and Q. Therefore, Employee P receives $2,444.50 ($2,037.50 + $407) and Employee Q receives $4,244.50 ($3,537.50 + $707). In addition, on the same date, a corrective contribution is made to the 401(k) plan equal to $6,689 (the sum of the $2,444.50 distributed to Employee P and the $4,244.50 distributed to Employee Q). The corrective contribution is allocated to the account balances of eligible nonhighly compensated employees for 1997, pro rata based on their compensation for 1997 (subject to § 415 for 1997).

Example 2:

The facts are the same as in Example 1.

Correction:

The correction is the same as in Example 1, except that the corrective contribution of $6,689 is allocated in an equal dollar amount to the account balances of eligible nonhighly compensated employees for 1997 who are employees on June 30, 1999 and who are nonhighly compensated employees for 1999 (subject to § 415 for 1997).

Example 3:

The facts are the same as in Example 1, except that for 1997 the plan also provides (1) for employee after-tax contributions and (2) for matching contributions equal to 50% of the sum of an employee's elective deferrals and employee after-tax contributions that do not exceed 10% of the employee's compensation. The plan provides that matching contributions are subject to the plan's 5-year graded vesting schedule and that matching contributions are forfeited and used to

reduce employer contributions if associated elective deferrals or employee after-tax contributions are distributed to correct an ADP, ACP or multiple use test failure. For 1997, nonhighly compensated employees made employee after-tax contributions and no highly compensated employee made any employee after-tax contributions. Employee P received a matching contribution of $4,000 (50% of $8,000) and Employee Q received a matching contribution of $4,750 (50% of $9,500). Employees P and Q were 100% vested in 1997. It is determined that, for 1997, the ACP for highly compensated employees was not more than 125% of the ACP for nonhighly compensated employees, so that the ACP and multiple use tests would have been satisfied for 1997 without any corrective action.

Correction:

The same corrective actions are taken as in Example 1. In addition, in accordance with the plan's terms, corrective action is taken to forfeit Employee P's and Employee Q's matching contributions associated with their distributed excess contributions. Employee P's distributed excess contributions and associated matching contributions are $2,037.50 and $1,018.75, respectively. Employee Q's distributed excess contributions and associated matching contributions are $3,537.50 and $1,768.75, respectively. Thus, $1,018.75 is forfeited from Employee P's account and $1,768.75 is forfeited from Employee Q's account. In addition, the earnings on the forfeited amounts are also forfeited. It is determined that the respective earnings on the forfeited amount for Employee P is $150 and for Employee Q is $204. The total amount of the forfeitures of $3,141.50 (Employee P's $1,018.75 + $150 and Employee Q's $1,768.75 + $204) is used to reduce contributions for 1999 and subsequent years.

.02 *Exclusion of Eligible Employees.*

(1) Exclusion of Eligible Employees in a 401(k) or (m) Plan. (a) Correction Method. (i) SVP Correction Method for Full Year Exclusion. Appendix A, section .05 of Rev. Proc. 98–22 sets forth the SVP correction method for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for one or more full plan years. (See Example 4.) In section 4.02(1)(a)(ii) below, the SVP correction method for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for a full year is expanded to include correction for the exclusion of an eligible employee from all contributions under a 401(k) or (m) plan for a partial plan year. This correction for a partial year exclusion may be used in conjunction with the correction for a full year exclusion.

(ii) Expansion of SVP Correction Method to Partial Year Exclusion. (A) In General. The correction method in Appendix A, section .05 of Rev. Proc. 98–22 is expanded to cover an employee who was improperly excluded from making elective deferrals or employee after-tax contributions for a portion of a plan year or from receiving matching contributions (on either elective deferrals or employee after-tax contributions) for a portion of a plan year. In such case, the permitted correction method under SVP for the failure is for the employer to satisfy this section 4.02(1)(a)(ii). The employer makes a corrective contribution on behalf of the excluded employee that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C).

(B) Elective Deferral Failures. The appropriate corrective contribution for the failure to allow employees to make elective deferrals for a portion of the plan year is equal to the ADP of the employee's group (either highly or nonhighly compensated), determined prior to correction under this section 4.02(1)(a)(ii), multiplied by the employee's plan compensation for the portion of the year during which the employee was improperly excluded. The corrective contribution for the portion of the plan year during which the employee was improperly excluded from being eligible to make elective deferrals is reduced to the extent that (*1*) the sum of that contribution and any elective deferrals actually made by the employee for that year would exceed (*2*) the maximum elective deferrals permitted under the plan for the employee for that plan year (including the § 402(g) limit). The corrective contribution is adjusted for earnings. (See Examples 5 and 6.)

(C) Employee After-Tax and Matching Contribution Failures. The appropriate corrective contribution for the failure to allow employees to make employee after-tax contributions or to receive matching contributions because the employee was precluded from making employee after-tax contributions or elective deferrals for a portion of the plan year is equal to the ACP of the employee's group (either highly or nonhighly compensated), determined prior to correction under this section 4.02(1)(a)(ii), multiplied by the employee's plan compensation for the portion of the year during which the employee was improperly excluded. The corrective contribution is reduced to the extent that (*1*) the sum of that contribution and the actual total employee after-tax and matching contributions made by and for the employee for the plan year would exceed (*2*) the sum of the maximum employee after-tax contributions permitted under the plan for the employee for the plan year and the matching contributions that would have been made if the employee had made the maximum matchable contributions permitted under the plan for the employee for that plan year. The corrective contribution is adjusted for earnings.

(D) Use of Prorated Compensation. For purposes of this paragraph (1)(a)(ii), for administrative convenience, in lieu of using the employee's actual plan compensation for the portion of the year during which the employee was improperly excluded, a pro rata portion of the employee's plan compensation that would have been taken into account for the plan year, if the employee had not been improperly excluded, may be used.

(E) Special Rule for Brief Exclusion from Elective Deferrals. An employer is not required to make a corrective contribution with respect to elective deferrals, as provided in section 4.02(1)(a)(ii)(B), (but is required to make a corrective contribution with respect to any employee after-tax and matching contributions, as provided in section 4.02(1)(a)(ii)(C)) for an employee for a plan year if the employee has been provided the opportunity to make elective deferrals under the plan for a period of at least the last 9 months in that plan year and during that period the employee had the opportunity to make elective deferrals in an amount not less than the maximum amount that would have been permitted if no failure had occurred. (See Example 7.)

(b) Examples.

Example 4:

Employer B maintains a 401(k) plan. The plan provides for matching contributions for eligible employees equal to 100% of elective deferrals that do not exceed 3% of an employee's compensation. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. Twelve employees (8 nonhighly compensated employees and 4 highly compensated employees) who had met the one year eligibility requirement after July 1, 1995 and before January 1, 1996 were inadvertently excluded from participating in the plan beginning on January 1, 1996. These employees were offered the opportunity to begin participating in the plan on Janu-

ary 1, 1997. For 1996, the ADP for the highly compensated employees was 8% and the ADP for the nonhighly compensated employees was 6%. In addition, for 1996, the ACP for the highly compensated employees was 2.5% and the ACP for the nonhighly compensated employees was 2%. The failure to include the 12 employees was discovered during 1998.

Correction:

Employer B uses the SVP correction method for full year exclusions to correct the failure to include the 12 eligible employees in the plan for the full plan year beginning January 1, 1996. Thus, Employer B makes a corrective contribution (that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C)) for each of the excluded employees. The contribution for each of the improperly excluded highly compensated employees is 10.5% (the highly compensated employees' ADP of 8% plus ACP of 2.5%) of the employee's plan compensation for the 1996 plan year (adjusted for earnings). The contribution for each of the improperly excluded nonhighly compensated employees is 8% (the nonhighly compensated employees' ADP of 6% plus ACP of 2%) of the employee's plan compensation for the 1996 plan year (adjusted for earnings).

Example 5:

Employer C maintains a 401(k) plan. The plan provides for matching contributions for each payroll period that are equal to 100% of an employee's elective deferrals that do not exceed 2% of the eligible employee's plan compensation during the payroll period. The plan does not provide for employee after-tax contributions. The plan provides that employees who complete one year of service are eligible to participate in the plan on the next January 1 or July 1 entry date. A nonhighly compensated employee who met the eligibility requirements and should have entered the plan on January 1, 1996 was not offered the opportunity to participate in the plan. In August of 1996, the error was discovered and Employer C offered the employee an election opportunity as of September 1, 1996. The employee made elective deferrals equal to 4% of the employee's plan compensation for each payroll period from September 1, 1996 through December 31, 1996 (resulting in elective deferrals of $500). The employee's plan compensation for 1996 was $36,000 ($23,500 for the first eight months and $12,500 for the last four months). Employer C made matching contributions equal to $250 for the excluded employee, which is 2% of the employee's plan compensation for each payroll period from September 1, 1996 through December 31, 1996 ($12,500). The ADP for nonhighly compensated employees for 1996 was 3% and the ACP for nonhighly compensated employees for 1996 was 1.8%.

Correction:

Employer C uses the SVP correction method for partial year exclusions to correct the failure to include the eligible employee in the plan. Thus, Employer C makes a corrective contribution (that satisfies the vesting requirements and distribution limitations of § 401(k)(2)(B) and (C)) for the excluded employee. In determining the amount of corrective contributions (both for the elective deferral and for the matching contribution), for administrative convenience, in lieu of using actual plan compensation of $23,500 for the period the employee was excluded, the employee's annual plan compensation is pro rated for the eight-month period that the employee was excluded from participating in the plan. The failure to provide the excluded employee the right to make elective deferrals is corrected by the employer making a corrective contribution on behalf of the employee that is equal to $720 (the 3% ADP percentage for nonhighly compensated employees multiplied by $24,000, which is 8/12ths of the employee's 1996 plan compensation of $36,000), adjusted for earnings. In addition, to correct for the failure to receive the plan's matching contribution, a corrective contribution is made on behalf of the employee that is equal to $432 (the 1.8% ACP for the nonhighly compensated group multiplied by $24,000, which is 8/12ths of the employee's 1996 plan compensation of $36,000), adjusted for earnings. Employer C determines that $682, the sum of the actual matching contribution received by the employee for the plan year ($250) and the corrective contribution to correct the matching contribution failure ($432), does not exceed $720, the maximum matching contribution available to the employee under the plan (2% of $36,000) determined as if the employee had made the maximum matchable contributions. In addition to correcting the failure to include the eligible employee in the plan, Employer C reruns the ADP and ACP tests for 1996 (taking into account the corrective contribution and plan compensation for 1996 for the excluded employee) and determines that the tests were satisfied.

Example 6:

The facts are the same as in Example 5, except that the plan provides for matching contributions that are equal to 100% of an eligible employee's elective deferrals that do not exceed 2% of the employee's plan compensation for the plan year. Accordingly, the actual matching contribution made by Employer C for the excluded employee for the last four months of 1996 is $500 (which is equal to 100% of the $500 of elective deferrals made by the employee for the last four months of 1996).

Correction:

The correction is the same as in Example 5, except that the corrective contribution made for the first 8 months of 1996 to correct the failure to make matching contributions is equal to $220 (adjusted for earnings), instead of the $432 (adjusted for earnings) in Example 5, because the corrective contribution is limited to the maximum matching contributions available under the plan for the employee for the plan year, $720 (2% of $36,000), reduced by the actual matching contributions made for the employee for the plan year, $500.

Example 7:

The facts are the same as in Example 5, except that the error is discovered in March of 1996 and the employee was given the opportunity to make elective deferrals beginning on April 1, 1996. The amount of elective deferrals that the employee was given the opportunity to make during 1996 was not less than the maximum elective deferrals that the employee could have made if the employee had been given the opportunity to make elective deferrals beginning on January 1, 1996. The employee made elective deferrals equal to 4% of the employee's plan compensation for each payroll period from April 1, 1996 through December 31, 1996 of $28,000 (resulting in elective deferrals of $1,120). Employer C made a matching contribution equal to $560, which is 2% of the employee's plan compensation for each payroll period from April 1, 1996 through December 31, 1996 ($28,000). The employee's plan compensation for 1996 was $36,000 ($8,000 for the first three months and $28,000 for the last nine months).

Correction:

Employer C uses the SVP correction method for partial year exclusions to correct the failure to include an eligible employee in the plan. Because the employee was given an opportunity to make elective deferrals to the plan for at least the last 9 months of the plan year (and the amount of the elective deferrals that the employee had the opportunity to make was not less than the maximum elective deferrals that the employee could have made if the employee had been given the opportunity to make elective deferrals beginning on January 1, 1996), under the special rule set forth in section 4.02(1)(a)(ii)(E), Employer C is not required to make a corrective contribution for the failure to allow the employee to make elective deferrals. In determining the amount of corrective contribution with respect to the failure to allow the employee to receive matching contributions, in lieu of using actual plan compensation of $8,000 for the period the employee was excluded, the employee's annual plan compensation is pro rated for the three-month period that the employee was excluded from participating in the plan. Accordingly, a corrective contribution is made on behalf of the employee that is equal to $160, which is the lesser of (i) $162 (a matching contribution of 1.8% of $9,000, which is 3/12ths of the employee's 1996 plan compensation of $36,000), and (ii) $160 (the excess of the maximum matching contribution for the entire plan year, which is equal to 2% of $36,000, or $720, over the matching contributions made after March 31, 1996, $560). The contribution is adjusted for earnings.

(2) Exclusion of Eligible Employees In a Profit-Sharing Plan.

(a) Correction Methods. (i) SVP Correction Method. Appendix A, section .05 of Rev. Proc. 98–22 sets forth the SVP correction method for correcting the exclusion of an eligible employee. In the case of a defined contribution plan, the SVP correction method is to make a contribution on behalf of the excluded employee. Section 4.02(2)(a)(ii) below clarifies the SVP correction method in the case of a profit-sharing or stock bonus plan that provides for nonelective contri-

butions (within the meaning of § 1.401(k)–1(g)(10)).

(ii) Clarification of SVP Correction Method for Profit-Sharing Plans. To correct for the exclusion of an eligible employee from nonelective contributions in a profit-sharing or stock bonus plan under the SVP correction method, an allocation amount is determined for each excluded employee on the same basis as the allocation amounts were determined for the other employees under the plan's allocation formula (e.g., the same ratio of allocation to compensation), taking into account all of the employee's relevant factors (e.g., compensation) under that formula for that year. The employer makes a corrective contribution on behalf of the excluded employee that is equal to the allocation amount for the excluded employee. The corrective contribution is adjusted for earnings. If, as a result of excluding an employee, an amount was improperly allocated to the account balance of an eligible employee who shared in the original allocation of the nonelective contribution, no reduction is made to the account balance of the employee who shared in the original allocation on account of the improper allocation. (See Example 8.)

(iii) Reallocation Correction Method. (A) In General. Subject to the limitations set forth in section 4.02(2)(a)(iii)(F) below, in addition to the SVP correction method, the exclusion of an eligible employee for a plan year from a profit-sharing or stock bonus plan that provides for nonelective contributions may be corrected using the reallocation correction method set forth in this section 4.02(2)(a)(iii). Under the reallocation correction method, the account balance of the excluded employee is increased as provided in paragraph (2)(a)(iii)(B) below, the account balances of other employees are reduced as provided in paragraph (2)(a)(iii)(C) below, and the increases and reductions are reconciled, as necessary, as provided in paragraph (2)(a)(iii)(D) below. (See Examples 9 and 10.)

(B) Increase in Account Balance of Excluded Employee. The account balance of the excluded employee is increased by an amount that is equal to the allocation the employee would have received had the employee shared in the allocation of the nonelective contribution. The amount is adjusted for earnings.

(C) Reduction in Account Balances of Other Employees. (*1*) The account balance of each employee who was an eligible employee who shared in the original allocation of the nonelective contribution is reduced by the excess, if any, of (I) the employee's allocation of that contribution over (II) the amount that would have been allocated to that employee had the failure not occurred. This amount is adjusted for earnings taking into account the rules set forth in section 4.02(2)(a)(iii)(C)(*2*) and (*3*) below. The amount after adjustment for earnings is limited in accordance with section 4.02(2)(a)(iii)(C)(*4*) below.

(*2*) This paragraph (2)(a)(iii)(C)(*2*) applies if most of the employees with account balances that are being reduced are nonhighly compensated employees. If there has been an overall gain for the period from the date of the original allocation of the contribution through the date of correction, no adjustment for earnings is required to the amount determined under section 4.02(2)(a)(iii)(C)(*1*) for the employee. If the amount for the employee is being adjusted for earnings and the plan permits investment of account balances in more than one investment fund, for administrative convenience, the reduction to the employee's account balance may be adjusted by the lowest earnings rate of any fund for the period from the date of the original allocation of the contribution through the date of correction.

(*3*) If an employee's account balance is reduced and the original allocation was made to more than one investment fund or there was a subsequent distribution or transfer from the fund receiving the original allocation, then, reasonable, consistent assumptions are used to determine the earnings adjustment.

(*4*) The amount determined in section 4.02(2)(a)(iii)(C)(*1*) for an employee after the application of section 4.02(2)(a)(iii)(C)(*2*) and (*3*) may not exceed the account balance of the employee on the date of correction, and the employee is permitted to retain any distribution made prior to the date of correction.

(D) Reconciliation of Increases and Reductions. If the aggregate amount of the increases under section 4.02(2)(a)(iii)(B) exceeds the aggregate amount of the reductions under section 4.02(2)(a)(iii)(C), the employer makes a corrective contribution to the plan for the amount of the excess. If the aggregate amount of the reductions under section 4.02(2)(a)(iii)(C) exceeds the aggregate amount of the increases under section 4.02(2)(a)(iii)(B), then the amount by which each employee's account balance is reduced under section 4.02(2)(a)(iii)(C) is decreased on a pro rata basis.

(E) Reductions Among Multiple Investment Funds. If an employee's account balance is reduced and the employee's account balance is invested in more than one investment fund, then the reduction may be made from the investment funds selected in any reasonable manner.

(F) Limitations on Use of Reallocation Correction Method. If any employee would be permitted to retain any distribution pursuant to section 4.02(2)(a)(iii)(C)(4), then the reallocation correction method may not be used unless most of the employees who would be permitted to retain a distribution are nonhighly compensated employees.

(b) Examples.

Example 8:

Employer D maintains a profit-sharing plan that provides for discretionary nonelective employer contributions. The plan provides that the employer's contributions are allocated to account balances in the ratio that each eligible employee's compensation for the plan year bears to the compensation of all eligible employees for the plan year and, therefore, the only relevant factor for determining an allocation is the employee's compensation. The plan provides for self-directed investments among four investment funds and daily valuations of account balances. For the 1997 plan year, Employer D made a contribution to the plan of a fixed dollar amount. However, five employees who met the eligibility requirements were inadvertently excluded from participating in the plan. The contribution resulted in an allocation on behalf of each of the eligible employees, other than the excluded employees, equal to 10% of compensation. Most of the employees who received allocations under the plan for the year of the failure were nonhighly compensated employees. No distributions have been made from the plan since 1997. If the five excluded employees had shared in the original allocation, the allocation made on behalf of each employee would have equaled 9% of compensation. The excluded employees began participating in the plan in the 1998 plan year.

Correction:

Employer D uses the SVP correction method to correct the failure to include the five eligible employees. Thus, Employer D makes a corrective contribution to the plan. The amount of the cor-

rective contribution on behalf of the five excluded employees for the 1997 plan year is equal to 10% of compensation of each excluded employee, the same allocation that was made for other eligible employees, adjusted for earnings. The excluded employees receive an allocation equal to 10% of compensation (adjusted for earnings) even though, had the excluded employees originally shared in the allocation for the 1997 contribution, their account balances, as well as those of the other eligible employees, would have received an allocation equal to only 9% of compensation.

Example 9:

The facts are the same as in Example 8.

Correction:

Employer D uses the reallocation correction method to correct the failure to include the five eligible employees. Thus, the account balances are adjusted to reflect what would have resulted from the correct allocation of the employer contribution for the 1997 plan year among all eligible employees, including the five excluded employees. The inclusion of the excluded employees in the allocation of that contribution would have resulted in each eligible employee, including each excluded employee, receiving an allocation equal to 9% of compensation. Accordingly, the account balance of each excluded employee is increased by 9% of the employee's 1997 compensation, adjusted for earnings. The account balance of each of the eligible employees other than the excluded employees is reduced by 1% of the employee's 1997 compensation, adjusted for earnings. Employer D determines the adjustment for earnings using the earnings rate of each eligible employee's excess allocation (using reasonable, consistent assumptions). Accordingly, for an employee who shared in the original allocation and directed the investment of the allocation into more than one investment fund or who subsequently transferred a portion of a fund that had been credited with a portion of the 1997 allocation to another fund, reasonable, consistent assumptions are followed to determine the adjustment for earnings. It is determined that the total of the initially determined reductions in account balances exceeds the total of the required increases in account balances. Accordingly, these initially determined reductions are decreased pro rata so that the total of the actual reductions in account balances equals the total of the increases in the account balances, and Employer D does not make any corrective contribution. The reduction from the account balances are made on a pro rata basis among all of the funds in which each employee's account balance is invested.

Example 10:

The facts are the same as in Example 8.

Correction:

The correction is the same as in Example 9, except that, because most of the employees whose account balances are being reduced are nonhighly compensated employees, for administrative convenience, Employer D uses the earnings rate of the fund with the lowest earnings rate for the period of the failure to adjust the reduction to each account balance. It is determined that the aggregate amount (adjusted for earnings) by which the account balances of the excluded employees is increased exceeds the aggregate amount (adjusted for earnings) by which the other employees' account balances are reduced. Accordingly, Employer D makes a contribution to the plan in an amount equal to the excess. The reduction from account balances is made on a pro rata basis among all of the funds in which each employee's account balance is invested.

.03 *Vesting Failures.*

(1) Correction Methods. (a) Contribution Correction Method. A failure in a defined contribution plan to apply the proper vesting percentage to an employee's account balance that results in forfeiture of too large a portion of the employee's account balance may be corrected using the contribution correction method set forth in this paragraph. The employer makes a corrective contribution on behalf of the employee whose account balance was improperly forfeited in an amount equal to the improper forfeiture. The corrective contribution is adjusted for earnings. If, as a result of the improper forfeiture, an amount was improperly allocated to the account balance of another employee, no reduction is made to the account balance of that employee. (See Example 11.)

(b) Reallocation Correction Method. In addition to the contribution correction method, in a defined contribution plan under which forfeitures of account balances are reallocated among the account balances of the other eligible employees in the plan, a failure to apply the proper vesting percentage to an employee's account balance which results in forfeiture of too large a portion of the employee's account balance may be corrected under the reallocation correction method set forth in this paragraph. A corrective reallocation is made in accordance with the reallocation correction method set forth in section 4.02(2)(a)(iii), subject to the limitations set forth in section 4.02(2)(a)-(iii)(F). In applying section 4.02(2)(a)-(iii)(B), the account balance of the employee who incurred the improper forfeiture is increased by an amount equal to the amount of the improper forfeiture and the amount is adjusted for earnings. In applying section 4.02(2)(a)(iii)(C)(*1*), the account balance of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that employee's account. The earnings adjustments for the account balances that are being reduced are determined in accordance with sections 4.02(2)(a)(iii)-(C)(*2*) and (*3*) and the reductions after adjustments for earnings are limited in accordance with section 4.02(2)(a)(iii)-(C)(*4*). In accordance with section 4.02(2)(a)(iii)(D), if the aggregate amount of the increases exceeds the aggregate amount of the reductions, the employer makes a corrective contribution to the plan for the amount of the excess. In accordance with section 4.02(2)(a)(iii)(D), if the aggregate amount of the reductions exceeds the aggregate amount of the increases, then the amount by which each employee's account balance is reduced is decreased on a pro rata basis. (See Example 12.)

(2) Examples.

Example 11:

Employer E maintains a profit-sharing plan that provides for nonelective contributions. The plan provides for self-directed investments among four investment funds and daily valuation of account balances. The plan provides that forfeitures of account balances are reallocated among the account balances of other eligible employees on the basis of compensation. During the 1997 plan year, Employee R terminated employment with Employer E and elected and received a single-sum distribution of the vested portion of his account balance. No other distributions have been made since 1997. However, an incorrect determination of Employee R's vested percentage was made resulting in Employee R receiving a distribution of less than the amount to which he was entitled under the plan. The remaining portion of Employee R's account balance was forfeited and reallocated (and these reallocations were not affected by the limitations of § 415). Most of the employees who received allocations of the improper forfeiture were nonhighly compensated employees.

Correction:

Employer E uses the contribution correction method to correct the improper forfeiture. Thus, Employer E makes a contribution on behalf of Employee R equal to the incorrectly forfeited amount (adjusted for earnings) and Employee R's account balance is increased accordingly. No reduction is made from the account balances of the employees who received an allocation of the improper forfeiture.

Example 12:

The facts are the same as in Example 11.

Correction:

Employer E uses the reallocation correction method to correct the improper forfeiture. Thus, Employee R's account balance is increased by the amount that was improperly forfeited (adjusted for earnings). The account of each employee who shared in the allocation of the improper forfeiture is reduced by the amount of the improper forfeiture that was allocated to that em-

ployee's account (adjusted for earnings). Because most of the employees whose account balances are being reduced are nonhighly compensated employees, for administrative convenience, Employer E uses the earnings rate of the fund with the lowest earnings rate for the period of the failure to adjust the reduction to each account balance. It is determined that the amount (adjusted for earnings) by which the account balance of Employee R is increased exceeds the aggregate amount (adjusted for earnings) by which the other employees' account balances are reduced. Accordingly, Employer E makes a contribution to the plan in an amount equal to the excess. The reduction from the account balances is made on a pro rata basis among all of the funds in which each employee's account balance is invested.

.04 *§ 415 Failures.*

(1) Failures Relating to a § 415(b) Excess.

(a) Correction Methods. (i) Return of Overpayment Correction Method. Overpayments as a result of amounts being paid in excess of the limits of § 415(b) may be corrected using the return of overpayment correction method set forth in this paragraph (1)(a)(i). The employer takes reasonable steps to have the Overpayment (with appropriate interest) returned by the recipient to the plan and reduces future benefit payments (if any) due to the employee to reflect § 415(b). To the extent the amount returned by the recipient is less than the Overpayment, adjusted for earnings at the plan's earnings rate, then the employer or another person contributes the difference to the plan. In addition, in accordance with section 3.04, the employer must notify the recipient that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). (See Examples 15 and 16.)

(ii) Adjustment of Future Payments Correction Method. (A) In General. In addition to the return of overpayment correction method, in the case of plan benefits that are being distributed in the form of periodic payments, Overpayments as a result of amounts being paid in excess of the limits in § 415(b) may be corrected by using the adjustment of future payments correction method set forth in this paragraph (1)(a)(ii). Future payments to the recipient are reduced so that they do not exceed the § 415(b) maximum limit and an additional reduction is made to recoup the Overpayment (over a period not longer than the remaining payment period) so that the actuarial present value of the additional reduction is equal to the Overpayment plus interest at the interest rate used by the plan to determine actuarial equivalence. (See Examples 13 and 14.)

(B) Joint and Survivor Annuity Payments. If the employee is receiving payments in the form of a joint and survivor annuity, with the employee's spouse to receive a life annuity upon the employee's death equal to a percentage (e.g., 75%) of the amount being paid to the employee, the reduction of future annuity payments to reflect § 415(b) reduces the amount of benefits payable during the lives of both the employee and spouse, but any reduction to recoup Overpayments made to the employee does not reduce the amount of the spouse's survivor benefit. Thus, the spouse's benefit will be based on the previous specified percentage (e.g., 75%) of the maximum permitted under § 415(b), instead of the reduced annual periodic amount payable to the employee.

(C) Overpayment Not Treated as an Excess Amount. An Overpayment corrected under this adjustment of future payment correction method, is not treated as an Excess Amount as defined in section 3.06(2).

(b) Examples.

Example 13:

Employer F maintains a defined benefit plan funded solely through employer contributions. The plan provides that the benefits of employees are limited to the maximum amount permitted under § 415(b), disregarding cost-of-living adjustments under § 415(d) after benefit payments have commenced. At the beginning of the 1998 plan year, Employee S retired and started receiving an annual straight life annuity of $140,000 from the plan. Due to an administrative error, the annual amount received by Employee S for 1998 included an Overpayment of $10,000 (because the § 415(b)(1)(A) limit for 1998 was $130,000). This error was discovered at the beginning of 1999.

Correction:

Employer F uses the adjustment of future payments correction method to correct the failure to satisfy the limit in § 415(b). Future annuity benefit payments to Employee S are reduced so that they do not exceed the § 415(b) maximum limit, and, in addition, Employee S's future benefit payments from the plan are actuarially reduced to recoup the Overpayment. Accordingly, Employee S's future benefit payments from the plan are reduced to $130,000 and further reduced by $1,000 annually for life, beginning in 1999. The annual benefit amount is reduced by $1,000 annually for life because, for Employee S, the actuarial present value of a benefit of $1,000 annually for life commencing in 1999 is equal to the sum of $10,000 and interest at the rate used by the plan to determine actuarial equivalence beginning with the date of the first Overpayment and ending with the date the reduced annuity payment begins. Thus, Employee S's remaining benefit payments are reduced so that Employee S receives $129,000 for 1999, and for each year thereafter.

Example 14:

The facts are the same as in Example 13.

Correction:

Employer F uses the adjustments of future payments correction method to correct the § 415(b) failure, by recouping the entire excess payment made in 1998 from Employee S's remaining benefit payments for 1999. Thus, Employee S's annual annuity benefit for 1999 is reduced to $119,400 to reflect the excess benefit amounts (increased by interest) that were paid from the plan to Employee S during the 1998 plan year. Beginning in 2000, Employee S begins to receive annual benefit payments of $130,000.

Example 15:

The facts are the same as in Example 13, except that the benefit was paid to Employee S in the form of a single-sum distribution in 1998, which exceeded the maximum § 415(b) limits by $110,000.

Correction:

Employer F uses the return of overpayment correction method to correct the § 415(b) failure. Thus, Employer F notifies Employee S of the $110,000 Overpayment and that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). The notice also informs Employee S that the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) is owed to the plan. Employer F takes reasonable steps to have the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) paid to the plan. Employee S pays the $110,000 (plus the requested interest) to the plan. It is determined that the plan's earnings rate for the relevant period was 2 percentage points more than the rate used by the plan to calculate the single-sum payment. Accordingly, Employer F contributes the difference to the plan.

Example 16:

The facts are the same as in Example 15.

Correction:

Employer F uses the return of overpayment correction method to correct the § 415(b) failure. Thus, Employer F notifies Employee S of the $110,000 Overpayment and that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover). The notice also informs Employee S that the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) is owed to the plan. Employer F takes reasonable steps to have the Overpayment (with interest at the rate used by the plan to calculate the single-sum payment) paid to the plan. As a result of Employer F's recovery efforts, some, but not all, of the Overpayment (with interest) is recov-

ered from Employee S. It is determined that the amount returned by Employee S to the plan is less than the Overpayment adjusted for earnings at the plan's earnings rate. Accordingly, Employer F contributes the difference to the plan.

(2) Failures Relating to a § 415(c) Excess.

(a) Correction Methods. (i) SVP Correction Method. Appendix A, section .08 of Rev. Proc. 98–22 sets forth the SVP correction method for correcting the failure to satisfy the § 415(c) limits on annual additions.

(ii) Forfeiture Correction Method. In addition to the SVP correction method, the failure to satisfy § 415(c) with respect to a nonhighly compensated employee (A) who in the limitation year of the failure had annual additions consisting of both (I) either elective deferrals or employee after-tax contributions and (II) either matching or nonelective contributions, (B) for whom the matching and nonelective contributions equal or exceed the portion of the employee's annual addition that exceeds the limits under § 415(c) ("§ 415(c) excess") for the limitation year, and (C) who has terminated with no vested interest in the matching and nonelective contributions (and has not been reemployed at the time of the correction), may be corrected by using the forfeiture correction method set forth in this paragraph. The § 415(c) excess is deemed to consist solely of the matching and nonelective contributions. If the employee's § 415(c) excess (adjusted for earnings) has previously been forfeited, the § 415(c) failure is deemed to be corrected. If the § 415(c) excess (adjusted for earnings) has not been forfeited, that amount is placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s) (or if the amount would have been allocated to other employees who were in the plan for the year of the failure if the failure had not occurred, then that amount is reallocated to the other employees in accordance with the plan's allocation formula). Note that while this correction method will permit more favorable tax treatment of elective deferrals for the employee than the SVP correction method, this correction method could be less favorable to the employee in certain cases, for example, if the employee is subsequently reemployed and becomes vested. (See Examples 17 and 18.)

(iii) Return of Overpayment Correction Method. A failure to satisfy § 415(c) that includes a distribution of the § 415(c) excess attributable to nonelective contributions and matching contributions may be corrected using the return of overpayment correction method set forth in this paragraph. The employer takes reasonable steps to have the Overpayment (i.e., the distribution of the 415(c) excess adjusted for earnings to the date of the distribution), plus appropriate interest from the date of the distribution to the date of the repayment, returned by the employee to the plan. To the extent the amount returned by the employee is less than the Overpayment adjusted for earnings at the plan's earnings rate, then the employer or another person contributes the difference to the plan. The Overpayment, adjusted for earnings at the plan's earnings rate to the date of the repayment, is to be placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s) (or if the amount would have been allocated to other eligible employees who were in the plan for the year of the failure if the failure had not occurred, then that amount is reallocated to the other eligible employees in accordance with the plan's allocation formula). In addition, the employer must notify the employee that the Overpayment was not eligible for favorable tax treatment accorded to distributions from qualified plans (and, specifically, was not eligible for tax-free rollover).

(b) Examples.

Example 17:

Employer G maintains a 401(k) plan. The plan provides for nonelective employer contributions, elective deferrals, and employee after-tax contributions. The plan provides that the nonelective contributions vest under a 5-year cliff vesting schedule. The plan provides that when an employee terminates employment, the employee's nonvested account balance is forfeited five years after a distribution of the employee's vested account balance and that forfeitures are used to reduce employer contributions. For the 1998 limitation year, the annual additions made on behalf of two nonhighly compensated employees in the plan, Employees T and U, exceeded the limit in § 415(c). For the 1998 limitation year, Employee T had § 415 compensation of $60,000, and, accordingly, a § 415(c)(1)(B) limit of $15,000. Employee T made elective deferrals and employee after-tax contributions. For the 1998 limitation year, Employee U had § 415 compensation of $40,000, and, accordingly, a § 415(c)(1)(B) limit of $10,000. Employee U made elective deferrals. Also, on January 1, 1999, Employee U, who had three years of service with Employer G, terminated his employment and received his entire vested account balance (which consisted of his elective deferrals). The annual additions for Employees T and U consisted of:

	T	U
Nonelective Contributions	$7,500	$4,500
Elective Deferrals	10,000	5,800
After-tax Contributions	500	0
Total Contributions	$18,000	$10,300
§ 415(c) Limit	$15,000	$10,000
§ 415(c) Excess	$3,000	$300

Correction:

Employer G uses the SVP correction method to correct the § 415(c) excess with respect to Employee T (i.e., $3,000). Thus, a distribution of plan assets (and corresponding reduction of the account balance) consisting of $500 (adjusted for earnings) of employee after-tax contributions and $2,500 (adjusted for earnings) of elective deferrals is made to Employee T. Employer G uses the forfeiture correction method to correct the § 415(c) excess with respect to Employee U. Thus, the § 415(c) excess is deemed to consist solely of the nonelective contributions. Accordingly, Employee U's nonvested account balance is reduced by $300 (adjusted for earnings) which is placed in an unallocated account, similar to the suspense account described in § 1.415-6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). After correction, it is determined that the ADP and ACP tests for 1998 were satisfied.

Example 18:

Employer H maintains a 401(k) plan. The plan provides for nonelective employer contributions, matching contributions and elective deferrals. The plan provides for matching contributions that are equal to 100% of an employee's elective deferrals that do not exceed 8% of the employee's plan compensation for the plan year. For the 1998 limitation year, Employee V had § 415 compensation of $50,000, and, accordingly, a § 415(c)(1)(B) limit of $12,500. During that limitation year, the annual additions for Employee V totaled $15,000, consisting of $5,000 in elective deferrals, a $4,000 matching contribution (8% of $50,000), and a $6,000 nonelective employer contribution. Thus, the annual additions for Employee V exceeded the § 415(c) limit by $2,500.

Correction:

Employer H uses the SVP correction method to correct the § 415(c) excess with respect to Employee V (i.e., $2,500). Accordingly, $1,000 of the unmatched elective deferrals (adjusted for earnings) are distributed to Employee V. The remaining $1,500 excess is apportioned equally between the elective deferrals and the associated matching employer contributions, so Employee V's account balance is further reduced by distributing to Employee V $750 (adjusted for earnings) of the elective deferrals and forfeiting $750 (adjusted for earnings) of the associated employer

matching contributions. The forfeited matching contributions are placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). After correction, it is determined that the ADP and ACP tests for 1998 were satisfied.

.05 *Other Overpayment Failures.*

(1) Correction of Overpayment. An Overpayment, other than one described in section 4.04(1) (relating to a § 415(b) excess) or section 4.04(2) (relating to a § 415(c) excess), may be corrected in accordance with this section 4.05. An Overpayment from a defined benefit plan is corrected in accordance with the rules in section 4.04(1). An Overpayment from a defined contribution plan is corrected in accordance with the rules in section 4.04(2)(a)(iii).

(2) Overpayment Defined. For purposes of this revenue procedure, an Overpayment is defined as a distribution to an employee or beneficiary that exceeds the employee's or beneficiary's benefit under the terms of the plan because of a failure to comply with plan terms that implement § 401(a)(17), 401(m) (but only with respect to the forfeiture of nonvested matching contributions that are excess aggregate contributions), 411(a)(3)(G), or 415. An Overpayment does not include a distribution of an Excess Amount described in section 3.06(2) (b), (c), (d), or (e).

.06 § 401(a)(17) Failures.

(1) Reduction of Account Balance Correction Method. The allocation of contributions or forfeitures under a defined contribution plan for a plan year on the basis of compensation in excess of the limit under § 401(a)(17) for the plan year may be corrected using the reduction of account balance correction method set forth in this paragraph. The account balance of an employee who received an allocation on the basis of compensation in excess of the § 401(a)(17) limit is reduced by this improperly allocated amount (adjusted for earnings). If the improperly allocated amount would have been allocated to other employees in the year of the failure if the failure had not occurred, then that amount (adjusted for earnings) is reallocated to those employees in accordance with the plan's allocation formula. If the improperly allocated amount would not have been allocated to other employees absent the failure, that amount (adjusted for earnings) is placed in an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s). For example, if a plan provides for a fixed level of employer contributions for each eligible employee, and the plan provides that forfeitures are used to reduce future employer contributions, the improperly allocated amount (adjusted for earnings) would be used to reduce future employer contributions. (See Example 19.) If a payment was made to an employee and that payment was attributable to an improperly allocated amount, then it is an Overpayment defined in section 4.05(2) that must be corrected (see section 4.05(1)).

(2) Example.

Example 19:

Employer J maintains a money purchase pension plan. Under the plan, an eligible employee is entitled to an employer contribution of 8% of the employee's compensation up to the § 401(a)(17) limit ($160,000 for 1998). During the 1998 plan year, an eligible employee, Employee W, inadvertently was credited with a contribution based on compensation above the § 401(a)(17) limit. Employee W's compensation for 1998 was $220,000. Employee W received a contribution of $17,600 for 1998 (8% of $220,000), rather than the contribution of $12,800 (8% of $160,000) provided by the plan for that year, resulting in an improper allocation of $4,800.

Correction:

The § 401(a)(17) failure is corrected using the reduction of account balance method by reducing Employee W's account balance by $4,800 (adjusted for earnings) and crediting that amount to an unallocated account, similar to the suspense account described in § 1.415–6(b)(6)(iii), to be used to reduce employer contributions in succeeding year(s).

.07 *Correction by Amendment Under Walk-in CAP.*

(1) § 401(a)(17) Failures. (a) Contribution Correction Method. In addition to the reduction of account balance correction method under section 4.06, an employer may correct a § 401(a)(17) failure for a plan year under a defined contribution plan under the Walk-in Closing Agreement Program ("Walk-in CAP") (in accordance with the requirements of section 11 of Rev. Proc. 98–22) by using the contribution correction method set forth in this paragraph. The employer contributes an additional amount on behalf of each of the other employees (excluding each employee for whom there was a § 401(a)(17) failure) who received an allocation for the year of the failure, amending the plan (as necessary) to provide for the additional allocation. The amount contributed for an employee is equal to the employee's plan compensation for the year of the failure multiplied by a fraction, the numerator of which is the improperly allocated amount made on behalf of the employee with the largest improperly allocated amount, and the denominator of which is the limit under § 401(a)(17) applicable to the year of the failure. The resulting additional amount for each of the other employees is adjusted for earnings. (See Example 20.)

(b) Examples.

Example 20:

The facts are the same as in Example 19.

Correction:

Employer J corrects the failure under Walk-in CAP using the contribution correction method by (1) amending the plan to increase the contribution percentage for all eligible employees (other than Employee W) for the 1998 plan year and (2) contributing an additional amount (adjusted for earnings) for those employees for that plan year. To determine the increase in the plan's contribution percentage (and the additional amount contributed on behalf of each eligible employee), the improperly allocated amount ($4,800) is divided by the § 401(a)(17) limit for 1998 ($160,000). Accordingly, the plan is amended to increase the contribution percentage by 3 percentage points ($4,800/$160,000) from 8% to 11%. In addition, each eligible employee for the 1998 plan year (other than Employee W) receives an additional contribution of 3% multiplied by that employee's plan compensation for 1998. This additional contribution is adjusted for earnings.

(2) Hardship Distribution Failures. (a) Plan Amendment Correction Method. The Operational Failure of making hardship distributions to employees under a plan that does not provide for hardship distributions may be corrected under Walk-in CAP (in accordance with the requirements of section 11 of Rev. Proc. 98-22) using the plan amendment correction method set forth in this paragraph. The plan is amended retroactively to provide for the hardship distributions that were made available. This paragraph does not apply unless (i) the amendment satisfies § 401(a), and (ii) the plan as amended would have satisfied the qualification requirements of § 401(a) (including the requirements applicable to hardship distributions under § 401(k), if applicable) had the amendment been adopted when hard-

ship distributions were first made available. (See Example 21.)

(b) Example.

Example 21:

Employer K, a for-profit corporation, maintains a 401(k) plan. Although plan provisions in 1998 did not provide for hardship distributions, beginning in 1998 hardship distributions of amounts allowed to be distributed under § 401(k) were made currently and effectively available to all employees (within the meaning of § 1.401(a)(4)–4). The standard used to determine hardship satisfied the deemed hardship distribution standards in § 1.401(k)–1(d)(2). Hardship distributions were made to a number of employees during the 1998 and 1999 plan years, creating an Operational Failure. The failure was discovered in 2000.

Correction:

Employer K corrects the failure through Walk-in CAP by adopting a plan amendment, effective January 1, 1998, to provide a hardship distribution option that satisfies the rules applicable to hardship distributions in § 1.401(k)–1(d)(2). The amendment provides that the hardship distribution option is available to all employees. Thus, the amendment satisfies § 401(a), and the plan as amended in 2000 would have satisfied § 401(a) (including § 1.401(a)(4)–4 and the requirements applicable to hardship distributions under § 401(k)) if the amendment had been adopted in 1998.

SECTION 5. EARNINGS ADJUSTMENT METHODS AND EXAMPLES

.01 *Earnings Adjustment Methods.* (1) In general. (a) Under section 6.02(3)(a) of Rev. Proc. 98–22, whenever the appropriate correction method for an Operational Failure in a defined contribution plan includes a corrective contribution or allocation that increases one or more employees' account balance (now or in the future), the contribution or allocation is adjusted for earnings and forfeitures. This section 5 provides earnings adjustment methods (but not forfeiture adjustment methods) that may be used by an employer to adjust a corrective contribution or allocation for earnings in a defined contribution plan. Consequently, these earnings adjustment methods may be used to determine the earnings adjustments for corrective contributions or allocations made under the correction methods in section 4 and under the SVP correction methods in Appendix A, in Rev. Proc. 98–22. If an earnings adjustment method in this section 5 is used to adjust a corrective contribution or allocation, that adjustment is treated as satisfying the earnings adjustment requirement of section 6.02(3)(a) of Rev. Proc. 98–22. Other earnings adjustment methods, different from those illustrated in this section 5, may also be appropriate for adjusting corrective contributions or allocations to reflect earnings.

(b) Under the earnings adjustment methods of this section 5, a corrective contribution or allocation that increases an employee's account balance is adjusted to reflect an "earnings amount" that is based on the earnings rate(s) (determined under section 5.01(3)) for the period of the failure (determined under section 5.01(2)). The earnings amount is allocated in accordance with section 5.01(4).

(c) The rule in section 6.02(4)(a) of Rev. Proc. 98–22 permitting reasonable estimates in certain circumstances applies for purposes of this section 5. For this purpose, a determination of earnings made in accordance with the rules of administrative convenience set forth in this section 5 is treated as a precise determination of earnings. Thus, if the probable difference between an approximate determination of earnings and a determination of earnings under this section 5 is insignificant and the administrative cost of a precise determination would significantly exceed the probable difference, reasonable estimates may be used in calculating the appropriate earnings.

(d) This section 5 does not apply to corrective distributions or corrective reductions in account balances. Thus, for example, while this section 5 applies in increasing the account balance of an improperly excluded employee to correct the exclusion of the employee under the reallocation correction method described in section 4.02(2)(a)(iii)(B), this section 5 does not apply in reducing the account balances of other employees under the reallocation correction method. (See section 4.02(2)(a)(iii)(C) for rules that apply to the earnings adjustments for such reductions.) In addition, this section 5 does not apply in determining earnings adjustments under the one-to-one correction method described in section 4.01(1)-(b)(iii).

(2) Period of the Failure. (a) General Rule. For purposes of this section 5, the "period of the failure" is the period from the date that the failure began through the date of correction. For example, in the case of an improper forfeiture of an employee's account balance, the beginning of the period of the failure is the date as of which the account balance was improperly reduced.

(b) Special Rules for Beginning Date for Exclusion of Eligible Employees from Plan. (i) General Rule. In the case of an exclusion of an eligible employee from a plan contribution, the beginning of the period of the failure is the date on which contributions of the same type (e.g., elective deferrals, matching contributions, or discretionary nonelective employer contributions) were made for other employees for the year of the failure. In the case of an exclusion of an eligible employee from an allocation of a forfeiture, the beginning of the period of the failure is the date on which forfeitures were allocated to other employees for the year of the failure.

(ii) Exclusion from a 401(k) or (m) Plan. For administrative convenience, for purposes of calculating the earnings rate for corrective contributions for a plan year (or the portion of the plan year) during which an employee was improperly excluded from making periodic elective deferrals or employee after-tax contributions, or from receiving periodic matching contributions, the employer may treat the date on which the contributions would have been made as the midpoint of the plan year (or the midpoint of the portion of the plan year) for which the failure occurred. Alternatively, in this case, the employer may treat the date on which the contributions would have been made as the first date of the plan year (or the portion of the plan year) during which an employee was excluded, provided that the earnings rate used is one half of the earnings rate applicable under section 5.01(3) for the plan year (or the portion of the plan year) for which the failure occurred.

(3) Earnings Rate. (a) General Rule. For purposes of this section 5, the earnings rate generally is based on the investment results that would have applied to the corrective contribution or allocation if the failure had not occurred.

(b) Multiple Investment Funds. If a plan permits employees to direct the investment of account balances into more than one investment fund, the earnings rate is based on the rate applicable to the employee's investment choices for the period of the failure. In accordance with

section 6.03(3)(a) of Rev. Proc. 98–22, for administrative convenience, if most of the employees for whom the corrective contribution or allocation is made are nonhighly compensated employees, the rate of return of the fund with the highest earnings rate under the plan for the period of the failure may be used to determine the earnings rate for all corrective contributions or allocations. If the employee had not made any applicable investment choices, the earnings rate may be based on the earnings rate under the plan as a whole (i.e., the average of the rates earned by all of the funds in the valuation periods during the period of the failure weighted by the portion of the plan assets invested in the various funds during the period of the failure).

(c) Other Simplifying Assumptions. For administrative convenience, the earnings rate applicable to the corrective contribution or allocation for a valuation period with respect to any investment fund may be assumed to be the actual earnings rate for the plan's investments in that fund during that valuation period. For example, the earnings rate may be determined without regard to any special investment provisions that vary according to the size of the fund. Further, the earnings rate applicable to the corrective contribution or allocation for a portion of a valuation period may be a pro rata portion of the earnings rate for the entire valuation period, unless the application of this rule would result in either a significant understatement or overstatement of the actual earnings during that portion of the valuation period.

(4) Allocation Methods. (a) In General. For purposes of this section 5, the earnings amount generally may be allocated in accordance with any of the methods set forth in this paragraph (4). The methods under paragraph (4)(c), (d), and (e) are intended to be particularly helpful where corrective contributions are made at dates between the plan's valuation dates.

(b) Plan Allocation Method. Under the plan allocation method, the earnings amount is allocated to account balances under the plan in accordance with the plan's method for allocating earnings as if the failure had not occurred. (See Example 22.)

(c) Specific Employee Allocation Method. Under the specific employee allocation method, the entire earnings amount is allocated solely to the account balance of the employee on whose behalf the corrective contribution or allocation is made (regardless of whether the plan's allocation method would have allocated the earnings solely to that employee). In determining the allocation of plan earnings for the valuation period during which the corrective contribution or allocation is made, the corrective contribution or allocation (including the earnings amount) is treated in the same manner as any other contribution under the plan on behalf of the employee during that valuation period. Alternatively, where the plan's allocation method does not allocate plan earnings for a valuation period to a contribution made during that valuation period, plan earnings for the valuation period during which the corrective contribution or allocation is made may be allocated as if that employee's account balance had been increased as of the last day of the prior valuation period by the corrective contribution or allocation, including only that portion of the earnings amount attributable to earnings through the last day of the prior valuation period. The employee's account balance is then further increased as of the last day of the valuation period during which the corrective contribution or allocation is made by that portion of the earnings amount attributable to earnings after the last day of the prior valuation period. (See Example 23.)

(d) Bifurcated Allocation Method. Under the bifurcated allocation method, the entire earnings amount for the valuation periods ending before the date the corrective contribution or allocation is made is allocated solely to the account balance of the employee on whose behalf the corrective contribution or allocation is made. The earnings amount for the valuation period during which the corrective contribution or allocation is made is allocated in accordance with the plan's method for allocating other earnings for that valuation period in accordance with section 5.01(4)(b). (See Example 24.)

(e) Current Period Allocation Method. Under the current period allocation method, the portion of the earnings amount attributable to the valuation period during which the period of the failure begins ("first partial valuation period") is allocated in the same manner as earnings for the valuation period during which the corrective contribution or allocation is made in accordance section 5.01(4)(b). The earnings for the subsequent full valuation periods ending before the beginning of the valuation period during which the corrective contribution or allocation is made are allocated solely to the employee for whom the required contribution should have been made. The earnings amount for the valuation period during which the corrective contribution or allocation is made ("second partial valuation period") is allocated in accordance with the plan's method for allocating other earnings for that valuation period in accordance with section 5.01(4)(b). (See Example 25.)

.02 Examples.

Example 22:

Employer L maintains a profit-sharing plan that provides only for nonelective contributions. The plan has a single investment fund. Under the plan, assets are valued annually (the last day of the plan year) and earnings for the year are allocated in proportion to account balances as of the last day of the prior year, after reduction for distributions during the current year but without regard to contributions received during the current year (the "prior year account balance"). Plan contributions for 1997 were made on March 31, 1998. On April 20, 2000 Employer L determines that an Operational Failure occurred for 1997 because Employee X was improperly excluded from the plan. Employer L decides to correct the failure by using the SVP correction method for the exclusion of an eligible employee from nonelective contributions in a profit-sharing plan. Under this method, Employer L determines that this failure is corrected by making a contribution on behalf of Employee X of $5,000 (adjusted for earnings). The earnings rate under the plan for 1998 was +20%. The earnings rate under the plan for 1999 was +10%. On May 15, 2000, when Employer L determines that a contribution to correct for the failure will be made on June 1, 2000, a reasonable estimate of the earnings rate under the plan from January 1, 2000 to June 1, 2000 is +12%.

Earnings Adjustment on the Corrective Contribution:

The $5,000 corrective contribution on behalf of Employee X is adjusted to reflect an earnings amount based on the earnings rates for the period of the failure (March 31, 1998 through June 1, 2000) and the earnings amount is allocated using the plan allocation method. Employer L determines that a pro rata simplifying assumption may be used to determine the earnings rate for the period from March 31, 1998 to December 31, 1998, because that rate does not significantly understate or overstate the actual earnings for that period. Accordingly, Employer L determines that the earnings rate for that period is 15% (9/12 of the plan's 20% earnings rate

for the year). Thus, applicable earnings rates under the plan during the period of the failure are:

Time Periods	Earnings Rate
3/31/98 – 12/31/98 (First Partial Valuation Period)	+15%
1/1/99 – 12/31/99	+10%
1/1/00 – 6/1/00 (Second Partial Valuation Period)	+12%

If the $5,000 corrective contribution had been contributed for Employee X on March 31, 1998, (1) earnings for 1998 would have been increased by the amount of the earnings on the additional $5,000 contribution from March 31, 1998 through December 31, 1998 and would have been allocated as 1998 earnings in proportion to the prior year (December 31, 1997) account balances, (2) Employee X's account balance as of December 31, 1998 would have been increased by the additional $5,000 contribution, (3) earnings for 1999 would have been increased by the 1999 earnings on the additional $5,000 contribution (including 1998 earnings thereon) allocated in proportion to the prior year (December 31, 1998) account balances along with other 1999 earnings, and (4) earnings for 2000 would have been increased by the earnings on the additional $5,000 (including 1998 and 1999 earnings thereon) from January 1 to June 1, 2000 and would be allocated in proportion to the prior year (December 31, 1999) account balances along with other 2000 earnings. Accordingly, the $5,000 corrective contribution is adjusted to reflect an earnings amount of $2,084 ($5,000[(1.15)(1.10)(1.12)–1]) and the earnings amount is allocated to the account balances under the plan allocation method as follows:

(a) Each account balance that shared in the allocation of earnings for 1998 is increased, as of December 31, 1998, by its appropriate share of the earnings amount for 1998, $750 ($5,000(.15)).

(b) Employee X's account balance is increased, as of December 31, 1998, by $5,000.

(c) The resulting December 31, 1998 account balances will share in the 1999 earnings, including the $575 for 1999 earnings included in the corrective contribution ($5,750(.10)), to determine the account balances as of December 31, 1999. However, each account balance other than Employee X's account balance has already shared in the 1999 earnings, excluding the $575. Accordingly, Employee X's account balance as of December 31, 1999 will include $500 of the 1999 portion of the earnings amount based on the $5,000 corrective contribution allocated to Employee X's account balance as of December 31, 1998 ($5,000(.10)). Then each account balance that originally shared in the allocation of earnings for 1999 (i.e., excluding the $5,500 additions to Employee X's account balance) is increased by its appropriate share of the remaining 1999 portion of the earnings amount, $75.

(d) The resulting December 31, 1999 account balances (including the $5,500 additions to Employee X's account balance) will share in the 2000 portion of the earnings amount based on the estimated January 1, 2000 to June 1, 2000 earnings included in the corrective contribution equal to $759 ($6,325(.12)). (See Table 1.)

TABLE 1
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	All 12/31/1997 Account Balances[4]
1999 Earnings	10%	575[2]	Employee X ($500)/ All 12/31/1998 Account Balances ($75)[4]
Second Partial Valuation Period Earnings	12%	759[3]	All 12/31/1999 Account Balances (including Employee X's $5,500)[4]
Total Amount Contributed		$7,084	

[1] $5,000 × 15%
[2] $5,750($5,000 + 750) × 10%
[3] $6,325($5,000 + 750 + 575) × 12%
[4] After reduction for distributions during the year for which earning are being determined but without regard to contributions received during the year for which earnings are being determined.

Example 23:

The facts are the same as in Example 22.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 22, but the earnings amount is allocated using the specific employee allocation method. Thus, the entire earnings amount for all periods through June 1, 2000 (i.e., $750 for March 31, 1998 to December 31, 1998, $575 for 1999, and $759 for January 1, 2000 to June 1, 2000) is allocated to Employee X. Accordingly, Employer L makes a contribution on June 1, 2000 to the plan of $7,084 ($5,000(1.15) (1.10)(1.12)). Employee X's account balance as of December 31, 2000 is increased by $7,084. Alternatively, Employee X's account balance as of December 31, 1999 is increased by $6,325 ($5,000(1.15)(1.10)), which shares in the allocation of earnings for 2000, and Employee X's account balance as of December 31, 2000 is increased by the remaining $759. (See Table 2.)

TABLE 2
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	Employee X
1999 Earnings	10%	575[2]	Employee X
Second Partial Valuation Period Earnings	12%	759[3]	Employee X
Total Amount Contributed		$7,084	

[1] $5,000 × 15%
[2] $5,750 ($5,000 + 750) × 10%
[3] $6,325 ($5,000 + 750 + 575) × 12%

Example 24:

The facts are the same as in Example 22.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 22, but the earnings amount is allocated using the bifurcated allocation method. Thus, the earnings for the first partial valuation period (March 31, 1998 to December 31, 1998) and the earnings for 1999 are allocated to Employee X. Accordingly, Employer L makes a contribution on June 1, 2000 to the plan of $7,084 ($5,000(1.15)(1.10)(1.12)). Employee X's account balance as of December 31, 1999 is increased by $6,325 ($5,000 (1.15)(1.10)); and the December 31, 1999 account balances of employees (including Employee X's increased account balance) will share in estimated January 1, 2000 to June 1, 2000 earnings on the corrective contribution equal to $759 ($6,325(.12)). (See Table 3.)

TABLE 3
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	Employee X
1999 Earnings	10%	575[2]	Employee X
Second Partial Valuation Period Earnings	12%	759[3]	12/31/99 Account Balances (including Employee X's $6,325)[4]
Total Amount Contributed		$7,084	

[1] $5,000 × 15%
[2] $5,750 ($5,000 + 750) × 10%
[3] $6,325 ($5,000 +750 + 575) × 12%
[4] After reduction for distributions during the 2000 year but without regard to contributions received during the 2000 year .

Example 25:

The facts are the same as in Example 22.

Earnings Adjustment on the Corrective Contribution:

The earnings amount on the corrective contribution is the same as in Example 22, but the earnings amount is allocated using the current period allocation method. Thus, the earnings for the first partial valuation period (March 31, 1998 to December 31, 1998) are allocated as 2000 earnings. Accordingly, Employer L makes a contribution on June 1, 2000 to the plan of $7,084 ($5,000 (1.15)(1.10) (1.12)). Employee X's account balance as of December 31, 1999 is increased by the sum of $5,500 ($5,000(1.10)) and the remaining 1999 earnings on the corrective contribution equal to $75 ($5,000(.15) (.10)). Further, both (1) the estimated March 31, 1998 to December 31, 1998 earnings on the corrective contribution equal to $750 ($5,000(.15)) and (2) the estimated January 1, 2000 to June 1, 2000 earnings on the corrective contribution equal to $759 ($6,325(.12)) are treated in the same manner as 2000 earnings by allocating these amounts to the December 31, 2000 account balances of employees in proportion to account balances as of December 31, 1999 (including Employee X's increased account balance). (See Table 4.) Thus, Employee X is allocated the earnings for the full valuation period during the period of the failure.

TABLE 4
CALCULATION AND ALLOCATION OF THE
CORRECTIVE AMOUNT ADJUSTED FOR EARNINGS

	Earnings Rate	Amount	Allocated to:
Corrective Contribution		$5,000	Employee X
First Partial Valuation Period Earnings	15%	750[1]	12/31/99 Account Balances (including Employee X's $5,575)[4]
1999 Earnings	10%	575[2]	Employee X
Second Partial Valuation Period Earnings	12%	759[3]	12/31/99 Account Balances (including Employee X's $5,575)[4]
Total Amount Contributed		$7,084	

[1] $5,000 × 15%
[2] $5,750($5,000 + 750) × 10%
[3] $6,325($5,000 + 750 + 575) × 12%
[4] After reduction for distributions during the year for which earnings are being determined but without regard to contributions received during the year for which earnings are being determined.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 98–22 clarified and supplemented. Rev. Proc. 98–22 is clarified and supplemented by this revenue procedure.

SECTION 7. EFFECTIVE DATE

The effective date of this revenue procedure is January 1, 2000. In addition, employers are permitted, at their option, to apply the provisions of this revenue procedure on or after March 9, 1998 (the release date of Rev. Proc. 98–22). Unless a plan sponsor applies the provisions of this revenue procedure earlier, this revenue procedure is effective:

(1) with respect to VCR and Walk-in CAP, for applications submitted on or after January 1, 2000;

(2) with respect to Audit CAP, for examinations begun on or after January 1, 2000; and

(3) with respect to APRSC, for failures for which correction is not complete before May 1, 2000.

SECTION 8. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1656.

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

The collections of information in this revenue procedure are in sections 3.04 and 4.01–4.07. This information is required to enable the Office of Assistant Commissioner (Employee Plans and Exempt Organizations) of the Internal Revenue Service to make determinations regarding the issuance of certain closing agreements and to ascertain if plan participants have been notified of certain actions. This information can allow individual plans to continue to maintain their tax qualified status. As a result, favorable tax treatment of the benefits of the eligible employees is retained. The likely respondents are individuals, state or local governments, business or other for- profit

institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting and/or recordkeeping burden is 10,800 hours.

The estimated annual burden per respondent/recordkeeper varies from 2 to 12 hours, depending on individual circumstances, with an estimated average of 10.8 hours. The estimated number of respondents and/or recordkeepers is 1,000.

The estimated annual frequency of responses is occasionally.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Jeanne Royal Singley and Maxine Terry of the Employee Plans Division. For more information concerning this revenue procedure, call the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Singley and Ms. Terry may be reached at (202) 622-6214 (also not a toll-free number).

Rev. Proc. 99–32

SUMMARY: This document contains a new revenue procedure that sets forth the Service's position regarding adjustments that may be made to conform the accounts of taxpayers to reflect allocations made under section 482 of the Internal Revenue Code.

SUPPLEMENTARY INFORMATION:

Background

In Announcement 99–1, 1999–2 I.R.B. 11, the Internal Revenue Service invited comment on a revision of Rev. Proc. 65–17, 1965–1 C.B. 833, on conforming a taxpayer's accounts to reflect a primary adjustment under section 482 of the Internal Revenue Code. The comments received and changes finally adopted in this revenue procedure are summarized below.

Explanation of Provisions

A. *Taxpayer-Initiated Primary Adjustments*

In furtherance of the overall goal of promoting upfront compliance with the arm's length standard, Announcement 99–1 proposed providing a mechanism for taxpayers to conform their accounts in connection with taxpayer-initiated (as well as Service-initiated) primary adjustments, without the Federal income tax consequences of the secondary adjustments that would otherwise result under section 482. Commentators welcomed this proposal and it is finally adopted in this revenue procedure. Accordingly, taxpayers may elect, by filing a statement with their Federal income their tax returns, to apply revenue procedure treatment for taxpayer-initiated upward and downward adjustments of taxable income pursuant to section 1.482–1(a)(3) of the Treasury regulations, in connection with inbound, outbound, and certain foreign-to-foreign controlled transactions. Election of revenue procedure treatment through such a statement shall be binding on the taxpayer.

B. *Offsets*

Announcement 99–1 proposed eliminating dividend offsets and making account treatment the sole means to repatriate the cash attributable to a primary adjustment, without the Federal income tax consequences of secondary adjustments. Some commentators supported this proposal on the ground that dividend paying policies are independent of transfer pricing. Other commentators, however, expressed the view that elimination of dividend offsets would discourage current repatriation of earnings, prolong transfer pricing disputes, and pose problems when payment of a form of income is restricted under foreign law. Others suggested that permitting offsets in connection with taxpayer-initiated adjustments would be consistent with upfront compliance with the arm's length standard.

In response to these comments, this revenue procedure allows taxpayers to offset accounts by distributions, including those that would otherwise be dividends, in the same year as that to which a taxpayer-initiated primary adjustment relates, provided the offset treatment is claimed on a timely-filed income tax return (including extensions). In addition, offsets may be claimed for distributions in the year in which a return is filed reporting a taxpayer-initiated adjustment or in the year a closing agreement is entered into in connection with a Service-initiated adjustment. Offsets are also permitted by means of entries offsetting bona fide debts and capital contributions. No offsets are allowed with respect to a year for which an income tax return has already been filed, except for pre-effective date years as described below. Offsets are treated as prepayments of the interest and principal of an account established under the revenue procedure for all Federal income tax purposes, regardless of their characterization under foreign law.

In the Service's view, these changes are consistent with the overall goal of upfront compliance with the arm's length standard and reduce any disincentive to repatriate earnings. Moreover, they improve administrability by dispensing with the need to reverse tax effects reported on prior income tax returns, as was required with the dividend offset pursuant to Rev. Proc. 65–17.

The Service recognizes that a domestic subsidiary of a foreign parent may claim an offset pursuant to this revenue procedure by reason of a distribution as to which the subsidiary withheld tax in accordance with its obligations pursuant to section 1442 of the Code. In such a case, the Service anticipates that the foreign parent will be able to file an income tax return to obtain a refund of such withholding tax.

The Service intends that offset treatment pursuant to this revenue procedure shall be the exclusive means of addressing the situations in which payments of certain forms of income are restricted under foreign law that are described in Example 2 and Example 3 of section 1.482–1(h)(2)(v) of the Treasury regulations.

C. *Effective Date and Transitional Treatment*

Announcement 99–1 proposed that the revised revenue procedure be prospectively effective for taxable years beginning after its publication. Commentators suggested that liberal transitional rules be provided for application of revenue pro-

cedure treatment in connection with taxpayer-initiated adjustments for pre-effective date taxable years.

In response to these comments, the final revised revenue procedure published in this document provides that for taxable years prior to the taxable year that includes the date of publication, taxpayers shall be permitted to use a reasonable interpretation of the principles of Rev. Proc. 65–17 for purposes of conforming their accounts to reflect a taxpayer-initiated primary adjustment. The Service considers an interpretation that applies the final revised revenue procedure or its general principles to be such a reasonable interpretation of Rev. Proc. 65–17. The Service also considers that a reasonable interpretation would include the permission of a taxpayer-initiated offset by reason of a distribution reported as a dividend on a prior income tax return for the taxable year to which the primary adjustment relates, provided the subsequent treatment reverses any previously claimed tax effects associated with such dividend in accordance with the principles of section 4.01 of Rev. Proc. 65–17.

For taxable years that include the date of publication of this revenue procedure, a taxpayer may elect to apply all of the provisions of this revenue procedure. Otherwise, Rev. Proc. 65–17 applies for such taxable years in accordance with its terms. In such cases, revenue procedure treatment for taxpayer-initiated adjustments will necessitate a closing agreement with the Service.

D. *Penalty Condition*

Announcement 99–1 proposed to substitute inapplicability of any penalty under section 6662(e), for absence of a principal tax avoidance purpose required under Rev. Proc. 65–17, as the condition for revenue procedure treatment. Commentators criticized the requirement of any condition for various reasons, including that such condition would inappropriately expand the section 6662(e) penalty and may yield apparently arbitrary results. Other commentators suggested that the determination of the inapplicability of the penalty was problematic in the case of a taxpayer-initiated adjustment.

This revenue procedure removes the penalty condition in the case of taxpayer-initiated adjustments, but retains the condition for Service-initiated adjustments, including such adjustments as result from examination of taxpayer-initiated adjustments. The condition is neither an expansion of the penalty, nor arbitrary, but, rather, it is a reasonable tax administration restriction on availability of the revenue procedure treatment. In the Service's view the penalty condition of this revenue procedure is more objective than absence of a principal tax avoidance purpose under Rev. Proc. 65–17 and, moreover, is consistent with the goal of upfront compliance.

E. *Other Changes and Clarifications*

As proposed by Announcement 99–1, the revenue procedure clarifies that a foreign tax credit shall be allowed for any foreign withholding tax with respect to the repayment of the principal or interest of the account to the extent and subject to the limitations provided under section 901 of the Code. The amount of any payment or prepayment of an account established under the revenue procedure is considered to include the amount of such foreign withholding tax. The revenue procedure does not adopt comments that allowance of a section 901 credit for a foreign withholding tax should be without regard to whether a taxpayer exhausts all effective and practical remedies, including invocation of competent authority procedures. This is a requirement under the applicable regulations. Treas. Reg. § 1.901–2(e)(5).

Persons eligible for revenue procedure treatment are limited to "United States taxpayers," i.e., either a domestic corporation or a foreign corporation that is, or is treated as, engaged in a trade or business within the United States. Controlled transactions between a controlled foreign corporation of a domestic corporation and a foreign related corporation are also eligible for treatment under the revenue procedure. Transactions with noncorporate persons, for example, a transaction between a partnership and its controlling corporate partner, are not covered by the revenue procedure, but will be the subject of further study by the Service.

Accounts under the revenue procedure are set up, and offsets are permitted, between the related corporation and the United States taxpayer, or any member of its affiliated group. See Rev. Proc. 70–23, 1970–2 C.B. 505, and Rev. Proc. 71–35, 1971–2 C.B. 573, both superseded by this revenue procedure. The revenue procedure clarifies application of the safe harbor interest rates in the case of interest on accounts. Where an account is paid in the form of term debt, such debt will be considered a new obligation commencing with a new term; however, payment by means of term debt shall be respected only to the extent the debt qualifies in substance as bona fide debt under applicable debt-equity rules. The revenue procedure provides that interest on accounts is includible in the income of the obligee on the accrual basis regardless of the obligee's method of accounting. See Rev. Proc. 72–48, 1972–2 C.B. 829, superseded by this revenue procedure. Account interest is deductible by the obligor, but subject to applicable limitations including sections 163(e)(3) and 267(a)(3) of the Code. Rules are prescribed for determining the currency in which the principal and interest of an account must be denominated, which generally will be the U.S. dollar.

Other conforming changes are made to incorporate the provisions of other various progeny of Rev. Proc. 65–17 that are superseded by this revenue procedure. Coordination of revenue procedure treatment and the competent authority process and the advance pricing agreement program will be considered in connection with the revision and updating of the revenue procedures governing those processes. See generally Rev. Proc. 96–13, 1996–1 C.B. 616; Rev. Proc. 96–14, 1996–1 C.B. 626; and Rev. Proc. 96–53, 1996–2 C.B. 375.

* * * * *

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also, Part I, section 482)

Rev. Proc. 99–32

SECTION 1. PURPOSE

Pursuant to section 1.482–1(g)(3) of the Income Tax Regulations, this revenue procedure prescribes the applicable procedures for the repatriation of cash by a United States taxpayer via an interest-bearing account receivable or payable (the "account") in an amount corresponding to the amount allocated to, or from,

such taxpayer under section 482 of the Internal Revenue Code (the "Code") from, or to, a related person with respect to a controlled transaction. Additionally, circumstances are prescribed in which a United States taxpayer may treat an account as offset (the "offset") in whole or part by the amount of a bona fide debt, distribution, or capital contribution between the taxpayer and such related person. Under this revenue procedure, taxpayers whose taxable income has been adjusted under section 482 of the Code are generally permitted to make certain adjustments to conform their accounts to reflect the section 482 allocation. The conditions for treatment under this revenue procedure are set forth in section 3, the adjustments to be made or allowed are described in section 4 (for Internal Revenue Service as well as taxpayer-initiated adjustments), and the prescribed procedures are set forth in section 5.

SEC. 2. BACKGROUND AND SCOPE

Section 482 of the Code gives the Internal Revenue Service authority to "distribute, apportion or allocate gross income, deductions, credits, or allowances" among certain related organizations, trades or businesses if it "determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income" of any such entity. Absent a United States taxpayer's election of treatment under this revenue procedure, an adjustment under section 482 (the "primary adjustment") entails secondary adjustments to conform the taxpayer's accounts to reflect the primary adjustment. These secondary adjustments may result in adverse tax consequences to the taxpayer. For example, an allocation of income under section 482 from a foreign parent corporation to its domestic subsidiary corporation would entail a deemed distribution from the domestic subsidiary to its foreign parent in an amount equal to the primary adjustment in the year for which the allocation is made. The deemed distribution would be treated as dividend income to the foreign parent to the extent of the earnings and profits of the domestic subsidiary, as recomputed after taking into account the primary adjustment. Under section 881 of the Code, the foreign parent would be subject to a 30-percent tax liability (as reduced by any applicable income tax treaty), and under section 1442 of the Code, the domestic subsidiary would be a withholding agent required to withhold the tax. See Rev. Rul. 82–80, 1982–1 C.B. 89; Treas. Reg. § 1.1441–2(e)(2). This revenue procedure allows the United States taxpayer to repatriate the cash attributable to a primary adjustment via an account without the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment.

Additionally, section 1.482–1(a)(3) of the Income Tax Regulations permits a controlled taxpayer to report an arm's length result for controlled transactions based upon prices different from those actually charged. If the adjustment results in an increase in taxable income, the increased income may be reported by the taxpayer at any time. If the adjustment results in a decrease in taxable income (after appropriate accounting for section 1059A of the Code), the arm's length result may be reported on a timely filed return (including extensions). A United States taxpayer can avail itself of the treatment provided by this revenue procedure to mitigate the Federal income tax consequences of the secondary adjustments that would otherwise result from the taxpayer's "self-initiated" primary adjustment. In the case of a taxpayer-initiated adjustment, a United States taxpayer may, in accordance with section 4.02 of this revenue procedure, use an offset in combination with an account to effectuate the repatriation of the cash attributable to the primary adjustment without the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment. The United States taxpayer is bound by its election of treatment under the revenue procedure. The taxpayer-initiated adjustment for the treatment provided under the revenue procedure will be subject to review and adjustment, and to possible imposition of the section 6662(e) or (h) penalty, by the Service upon examination.

This revenue procedure applies in situations where an adjustment is made under section 482 of the Code, as well as to Service-initiated adjustments made under sections 61 or 162 of the Code, provided the adjustment could have been made under section 482 of the Code. All references in this revenue procedure to section 482 of the Code will be deemed to include sections 61 and 162 of the Code, except when the context or express language indicates or provides otherwise.

Any reference in this revenue procedure to an increase or decrease in, or an adjustment of, taxable income shall also be deemed a reference, in an appropriate case, to a reduction or increase in, or an adjustment of, a taxpayer's loss.

Any reference in this revenue procedure to the Service shall be deemed a reference to the office within the Service that has jurisdiction over the Federal income tax return filed for the taxable year for which the primary adjustment is made.

For purposes of this revenue procedure, a "United States taxpayer" is a domestic corporation, or a foreign corporation that is, or is treated as, engaged in trade or business within the United States.

For purposes of this revenue procedure, an increase or decrease, or an adjustment of, the taxable income of a United States taxpayer that is a domestic corporation pursuant to section 482 of the Code shall be deemed to include an allocation of an amount to, or from, a related person (being a corporation as defined in section 7701(a)(3) of the Code), from, or to, a foreign corporation that is a controlled foreign corporation within the meaning of section 957 of the Code solely by reason of ownership of such foreign corporation's stock by such domestic corporation (or any member of the affiliated group within the meaning of section 1504(a) of the Code in which such domestic corporation is included) with respect to a controlled transaction. In the latter circumstances, the parties to any account established under section 4.01 shall be such controlled foreign corporation and such related person, and for purposes of section 4.01(2) the requirement to accrue and include, or deduct, interest in, or from, taxable income shall mean accounting for such interest for all Federal income tax purposes that may affect the determination of the taxable income or tax liability of such domestic corporation, including, for example, the computation of earnings and profits, subpart F income, and the foreign tax credit provided under section 901 of the Code.

Treatment under this revenue procedure shall not be denied solely by reason of the fact a corporation under State law is

in existence for the purpose of winding up its affairs, where such corporation, subsequent to its liquidation, was a corporation from, or to, which an amount was allocated pursuant to section 482 of the Code.

SEC. 3. CONDITIONS FOR TREATMENT UNDER THIS REVENUE PROCEDURE

A United States taxpayer described in section 5 shall qualify for the treatment provided in this revenue procedure only if it satisfies the conditions described in this section 3.

.01 A United States taxpayer described in section 5.01 shall qualify for the treatment provided in this revenue procedure if the taxable income of such United States taxpayer is adjusted by the Internal Revenue Service under section 482 and no penalty under section 6662(e)(1)(B) or (h) of the Code on account of such primary adjustment is asserted and, if challenged, finally sustained. In the case of an adjustment under section 61 or 162, this condition will be deemed to be satisfied if no penalty could have been sustained under section 6662(e)(1)(B) or (h) on account of the adjustment that could have been made under section 482.

.02 A United States taxpayer described in section 5.02 shall qualify for the treatment provided in this revenue procedure, provided that the taxpayer shall be bound by its election of such treatment.

.03 A United States taxpayer shall not qualify under sections 3.01 or 3.02 for the treatment provided in this revenue procedure if any part of any underpayment of tax by such taxpayer for the taxable year involved in the section 482 allocation is due to fraud.

SEC. 4. ADJUSTMENTS TO BE MADE OR ALLOWED

.01 *Account, interest, currency, and payment.* If a United States taxpayer qualifying under section 3 complies with the requirements of section 5, such taxpayer (or any member of the affiliated group within the meaning of section 1504(a) of the Code in which such taxpayer is included) shall be permitted to establish an interest-bearing account receivable from, or payable to, the related person (being a corporation as defined in section 7701(a)(3) of the Code) from, or to, whom the section 482 allocation is made with respect to a controlled transaction in an amount equal to the primary adjustment for each of the years in which an allocation is made. The account may be established and paid in accordance with this revenue procedure without the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment. The account shall:

(1) be deemed to have been created as of the last day of the taxpayer's taxable year for which the primary adjustment is made;

(2) bear interest at an arm's length rate, computed in the manner provided in section 1.482–2(a)(2) of the regulations, from the day after the date the account is deemed to have been created to the date of payment. For purposes of section 1.482–2(a)(2)(iii), where applicable, the account shall be considered to be a loan or advance having a term extending from the day after the date the account is deemed to have been created through the expiration of the 90-day period required in section 5. The interest so computed shall be accrued and included by the obligee in taxable income for each taxable year during which the account is deemed outstanding, regardless of whether the obligee uses the cash receipts and disbursements method of accounting or the accrual method of accounting. The interest so computed shall be accrued and deducted (subject to applicable limitations) by the obligor from taxable income for each taxable year during which the account is deemed outstanding;

(3) be expressed, both as to principal and interest, in the functional currency of a qualified business unit, as defined in section 1.989(a)–1 of the regulations, through which the controlled transaction was carried out, if the residence of such qualified business unit, as defined in section 988(a)(3)(B)(ii), is the United States. If the residence of both of the qualified business units through which the controlled transaction was carried out is the United States, then the account shall be expressed, both as to principal and interest, in the functional currency of such U.S. resident qualified business unit of the obligee. If the residence of both of the qualified business units through which the controlled transaction was carried out is a country other than the United States, then the account shall be expressed, both as to principal and interest, in the functional currency of such non-U.S. resident qualified business unit of the corporation that is a domestic corporation, or if both corporations are domestic corporations, or neither corporation is a domestic corporation, then in the functional currency of such non-U.S. resident qualified business unit of the obligee;

(4) be paid within the 90-day period required in section 5, or treated as prepaid by offset prior to that time as provided in section 4.02. Payment within the 90-day period must be in the form of money, a written debt obligation payable at a fixed date and bearing interest at an arm's length rate determined in the manner provided in section 1.482–2(a)(2) of the regulations, or an accounting entry offsetting such account against an existing bona fide debt between the United States taxpayer (or member of its affiliated group) and the related person. Any such payment within the 90-day period, and any such prepayment prior to that time pursuant to section 4.02, shall be treated as a payment of the account for all Federal income tax purposes, regardless of its characterization under foreign law. For example, to the extent that an account is offset pursuant to section 4.02, by a distribution that would otherwise have constituted a dividend, such distribution shall cease to qualify as a dividend under section 316 of the Code or as a dividend for any Federal income tax purpose; for instance, no foreign tax shall be deemed to have been paid with respect thereto under section 902 of the Code for the purpose of the credit allowed under section 901 of the Code and no dividend received deduction shall be allowed with respect thereto under sections 241 through 247 of the Code. An amount includible in income under section 551 or 951 of the Code shall not be considered a distribution for purposes of this paragraph or section 4.02.

A foreign tax credit shall be allowed for any foreign withholding tax with respect to the repayment of the principal or interest of the account to the extent and subject to the limitations provided under section 901 of the Code. See Treas. Reg. §§ 1.901–2(e)(5) and 1.904–6(a)(1)(iv).

.02 *Offset.* All or part of the interest and principal of an account may be

treated as prepaid prior to the beginning of the 90-day period required in section 5 to the extent of an accounting entry offsetting such account against a bona fide debt between the United States taxpayer (or member of its affiliated group) and the related person, or to the extent of any distribution of property or contribution to capital between such parties, where the offsetting entry, the distribution, or the capital contribution occurs during the taxable year in which occurs the execution of the closing agreement on behalf of the Commissioner (in a case under section 5.01), or during the taxable year in which occurs the date on which the United States taxpayer files the return reporting the primary adjustment (in a case under section 5.02), or during the taxable year for which the section 482 allocation is made (in a case under section 5.02, but subject to the provisions stated in the next two sentences). For purposes of this revenue procedure, any offset of the account by reason of such a bona fide debt, distribution, or capital contribution during the taxable year for which the section 482 allocation is made shall be treated as a prepayment of the account made as of the beginning of the day after the date the account is deemed to have been created. No untimely or amended returns will be permitted to claim offset treatment by reason of such a bona fide debt, distribution, or capital contribution during the taxable year for which the section 482 allocation is made.

.03 *Primary adjustment not affected.* A United States taxpayer's election to avail itself of the provisions of this revenue procedure shall in no way affect the primary adjustment under section 482 of the Code. Such election shall, however, affect the taxpayer's taxable income and credits to the extent indicated by section 4.01 and eliminate the collateral effects of secondary adjustments, such as those described in section 2.

SEC. 5. PROCEDURES TO BE FOLLOWED

.01 *Cases pending with the Internal Revenue Service.*

(1) If a United States taxpayer whose taxable income has been adjusted by the Internal Revenue Service pursuant to section 482 of the Code desires to avail itself of the treatment provided in section 4, it must file a request in writing with the Service before closing action is taken on the primary adjustment. For purposes of this revenue procedure, the first occurring of the following shall constitute "closing action":

(a) Execution and acceptance of Form 870-AD, Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment, or execution of a closing agreement relative to the section 482 allocation;

(b) Stipulation of a section 482 allocation in the Tax Court of the United States;

(c) Expiration of the statute of limitations on assessments for the year to which the allocation applies;

(d) Final determination of tax liability for the year to which the allocation relates by offer-in-compromise, closing agreement, or court action.

(2) The request shall be signed by a person having the authority to sign the United States taxpayer's Federal income tax returns, and shall contain the following:

(a) A statement that the taxpayer desires the treatment provided by section 4 of this revenue procedure and the years for which the treatment is requested;

(b) A description of the arrangements or transactions, or the terms thereof, which gave rise to the primary adjustment;

(c) An offer to enter into a closing agreement under section 7121 of the Code as provided in section 5.01(4).

(3) The Service will determine whether the United States taxpayer qualifies for the requested treatment and inform the taxpayer of its decision.

(4) If the Service concludes that section 4 of this revenue procedure properly applies, and if the amount of the primary adjustment has been agreed upon, the United States taxpayer will be requested to enter into a closing agreement under section 7121 of the Code, establishing for each year involved:

(a) The amount of the primary adjustment;

(b) The amount and currency of, and parties to, the account which the taxpayer elects to establish under section 4.01;

(c) The amount of the interest on the account includible in income, or deductible, pursuant to section 4.01;

(d) The amount of any foreign tax credit that the taxpayer will claim under section 901 of the Code with respect to payment of the principal or interest on an account established pursuant to section 4.01;

(e) The manner of payment of the account pursuant to sections 4.01 and 4.02 and the taxpayer's right to receive or make such payment free of the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment, provided the payment of the balance of the account, after taking into consideration any prepayment pursuant to section 4.02 is made within 90 days after execution of the closing agreement on behalf of the Commissioner.

.02 *Cases of a United States taxpayer reporting an adjustment pursuant to section 1.482–1(a)(3) of the regulations.* If a United States taxpayer that has increased or decreased its taxable income pursuant to section 482 and section 1.482–1(a)(3) of the regulations desires to avail itself of the treatment provided in section 4, it must file a statement with its Federal income tax return reporting the primary adjustment:

(1) A statement that the taxpayer desires the treatment provided by section 4 of this revenue procedure for the years indicated and acknowledges that it is bound by its election of such treatment;

(2) A description of the arrangements or transactions, or the terms thereof, which gave rise to the primary adjustment;

(3) The amount of the primary adjustment;

(4) The amount and nature of any correlative allocation to each related person from, or to, whom the section 482 allocation is made with respect to a controlled transaction, and the corresponding account and treatment thereof by each such related person that is consistent with the treatment applied under this revenue procedure;

(5) The amount and currency of, and parties to, the account which the taxpayer elects to establish under section 4.01;

(6) The amount of interest on the account includible in income, or deductible, pursuant to section 4.01 and the years of such inclusion or deduction;

(7) The amount of any foreign tax credit that the taxpayer will claim under section

901 of the Code with respect to payment of the principal or interest on an account established pursuant to section 4.01;

(8) The manner of payment of the account pursuant to sections 4.01 and 4.02, which shall be free of the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment, provided the payment of the balance of the account, after taking into consideration any prepayment pursuant to section 4.02, is made within 90 days of the date on which the taxpayer files the return reporting the primary adjustment, and a statement that any such payment within the 90-day period, and any such prepayment prior to that time, shall be treated as a payment of the account for all Federal income tax purposes, regardless of its characterization under foreign law.

.03 *Cases pending before the Tax Court of the United States.* If a case reaches trial status in the Tax Court and it is determined that the United States taxpayer is entitled to the treatment provided in section 4, 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, provided the taxpayer executes the required closing agreement.

.04 *Cases within the jurisdiction of the Department of Justice.* If a United States taxpayer files with the Service a request for treatment under section 4, 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

.01 *In general.* This revenue procedure is effective for taxable years beginning after August 23, 1999.

.02 *Election for taxable year including August 23, 1999.* A United States taxpayer may elect to apply all of the provisions of this revenue procedure on its U.S. income tax return for its taxable year including August 23, 1999.

.03 *Taxpayer-initiated adjustments for taxable years prior to the taxable year including August 23, 1999.* A United States taxpayer that increased or decreased its taxable income pursuant to section 482 and section 1.482–1(a)(3) for a taxable year prior to the taxable year including August 23, 1999, shall be permitted to apply the principles of Rev. Proc. 65-17, 1965–1 C.B. 833, and its progeny, in accordance with any reasonable interpretation thereof for purposes of conforming accounts to reflect the taxpayer-initiated primary adjustment. The Service considers an interpretation that applies the final revised revenue procedure published in this document or its general principles to be such a reasonable interpretation of Rev. Proc. 65–17.

SEC. 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 65–17, 1965–1 C.B. 833, as amended by Rev. Proc. 65–17 (Amend. I), 1966–2 C.B. 1211 and Rev. Proc. 65–17 (Amend. II), 1974–1 C.B. 411, is superseded. Rev. Proc. 65–31, 1965–2 C.B. 1024, Rev. Proc. 70–23, 1970–2 C.B. 505, Rev. Proc. 71–35, 1971–2 C.B. 573, Rev. Proc. 72–22, 1972–1 C.B. 747, Rev. Proc. 72–46, 1972–2 C.B. 827, Rev. Proc. 72–48, 1972–2 C.B. 829, Rev. Proc. 72–53, 1972–2 C.B. 833 and Rev. Rul. 82–80, 1982–1 C.B. 89, are superseded. The references to Rev. Proc. 65–17 in Rev. Proc. 68–16, 1968–1 C.B. 770, Rev. Proc. 89–8, 1989–1 C.B. 778, Rev. Proc. 96–13, 1996–1 C.B. 616, Rev. Proc. 96–14, 1996–1 C.B. 626, and Rev. Proc. 96–53, 1996–2 C.B. 375, shall be treated as references to this revenue procedure.

SEC. 8. DRAFTING INFORMATION

The principal author of this Revenue Procedure is J. Peter Luedtke of the Office of the Associate Chief Counsel (International). For further information on this revenue procedure, contact J. Peter Luedtke at 202-874-1490 (not a toll-free call) or write to CC:INTL:Br6, Room 3319, 950 L'Enfant Plaza South, SW, Washington, DC 20024.

SEC. 9. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1657.

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

The collection of information in this revenue procedure is in section 5. This information is required to determine whether a United States taxpayer that has made a primary adjustment under section 482 of the Code will be permitted to make certain adjustments to conform their accounts to reflect the section 482 allocation. The collections of information are required for a United States taxpayer to obtain the Commissioner's permission to repatriate the cash attributable to a primary adjustment via an account without the Federal income tax consequences of the secondary adjustments that would otherwise result from the primary adjustment. The likely respondents are businesses or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 1,620 hours.

The estimated annual burden per respondent/recordkeeper varies from 8 hours to 10 hours depending on individual circumstances, with an estimated average of 9 hours. The estimated number of respondents and/or recordkeepers is 180.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

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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 42; 1.42-14.)

Rev. Proc. 99–33

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under § 42(h)(3)(D) of the Internal Revenue Code for calendar year 1999.

SECTION 2. BACKGROUND

Rev. Proc. 92–31, 1992–1 C.B. 775, provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92–31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 1999.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 1999 is as follows:

Qualified State	*Amount Allocated*
Alabama	$12,062
California	90,540
Connecticut	9,075
Delaware	2,061
Florida	41,342
Georgia	21,181
Idaho	3,405
Illinois	33,385
Indiana	16,350
Iowa	7,934
Kansas	7,287
Kentucky	10,911
Maryland	14,232
Massachusetts	17,038
Michigan	27,210
Minnesota	13,097
Missouri	15,074
Nebraska	4,608
Nevada	4,842
New Hampshire	3,285
New Jersey	22,492
New York	50,375
North Dakota	1,769
Ohio	31,069
Oklahoma	9,276
Oregon	9,096
Pennsylvania	33,264
Puerto Rico	9,762
Rhode Island	2,740
South Carolina	10,632
Tennessee	15,052
Texas	54,766
Utah	5,820
Vermont	1,638
Virginia	18,823
Washington	15,769
West Virginia	5,020

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state's housing credit ceiling for calendar year 1999.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson on (202) 622-3040 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross Reference to Temporary Regulations and Notice of Public Hearing

Inbound Grantor Trusts With Foreign Grantors

REG–252487–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross reference to temporary regulations.

SUMMARY: The IRS is proposing regulations relating to the definition of the term grantor for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code. The text of temporary regulations published in T.D. 8831, on page 264, also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by October 12, 1999. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for November 2, 1999, at 10 a.m. must be submitted by October 12, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–252487–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–252487–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, James A. Quinn, (202) 622-3060; concerning submissions and the hearing, Guy R. Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in T.D. 8831, on page 264, amends the Income Tax Regulations (26 CFR part 1) relating to section 671. The temporary regulations contain rules relating to the definition of grantor for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code.

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 2, 1999, at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by October 12, 1999, and submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by October 12, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is James A. Quinn of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. In §1.671–2, paragraph (e) is revised to read as follows:

§1.671–2 Applicable principles.

* * * * *

(e) [The text of this proposed paragraph (e) is the same as the text of §1.671–2T(e) published in T.D. 8831.]

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 5, 1999, 2:09 p.m., and published in the issue of the Federal Register for August 10, 1999, 64 F.R. 43323)

Notice of Proposed Rulemaking and Notice of Public Hearing

Capital Gains, Partnership, Subchapter S, and Trust Provisions

REG–106527–98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to sales or exchanges of interests in partnerships, S corporations, and trusts. The proposed regulations interpret the look-through provisions of section 1(h), added by section 311 of the Taxpayer Relief Act of 1997 and amended by sections 5001 and 6005(d) of the Internal Revenue Service Restructuring and Reform Act of 1998, and explain the rules relating to the division of the holding period of a partnership interest. The proposed regulations affect partnerships, partners, S corporations, S corporation shareholders, trusts, and trust beneficiaries.

DATES: Written comments must be received by November 8, 1999. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for November 18, 1999, must be received by October 28, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–106527–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–106527–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in room 3411, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jeanne Sullivan (202) 622-3050; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the **Office of Management and Budget** for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collections of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **IRS,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by October 8, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the collections will have a practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in §1.1(h)–1(e). This information is required by the IRS to implement section 311 of the Taxpayer Relief Act of 1997, as amended by the Internal Revenue Service Restructuring and Reform Act of 1998. The collections of information are required to provide information to the IRS regarding the capital gain attributable to collectibles and section 1250 property held by a partnership when a partner sells or exchanges an interest in that partnership and the capital gain attributable to collectibles when a shareholder sells or exchanges an interest in an S corporation or a trust beneficiary sells or exchanges an interest in a trust. This information will be used to verify compliance with section 1(h) and to determine that the tax on capital gains has been computed correctly. The collection of information is mandatory. The likely respondents are individuals and businesses.

Respondent taxpayers provide information by attaching a statement to the appropriate tax return. The burden for this requirement is reflected in the burden estimates for: Form 1040, U.S. Individual Income Tax Return; Form 1065, U.S. Partnership Return of Income; Form 1041, U.S. Income Tax Return for Estates and Trusts; and Form 1120S, U.S. Income Tax Return for an S Corporation. The estimated burden of information collection for the statement required is 10 minutes.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to taxation of capital gains in the case of sales or exchanges of interests in partnerships, S

corporations, and trusts. The Taxpayer Relief Act of 1997, Public Law 105–34, 111 Stat. 788, 831 (1997 Act), amended section 1(h) of the Internal Revenue Code to reduce the maximum statutory tax rates for long-term capital gains of individuals in general. Certain technical corrections and other amendments to section 1(h) were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206, 112 Stat. 685, 787, 800 (1998 Act).

Section 1(h) provides that intermediate level rates apply to long-term capital gains from certain transactions, such as sales or exchanges of collectibles, section 1202 stock (with respect to a portion of the gain), and section 1250 property with gain attributable to straight-line depreciation. Section 1(h)(11) provides authority to the Secretary to issue such regulations as are appropriate to apply these rules in the case of sales or exchanges by pass-thru entities and of interests in pass-thru entities. This document provides rules for sales or exchanges of interests in partnerships, S corporations, and trusts. This document also provides rules relating to dividing the holding period of a partnership interest.

Explanation of Provisions

In general, prior to the 1997 Act, individuals were taxed on capital gains at the same rate as ordinary income, except that the rate for net capital gain was capped at 28 percent. The 1997 Act provided for lower maximum rates of taxation on gain from the sale or exchange of certain types of property. As amended by the 1998 Act, section 1(h) currently provides for maximum capital gains rates on the sale or exchange of certain types of property in three categories: 20-percent rate gain, 25-percent rate gain, and 28-percent rate gain. Twenty percent rate gain is net capital gain from the sale or exchange of capital assets held for more than one year, reduced by the sum of 25-percent rate gain and 28-percent rate gain. Twenty-five percent rate gain is limited to unrecaptured section 1250 gain. Unrecaptured section 1250 gain is the amount of long-term capital gain (not otherwise treated as ordinary income) which would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, reduced by any net loss in the 28-percent rate gain category. Twenty-eight percent rate gain is capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to section 408(m)(3)) held for more than one year, a portion of the gain attributable to the sale of section 1202 stock, and capital gains and losses determined under the rules of section 1(h)(13), reduced by net short-term capital loss for the taxable year and any long-term capital loss carryover under section 1212(b)(1)(B).

Collectibles Gain and Unrecaptured Section 1250 Gain

The sale or exchange of an interest in a partnership with a long-term holding period generally will result in capital gain in the 20-percent rate gain category to the extent that section 751(a) is not applicable. Section 751(a) generally provides that an amount received in exchange for a partnership interest, to the extent attributable to unrealized receivables and inventory, shall be considered as an amount realized from the sale or exchange of property other than a capital asset. Section 1250 property is treated as an unrealized receivable for purposes of section 751 to the extent of the amount that would be treated as gain to which section 1250(a) would apply.

The sale or exchange of stock in an S corporation with a long-term holding period generally will result in gain or loss in the 20-percent rate gain category, unless an exception to capital gain treatment applies. Certain of those exceptions are provided in sections 304, 306, 341, and 1254.

The sale or exchange of an interest in a trust with a long-term holding period generally will result in gain or loss in the 20-percent rate gain category. However, if the transferor is treated as the owner of the portion of the trust attributable to an interest under sections 673 through 679, the transferor is treated as transferring an undivided interest in the assets of the trust rather than an interest in the trust itself.

Effective for taxable years ending after May 6, 1997, when an interest in a partnership, an S corporation, or a trust held for more than one year (or more than 18 months during certain periods in 1997) is sold or exchanged, section 1(h) provides special treatment for "collectibles gain" in property held by a partnership, S corporation, or trust and for "section 1250 capital gain" in property held by a partnership. Specifically, section 1(h)(6)(B) provides that any gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible, applying rules similar to section 751(a) to determine the amount of the gain. In addition, under section 1(h)(7)(A) (in conjunction with sections 751(a) and (c)), the amount of long-term capital gain (not otherwise treated as ordinary income under section 751(a)) that would be treated as ordinary income under section 751(a) if section 1250 applied to all depreciation (section 1250 capital gain) must be taken into account in computing unrecaptured section 1250 gain when an interest in a partnership (with a holding period of more than one year, or more than 18 months during certain periods in 1997) is sold or exchanged. See H. Rep. No. 105–356, 105th Cong. 1st Sess. (1997), at 16, fn. 11; S. Rep. No. 105–174, 105th Cong. 2d Sess. (1998), at 149, fn. 65.

The proposed regulations provide guidance with respect to the application of these rules to a sale or exchange of an interest in a partnership, S corporation, or trust holding assets with collectibles gain and a partnership holding assets with section 1250 capital gain. Generally, the amount of such gain is determined by reference to the gain that would be allocated to the selling partner, shareholder, or beneficiary (to the extent attributable to the portion of the transferred interest that is subject to long-term capital gain) if the partnership, S corporation, or trust had sold all of its collectibles or if the partnership had sold all of its section 1250 property in a fully taxable transaction immediately before the transfer of the partnership, S corporation, or trust interest. Special rules are provided where the partner, S corporation shareholder, or trust beneficiary recognizes less than all of the gain upon the sale or exchange of its interest.

In addition, for purposes of applying section 1(h)(7)(B), which provides that a taxpayer's unrecaptured section 1250

gain cannot exceed the taxpayer's net section 1231 gain, gain from the sale of a partnership interest that results in section 1250 capital gain is not treated as section 1231 gain even if section 1231 could apply to the disposition of the underlying partnership property. Although section 1(h)(7) (in combination with section 751) applies a limited look-thru rule for purposes of determining the capital gain rate applicable to the sale of a partnership interest, no similar look-thru rule applies for purposes of applying section 1231. Anomalous results would follow if section 1250 capital gain derived from the sale of a partnership interest were treated as section 1231 gain for purposes of applying the limitation in section 1(h)(7)(B) but not for purposes of actually applying section 1231.

Determination of Holding Period in a Partnership

In view of the long-established principle that a partner has a single basis in a partnership interest (see Rev. Rul. 84–53 (1984–1 C.B. 159)), there is some confusion under current law as to how the principles of section 1223 apply to the sale of an interest, or a portion of an interest, in a partnership. The proposed regulations provide rules relating to the allocation of a divided holding period with respect to an interest in a partnership. These rules generally provide that the holding period of a partnership interest will be divided if a partner acquires portions of an interest at different times or if an interest is acquired in a single transaction that gives rise to different holding periods under section 1223. The holding period of a portion of a partnership interest shall be determined based on a fraction that is equal to the fair market value of the portion of the partnership interest to which the holding period relates (determined immediately after the acquisition) over the fair market value of the entire partnership interest. A selling partner may use the actual holding period of the portion of a partnership interest sold if the partnership is a "publicly traded partnership" (as defined under section 7704(b)), the partnership interest is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the interest transferred. Otherwise, the holding period(s) of the transferred interest must be divided in the same ratio as the holding period(s) of the partner's entire partnership interest.

These proposed regulations do not contain a specific anti- abuse rule regarding holding periods. However, there may be situations where taxpayers will attempt to undertake abusive transactions using the rules in these regulations. For instance, taxpayers may attempt to shift gain from property with a short-term holding period to property with a long-term holding period by contributing the short-term property to a partnership and selling the partnership interest. Because the basis of a partnership interest cannot be segregated to a portion of an interest, basis in the portion of a partnership interest with a long-term holding period could reduce gain attributable to the portion of a partnership interest with a short-term holding period in situations where such interest was recently received in exchange for contributed short-term capital gain property. In appropriate situations, the IRS may attack such abusive transactions under a variety of judicial doctrines, including substance over form or step transaction, or under §1.701–2 of the regulations.

Proposed Effective Date

The amendments are proposed to be effective for all transfers of interests in a partnership, S corporation, or trust and for all distributions from a partnership on or after the date the regulations are published as final regulations in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the facts that: (1) the time required to prepare and file the statement is minimal (currently estimated at 10 minutes per statement); and (2) it is anticipated that, as a result of these regulations, small entities will file no more than one statement per year. Furthermore, taxpayers will have to respond to the requests for information contained in §1.1(h)–1(e) only if there is a sale or exchange of an interest in a partnership, an S corporation, or a trust that holds certain property. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 18, 1999, beginning at 1 p.m. in **room 3411** of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must request to speak and submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 28, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Jeanne Sullivan, Office of the Assistant Chief Counsel (Pass-throughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

Part 1—INCOME TAXES

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

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

Par. 2. Section 1.1(h)–1 is added to read as follows:

§1.1(h)–1 Capital gains look-through rule for sales or exchanges of interests in a partnership, S corporation, or trust.

(a) *In general.* When an interest in a partnership held for more than one year is sold or exchanged, the transferor may recognize ordinary income (e.g., section 751(a)), collectibles gain, section 1250 capital gain, and residual long-term capital gain or loss. When stock in an S corporation held for more than one year is sold or exchanged, the transferor may recognize ordinary income (e.g., sections 304, 306, 341, 1254), collectibles gain, and residual long-term capital gain or loss. When an interest in a trust held for more than one year is sold or exchanged, a transferor who is not treated as the owner of the portion of the trust attributable to the interest sold or exchanged (sections 673 through 679) (a non-grantor transferor) may recognize collectibles gain and residual long-term capital gain or loss.

(b) *Look-through capital gain*—(1) *In general.* Look-through capital gain is the share of collectibles gain allocable to an interest in a partnership, S corporation, or trust, plus the share of section 1250 capital gain allocable to an interest in a partnership, determined under paragraphs (b)(2) and (3) of this section.

(2) *Collectibles gain and collectibles loss*—(i) *Definitions.* For purposes of this section, collectibles gain and collectibles loss mean gain or loss, respectively, from the sale or exchange of a collectible (as defined in section 408(m) without regard to section 408(m)(3)) that is a capital asset held for more than 1 year, but only to the extent such gain is taken into account in computing gross income, and such loss is taken into account in computing taxable income.

(ii) *Share of collectibles gain allocable to an interest in a partnership, S corporation, or trust.* When an interest in a partnership, S corporation, or trust held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, the transferor shall recognize as collectibles gain the amount of net collectibles gain (but not net collectibles loss) that would be allocated to that partner (taking into account any remedial allocation under §1.704-3(d)), shareholder, or beneficiary (to the extent attributable to the portion of the partnership interest, S corporation stock, or trust interest transferred that was held for more than one year) if the partnership, S corporation, or trust transferred all of its collectibles in a fully taxable transaction immediately before the transfer of the interest in the partnership, S corporation, or trust. If less than all of the realized gain is recognized upon the sale or exchange of an interest in a partnership, S corporation, or trust, the same methodology shall apply to determine the collectibles gain recognized by the transferor, except that the partnership, S corporation, or trust shall be treated as transferring only a proportionate amount of each of its collectibles determined as a fraction that is the amount of gain recognized in the sale or exchange over the amount of gain realized in the sale or exchange. With respect to the transfer of an interest in a trust, this paragraph applies only to transfers by non-grantor transferors (as defined in paragraph (a) of this section).

(3) *Section 1250 capital gain*—(i) *Definition.* For purposes of this section, *section 1250 capital gain* means the long-term capital gain (not otherwise treated as ordinary income) that would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent.

(ii) *Share of section 1250 capital gain allocable to interest in partnership.* When an interest in a partnership held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, there shall be taken into account under section 1(h)(7)(A)(i) in determining the partner's unrecaptured section 1250 gain the amount of section 1250 capital gain that would be allocated (taking into account any remedial allocation under §1.704–3(d)) to that partner (to the extent attributable to the portion of the partnership interest transferred that was held for more than one year) if the partnership transferred all of its section 1250 property in a fully taxable transaction immediately before the transfer of the interest in the partnership. If less than all of the realized gain is recognized upon the sale or exchange of an interest in a partnership, the same methodology shall apply to determine the section 1250 gain recognized by the transferor, except that the partnership shall be treated as transferring only a proportionate amount of each section 1250 property determined as a fraction that is the amount of gain recognized in the sale or exchange over the amount of gain realized in the sale or exchange.

(iii) *Limitation with respect to net section 1231 gain.* In determining a transferor partner's net section 1231 gain (as defined in section 1231(c)(3)) for purposes of section 1(h)(7)(B), the transferor partner's allocable share of section 1250 capital gain in partnership property shall not be treated as section 1231 gain, regardless of whether the partnership property is used in the trade or business (as defined in section 1231(b)).

(c) *Residual long-term capital gain or loss.* The amount of residual long-term capital gain or loss recognized by a partner, shareholder of an S corporation, or beneficiary of a trust on account of the sale or exchange of an interest in a partnership, S corporation, or trust shall equal the amount of long-term capital gain or loss that the partner would recognize under section 741, that the shareholder would recognize upon the sale or exchange of stock of an S corporation, or that the beneficiary would recognize upon the sale or exchange of an interest in a trust (pre-look-through long-term capital gain or loss) minus the amount of long-term capital gain determined under paragraph (b) of this section (look-through capital gain).

(d) *Special rule for tiered entities.* In determining whether a partnership, S corporation, or trust has collectibles gain and whether a partnership has section 1250 capital gain, such partnership, S corporation, or trust shall be treated as owning its proportionate share of the property of any partnership, S corporation, or trust in which it owns an interest, either directly or indirectly through a chain comprised exclusively of such entities.

(e) *Notification requirements.* Rules similar to those that apply to the partners and the partnership under section 751(a) shall apply in the case of sales or exchanges of interests in a partnership, S corporation, or trust that holds property with collectibles gain and in the case of sales or exchanges of interests in a partnership that holds property with section 1250 capital gain. See §1.751–1(a)(3).

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

Example 1. Collectibles gain. (i) *A* and *B* are equal partners in a personal service partnership (*PRS*). *B* transfers *B*'s interest in *PRS* to *T* for $15,000 when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	ASSETS	
	Adjusted Basis	Market Value
Cash	$ 3,000	$ 3,000
Loans Owed to Partnership	10,000	10,000
Collectibles	1,000	3,000
Other Capital Assets	6,000	2,000
Capital Assets	7,000	5,000
Unrealized Receivables	0	14,000
Total	$20,000	$32,000
	LIABILITIES AND CAPITAL	
Liabilities	$ 2,000	$ 2,000
Capital:		
A	9,000	15,000
B	9,000	15,000
Total	$20,000	$32,000

(ii) At the time of the transfer, *B* has held the interest in *PRS* for more than one year, and none of the property owned by *PRS* is section 704(c) property. The total amount realized by *B* is $16,000, consisting of the cash received, $15,000, plus $1,000, *B*'s share of the partnership liabilities assumed by T. See section 752. *B*'s basis for the partnership interest is $10,000 ($9,000 plus $1,000, *B*'s share of partnership liabilities). *B*'s undivided one-half interest in *PRS* includes a one-half interest in the partnership's unrealized receivables and a one-half interest in the partnership's collectibles.

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $7,000 of ordinary income from the sale of *PRS*'s unrealized receivables. Therefore, *B* will recognize $7,000 of ordinary income with respect to the unrealized receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 ($6,000) and the amount of ordinary income or loss determined under §1.751–1(a)(2) ($7,000) is the partner's capital gain or loss on the sale of the partnership interest under section 741. In this case, the transferor has a $1,000 pre-look-through long-term capital loss.

(iv) If *PRS* were to sell all of its collectibles in a fully taxable transaction immediately prior to the transfer of *B*'s partnership interest to T, *B* would be allocated $1,000 of collectibles gain from the sale of the collectibles. Therefore, *B* will recognize $1,000 of collectibles gain on account of the collectibles held by *PRS*.

(v) The difference between the transferor's pre-look-through long-term capital gain or loss (–$1,000) and the look-through capital gain determined under this section ($1,000) is the transferor's residual long-term capital gain or loss on the sale of the partnership interest. Under these facts, *B* will recognize a $2,000 residual long-term capital loss on account of the sale or exchange of the interest in *PRS*.

Example 2. Special allocations. Assume the same facts as in *Example 1*, except that under the partnership agreement, all gain from the sale of the collectibles is specially allocated to *B*, and *B* transfers *B*'s interest to *T* for $16,000. All items of income, gain, loss, or deduction of *PRS*, other than the collectibles gain, are divided equally between A and *B*. Under these facts, *B*'s pre-look-through long-term capital gain would be $0. If *PRS* were to sell all of its collectibles in a fully taxable transaction immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $2,000 of collectibles gain from the sale of the collectibles. Therefore, *B* will recognize $2,000 of collectibles gain on account of the collectibles held by *PRS*. *B* also will recognize $7,000 of ordinary income (determined under §1.751–1(a)(2)) and a $2,000 long-term capital loss on account of the sale of *B*'s interest in *PRS*.

Example 3. Net collectibles loss ignored. Assume the same facts as in *Example 1*, except that the collectibles held by *PRS* have an adjusted basis of $3,000 and a fair market value of $1,000, and the other capital assets have an adjusted basis of $4,000 and a fair market value of $4,000. If *PRS* were to sell all of its collectibles in a fully taxable transaction immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $1,000 of collectibles loss. Because none of the gain from the sale of the interest in *PRS* is attributable to unrealized appreciation in the value of collectibles held by *PRS*, the net loss in collectibles held by *PRS* is not recognized at the time *B* transfers the interest in *PRS*. *B* will recognize $7,000 of ordinary income (determined under §1.751–1(a)(2)) and a $1,000 long-term capital loss on account of the sale of *B*'s interest in *PRS*.

Example 4. Collectibles gain in an S corporation. (i) A corporation (*X*) has always been an S corporation and is owned by individuals A, *B*, and *C*. In 1996, *X* invested in antiques. Subsequent to their purchase, the antiques appreciated in value by $300. A owns one-third of the shares of *X* stock and has held that stock for more than one year. A's adjusted basis in the *X* stock is $100. If A were to sell all of the *X* stock to *T* for $150, A would realize $50 of pre-look-through long-term capital gain.

(ii) If *X* were to sell its antiques in a fully taxable transaction immediately before the transfer to *T*, A would be allocated $100 of collectibles gain on account of the sale. Therefore, A will recognize $100 of collectibles gain (look- through capital gain) on account of the collectibles held by *X*.

(iii) The difference between the transferor's pre-look-through long-term capital gain or loss ($50) and the look-through capital gain determined under this section ($100) is the transferor's residual long-term capital gain or loss on the sale of the S corporation stock. Under these facts, A will recognize $100 of collectibles gain and a $50 residual long-term capital loss on account of the sale of A's interest in *X*.

(g) *Effective date.* This section applies to transfers of interests in partnerships, S corporations, and trusts that occur on or after the date these regulations are published as final regulations in the **Federal Register.**

Par. 3. Section 1.1223–3 is added to read as follows:

§1.1223–3 Rules relating to the holding periods of partnership interests.

(a) *In general.* A partner shall have a divided holding period in an interest in a partnership if:

(1) The partner acquired portions of an interest at different times; or

(2) The partner acquired portions of the partnership interest in exchange for property transferred at the same time but resulting in different holding periods determined under section 1223.

(b) *Accounting for holding periods of an interest in a partnership.* The portion of a partnership interest to which a holding period relates shall be determined by reference to a fraction that is the fair market value of the portion of the partnership interest received in the transaction to which the holding period relates over the fair market value of the entire partnership interest (determined immediately after the transaction).

(c) *Sale or exchange of all or a portion of an interest in a partnership*—(1) *Sale or exchange of entire interest in a partnership.* If a partner sells or exchanges the partner's entire interest in a partnership, any capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the holding period of the

interest in the partnership is divided between the portion of the interest held for more than one year and the portion of the interest held for one year or less.

(2) *Sale or exchange of a portion of an interest in a partnership.* (i) If the ownership interest in a publicly traded partnership (as defined under section 7704(b)) is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the partnership interest transferred, the selling partner may use the actual holding period of the portion transferred.

(ii) If a partner has a divided holding period in a partnership interest, and paragraph (c)(2)(i) of this section does not apply, then the holding period of the transferred interest shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the transferor partner would realize if the entire interest in the partnership were transferred in a fully taxable transaction immediately before the actual transfer.

(d) *Distributions*—(1) *In general.* A partner's holding period in a partnership interest is not affected by distributions from the partnership.

(2) *Character of capital gain or loss recognized as a result of a distribution from a partnership.* If a partner is required to recognize capital gain or loss as a result of a distribution from a partnership, then the capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the distributee partner would realize if such partner's entire interest in the partnership were transferred in a fully taxable transaction immediately before the distribution.

(e) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Division of holding period—contribution of money and a capital asset. (i) A contributes $5,000 of cash and a nondepreciable capital asset *A* has held for two years to a partnership (*PRS*) for a 50% interest in *PRS*. *A*'s basis in the capital asset is $5,000, and the fair market value of the asset is $10,000. After the exchange, *A*'s basis in *A*'s interest in *PRS* is $10,000, and the fair market value of the interest is $15,000. *A* received one-third of the interest in *PRS* for a cash payment of $5,000 ($5,000/$15,000). Therefore, *A*'s holding period in one- third of the interest received (attributable to the contribution of money to the partnership) begins on the day after the contribution. *A* received two-thirds of the interest in *PRS* in exchange for the capital asset ($10,000/$15,000). Accordingly, pursuant to section 1223(1), *A* has a two-year holding period in two-thirds of the interest received in *PRS*.

(ii) Six months later, when *A*'s basis in *PRS* is $12,000 (due to a $2,000 allocation of partnership income to *A*), *A* sells the interest in *PRS* for $15,000. Assuming *PRS* holds no inventory or unrealized receivables (as defined under section 751(c)) and no collectibles or section 1250 property, *A* will realize $3,000 of capital gain. As determined above, one-third of *A*'s interest in *PRS* has a holding period of one year or less, and two-thirds of *A*'s interest in *PRS* has a holding period equal to two years and six months. Therefore, one-third of the capital gain will be short-term capital gain, and two-thirds of the capital gain will be long-term capital gain.

Example 2. Division of holding period—contribution of money, section 1231 property, and other property. In exchange for a 30% interest in a partnership (ABC), *A* contributes to *ABC* $50,000 cash and equipment used in a trade or business and held for more than one year with a fair market value of $100,000 and an adjusted basis of $40,000. The equipment has a recomputed basis under section 1245 of $60,000. Accordingly, a portion of the equipment equal in value to $20,000 is section 1245 property that is not section 1231 property. See §1.1245-6(a). *A*'s partnership interest has a fair market value of $150,000, a basis of $90,000, and a divided holding period. *A* received 46.67% ($70,000/$150,000) of the interest in *ABC* in exchange for property that is neither a capital asset nor section 1231 property (that is, cash of $50,000 and a portion of the equipment attributable to section 1245 recapture in an amount equal to $20,000). Therefore, *A*'s holding period for 46.67% of *A*'s interest begins on the day after the exchange of the property for the partnership interest. *A* received 53.33% ($80,000/$150,000) of *A*'s interest in *ABC* in exchange for section 1231 property. Accordingly, *A*'s holding period for 53.33% of *A*'s interest includes *A*'s holding period for the section 1231 property.

Example 3. Division of holding period when capital account is increased by contribution. A, B, C, and *D* are equal partners in a partnership (*PRS*), and the fair market value of a 25% interest in *PRS* is $90x. *A, B, C,* and *D* each contribute an additional $10x to partnership capital, thereby increasing the fair market value of each partner's interest to $100x. As a result of the contribution, each partner has a new holding period in the portion of the partner's interest in *PRS* that is attributable to the contribution. That portion equals 10% ($10x/$100x) of each partner's interest in *PRS*.

Example 4. Sale or exchange of a portion of an interest in a partnership. (i) *A* contributes $5,000 in cash and a capital asset with a fair market value of $5,000 and a basis of $2,000 to a partnership (*PRS*) in exchange for an interest in *PRS*. At the time of the contribution, *A* had held the contributed property for two years. Six months later, when *A*'s basis in *PRS* is $7,000, *A* transfers one-half of *A*'s interest in *PRS* to T for $6,000 at a time when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

ASSETS	Adjusted Basis	Market Value
Cash	$5,000	$5,000
Unrealized Receivables	0	6,000
Capital Asset 1	3,000	8,000
Capital Asset 2	2,000	5,000
Capital Assets	5,000	13,000
Total	$10,000	$24,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50% of the fair market value of *A*'s interest in *PRS* was received in exchange for property with a long-term holding period. Therefore, 50% of *A*'s interest in *PRS* has a long-term holding period.

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $3,000 of ordinary income. One-half of that amount ($1,500) is attributable to the portion of *A*'s interest in *PRS* transferred to *T*. Accordingly, *A* will recognize $1,500 ordinary income and $1,000 ($2,500 – $1,500) of capital gain on account of the transfer to T of one-half of *A*'s interest in *PRS*. Fifty percent ($500) of that gain is long-term capital gain and 50% ($500) is short-term capital gain.

Example 5. Sale or exchange of a portion of an interest in a partnership. (i) The facts are the same as in *Example 4*, except that capital asset 1 is a collectible that was purchased by *PRS* more than one year earlier. If capital asset 1 were sold or exchanged in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated

$2,500 of collectibles gain. Fifty percent of that amount ($1,250) is attributable to the portion of *A*'s interest in *PRS* sold to *T*. The collectibles gain allocable to the portion of the transferred interest in *PRS* with a long-term holding period is $625 (50% of $1,250). Accordingly, *A* will recognize $625 of collectibles gain on account of the transfer of one-half of the interest in *PRS*.

(ii) The difference between the amount of pre-look-through long-term capital gain or loss ($500) and the look-through capital gain ($625) is the amount of residual long-term capital gain or loss that *A* will recognize on account of the transfer of one-half of the interest in *PRS*. Under these facts, *A* will recognize a residual long-term capital loss of $125 and a short-term capital gain of $500.

Example 6. Sale of units of interests in partnership. A publicly traded partnership (*PRS*) has ownership interests that are segregated into identifiable units of interest. *A* owns 10 limited partnership units in *PRS* for which *A* paid $10,000 three years ago. Later, *A* purchases five additional units for $10,000 at a time when the fair market value of each unit has increased to $2,000. *A*'s holding period for one-third ($10,000/$30,000) of the interest in *PRS* begins on the day after the purchase of the five additional units. Less than one year later, *A* sells five units of ownership in *PRS* for $11,000. At the time, *A*'s basis in the 15 units of *PRS* is $20,000, and *A*'s capital gain on the sale of 5 units is $4,333 (amount realized of $11,000 – one-third of the adjusted basis or $6,667). For purposes of determining the holding period, *A* can designate the specific units of *PRS* sold. If *A* properly identifies the five units sold as

five of the ten units for which *A* has a long-term holding period, the capital gain realized will be long-term capital gain.

Example 7. Disproportionate distribution. In 1997, *A* and *B* each contribute cash of $50,000 to form and become equal partners in a partnership (*PRS*). Sometime later, *A* receives a distribution worth $22,000 from *PRS*, which reduces *A*'s interest in *PRS* to 36%. After the distribution, *B* owns 64% of *PRS*. The holding periods of *A* and *B* in their interests in *PRS* are not affected by the distribution.

Example 8. Gain or loss as a result of a distribution. In 1996, *A* contributes property with a basis of $10 and a fair market value of $10,000 in exchange for an interest in a partnership (*ABC*). In 1999, when *A*'s interest in *ABC* is worth $12,000, *A* contributes $6,000 cash in exchange for an additional interest in *ABC*, bringing the fair market value of *A*'s interest to $18,000. The holding period of *A*'s interest in *ABC* is determined immediately after that exchange. *A*'s holding period in one-third of *A*'s interest in *ABC* ($6,000 cash contributed over the $18,000 value of the entire interest) begins on the day after the cash contribution. (*ABC* holds no inventory or unrealized receivables.) Later in 1999, *ABC* makes a cash distribution to *A* of $10,000. *A*'s basis in *ABC* immediately before the distribution is $6,010. Accordingly, *A* must recognize $3990 of capital gain as a result of the distribution. See section 731(a)(1). One-third of the capital gain recognized as a result of the distribution is short-term capital gain, and two-thirds of the capital gain is long-term capital gain. After the distribution, *A*'s basis in the interest in *PRS* is $0, and the holding period for the interest in *PRS* continues to be divided in the same proportions as before the distribution.

(f) *Effective date.* This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after the date final regulations are published in the **Federal Register.**

Par. 4. Section 1.741–1 is amended by adding paragraphs (e) and (f) to read as follows:

§1.741–1 Recognition and character of gain or loss on sale or exchange.

* * * * *

(e) For rules relating to the capital gain or loss recognized when a partner sells or exchanges an interest in a partnership that holds appreciated collectibles or section 1250 property with section 1250 capital gain, see §1.1(h)–1.

(f) For rules relating to dividing the holding period of an interest in a partnership, see §1.1223–3.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 6, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 9, 1999, 64 F.R. 43117)

Foundations Status of Certain Organizations

Announcement 99–80

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Childrens Rights Council–Lincoln Chapter, Lincoln, NE
Chimes District of Columbia Inc., Baltimore, MD
Chimes Virginia Inc., Baltimore, MD
Chinatown Beautification Committee, Boston, MA
Chinese Evangelical Fellowship Inc., Zion, IL
Christian Employment Network, Bellevue, WA
Chuck Pack Memorial Scholarship Foundation Inc., Louisa, KY
Circle Building Power for Peaceful Social Change, Kannapolis, NC
Circleville Artist Series, Circleville, OH
Cities in Schools-Aurora 2000 Inc., Aurora, IL
Citizens Creating Responsive Communities Inc., Elizabethtown, KY
Citizens for Equal Protection Inc., Omaha, NE
City of Church Hill Community Chest Inc., Church Hill, TN
Civil Society Development Program Inc., Nashville, TN
Claremont Homes Tenant Council Inc., Baltimore, MD
Clarendon School District Three Educational Foundation, Turbeville, SC
Clean Cities Recycling Inc., Griffith, IN
Clean Start Services Inc., Yonkers, NY
Coalition for Adolescent Pregnancy Prevention Soldotna, AK
Coalition for the Advancement of Science Education in Mass, Worcester, MA
Collegiate School of New Hampshire, Nashua, NH
Collier Family Planning Inc., Naples, FL
Colorado Institute for Youth Leadership, Colorado Springs, CO
Columbia Jewish Congregation Development Corporation, Columbia, MD
Commonwealth Community Services Incorporated, Elsa, TX
Communities in Schools of Pueblo Colorado, Pueblo, CO
Community AIDS Advocate Project, Stuart, FL
Community Interaction Service Inc., Bossier City, LA
Community Justice for Children Inc., Glendale, AZ
Community Services Network Inc., Orlando, FL
Community Share Foundation Inc., Carrboro, NC
Company of Fools Inc., Richmond, VA
Concerned Americans for Responsible Driving Inc., St. Louis, MO
Concerts for the Heartland Inc., New York, NY
Congaree Soccer Association Inc., Cayce, SC
Connecticut Positive Action Coalition Inc., Hartford, CT
Consortium for Sustainable Village-Based Development, Denver, CO
Cool Schools Corporation of New York City, New York, NY
Cooperative Baptist Fellowship Foundation Inc., Atlanta, GA
Cornerstone Foundation Inc., Tucson, AZ
Coryton & Company Inc., Gates Mills, OH
Council for Electronic Revenue Communication Advancement, Chicago, IL
Coupons Inc., Boston, MA
Creative Options Inc., Ellicott City, MD
Creative Training Centers Inc., Springfield, IL

Credo Housing Inc., Oakland, CA
Crestwood Services Inc., Langhorne, PA
Crispus Attucks Neighborhood Development Organization Inc., Lancaster, PA
Crossroads Foundation Inc., Webb City, MO
Cross Training Ministries, St. Paul, MN
Cuban-American Endowment for the Arts Inc., Coral Gables, FL
Cumberland County Parent Awareness Inc., Portland, ME
Daily Care Nurses Inc., Providence, RI
DCL Foundation Inc., Del City, OK
De Azur Inc., New York, NY
December Rose Association, Long Beach, CA
Defense Equal Opportunity Management Institute Fndtn Inc., Patrick AFB, FL
Del Rio Rotary Housing, Del Rio, TX
Delbac Inc., Brooklyn, NY
Demopolis City Schools Foundation Inc., Demopolis, AL
Desert Services for Children & Families with AIDS, Cathedral City, CA
Design and Construction Quality Institute, Silver Spring, MD
Destinasian, Chicago, IL
Destined for Unity Inc., Palmetto, FL
Development Consortium for Innovative Classrooms, Issaquah, WA
DHS Athletic Boosters Inc., Dunnellon, FL
Diabetes Directory, Colorado Springs, CO
Diamond and Jewelry Industries Development Corporation, New York, NY
Disabled Divers International Inc., Santa Barbara, CA
Discipleship for Christ, Littleton, CO
Ditson Street Senior Housing Inc., Dorchester, MA
Divide County Quarterback Club Inc., Fortuna, ND
Divine Assistance Inc., Rocky Point, NY
Division for Early Childhood Inc., Pine Bluff, AR
Dog Star Institute Inc., Missoula, MT
Dominguez Family Shelter, Carson, CA
Donan & Associates Community Services, Denver, CO
Dreams into Action Inc., New York, NY
Drug Abuse and Violence Prevention Outreach Inc., Montgomery, AL
Dunbar Coalition Inc., Tucson, AZ
East Harlem Neighborhood Based Alliance Corporation, New York, NY
East Lake Youth Association, Birmingham, AL
Education Law Foundation Inc., Northampton, MA
Educational & Healthcare Development Foundation of Beloit, Colorado Springs, CO
Educational Initiative, Asheville, NC
Educational Institute of America Inc., Greensboro, NC
Educational Seminars Inc., Haverhill, MA
El Caldito, Las Cruces, NM
El Dorado Fire and Rescue Association, Santa Fe, NM
Elbert County Council for Effective Literacy Inc., Elberton, GA
Emergency Living Family Fund Inc., Columbia, SC
Emory Valley Center Foundation, Oak Ridge, TN
En Garde Inc., Overland Park, KS
Enid Tennis Booster Club, Enid, OK
Entrepreneurial Resource Center, San Diego, CA
Entz Elementary Parent Teacher Organization, Mesa, AZ
Epilepsy Services of Southeast Florida Inc., West Palm Beach, FL
Erie County Coalition of Mental Health Consumers, Erie, PA
Etowah Junior Pro Basketball Booster Club, Etowah, TN
Families & Children Together Inc., Amherst, VA
Family and Child Enrichment Services Inc., Marietta, OH
Family Network of Jacksonville Inc., Jackson, IL
Family Resource Services Inc., Atlanta, GA
Family Support Group Inc., Phoenix, AZ
Featherstone, Ames, IA
Feed the Hungry Inc., Brooklyn, NY
Firehouse Arts Resources, Columbus, OH
First Night Freeport Inc., Freeport, NY
Florence United Methodist Properties Inc., Florence, KY
Foundation for Educational Excellent Kildeer School District, Buffalo Grove, IL
Foundation for Human Rights and Democracy in South Africa, Washington, DC
Foundation for the Milwaukee Fire Education Center Inc., Milwaukee, WI
Foundation for the Support and Enhancement of High Ed in Bolivia, Roland, AR
Foundation-Governor Baxter School for the Deaf, Portland, ME
Foundation of Cabo Verde Inc., East Providence, RI
Fountain of Love Ministries, Monroe, LA
Framingham Housing Development Corporation II, Framingham, MA
Franchell Boswell Educational Foundation Inc., Chicago, IL
Franciscan Counselling Services Inc., Boston, MA
Frankfort Franklin County Education Foundation Inc., Frankfort, KY
Franklin Resident Council Inc., Franklin, VA
Freedom for Youth Inc., Helena, AR
Friends of AE-4 PTSA, Seattle, WA
Friends of Argus and Aurora House, Arlington, VA
Friends of Davenport Tennis, Davenport, IA
Friends of Fire District Fourteen Inc., Maynard, MA
Friends of Landmark Academy Inc., Wilton, CT
Friends of Maricopa Medical Center, Phoenix, AZ
Friends of S C P A, San Diego, CA
Friends of the Catholic University of America Rowing Association, Arlington, VA
Friends of the Gordon Highlands, Washington, DC
Friends of the Northwest, Clackamas, OR
Friends of the Northwest Regional Library, Philadelphia, PA
Friends of the Performing Arts Inc., Baltimore, MD
Friends of the Webster Animals Inc., Webster, MA
Friends of Valley Debate Inc., Des Moines, IA
Frontiers International Inc-Chicago, Chicago, IL
Gainesville Commission on the Status of Women Inc., Gainesville, FL
Ganoderma International Research Institute, New York, NY
Georgia Association of Community Leaders, Warner Robins, GA
Georgia Council on Compulsive Gambling Incorporated, Atlanta, GA
Georgia Mountain Theatre Inc., Atlanta, GA

GHS Band Alumni Association Inc., Gardner, MA
Globewide Network Academy, Austin, TX
Goffstown Area Diversion Program Inc., Goffstown, NH
Golden Gate Middle School PTO Inc., Naples, FL
Good News Incorporated, Oklahoma City, OK
Government Research Institute of Western New York Inc., Buffalo, NY
Grand Avenue Substance Abuse Prevention-Education Center, Dequincy, LA
Grand View Industries Inc., Grand Junction, CO
Grant Hussey Foundation, Eden Prairie, MN
Grantme Entertainment Inc., Miami, FL
Gratitude Retreat Inc., Greenville, SC
Great Artists Series, St. Louis, MO
Great Expectations I Inc., Nelson, MN
Greater Houston Renewal and Development, Houston, TX
Greek Spirit of Boston Association a Non-profit Corporation, Jamacia Plain, MA
Grosse Pointe Public Schools Foundation, Grosse Pointe, MI
Growing Need Inc., Batavia, IL
H O S T Youth Shelter Inc., Lagrange, KY
Hacemos Scholarship Foundation, Dallas, TX
Haiti Resource Cosortium International Inc., New York, NY
Hampton Roads Public Transportation Alliance, Hampton, VA
Hand in Hand Early Childhood Center Inc., Lowville, NY
Happy Child Mission, Carrollton, TX
Harlem Empowerment Zone Arts Industry Council Inc., New York, NY
Harlem Institute, New York, NY
Harrison Educational Foundation Incorporated, Harrison, NY
HBHCI HUD 1 Inc., New Port Richey, FL
HBHCI HUD 2 Inc., New Port Richey, FL
HBHCI HUD 3 Inc., New Port Richey, FL
Healthy Intercollegiate Visions Coalition, Raleigh, NC
Heart Sparks, Louisville, KY
Heartland Telecommunications Consortium Inc., Huron, SD
Henry S Baird Parent-Teacher Organization, Green Bay, WI
Heritage South Commercial Revitalization Association, Toledo, OH
Hi-Tech Council of Sarasota & Manatee Counties Inc., Sarasota, FL
Hicksville High School Band Parents Association Inc., Hicksville, NY
Hidden Theater, Minneapolis, MN
Higher Plains Ministry Inc., Atlanta, GA
Highland Rim Residential Services, Tullahoma, TN
Historic Savage Mill Inc., Savage, MD
Holistic Managed Care Services Inc., Chicago, IL
Homeless Empowerment Project Inc., Cambridge, MA
Homeless Veterans Action Corporation, Tuscaloosa, AL
Hoosh Doh DII to Development Inc., Pinon, AZ
Hope Thru Horses, New Bury Park, CA
Horizon International Childrens Services Inc., Buckner, KY
Housing Program Administrator Inc., Washington, DC
Hughes Neighborhood Housing Inc., Wheaton, MD
Hunnewell School Parent-Teacher Organization Inc., Wellesley, MA
Illinois Partners for Social & Economic Development, Chicago, IL
Illinois Philippine Medical Society, Oakbrook, IL
Immaculate Conception Church-St. Paul Mission Chapel Restoration, Douglassville, PA
Indian World Inc., Detroit, MI
Information Networking and Communication Association, Bronx, NY
Inmate Family Services Inc., Philadelphia, PA
Innovation Cities Development Corporation, Jackson, NJ
Innovative Horizons Inc., Bartlesville, OK
Inside the Nonprofits Charitable Trust, New York, NY
Institute for Child and Adolescent Sexual Health Inc., Minneapolis, MN
Institute for Community Development, Richmond, VA
Institute for Mediation Training, La Grange Park, IL
Institute for Peaceable Community Inc., Cambridge, MA
Institute for Systemic Change in Education, Ann Anbor, MI
Inter-Act, Cicero, IL
Interactive Visual Technologies Center of North Carolina Inc., Raleigh, NC
Intercessions Child Welfare Agency, Chicago, IL
International Center for Clubhouse Development Inc., New York, NY
International Center for Management Decisions Inc., Ithaca, NY
International Childrens Centers Inc., Chicago, IL
International Commission for Joint Projects in Modern Russian History, New York, NY
International Tzedakah Foundation Inc., Milwaukee, WI
Iowa Prairie Network Inc., Mason City, IA
Irish Dance Teachers Association of North America Inc., Irvington, NJ
Jasper Pride Inc., Jasper, TX
Jewel County Arts Council Inc., Mankato, KS
Jewish Association on Aging, Pittsburgh,, PA
Joanco Development Inc., Anoka, MN
Jordan High School Athletic Booster Inc., Durham, NC
JTD Homes Inc., Orangeburg, SC
Julius Humann Elementary School Parent Teacher Organization, Lincoln, NE
Kansas Leadership Forum Inc., Manhattan, KS
Kansas University Ophthalmic Foundation, Kansas City, KS
Keeper of the Plains Scholarship Board Inc., Enid, OK
Kenai Peninsula Opportunities Incorporated, Kenai, AK
Kendall Khoury League Inc., Miami, FL
Kids Island Inc., Poquoson, Va
Kids Kastle Inc., Chicago, IL
Kids Voting Horry County Inc., Myrtle Beach, SC
Kid works Inc., Easton, MD
Kidz Xpress, Orangeburg, SC
Kindergarten Association of Connecticut Inc., Branford, CT
King of Kings Community Center, Fresno, CA
Kip Laxson Ministeries Inc., Columbia, MO
Knob Noster Panther Athletic Booster Club, Knob Noster, MO
Korean-American Gospel Foundation, Greenville, SC
L Alliance Francaise de Panama City Inc., Panama City, FL

La Pradera Park Council Inc., Phoenix, AZ
Lake County Youth Orchestra, Grayslake, IL
Lamokin Village Resident Council Inc., Chester, PA
Latinos for a Better Brooklyn Inc., Brooklyn, NY
Leadership Albany Inc., Albany, GA
Leadership Monterey Peninsula Inc., Monterey, CA
Leonard Eisner Memorial Committee Inc., New York, NY
Liberty House Inc., Manchester, NH
Life International Inc., Clarksville, IN
Life Line International, Seattle, WA
Lifequest International, Seattle, WA
Lincoln Larimer Lemington Belmar Citizens Revitalization Development, Pittsburgh, PA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Weighted Average Interest Rate Update

Notice 99–39

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for July 1999 is 5.98 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
August	1999	6.01	5.41 to 6.31	5.41 to 6.61

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number.

Actions Relating to Court Decisions

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. Nonacquiescence signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a nonacquiescence indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

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:

Internal Revenue Service v. Waldschmidt (In re Bradley),[1]
(M.D. Tenn. 1999)

Estate of Mellinger v. Commissioner,[2] 112 T.C. 4 (1999)

Hospital Corp. of America and Subsidiaries v. Commissioner,[3]
109 T.C. 21 (1997)

Boyd Gaming Corporation v. Commissioner,[4]
F.3d (9th Cir. 1999)

The Commissioner NONACQUIESCES in the following decisions:

Vulcan Materials Company and Subsidiaries v. Commissioner,[5]
96 T.C. 410 (1991)

St. Jude Medical, Inc. v. Commissioner,[6]
34 F.3d 1394 (8th Cir. 1994)

Hospital Corp. of America and Subsidiaries v. Commissioner,[7]
109 T.C. 21 (1997)

[1] Acquiescence in result only relating to whether gain on the sale of the debtor's residence is excluded from gross income of the bankruptcy estate to the extent provided by I.R.C. §121 and in accord with section 1398.

[2] Acquiescence in result only relating to whether, for estate tax valuation purposes, a minority interest in a closely-held corporation held in a Qualified Terminable Interest Property (QTIP) trust, which is includible in the gross estate under I.R.C. §2044, is aggregated with a minority interest in the same corporation that is includible in a decedent's gross estate under other provisions of the Code.

[3] Acquiescence in result only relating to whether the tests developed under the investment tax credit (ITC) prior to the 1981 adoption of the cost recovery system are applicable in determining a structural component for the purposes of Accelerated Cost Recovery System (ACRS) and Modified Accelerated Cost Recovery System (MACRS).

[4] Acquiescence in result only relating to whether a meal furnished by the taxpayer/employer on its business premises to an employee is furnished for "the convenience of the employer" within the meaning of that phrase in section 119 of the Internal Revenue Code.

[5] Nonacquiescence in result only relating to whether the term "accumulated profits" as used in the denominator of the section 902 deemed paid credit fraction before the Tax Reform Act of 1986 means all of a foreign corporation's accumulated profits for the taxable year. This revised action on decision clarifies the Service's position on this issue in cases appealable to the 11th Circuit.

[6] Nonacquiescence in result only relating to whether section 1.861–8(e)(3) of the Income Tax Regulations is invalid as applied to DISC combined taxable income (CTI) calculations.

[7] Nonacquiescence in result only relating to whether certain items treated as tangible personal property and depreciated over a 5-year recovery period were in fact structural components of the buildings to which they relate which must be depreciated over the same recovery period as the buildings, pursuant to I.R.C. § 168.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 3221.—Rate of Tax

26 CFR 31.3221–4: Exception from supplemental tax.

T.D. 8832

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 31

Exception From Supplemental Annuity Tax on Railroad Employers

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance to employers covered by the Railroad Retirement Tax Act. The Railroad Retirement Tax Act imposes a supplemental tax on those employers, at a rate determined by the Railroad Retirement Board, to fund the Railroad Retirement Board's supplemental annuity benefit. These regulations provide rules for applying the exception from the supplemental annuity tax with respect to employees covered by a supplemental pension plan established pursuant to a collective bargaining agreement and for applying a related excise tax with respect to employees for whom the exception applies.

DATES: *Effective Date:* These regulations are effective August 6, 1999.

Applicability Date: These regulations generally apply beginning on October 1, 1998, except as provided in §31.3221–4(e)(2).

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Employment Tax Regulations (26 CFR Part 31) under section 3221(d). On September 23, 1998, REG–209769–95, 1998–41 I.R.B. 8, was published in the **Federal Register** (63 F.R. 50819) under section 3221(d). The proposed regulations provide guidance regarding the section 3221(d) exception from the tax imposed under section 3221(c) with respect to employees covered by a supplemental pension plan of the employer established pursuant to an agreement reached through collective bargaining. Two written comments were received on the proposed regulations. A public hearing was held on the proposed regulations on January 20, 1999. After consideration of the comments, the proposed regulations under section 3221(d) are adopted as revised by this Treasury decision.

Under the Railroad Retirement Act of 1974, as amended, codified at 45 U.S.C. 231 et seq., if an employee has performed at least 25 years of covered service with the railroad industry, including service with the railroad industry before October 1, 1981, the Railroad Retirement Board (RRB) will pay the employee a supplemental annuity at retirement. The monthly amount of the supplemental annuity ranges from $23 to $43, based on the employee's number of years of service. See 45 U.S.C. 231b(e). Under 45 U.S.C. 231a(h)(2), the employee's supplemental annuity is reduced by the amount of payments received by the employee from any plan determined by the RRB to be a supplemental pension plan of the employer, to the extent those payments are derived from employer contributions.

Section 3221(c) imposes a tax on each railroad employer to fund the supplemental annuity benefits payable by the RRB. The tax imposed under section 3221(c) is based on work-hours for which compensation is paid. The RRB establishes the rate of tax under section 3221(c) quarterly, and calculates the rate to generate sufficient tax revenue to fund the RRB's current supplemental annuity obligations.

Under section 3221(d), the tax imposed by section 3221(c) does not apply to an employer with respect to employees who are covered by a supplemental pension plan established pursuant to an agreement reached through collective bargaining between the employer and employees. However, if an employee for whom the employer is relieved of any tax under the section 3221(d) exception becomes entitled to a supplemental annuity from the RRB, the employer is subject to an excise tax equal to the amount of the supplemental annuity paid to the employee (plus a percentage determined by the RRB to be sufficient to cover administrative costs attributable to those supplemental annuity payments).

Section 3221(d) was enacted by Public Law 91–215, 84 Stat. 70, which amended the Railroad Retirement Act of 1937 and the Railroad Retirement Tax Act. The legislative history to Public Law 91–215 indicates that the exception under section 3221(d) from the tax imposed under section 3221(c) was "directed primarily at the situation existing on certain short-line railroads which are owned by the steel companies. The employees of these lines are, for the most part, covered by other supplemental pension plans established pursuant to collective bargaining agreements between the steel companies and the unions representing the majority of their employees. * * * [T]hese railroads will no longer be required to pay a tax to finance the supplemental annuity fund, but will be required to reimburse the Railroad Retirement Board for any supplemental annuities that their employees may be paid upon retirement." S. Rep. 91–650, 91st Cong., 2d Sess. 6 (February 3, 1970).

Explanation of Provisions

These regulations retain the rules set forth in the proposed regulations for determining whether a plan is a supplemental pension plan established pursuant to an agreement reached through collective bargaining. Under these regulations, a plan is a supplemental pension plan only if the plan is a pension plan within the meaning of §1.401–1(b)(1)(i). Under this definition, a plan is a pension plan only if the plan is established and maintained primarily to provide systematically for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. Thus, for example, a plan generally is not a supplemental pension plan if distributions from the plan that are attributable to employer contributions may be made prior to a participant's death, disability, or termination

of employment. See Rev. Rul. 74–254 (1974–1 C.B. 90); Rev. Rul. 56–693 (1956–2 C.B. 282). A pension plan that is tax-qualified under section 401(a) is subject to special rules with respect to joint and survivor benefits under sections 401(a)(11) and 417.

One commentator requested clarification that these regulations do not preclude a plan from being a supplemental pension plan merely because the plan provides for a single sum distribution form (in addition to providing for periodic payments as described above). A plan is not precluded from being a pension plan within the meaning of §1.401–1(b)(1)(i) merely because it provides for a single sum distribution form in addition to providing for the required periodic payment forms. See section 417(e)(1) and (2). Thus, the availability of a single sum distribution form (offered in addition to the periodic payment form or forms described above) does not preclude a plan from being a supplemental pension plan under these regulations.

Another commentator requested clarification that a plan in which the employer contribution is discretionary or conditioned on contributions made at the election of employees pursuant to a qualified cash or deferred arrangement described in section 401(k)(2) could not qualify as a supplemental pension plan under section 3221(d) and the regulations. A plan that provides for discretionary employer contributions cannot be a pension plan under §1.401(b)–1(b)(1)(i) because it does not provide for the payment of definitely determinable benefits. Under section 401(k)(1), a qualified cash or deferred arrangement under section 401(k) must be part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan. Thus, a plan that provides for a section 401(k) qualified cash or deferred arrangement with employer matching contributions cannot be a pension plan under §1.401(b)– 1(b)(1)(i) (unless the plan is a pre-ERISA money purchase plan or a rural cooperative plan). Thus, apart from these narrow exceptions for certain pre-ERISA and rural cooperative plans, neither of the types of plans noted by the commentator could qualify as supplemental pension plans under section 3221(d) and these regulations.

As provided in the proposed regulations, these regulations also require that the RRB determine that a plan is a private pension under its regulations in order for the plan to be a supplemental pension plan under section 3221(d) and these regulations. This requirement is included because the section 3221(d) exception to the section 3221(c) tax is based on the assumption that any participant for whom the exception applies will receive a reduced supplemental annuity because of the supplemental pension plan on account of which the section 3221(c) tax is eliminated.

These regulations also retain the rules set forth in the proposed regulations for determining whether a plan is established pursuant to a collective bargaining agreement with respect to an employee. These rules generally follow the rules applicable to qualified plans for this purpose. Under these regulations, a plan is established pursuant to a collective bargaining agreement with respect to an employee only if the employee is included in the collective bargaining unit covered by the collective bargaining agreement.

One commentator maintained that employers should also be exempted from supplemental annuity tax with respect to nonbargaining unit employees covered by a plan that is the subject of collective bargaining. The IRS and Treasury Department have determined that it is inappropriate to extend the exception to nonbargaining unit employees. This determination is consistent with the RRB's administrative rulings. As noted below, the final regulations include a delayed effective date for this requirement.

Section 3221(d) imposes an excise tax equal to the amount of the supplemental annuity paid to any employee with respect to whom the employer has been excepted from the section 3221(c) excise tax under the section 3221(d) exception. These regulations retain the rules set forth in the proposed regulations for applying this excise tax under section 3221(d).

Effective Date

These regulations generally apply beginning on October 1, 1998, as provided in the proposed regulations. However, the IRS and Treasury have determined that it is appropriate to provide a delayed applicability date with respect to the portion of the final regulations clarifying what constitutes a plan established pursuant to a collective bargaining agreement with respect to an employee for purposes of section 3221(d). Accordingly, the final regulations provide that the definition in §31.3221–4(c) applies beginning on January 1, 2000.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Linda S. F. Marshall, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

PART 31–EMPLOYMENT TAXES AND COLLECTION OF INCOME AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3221-4 is added under the undesignated center heading "Tax on Employers" to read as follows:

§31.3221–4 Exception from supplemental tax.

(a) *General rule.* Section 3221(d) provides an exception from the excise tax imposed by section 3221(c). Under this exception, the excise tax imposed by section 3221(c) does not apply to an employer with respect to employees who are covered by a supplemental pension plan, as defined in paragraph (b) of this section, that is established pursuant to an agreement reached through collective bargaining between the employer and employees, within the meaning of paragraph (c) of this section.

(b) *Definition of supplemental pension plan*–(1) *In general.* A plan is a supplemental pension plan covered by the section 3221(d) exception described in paragraph (a) of this section only if it meets the requirements of paragraphs (b)(2) through (b)(4) of this section.

(2) *Pension benefit requirement.* A plan is a supplemental pension plan within the meaning of this section only if the plan is a pension plan within the meaning of §1.401–1(b)(1)(i) of this chapter. Thus, a plan is a supplemental pension plan only if the plan provides for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. A plan need not be funded through a qualified trust that meets the requirements of section 401(a) or an annuity contract that meets the requirements of section 403(a) in order to meet the requirements of this paragraph (b)(2). A plan that is a profit-sharing plan within the meaning of §1.401–1(b)(1)(ii) of this chapter or a stock bonus plan within the meaning of §1.401–1(b)(1)(iii) of this chapter is not a supplemental pension plan within the meaning of this paragraph (b).

(3) *Railroad Retirement Board determination with respect to the plan.* A plan is a supplemental pension plan within the meaning of this paragraph (b) with respect to an employee only during any period for which the Railroad Retirement Board has made a determination under 20 CFR 216.42(d) that the plan is a private pension, the payments from which will result in a reduction in the employee's supplemental annuity payable under 45 U.S.C. 231a(b). A plan is not a supplemental pension plan for any time period before the Railroad Retirement Board has made such a determination, or after that determination is no longer in force.

(4) *Other requirements.* [Reserved]

(c) *Collective bargaining agreement.* A plan is established pursuant to a collective bargaining agreement with respect to an employee only if, in accordance with the rules of §1.410(b)–6(d)(2) of this chapter, the employee is included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, provided that there is evidence that retirement benefits were the subject of good faith bargaining between employee representatives and the employer or employers.

(d) *Substitute section 3221(d) excise tax.* Section 3221(d) imposes an excise tax on any employer who has been excepted from the excise tax imposed under section 3221(c) by the application of section 3221(d) and paragraph (a) of this section with respect to an employee. The excise tax is equal to the amount of the supplemental annuity paid to that employee under 45 U.S.C. 231a(b), plus a percentage thereof determined by the Railroad Retirement Board to be sufficient to cover the administrative costs attributable to such payments under 45 U.S.C. 231a(b).

(e) *Effective date*–(1) *In general.* Except as provided in paragraph (e)(2) of this section, this section applies beginning on October 1, 1998.

(2) *Delayed effective date for collective bargaining agreement provisions.* Paragraph (c) of this section applies beginning on January 1, 2000.

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved July 27, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 5, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 6, 1999, 64 F.R. 42831)

Section 6109.—Identifying Numbers

26 CFR 1.6109–2: Furnishing identifying number of income tax return preparer.

T.D. 8835

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Furnishing Identifying Number of Income Tax Return Preparer

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary and final regulations.

SUMMARY: This document contains temporary and final regulations that allow income tax return preparers to elect an alternative to their social security number (SSN) for purposes of identifying themselves on returns they prepare. The regulations are needed to implement changes made to the applicable law by the Internal Revenue Service Restructuring and Reform Act of 1998. The regulations affect individual preparers who elect to identify themselves using a number other than their SSN. The text of the temporary regulations also serves as the text of the proposed regulations set forth in REG–105237–99, see page 331.

DATES: *Effective Date:* These regulations are effective August 12, 1999.

Applicability Date: For dates of applicability of these regulations, see §§1.6109–2(d) and 1.6109–2T(d).

FOR FURTHER INFORMATION CONTACT: Andrew J. Keyso, (202) 622-4910 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Section 6109(a)(4) of the Internal Revenue Code provides that any return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer as required by regulations prescribed by the Secretary. Prior to its amendment by the Internal Revenue Service Restructuring and Re-

form Act of 1998 (Public Law 105–206, 112 Stat. 685 (RRA '98)), section 6109(a) provided that the identifying number of an individual preparer was that preparer's social security number (SSN).

Section 3710 of RRA '98 amended section 6109(a) by removing the requirement that an individual preparer's identifying number be the preparer's SSN. Instead, the Secretary may prescribe alternatives to the SSN for purposes of identifying individual preparers.

Explanation of Provisions

On December 21, 1998, the IRS published Notice 98–63, 1998–51 IRB 15, to inform preparers of the IRS's intention to develop a system of alternative identifying numbers. This document contains amendments to the Income Tax Regulations (26 CFR part 1) to allow individual preparers to either use their SSN or elect an alternative identifying number for purposes of identifying themselves on returns they prepare. The IRS will develop a form on which preparers may apply for an alternative identifying number.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) refer to the Special Analyses section of the preamble of the cross-reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register.** Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Andrew J. Keyso, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6109–2 is amended by:

1. Revising the first sentence of paragraph (a) introductory text;

2. Adding paragraph (d).

The revision and addition read as follows:

§1.6109–2 Furnishing identifying number of income tax return preparer.

(a) *Furnishing identifying number.* For returns or claims for refund filed prior to January 1, 2000, each return of tax under subtitle A of the Internal Revenue Code or claim for refund of tax under subtitle A of the Internal Revenue Code prepared by one or more income tax return preparers must bear the identifying number of the preparer required by §1.6695–1(b) to sign the return or claim for refund. * * *

* * * * *

(d) *Effective date.* Paragraph (a) of this section and this paragraph (d) apply to returns or claims for refund filed prior to January 1, 2000. For returns or claims for refund filed after December 31, 1999, see §1.6109–2T(a).

Par. 3. Section 1.6109–2T is added to read as follows:

§1.6109–2T Furnishing identifying number of income tax return preparer (temporary).

(a) *Furnishing identifying number.* (1) Each return of tax, or claim for refund of tax, under subtitle A of the Internal Revenue Code prepared by one or more income tax return preparers must include the identifying number of the preparer required by §1.6695–1(b) to sign the return or claim for refund. In addition, if there is a partnership or employment arrangement between two or more preparers, the identifying number of the partnership or employer must also appear on the return or claim for refund. For the definition of the term income tax return preparer (or preparer) see section 7701(a)(36) and §301.7701–15 of this chapter.

(2) The identifying number of a preparer who is an individual (not described in paragraph (a)(3) of this section) is that individual's social security account number, or such alternative number as may be prescribed by the Internal Revenue Service in forms, instructions, or other appropriate guidance.

(3) The identifying number of a preparer (whether an individual, corporation, or partnership) who employs or engages one or more persons to prepare the return or claim for refund (other than for the preparer) is that preparer's employer identification number.

(b) and (c) [Reserved]. For further guidance, see §1.6109–2(b) and (c).

(d) *Effective date.* Paragraph (a) of this section and this paragraph (d) apply to returns or claims for refund filed after December 31, 1999. For returns or claims for refund filed prior to January 1, 2000, see §1.6109–2(a).

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 3, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 11, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 12, 1999, 64 F.R. 43910)

Section 6621.— Determination of Interest Rate

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calender quarter beginning October 1,

1999, will be 8 percent for overpayments (7 percent in the case of corporate overpayments), 8 percent for underpayments, 5.5 percent for the portion of a corporate overpayment exceeding $10,000, and 10 percent for large corporate underpayments.

Rev. Rul. 99-36

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under § 6621(a)(1), the overpayment rate beginning October 1, 1999, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See § 6621(c) and § 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of July 1999 is 5 percent. Accordingly, an overpayment rate of 8 percent (7 percent in the case of a corporation) and an underpayment rate of 8 percent are established for the calendar quarter beginning October 1, 1999. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning October 1, 1999, is 5.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 1999, is 10 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 5.5 percent, 7 percent, 8 percent, and 10 percent are published in Tables 16, 19, 21, and 25 of Rev. Proc. 95–17, 1995–1 C.B. 556, 570, 573, 575, and 579.

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Bailey on (202) 622-6226 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 – PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 – PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS—Continued

FROM JANUARY 1, 1991 – PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 - PRESENT

	RATE	1995–1 C.B TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1. 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570

Part III. Administrative, Procedural, and Miscellaneous

Treasury Depreciation Study: Request for Public Comment

Notice 99–34

PURPOSE

As directed by Congress in the Tax and Trade Relief Extension Act of 1998 (the Act), the Treasury Department is conducting a comprehensive study of the recovery periods and depreciation methods under section 168 of the Internal Revenue Code. This notice invites public comment on the determination of depreciation recovery periods and methods. The Treasury Department will review and consider all comments and other information received in response to this notice in preparing its depreciation study.

BACKGROUND

Section 167 provides for a depreciation deduction representing a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business, or property held for the production of income.

Section 168 provides a modified Accelerated Cost Recovery System (MACRS) for determining depreciation deductions for most tangible property placed in service after December 31, 1986. Section 168(e) classifies tangible property into a number of asset types based on either a specific statutory provision or the property's class life. The class life of tangible property is determined with reference to the list of class lives provided by the Treasury Department that was in effect as of January 1, 1986, now listed in Rev. Proc. 87–56, 1987–2 C.B. 674. A property's classification determines the applicable depreciation method under section 168(b), recovery period under section 168(c), and first-year convention under section 168(d) that are used to calculate the property's allowable depreciation deductions.

Special recovery periods and methods apply in certain situations. In particular, section 168(g) establishes an Alternative Depreciation System (ADS) for certain property, including tangible property used predominantly outside the United States, tax-exempt use property, tax-exempt bond financed property, and property for which an election is made to use the ADS. The ADS specifies use of the straight-line method with alternative recovery periods (generally equal to the property's class life) for calculating allowable depreciation deductions. The ADS also is used to determine depreciation allowances for most tangible property for the purpose of computing corporate earnings and profits (section 312(k)(3)).

Section 205 of the Act directed the Secretary of the Treasury (or the Secretary's delegate) to conduct a comprehensive study of the recovery periods and depreciation methods under section 168. The Secretary is directed to submit the results of the study, together with recommendations for determining such periods and methods in a more rational manner, to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate no later than March 31, 2000.

REQUEST FOR PUBLIC COMMENT

In accordance with the Act's directive to study depreciation recovery periods and methods, the Treasury Department's Office of Tax Analysis (OTA) requests public comment and information relating to problems encountered under current law. OTA also seeks recommendations for possible improvements to the current system.

OTA is specifically interested in information pertaining to alternative approaches to measuring asset depreciation and in alternative frameworks for analyzing current issues in depreciation. Where appropriate, each public submission should include an analysis (with supporting data) that informs OTA on specific depreciation issues. Issues may include, but need not be limited to, the following: (1) principles that should govern the classification of tangible depreciable property, (2) the meaning of a class life and the method or methods that should be used to estimate class lives, (3) the institutions and procedures under which asset class definitions and class lives should be reviewed and (if necessary) modified, (4) methods by which class lives should be estimated for newly developing industries (where historical data may not be available), (5) the rules under which depreciation recovery periods and methods should be derived from asset class lives, (6) the application of the methods used to compute depreciation allowances, and (7) situations in which the application of the current section 168 approach is inappropriate or unnecessary for the determination of a reasonable measure of tangible property depreciation.

Because the Treasury Department was directed to provide general recommendations for determining depreciation recovery periods and methods in a more rational manner, the study is not intended to recommend specific changes in particular current class lives, recovery periods, or depreciation methods. Thus, this notice is an invitation to the public to submit information, including specific examples, that will highlight general problems with the current depreciation system, rather than narrower problems with respect to particular class lives or types of property. It is also a request for analysis and commentary that can lead to improvements that will cause depreciation allowances to better reflect the actual reductions in tangible asset values over time or that reduce taxpayer compliance and IRS administrative burdens.

Taxpayers should be aware that all comments and information submitted are subject to public disclosure. Consideration will be given to all submissions received by November 1, 1999.

Written submissions should be sent to:

Depreciation Study
Office of Tax Analysis
Room 4217, Main Treasury Building
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Alternatively, comments may be submitted through the Internet to: *taxpolicy@do.treas.gov.* The Internet e-mail *subject line must include* "Depreciation Study".

DRAFTING INFORMATION

The principal author of this notice is David Brazell, Financial Economist, Office of Tax Analysis. For further information regarding this notice, please contact

Mr. Brazell on (202) 622-1786 (not a toll-free call).

Extension of Relief Relating to Application of Nondiscrimination Rules for Certain Governmental Plans

Notice 99–40

I. PURPOSE

This notice provides that certain governmental plans shall be deemed to satisfy § 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Internal Revenue Code until the first day of the first plan year beginning on or after January 1, 2001. In accordance with this relief, the regulations relating to these provisions do not apply until plan years beginning after that date. This relief is available with respect to governmental plans within the meaning of § 414(d) other than plans of State and local governments or political subdivisions, agencies or instrumentalities thereof. This relief is provided in light of difficulties, which are unique to the governmental employers that maintain these plans, in determining compliance with the nondiscrimination requirements. See § 3.07 of Rev. Proc. 99–23, 1999–16 I.R.B. 5, for the remedial amendment period for disqualifying provisions of these plans relating to these nondiscrimination and other requirements.

II. BACKGROUND

A. Governmental Plans

Section 414(d) of the Code provides that the term "governmental plan" means a plan established and maintained for its employees by the government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term "governmental plan" also includes any plan to which the Railroad Retirement Act of 1935 or 1937 (the "Act") applies and which is financed by contributions under that Act and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669).

Section 1505 of the Taxpayer Relief Act of 1997 ("TRA '97") generally provides that the nondiscrimination rules do not apply to State and local governmental plans. In particular, § 1505 amended the Code to provide that § 401(a)(3), 401(a)(4), and 401(a)(26) shall not apply to such plans. Section 1505 of TRA '97 amended § 401(k) of the Code to provide that State and local governmental plans shall be treated as meeting the requirements of § 401(k)(3). In addition, § 1505(a)(3) of TRA '97 amended § 410(c) of the Code to provide that governmental plans shall be treated as meeting the requirements of § 410 for purposes of § 401(a). This amendment to § 410(c), by its terms, is not limited to State and local governmental plans but applies to all governmental plans within the meaning of § 414(d).

B. Administrative Guidance

The nondiscrimination requirements under the Code were substantially changed by the Tax Reform Act of 1986 (TRA '86). Announcement 95–48, 1995–23 I.R.B. 13, and Notice 96–64, 1996–2 C.B. 229, provided that the regulations under §§ 401(a)(4), 401(a)(26), 410(b) and 414(s) apply, in the case of governmental plans described in § 414(d), to plan years beginning on or after the later of January 1, 1999, or 90 days after the opening of the first legislative session beginning on or after January 1, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously ("1999 legislative date"). Notice 96–64 also provided that the regulations under § 401(k) and (m) apply to governmental plans only for plan years beginning on or after the later of October 1, 1997, or 90 days after the opening of the first legislative session beginning on or after October 1, 1997, of the governing body with authority to amend the plan, if that body does not meet continuously. For plan years beginning before the applicable effective date, governmental plans are deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k), 401(m), 410(b), and 414(s).

Section 3.07 of Rev. Proc. 99–23 extended, in the case of governmental plans described in § 414(d), the remedial amendment period under § 401(b) for certain amendments ("TRA '86 remedial amendment period") until the date described in Rev. Proc. 98–14, 1998–4 I.R.B. 22: the later of (i) the last day of the last plan year beginning before January 1, 2001, or (ii) the last day of the first plan year beginning on or after the 1999 legislative date. The amendments to which the TRA '86 remedial amendment period applies are those required to comply with TRA '86 and subsequent legislation through the Omnibus Budget Reconciliation Act of 1993.

III. EXTENSION OF RELIEF RELATING TO APPLICATION OF NONDISCRIMINATION RULES FOR CERTAIN GOVERNMENTAL PLANS

Under the relief provided by this notice, governmental plans within the meaning of § 414(d), other than those maintained by State or local governments or political subdivisions, agencies or instrumentalities thereof, shall be treated as satisfying the requirements of § 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) until the first plan year beginning on or after January 1, 2001. In accordance with this relief, the regulations under §§ 401(a)(4), 401(a)(26), 401(m), 410(b) and 414(s), and the regulations implementing § 401(k)(3), apply to governmental plans described in this part only for plan years beginning on or after January 1, 2001.

IV. COMMENTS

Comments or suggestions regarding this notice should be addressed to CC:DOM:CORP:R (Notice 99–40), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, taxpayers may hand-deliver comments between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (Notice 99–40), Courier's desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC, or may submit comments electronically by using the following site: cynthia.grigsby@m1.irscounsel.treas.gov

V. EFFECT ON OTHER DOCUMENTS

Notice 96–64 is modified.

DRAFTING INFORMATION

The principal author of this notice is Diane S. Bloom of the Employee Plans Division. For further information regard-

ing this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074 or (202) 622-6075, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Bloom may be reached at (202) 622-6214. These telephone numbers are not toll-free.

Designated Private Delivery Services

Notice 99–41

This notice updates the list of designated private delivery services ("designated PDSs") set forth in Notice 98–47, 1998–37 I.R.B. 8, for purposes of the "timely mailing as timely filing/paying" rule of § 7502 of the Internal Revenue Code, effective September 1, 1999. The list of designated PDSs remains unchanged. Also, this notice modifies Rev. Proc. 97–19, 1997–1 C.B. 644 and Notice 97–26, 1997–1 C.B. 413 (both previously modified by Notice 97–50, 1997–2 C.B. 305), to provide that the Service will no longer routinely publish an annual list of designated PDSs. Instead, the Service will publish a new list only when a designated PDS (or service) is being added to, or removed from, the current list.

Section 7502(f) authorizes the Secretary to designate certain PDSs for the "timely mailing as timely filing/paying" rule of § 7502. Rev. Proc. 97–19 provides the criteria currently applicable for designation of a PDS. Notice 97–26 provides special rules to determine the date that will be treated as the postmark date for purposes of § 7502. Notice 97–50, modifying Rev. Proc. 97–19 and Notice 97–26, provides that each year there will be only one application period to apply for designation, which will end on June 30th. Notice 97–50 also provides that the Service will issue a notice providing a new list of designated PDSs on or before September 1st of each year for which Rev. Proc. 97–19 is in effect.

Effective September 1, 1999, the list of designated PDSs is as follows:

1. Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, and Second Day Service;

2. DHL Worldwide Express (DHL): DHL "Same Day" Service and DHL USA Overnight;

3. Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, and FedEx 2Day; and

4. United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, and UPS 2nd Day Air A.M.

The list above remains unchanged from the list published in Notice 98–47. Airborne, DHL, FedEx, and UPS are not designated with respect to any type of delivery service not identified above.

The list of designated PDSs and services set forth above will remain in effect until further notice. The Service will publish a subsequent notice setting forth a new list only if a designated PDS (or service) is added to, or removed from, the current list. Delivery services that wish to be designated in time for an upcoming filing season must continue to submit applications by June 30th of the year preceding that filing season, as required by Rev. Proc. 97–19 (as modified by Notice 97–50). Notice 97–26 continues to provide special rules used to determine the date that will be treated as the postmark date for purposes of § 7502.

EFFECT ON OTHER DOCUMENTS

Revenue Procedure 97–19 and Notice 97–26 are modified. Notices 97–50 and 98–47 are modified and, as so modified, are superseded.

EFFECTIVE DATE

This notice is effective on September 1, 1999.

FOR FURTHER INFORMATION

The principal author of this notice is Renay France of the Office of the Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. France at (202) 622-6232 (not a toll-free call).

Elimination of Magnetic Tape Program for Federal Tax Deposits

Notice 99–42

This notice advises taxpayers of the termination of the Internal Revenue Service magnetic tape program for the reporting of federal tax deposits and certain estimated income tax payments effective with respect to deposits or payments made after January 31, 2000.

BACKGROUND

On February 10, 1999, the Internal Revenue Service announced in the Federal Register (64 F.R. 6739) that consideration was being given to ending the program which allows certain reporting agents to transmit to the Service by magnetic tape federal tax deposit and estimated income tax information.

Rev. Proc. 89–48, 1989–2 C.B. 599, provides the requirements under which qualifying reporting agents may submit magnetic tapes to report their clients' federal tax deposit payments instead of using paper coupons (Form 8109–Federal Tax Deposit Coupon). The authorization to use magnetic tape extends only to those reporting agents who have a minimum of 200 clients and who satisfy all of the requirements of the revenue procedure.

Rev. Proc. 89–49, 1989–2 C.B. 615, provides that certain banks and financial institutions having a Treasury Tax and Loan Account (TT&L Account), and acting as fiduciaries with respect to at least 200 taxable trusts, are *required* to submit the trusts' estimated income tax payment information on magnetic tape instead of using vouchers (Form 1041-ES, Estimated Income Tax for Estates and Trusts). In addition, the revenue procedure provides that authorizations will also be extended to those fiduciaries which have at least 50 but fewer than 200 taxable trusts with or without a TT&L account and that wish to submit estimated income tax information by magnetic tape.

MAGNETIC TAPE REPORTING OF FEDERAL TAX DEPOSITS IS TERMINATED

The program under which qualifying reporting agents may submit magnetic tapes to report their clients' federal tax deposit information and under which certain fiduciaries submit magnetic tape to report trust estimated income tax payment information is terminated for federal tax deposits or estimated tax payments made after January 31, 2000.

After termination of the program, current magnetic tape filers may either use paper coupons (Form 8109), estimated tax vouchers (Form 1041-ES), or the

Electronic Federal Tax Payment System (EFTPS). If the client is required to deposit using EFTPS, the reporting agent must also use EFTPS with respect to that client. In addition, the reporting agent may voluntarily use EFTPS with respect to any other client that is voluntarily enrolled in EFTPS.

Rev. Proc. 98–32, 1998–17 I.R.B. 11, provides information about the EFTPS programs for Batch Filers and Bulk Filers. These electronic programs are used by Batch Filers and Bulk Filers (Filers) to submit enrollments, federal tax deposits, and federal tax payments on behalf of multiple taxpayers. The Bulk Filer program is recommended for Filers who anticipate making 750 or more payments on a peak day. The Batch Filer program is recommended for all other Filers who anticipate submitting 50 or more enrollments.

In addition, a Single Debit Filer application is available for banks and financial institutions that prefer to make a single payment out of one account to cover the estimated taxes of multiple trusts. Filers should consult Publication 3394, EFTPS Single Debit Guide, and Publication 3393, EFTPS Single Debit Technical Requirements, for assistance in using this program.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 89–48 and Rev. Proc. 89–49 are obsolete after January 31, 2000.

EFFECTIVE DATE

This notice is effective with respect to federal tax deposits or estimated income tax payments made after January 31, 2000.

DRAFTING INFORMATION

The principal author of this Notice is Vincent G. Surabian of the Office of Assistant Chief Counsel (Income Tax & Accounting). For further information regarding this Notice contact Mr. Surabian on (202) 622-4940 (not a toll-free call). For further information regarding alternate reporting options available to current magnetic tape users, contact Melvyn S. Barkin at (202) 283-0259 (not a toll-free call).

Section 415 Limitations on Benefits and Contributions Under Qualified Plans

Notice 99–44

I. PURPOSE

This notice provides guidance relating to the repeal of the combined limitation on defined benefit and defined contribution plans under § 415(e) of the Internal Revenue Code (the Code) made by the Small Business Job Protection Act of 1996 (SBJPA), Pub. L. 104-88. In addition, this notice provides guidance on the amendment to the definition of compensation under § 415(c)(3) made by the same act. Specifically, this notice provides questions and answers on

- Benefit increases that may be provided upon the repeal of § 415(e).
- Plan amendments that may be adopted to take into account the repeal of § 415(e).
- The treatment of the repeal of § 415(e) for purposes of applying the minimum funding standards under § 412.
- The effect of the repeal of § 415(e) and the modification of § 415(c)(3) on other qualification requirements.
- Relief under § 7805(b)(8) for certain plans that continue to use a definition of compensation under § 415(c)(3) as it existed prior to SBJPA.

II. BACKGROUND

Section 415 of the Code imposes limitations on contributions and benefits under qualified plans. Section 415(e) imposes limitations that apply to an individual who participates in both a defined benefit plan and a defined contribution plan maintained by the same employer. Section 1452(a) of SBJPA repealed § 415(e) of the Code, effective for limitation years beginning on or after January 1, 2000. The limitations of § 415(e) as in effect immediately prior to this effective date are referred to in this notice as the "pre-SBJPA § 415(e) limitations."

Section 415(c)(3) of the Code and the regulations thereunder provide a definition of compensation for purposes of computing the limitations on contributions and benefits for a participant in a qualified plan. Section 1434 of SBJPA amended § 415(c)(3) to include elective deferrals described in § 402(g)(3), and elective contributions to a § 125 cafeteria plan or a § 457(b) eligible deferred compensation plan, in a participant's compensation, effective for limitation years beginning on or after January 1, 1998.

Section 411(a) prescribes rules as to when an employee's right to his or her normal retirement benefit must become nonforfeitable under a qualified plan. Section 411(d)(6) generally prohibits a plan amendment, except for an amendment described in § 412(c)(8), that has the effect of decreasing a participant's accrued benefits under the plan.

Section 1106(h) of the Taxpayer Reform Act of 1986, Pub. L. 99–514, provides that notwithstanding any other provision of law, except as provided in regulations prescribed by the Secretary of the Treasury, a plan may incorporate by reference the limitations under § 415 of the Code. In Notice 87–21, 1987–1 C.B. 458, Q&A-11, the Service provided guidance for plans to incorporate by reference the limitations of § 415, for limitation years beginning on or after January 1, 1987.

Section 401(a)(4) prescribes nondiscrimination rules for qualified plans. Section 1.401(a)(4)–2 of the Income Tax Regulations imposes requirements relating to nondiscrimination in amount of employer contributions under a defined contribution plan. For this purpose, § 1.401(a)(4)–2(b) provides two safe harbor tests, and § 1.401(a)(4)–2(c) provides a general test. Plans that satisfy one of these safe harbors must provide for either a uniform allocation formula or a uniform points allocation formula as described in the regulation. Under § 1.401(a)(4)–2(b)(4)(iv), a safe-harbor plan does not fail to satisfy these uniformity requirements merely because the plan limits allocations otherwise provided under the allocation formula in accordance with the limitations of § 415.

Section 1.401(a)(4)–3 imposes requirements relating to nondiscrimination in amount of benefits under a defined benefit plan. For this purpose, § 1.401(a)(4)–3(b) provides for several safe harbor tests, and § 1.401(a)(4)–3(c) provides a general test. To satisfy one of these safe harbors, a plan must provide for a uniform normal retire-

ment benefit, uniform post-normal retirement benefit, and uniform subsidies. Under § 1.401(a)(4)–3(b)(6)(v), a safe-harbor plan does not fail to satisfy these uniformity requirements merely because the plan limits benefits otherwise provided under the benefit formula or accrual method in accordance with the limitations of § 415. Plans that satisfy the general test may do so by testing benefits with or without the application of the § 415 limitations.

Section 401(b) specifies a remedial amendment period during which a plan may be amended retroactively, under certain circumstances, to comply with the Code's qualification requirements. Pursuant to Rev. Proc. 99–23, 1999–16 I.R.B. 5, the remedial amendment period for plan amendments relating to recent legislation for most plans has been extended until the last day of the first plan year beginning on or after January 1, 2000. Section 4 of Rev. Proc. 99–23 provides that this remedial amendment period applies to plan amendments made to implement the repeal of § 415(e).

III. QUESTIONS AND ANSWERS

Q-1: What is the effective date of the repeal of § 415(e) of the Code by § 1452(a) of SBJPA?

A-1: In accordance with § 1452(d)(1) of SBJPA, § 415(e) of the Code is repealed effective as of the first day of the first limitation year beginning on or after January 1, 2000. With respect to limitation years beginning on or after January 1, 2000, a defined contribution plan will not fail to satisfy § 415 solely because the annual additions for any participant for such years exceed the pre-SBJPA § 415(e) limitations. With respect to limitation years beginning on or after January 1, 2000, a defined benefit plan will not fail to satisfy § 415 solely because the plan provides that the benefit of any participant exceeds the pre-SBJPA § 415(e) limitations. Accordingly, the pre-SBJPA § 415(e) limitations will not limit the benefit of a participant in a defined benefit plan whose benefit has not commenced as of the first day of the first limitation year beginning on or after January 1, 2000. For rules regarding the application of the pre-SBJPA § 415(e) limitations to a participant in a defined benefit plan whose benefit has commenced as of that date, see Q&A-3 and 4.

Q-2: If a plan is not amended to take into account the repeal of § 415(e), how may the benefits of plan participants be affected?

A-2: If a plan is not amended to take into account the repeal of § 415(e), the effect on the benefits of plan participants will depend on the plan's existing provisions for applying the limitations of § 415(e) and any other relevant plan provisions. In some circumstances, a plan's existing provisions could result in automatic benefit increases for participants as of the effective date of the repeal of § 415(e) for the plan. For example, the repeal of § 415(e) could result in automatic benefit increases for participants in defined benefit plans that incorporate by reference the limitations under § 415. Similarly, the repeal of § 415(e) could result in automatic changes to annual additions for participants in defined contribution plans.

Q-3: May a defined benefit plan provide for benefit increases to reflect the repeal of § 415(e) for a current or former employee who has commenced benefits under the plan prior to the effective date of the repeal?

A-3: A defined benefit plan may provide for benefit increases to reflect the repeal of § 415(e) for a current or former employee who has commenced benefits under the plan prior to the effective date of the repeal of § 415(e) for the plan, but only if the employee or former employee is a participant in the plan on or after that effective date. For this purpose, an employee or former employee is a participant in the plan on a date if the employee or former employee has an accrued benefit (other than an accrued benefit resulting from a benefit increase that arises solely as a result of the repeal of § 415(e)) on that date. Thus, benefit increases to reflect the repeal of § 415(e) cannot be provided to current or former employees who do not have accrued benefits under the plan on or after the effective date of the repeal of § 415(e) for the plan. However, if a current or former employee accrues additional benefits under the plan that could have been accrued without regard to the repeal of § 415(e) (including benefits that accrue as a result of a plan amendment) on or after the effective date of the repeal of § 415(e) for the plan, then the current or former employee may receive a benefit arising from the repeal of § 415(e).

Q-4: How is the maximum permissible benefit increase calculated for a current or former employee who has commenced benefits under a defined benefit plan prior to the effective date of the repeal of § 415(e) for the plan?

A-4: For any limitation year beginning on or after the effective date of the repeal of § 415(e) for the plan, the benefit payable to any current or former employee who has commenced benefits under the plan prior to that date in a form not subject to § 417(e)(3) may be increased to a benefit that is no greater than the benefit that would have been permitted for that year under § 415(b) for the employee had § 415(e) not limited the benefit at the time of commencement. Thus, the annual benefit for limitation years beginning on or after the effective date of the repeal of § 415(e) for the plan is limited to the § 415(b) limitation for the employee (increased for cost-of-living-adjustments, if the plan provided for such adjustments) based on the employee's age at the time of commencement. In the case of a form of benefit that is subject to § 417(e)(3), the benefit payable for any limitation year beginning on or after the effective date of the repeal of § 415(e) for the plan may be increased by an amount that is actuarially equivalent to the amount of increase that could have been provided had the benefit been paid in the form of a straight life annuity. Whether or not the form of benefit is subject to § 417(e)(3), benefits attributable to limitation years beginning before January 1, 2000, cannot reflect benefit increases that could not be paid for those years because of § 415(e). In addition, any plan amendment to provide an increase as a result of the repeal of § 415(e) can be effective no earlier than the effective date of the repeal of § 415(e) for the plan. The following examples illustrate these principles:

Example 1: Plan *M*, a defined benefit plan, has a calendar plan year and limitation year. Plan *M* is not a top-heavy plan during any relevant period. Under Plan *M*, participants may elect to receive benefit distributions either in the form of an annuity or a single sum. Plan *M* provides that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code. Plan *M* also provides that benefits will be limited to the extent necessary to satisfy the requirements of § 415(e). In order to reflect the

§ 417(e)(3) change made by GATT, Plan *M* was amended on January 1, 1995, effective as of that date, to substitute the applicable interest rate and the applicable mortality table for the original plan rate and the UP-1984 Mortality Table, respectively, to compute single-sum benefits under the plan. Additionally, Plan *M* was amended on July 1, 1998, effective as of January 1, 1995, to apply the § 415(b)-(2)(E) changes made by GATT and SBJPA to all benefits under the plan on or after the RPA '94 § 415 effective date, as defined in Rev. Rul. 98–1, 1998–2 I.R.B. 5. Under Plan *M*, early retirement benefits and other optional forms of benefit are determined as the actuarial equivalents of a straight life annuity at normal retirement age using the applicable interest rate and applicable mortality table. For purposes of this example, the applicable interest rate for all relevant periods is assumed to be 6 percent.

P was a participant both in Plan *M*, and in Plan *N*, a defined contribution plan, before retiring at the end of 1995. *P* is unmarried and has a date of birth of January 1, 1940. *P*'s social security retirement age is 66. *P* commenced receiving distributions from Plan *M* in the form of a single life annuity on January 1, 1996, at age 56. The dollar limitation of § 415(b)(1)(A) for 1996 was $120,000. *P*'s compensation-based limit under § 415(b)(1)(B) was $150,000 for all relevant periods. Accordingly, the § 415(b) limitation for *P*'s benefit in 1996 was $54,753 ($120,000 reduced for early retirement at age 56).

P's defined contribution fraction for 1996 was 0.36. Therefore, in order to comply with § 415(e) in the manner provided under the plan, *P*'s benefit in Plan *M* was limited so that *P*'s defined benefit fraction was equal to 0.64 (1 minus 0.36). Thus, *P*'s benefit in 1996 was limited to $43,802 (0.64 multiplied by the lesser of (A) 1.25 multiplied by $54,753 or (B) 1.4 multiplied by $150,000).

The dollar limitation under § 415(b)(1)(A) increased to $125,000 in 1997, and to $130,000 in 1998 and 1999. In 1997, because of the indexing of the dollar limitation under Plan *M*, *P*'s benefit was increased to $45,628. Similarly, in 1998, *P*'s benefit was increased to $47,453. In 1999, because the dollar limitation was unchanged from 1998, *P*'s benefit continued to be limited to $47,453. For purposes of this example, it is assumed that the § 415(b)(1)(A) dollar limitation will be $135,000 in 2000.

Effective January 1, 2000, *P*'s annuity payments under Plan *M* are permitted to be increased to a maximum annuity benefit of $61,597 ($135,000 reduced for early retirement at age 56). However, no increase in *P*'s benefit is permitted to reflect the difference between the limitation of § 415(b) and the limitation of § 415(e) in prior limitation years.

Alternatively, if Plan *M* had not provided that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code, but was amended to provide for such increases effective for the limitation year beginning January 1, 2000, *P*'s benefit could be increased from $43,802 (the benefit without adjustment for increases in the § 415(b)(1)(A) dollar limitation) to $61,597, plus the annual amount that is actuarially equivalent to the $9,128 that could have been paid in the prior limitation years ($1,826 for 1997, and $3,651 each for 1998 and 1999) had the plan provided for benefit increases to reflect the cost-of-living increases under § 415(d).

Example 2: Assume the same facts as in *Example 1*, except that Plan *M* does not provide that benefits for retirees are increased as the dollar limitation is indexed under § 415(d) of the Code, and *P* commenced distributions from Plan *M* in the form of ten equal annual installments commencing on January 1, 1996. Accordingly, the § 415(b) limitation for *P*'s benefit in 1996 was $89,635 ($120,000 reduced for early retirement at age 56 and adjusted for the installment option). In order to comply with § 415(e), *P*'s installment payment in 1996 was limited to $71,707. Similarly, for the years 1997 through 1999, *P* received installment payments of $71,707. As of January 1, 2000, *P* has six installment payments remaining. Because Plan *M* does not provide for cost-of-living adjustments under § 415(d), *P*'s six remaining installment payments under Plan *M* are permitted to be increased, effective January 1, 2000, by the actuarial equivalent (spread over a period of six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 (i.e., the increase from $43,802 to $54,753) if *P* had elected a single life annuity rather than the installment payment option.

If Plan *M*, however, was amended to provide for cost-of-living adjustments under § 415(d), effective January 1, 2000, then *P*'s six remaining installment payments would be permitted to be increased by the actuarial equivalent (spread over a period of six years) of the value of the increases in the single life annuity that would have been payable beginning on January 1, 2000 (i.e., the increase from $43,802 to $61,597) if *P* had elected a single life annuity rather than the installment payment option. Furthermore, Plan *M* could provide that each of *P*'s six remaining installment payments under Plan *M* are increased by the actuarial equivalent (spread over six years) of the value of the increases in the prior installment payment that would have been paid in the prior limitation years had the plan provided for increases in the installment payments to reflect the increases under § 415(d).

Q-5: How will a plan that takes into account the repeal of § 415(e) as of the first day of the first limitation year beginning on or after January 1, 2000, satisfy the nondiscrimination in amount of benefits requirement?

A-5: A plan that uses the safe harbor and takes into account the repeal of § 415(e) as of the first day of the first limitation year beginning on or after January 1, 2000, will not fail to satisfy the uniformity requirements of §§ 1.401(a)(4)–2(b) or 1.401(a)(4)–3(b)(2) merely because the repeal of § 415(e) is taken into account under the plan.

For purposes of the general test for nondiscrimination in amount of contributions, increased contributions allocated under the terms of a defined contribution plan due to the repeal of § 415(e) must be taken into account in accordance with the rules of § 1.401(a)(4)–2(c)(2)(ii) for the plan year for which the increased allocations are made. For purposes of the general test for nondiscrimination in amount of benefits, increased benefits provided to an employee under the terms of a defined benefit plan due to the repeal of § 415(e) must be included as increases in the employee's accrued benefit (within the meaning of § 411(a)(7)(A)(i)) and the employee's most valuable optional form of payment of the accrued benefit (within the meaning of § 1.401(a)(4)–3(d)(1)(ii)) in accordance with the rules of § 1.401(a)(4)–3(d), and must be included in the computation of both the normal and most valuable accrual rates for any measurement period that includes the plan year for which the increase occurs. If the limitations of § 415 are taken into account in testing the plan for limitation years beginning on or after January 1, 2000, those limitations must reflect the repeal of § 415(e).

Q-6: If benefit increases are provided to employees and former employees under a plan as a result of the repeal of § 415(e), how are the requirements of §§ 1.401(a)-(4)–5 and 1.401(a)(4)–10 of the regulations satisfied?

A-6: If benefit increases resulting from the repeal of § 415(e) are provided, as of the effective date of the repeal of § 415(e) for the plan, to either (1) all current and former employees who have an accrued benefit under the plan immediately before the effective date of the repeal of § 415(e) for the plan, or (2) all employees participating in the plan that have one hour of service after the effective date of the repeal of § 415(e) for the plan, through the adoption of a plan amendment, then the timing of such an amendment satisfies the requirements of § 1.401(a)(4)–5 of the regulations, and the requirements of § 1.401(a)(4)-10(b) of the regulations are satisfied. In addition, if benefit increases are provided, as of the effective date of the repeal of § 415(e) for the plan, to either of the two groups described in the preceding sentence through the operation

of the plan's existing provisions, then the requirements of §§ 1.401(a)(4)–5 and 1.401(a)(4)-10(b) of the regulations are satisfied.

If benefit increases due to the repeal of § 415(e) are provided only to a certain group of current or former employees not described in the preceding paragraph through the adoption of a plan amendment, or if a plan amendment to reflect the repeal of § 415(e) is effective as of a later date than the effective date of the repeal of § 415(e) for the plan, then the timing of such an amendment (considered in conjunction with the effect of the repeal of § 415(e)) must satisfy a facts-and-circumstances determination under § 1.401(a)(4)–5(a)(2) of the regulations, and the requirements of § 1.401(a)(4)–10 must be applied.

Q-7: May a plan be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of § 415(e)?

A-7: Yes, a plan may be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the repeal of § 415(e). However, see Q&A-8 for certain qualification requirements that may be affected by such an amendment. A plan sponsor may wish to make a plan amendment to preclude a benefit increase that would otherwise occur as a result of the repeal of § 415(e) in order to provide time for the plan sponsor to consider the extent to which a benefit increase relating to the repeal of § 415(e) should or should not be provided at some later date consistent with all relevant qualification requirements. A plan amendment to limit the extent to which such a benefit increase would otherwise occur that is not both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000, may fail to satisfy § 411(d)(6). Therefore, a plan amendment that is intended to limit such a benefit increase should be both adopted prior to, and effective as of, the first day of the first limitation year beginning on or after January 1, 2000 (even though the plan could be later amended during the plan's remedial amendment, at the option of the plan sponsor, to retroactively provide for the benefit increase). The following is an example of language that could be used by a plan sponsor, on an interim or permanent basis, in amending a defined benefit plan that would otherwise provide for a benefit increase due to the repeal of § 415(e), to retain the effect of the pre-SBJPA § 415(e) limitations in determining a participant's accrued benefit under the plan (without failing to satisfy § 411(d)(6)):

> *Effective as of the first day of the first limitation year beginning on or after January 1, 2000 (the "Effective Date"), and notwithstanding any other provision of the Plan, the accrued benefit for any participant shall be determined by applying the terms of the Plan implementing the limitations of § 415 as if the limitations of § 415 continued to include the limitations of § 415(e) as in effect on the day immediately prior to the Effective Date. For this purpose, the defined contribution fraction is set equal to the defined contribution fraction as of the day immediately prior to the Effective Date.*

Q-8: Are there qualification requirements that may not be satisfied if a plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations?

A-8: There are some qualification requirements that may not be satisfied for a plan if the plan continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations. Any exception from the otherwise applicable qualification rules that is permitted solely in order to satisfy the maximum limitations on contributions or benefits under § 415 with respect to a participant does not apply if the participant's contributions or benefits are below the limitations of § 415. Thus, such an exception is not permitted where a plan limits benefits in a manner that is more restrictive than required under § 415. For example, at any time on or after the first day of the first limitation year beginning on or after January 1, 2000, a qualified defined contribution plan could not provide that the provisions of § 1.415-6(b)(6) would be applied to place an amount that does not exceed the limitations under § 415, but that does exceed the pre-SBJPA § 415(e) limitations, in an unallocated suspense account as an excess annual addition. Similarly, a qualified cash or deferred arrangement could not provide that the provisions of § 1.415–6(b)(6)(iv) would be applied to permit the distribution of elective deferrals that do not exceed the limitations under § 415, but that exceed the pre-SBJPA § 415(e) limitations. See Q&A-10 for a description of the effects that the continued application of the pre-SBJPA § 415(e) limitations may have on the requirements for nondiscrimination testing. Additionally, if a participant's annual additions to a defined contribution plan result in a decrease in the participant's accrued benefit under a defined benefit plan (under the terms of both plans), the relief previously provided under Q&A G-10 of Notice 83–10, 1983–1 C.B. 536 no longer applies, and such a reduction would violate § 411.

The qualification issues described in this Q&A-8 may arise whenever a lower limitation is applied under a plan in lieu of a statutory § 415 limitation that applies for the limitation year. For example, the issues described in this Q&A-8 may arise if a lower limitation is applied under a plan as a result of using a definition of compensation that is not within the meaning of § 415(c)(3), as amended by SBJPA. Q&A-9 provides § 7805(b)(8) relief that applies where a plan uses the pre-SBJPA § 415(c)(3) definition of compensation instead of the current § 415(c)(3) definition.

Q-9: To the extent that a qualified defined contribution plan applies the rules in § 1.415–6(b)(6) with respect to excess annual additions, must the plan apply the rules in § 1.415–6(b)(6) using a definition of compensation within the meaning of § 415(c)(3) as amended by SBJPA?

A-9: For limitation years ending on or after December 1, 1999, to the extent that a plan applies the rules in § 1.415–6(b)(6), a defined contribution plan will not satisfy the requirements of § 401(a) unless the rules of § 1.415–6(b)(6) are applied using a definition of compensation within the meaning of § 415(c)(3) as amended by SBJPA. However, for limitation years ending on or before November 30, 1999, pursuant to § 7805(b)(8), the Service will not treat a defined contribu-

tion plan as failing to satisfy the requirements of § 401(a) merely because the rules in § 1.415-6(b)(6) are applied using a definition of compensation within the meaning of § 415(c)(3) prior to its amendment by SBJPA.

Q-10: How may a plan that continues to limit benefits after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations, satisfy the nondiscrimination in amount of benefits requirement?

A-10: A plan does not fail to satisfy the uniformity requirements of §§ 1.401(a)-(4)–2(b) or 1.401(a)(4)–3(b)(2) merely because the limitations under § 415 are taken into account under the safe harbor requirements. The continued application of the pre-SBJPA § 415(e) limitations for a plan year after the effective date of the repeal of § 415(e) for a plan would cause the plan to fail to satisfy the uniformity requirements for the otherwise applicable nondiscrimination in amount safe harbor. However, if a plan limits benefits at any time on or after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations for highly compensated employees (but not for nonhighly compensated employees), the plan will not fail to satisfy the uniformity requirements and thus will not fail to satisfy a nondiscrimination in amount safe harbor merely because of this limited application of the pre-SBJPA § 415(e) limitations. See §§ 1.401(a)(4)–2(b)(4)(v) and 1.401(a)-(4)–3(b)(6)(x) of the regulations.

If a plan continues to limit benefits on or after the first day of the first limitation year beginning on or after January 1, 2000, using the pre-SBJPA § 415(e) limitations, the annual additions or accrued benefits that are taken into account in performing the general tests for nondiscrimination in amount of contributions or benefits must reflect the plan provisions that limit benefits in this manner.

Q-11: How is the repeal of § 415(e) treated under the plan for purposes of § 412?

A-11: For purposes of § 412, any increase in the liabilities of a plan as a result of the repeal of § 415(e) must be treated as occurring pursuant to a plan amendment effective no earlier than the first day of the first limitation year beginning on or after January 1, 2000 (whether the increase in liabilities under the terms of the plan arises pursuant to a plan amendment, or pursuant to existing plan provisions, e.g., where benefits automatically increase as of the effective date of the repeal of § 415(e) for the plan). Accordingly, any amortization base that is established under § 412 for an increase in liabilities under a plan resulting from the repeal of § 415(e) must have an amortization period of 30 years. A plan amendment that makes the repeal of § 415(e) effective for a plan cannot be taken into account for purposes of § 412 prior to the effective date of the repeal of § 415(e) for the plan.

Q-12: What is the effect of the repeal of § 415(e) on an "old-law benefit" defined in Q&A-12 of Rev. Rul. 98–1, 1998–2 I.R.B. 5?

A-12: Under Q&A-13 of Rev. Rul. 98–1, a participant's old-law benefit under a plan is determined as of a specified freeze date that precedes the final implementation date for the plan. Under Q&A-15 of Rev. Rul. 98–1, a participant's old-law benefit cannot increase after the participant's freeze date. Under Q&A-12 of Rev. Rul. 98–1, the final implementation date for the plan cannot be later than the first day of the first limitation year beginning after December 31, 1999. Because the freeze date must precede the final implementation date, the latest possible freeze date under a plan is the day before the first day of the first limitation year beginning after December 31, 1999. Thus, the latest possible freeze date for a plan is the day before the effective date of the repeal of § 415(e) for the plan. As a result, the repeal of § 415(e) generally will have no effect on the amount of a participant's old-law benefit, as the old-law benefit would be determined prior to the effective date of the repeal of § 415(e) for the plan. Nevertheless, if the old-law benefit for a participant in a defined benefit plan was reduced during the period between the freeze date and the effective date of the repeal of § 415(e) for the plan because of annual additions credited to a participant's account in an existing defined contribution plan, the old-law benefit may increase to the freeze-date level as of the effective date of the repeal of § 415(e) for the plan.

Q-13: Are the requirements of § 415(b)(4)(B) affected by the repeal of § 415(e)?

A-13: No. Section 415(b)(4)(B) generally provides that the limitation on benefits under a defined benefit plan under § 415(b) with respect to a participant cannot be less than $10,000, but only if the employer has not at any time maintained a defined contribution plan in which the participant participated. The statutory provision repealing § 415(e) did not modify § 415(b)(4)(B). Accordingly, the requirements of § 415(b)(4)(B) are unaffected by the repeal of § 415(e).

Q-14: How will the repeal of § 415(e) affect the regulations relating to § 403(b)?

A-14: Under § 415(c)(4)(D) and the regulations regarding the exclusion allowance under § 403(b)(2), an employee may elect to have the provisions of § 415(c)(4)(C) apply for a taxable year. If the employee so elects, the employee's exclusion allowance is the maximum amount under § 415 that could be contributed by the employer for the benefit of the employee if the annuity contract for the benefit of the employee were treated as a defined contribution plan maintained by the employer. The fourth sentence of § 1.403(b)–1(d)(5) provides that the rules under § 415(e) apply where such an election is made. Section 1504(b) of the Taxpayer Relief Act of 1997, Pub. L. 105-34, provides that regulations regarding the exclusion allowance under § 403(b)(2) of the Code shall be modified to reflect the repeal of § 415(e). Accordingly, the Commissioner intends to modify the regulations such that the fourth sentence of § 1.403(b)–1(d)(5) does not apply after the effective date of the repeal of § 415(e).

IV. EFFECT ON OTHER DOCUMENTS

Notice 83–10 is modified.

V. DRAFTING INFORMATION

The principal author of this notice is Martin Pippins of the Employee Plans Division. For further information regarding this notice, contact the Employee Plans Division's taxpayer assistance number at (202) 622-6076 (not a toll-free number) between the hours of 2:30 p.m. and 3:30 p.m., Eastern Time, Monday through Thursday. Mr. Pippins' telephone number is (202) 622-7863 (also not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross Reference to Temporary Regulations

Furnishing Identifying Number of Income Tax Return Preparer

REG–105237–99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross reference to temporary regulations.

SUMMARY: The IRS is proposing regulations relating that allow income tax return preparers to elect an alternative to their social security number (SSN) for purposes of identifying themselves on returns they prepare. The text of the temporary regulations T.D. 8835, page 317, also serve as the text of these proposed regulations. The regulations affect individual preparers who elect to identify themselves using a number other than the SSN.

DATES: Written or electronically generated comments and requests for a public hearing must be received by November 10, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–105237–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–105237–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Andrew J. Keyso, (202) 622-4910; concerning submissions, Michael Slaughter, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** (64 F.R. 43910) amends the Income Tax Regulations (26 CFR part 1) relating to section 6109. The temporary regulations provide that an income tax return preparer who is an individual may furnish either a social security number or an alternative identifying number to satisfy the requirements of section 6109(a)(4). The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Andrew J. Keyso, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. In §1.6109–2, is amended by revising paragraphs (a) and (d) to read as follows:

§1.6109–2 Furnishing identifying number of income tax return preparer.

(a) [The text of this proposed paragraph (a) is the same as the text of §1.6109–2T(a) published in T.D. 8835.]

* * * * *

(d) [The text of this proposed paragraph (d) is the same as the text of §1.6109–2T(d) published in T.D. 8835.]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 11, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 12, 1999, 64 F.R. 43969)

Consolidated Returns, Limitations on the Use of Certain Losses and Deductions; Correction

Announcement 99–86

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to T.D. 8823, 1999–29 I.R.B. 34, which were published in the **Federal Register** on Friday, July 2, 1999, (64 F.R. 36092), relating to consolidated returns and limitations on the use of certain losses and deductions.

DATES: This correction is effective July 2, 1999.

FOR FURTHER INFORMATION CONTACT: Jeffrey L. Vogel or Marie Milnes-Vasquez at (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under section 1502 of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 8823, 1999–29 I.R.B. 34) contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 8823), which were the subject of F.R. Doc. 99–16161, is corrected as follows:

1. On page 36095, column 3, in the preamble under the heading, Built-in Losses, line 2 from the bottom of the paragraph, the language "latter or the SRLY event or section 382" is corrected to read "latter of the SRLY event or section 382".

§1.1502–15 [Corrected]

2. On page 36103, column 1, §1.1502–15(d), paragraph (i) of *Example 3.*, line 3, the language "M are each common parents of a" is corrected to read "M are each the common parent of a".

3. On page 36103, column 3, §1.1502–15(d), paragraph (vii) of *Example 4.*, lines 6 and 7, the language "determining the SRLY limitation for these additional losses in Year 4 (or any" is corrected to read "determining the SRLY limitation for this additional loss in Year 4 (or any".

4 & 5. On page 36104, column 3, §1.1502–15 paragraph (g)(4)(i) and (g)(4)(ii) are corrected to read as follows:

§1.1502–15 SRLY limitation on built-in losses.

* * * * *

(g) * * *

(4) * * *

(i) All members of the SRLY subgroup with respect to those built-in losses are also included in a loss subgroup (as defined in §1.1502–91(d)(2)); and

(ii) All members of a loss subgroup (as defined in §1.1502–91(d)(2)) are also members of a SRLY subgroup with respect to those built-in losses.

* * * * *

6. On page 36105, column 1, §1.1502–15(g)(6), paragraph (v) of *Example 1.*, the last line in the paragraph, the language "and the application of the section 382." is corrected to read "and the application of section 82.".

7. On page 36105, column 1, §1.1502–15(g)(6), paragraph (ix) of *Example 1.*, the last line in the paragraph, the language "recognized with the recognition period." is corrected to read "recognized within the recognition period.".

§1.1502–21 [Corrected]

8. On page 36109, column 2, §1.1502–21(c)(2), line 13 from the bottom of the introductory text, the language "(the former group), or for a carryover" is corrected to read "(the former group), whether or not the group is a consolidated group, or for a carryover".

9. On page 36110, column 1, §1.1502–21(c)(2)(viii), paragraph (i) of *Example 1.*, lines 2 and 3, the language "S, T and M. P and M are each common parents of a consolidated group. During Year" is corrected to read "S, T, and M. P and M are each the common parent of a consolidated group. During Year".

10. On page 36110, column 3, §1.1502–21(c)(2)(viii), paragraph (i) of *Example 2.*, lines 2 and 3, the language "of the stock of S, T, P and M. P and M are each common parents of a consolidated" is corrected to read "of the stock of S, T, P, and M. P and M are each the common parent of a consolidated".

11. On page 36111, column 1, §1.1502–21(c)(2)(viii), paragraph (i) of *Example 3.*, lines 2 and 3, the language "the stock of S, T, P and M. S, P and M are each common parents of a consolidated" is corrected to read "the stock of S, T, P, and M. S, P, and M are each the common parent of a consolidated".

12. On page 36112, column 3, §1.1502–21(g)(5), paragraph (i) of *Example 4.*, line 3, the language "for 6 years. For Year 6, T has an net operating" is corrected to read "for 6 years. For Year 6, T has a net operating".

13. On page 36112, column 3, §1.1502–21(g)(5), paragraph (i) of *Example 5.*, line 5, the language "unrelated to A, owns all of the stock of P, the" is corrected to read "unrelated to Individual A, owns all of the stock of P, the".

14. On page 36113, column 3, §1.1502–21(g)(5), paragraph (i) of *Example 9.*, line 11, the language "Individual A. On January 1 of Year 3, M" is corrected to read "Individual A. On December 31 of Year 2, M".

15. On page 36113, column 3, §1.1502–21(g)(5), paragraph (iii) of *Example 9.*, lines 1 through 3, the language "M's January 1 purchase of 51% of P is a section 382 event because it results in an ownership change of S and T that gives rise" is corrected to read "M's December 31 purchase of 51% of P is a section 382 event because it results in an ownership change of the S loss subgroup that gives rise".

16. On page 36113, column 3, §1.1502–21(g)(5), paragraph (v) of *Example 9.*, lines 1 through 3, the language "Because the SRLY event and the change date of the section 382 event occur on the same date and the SRLY subgroup and loss" is corrected to read "Because the SRLY event occurred within six months of the change date of the section 382 event and the SRLY subgroup and loss".

§1.1502–23 [Corrected]

17. On page 36116, column 1, §1.1502–23(d)(1), second line from the bottom of the paragraph, the language "consolidated return is taxable years is" is corrected to read "consolidated return is".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on July 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 2, 1999, 64 F.R. 41783)

Foundations Status of Certain Organizations

Announcement 99–87

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Affordable Housing Alliance Inc., Irvine, CA
Ahepa Hellenic Center, Dayton, OH
Amandla Community Development Corporation, Detroit, MI
American Friends of Netivot Family Institute Inc., Flushing, NY
American Help Network, Inc., Middletown, NY
American Hope Foundation, Irvington, NJ
American Spirit Foundation, Beverly Hills, CA
Ancient Cities, Ancient Eyes, Inc., Redondo Beach, CA
Apostles of Christ-A-Confraternity of the Faithful, Oakland, CA
Applewick Sports Fitness Corp., Hamilton, OH
Association of North Carolina Big Brothers-Big Sisters Agencies, Greensboro, NC
Bachbridge Limited a Non Profit Corporation, Riverside, CA
Barnabas, Beatrice, NE
Beta Pi Boule Inc., Harrisburg, PA
Bethea Institute for Research on the Transformation of Humanity, Boulder, CO
Buddha Dharma Kyokai Society Inc., Emerson, NJ
Cardinal Scholarship Fund, North Plainfield, NJ
Children of Hope, Inc., Brandon, VT
Cognitive Developmental Institute for Youth Incorporated, Osceola, IN
Concerned About Recovery Education, Inc., Santa Rosa, CA
Cooperative Service League, West Chester, OH
Council Valley Volunteer Fire Fighters Association, Inc., Council, ID
Creative Educational Learning Inc., Philadelphia, PA
Creative Mountain Incorporated, Salida, CO
Crossing the Bridge, Inc., Houston, TX
Diversity Business Development Network, Bellevue, WA
Domestic Violence Emergency Services of Grant County Ind., Ulysses, KS
Edlo Charities Inc., Eagle Rock, VA
Education-Yours, Inc., Chagrin Falls, OH
Elder Circle Inc., Scarborough, MA
Emma R. Webster Trust UA-Utica 2-2596-0, Buffalo, NY
Energy America Education Fund Inc., Warner, NH
Estonian-Revelia Academic Fund, Inc., Bowie, MD
Eubank Elementary Parent Teacher Student Organization,
Fleming Providercare, Inc., Baltimore, MD
Freedoms Way Inc., Stem, NC
Friends of Karayan Inc., Jamaica, NY
FSL Corporation, Morrisville, VT
Georgia Center for Community Empowerment, Atlanta, GA
Gods Glory Land, Inc., Winchester, VA
Grand Valley Public Radio Company, Grand Junction, CO
Greater Grace Downriver Community Service Corporation, Taylor, MI
Hope Development Company, Baltimore, MD
Industrial Tribology Institute, Inc., Austin, TX
In His Footsteps Ministries, Inc., Lexington, OK
Interamerican Health and Education Foundation, San Antonio, TX
Intergenerational Community Action Network, Pacific Grove, CA
Jos House Inc., Houston, TX
Kent Bramlett Foundation, Inc., Nashville, TN
Life Improvement Inc., Cleburne, TX
Living Water Ministries, Inc., Tonawanda, NY
Long Island Sickle Cell Support Group Inc., Bay Shore, NY
Manitou Park Affordable Housing Development Corporation Incorporated, Newark, NJ
Mena Area Historic Museum Trust, Mena, AR
Minority Unity Foundation, Los Angeles, CA
More Than Conquerors Inc., Lithonia, GA
Nannie Berry Elementary Parent Teacher Org PTO Hendersonville, TN, Hendersonville, TN
Natchitoches Student Housing Corporation, Shreveport, LA
National High School Football Hall of Fame Foundation, Inc., Valdosta, GA
Native American Pedagogic Institute, Bigfork, MT
Nautilus Malacology Institute, La Jolla, CA
Neb Avrohom Chaim Foundation, Brooklyn, NY
Network Housing Inc., Portland,OR
New Horizons Haven for Boys Incorporated, Middletown, OH
Nicole Capuana Foundation, Rochester, NY
Niota Flood Control Council, Niota, IL
North Pulaski Development & Management, Inc., North Little Rock, AR
Oakview Inc., Columbus, IN
Ohio Aerospace Council, Cleveland, OH
Olatunji International School for Life Learning, Charlotte, NC
One Good Turn Inc., Sedona, AZ
Owatonna Youth Baseball Association Inc., Owatonna, MN
Paramus Affordable Housing Corporation, Paramus, NJ
Peer Inc., Revo, NV

Pentecostal International Missions for Christ, Inc., Cleveland, TN
Port Stephen Decatur, Decatur, AL
Prairie Fire Urban Rural Renewal Inc., Lincoln, NE
Project Barter Feed, Inc., Boynton Beach, FL
Protect the Children, Salt Lake City, UT
Public Housing, Inc., Gordo, AL
Rebuild Inc., St. Louis, MO
Renaissance Worldwide, Inc., San Ramon, CA
A Second Chance-A Haven for Abuse-N-Battered Women & Children, Philadelphia, PA
Serving Humanity and Relief Effort Inc., North Logan, UT
Shakti Foundation for the Performing Arts, Torrance, CA
Sierra County Eldercare Services, Truth of Consequences, NM
S O H I, Glendale, AZ
Sun of Man, New York, NY
Sustainable Resource Development, Bothell, WA
T & E, Inc., Cortaro, AZ
Texas Child Nutrition & Care Corporation, Inc., Houston, TX
Texas Internal Medicine Educational Foundation, Austin, TX
Ultimate Potential Fitness and Training Facility, Inc., Columbus, OH
United Helping Hands, San Diego, CA
USA Compete Inc., Greeley, CO
Utah Amateur Sports Foundation Inc., Bountiful, UT
Valley Multi Purpose Center, Inc., N. Hollywood, CA
V I A Art Inc., New York, NY
Victory Over Addiction International Inc., Stuart, FL
Vietnam Forum Foundation, Inc., Houston, TX
Westchester Jewish Historical Society Inc., Scarsdale, NY
Wheels of Fire, Dallas, TX
Wiz Kids Enrichment Center, Rockford, IL
Write to Change Inc., Clemson, SC
Yellow Breeches Creek Allance, Inc., Carlisle, PA
Youth Business League, Kansas City, MO
Youth Educational Support Services, Houston, TX

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period July through September 1999. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 1999.

Rev. Rul. 99–38

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) for dispositions of qualified low-income buildings or interests therein during the period July through September 1999.

Table 1
Rev. Rul. 99–38
Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year												
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Jul '99	45.71	60.18	75.06	76.18	79.16	82.50	85.93	89.30	92.70	96.38	100.22	104.36	107.43
Aug '99	45.71	60.18	75.06	75.97	78.94	82.27	85.69	89.04	92.44	96.11	99.95	104.10	107.43
Sep '99	45.71	60.18	75.06	75.77	78.73	82.05	85.45	88.80	92.19	95.85	99.69	103.86	107.43

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul.98–3, 1998-2 I.R.B. 4, for dispositions occurring during the calendar years 1996 and 1997; Rev. Rul. 98–13, 1998–11 I.R.B. 4, for dispositions occurring during the period January through March 1998; Rev. Rul. 98–31, 1998–25 I.R.B. 4, for dispositions occurring during the period April through June 1998; Rev. Rul. 98–45, 1998–38 I.R.B. 4, for dispositions occurring during the period July through September 1998; Rev. Rul. 99–1, 1999–2 I.R.B. 4, for dispositions occurring during the period October through December 1998; Rev. Rul. 99–18, 1999–14 I.R.B. 3, for dispositions occurring during the period January through March 1999; and Rev. Rul. 99–24, 1999–21 I.R.B. 3, for dispositions occurring during the period April through June 1999.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran on (202) 622-3040 (not a toll-free call).

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, page 336.

Section 354.—Exchange of Stock

26 CFR 1.354–1: Exchange of stock and securities in certain reorganizations.

To what extent are I.R.C. section 354 exchanges of stock of U.S. real property holding corporations in reorganizations described in I.R.C. section 368(a)(1)(E) or (F) taxable under Temp. Reg. section 1.897–6T(a)(1)? See Notice 99–43, page 345.

Section 368(a)(1)(E) or (F).—Corporate Reorganizations

26 CFR 1.368–2: Definitions relating to corporate reorganizations.

To what extent are I.R.C. section 354 exchanges of stock of U.S. real property holding corporations in reorganizations described in I.R.C. section 368(a)(1)(E) or (F) taxable under Temp. Reg. section 1.897–6T(a)(1)? See Notice 99–43, page 345.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month

of September 1999. See Rev. Rul. 99–37, on this page.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing osts

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for September 1999.

Rev. Rul. 99–37

This revenue ruling provides various prescribed rates for federal income tax purposes for September 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 99–37 TABLE 1

Applicable Federal Rates (AFR) for September 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	5.42%	5.35%	5.31%	5.29%
110% AFR	5.98%	5.89%	5.85%	5.82%
120% AFR	6.52%	6.42%	6.37%	6.34%
130% AFR	7.08%	6.96%	6.90%	6.86%
Mid-Term				
AFR	5.98%	5.89%	5.85%	5.82%
110% AFR	6.58%	6.48%	6.43%	6.39%
120% AFR	7.19%	7.07%	7.01%	6.97%
130% AFR	7.81%	7.66%	7.59%	7.54%

REV. RUL. 99–37 TABLE 1—Continued

Applicable Federal Rates (AFR) for September 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Mid-Term—Continued				
150% AFR	9.04%	8.84%	8.74%	8.68%
175% AFR	10.58%	10.31%	10.18%	10.10%
Long-Term				
AFR	6.25%	6.16%	6.11%	6.08%
110% AFR	6.89%	6.78%	6.72%	6.69%
120% AFR	7.53%	7.39%	7.32%	7.28%
130% AFR	8.17%	8.01%	7.93%	7.88%

REV. RUL. 99–37 TABLE 2

Adjusted AFR for September 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.77%	3.74%	3.72%	3.71%
Mid-term adjusted AFR	4.49%	4.44%	4.42%	4.40%
Long-term adjusted AFR	5.26%	5.19%	5.16%	5.13%

REV. RUL. 99–37 TABLE 3

Rates Under Section 382 for September 1999

Adjusted federal long-term rate for the current month	5.26%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.26%

REV. RUL. 99–37 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for September 1999

Appropriate percentage for the 70% present value low-income housing credit	8.43%
Appropriate percentage for the 30% present value low-income housing credit	3.61%

REV. RUL. 99–37 TABLE 5

Rate Under Section 7520 for September 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, page 336.

Section 1502.—Regulations

26 CFR 1.1502–9: Consolidated overall foreign losses and separate limitation losses.

T.D. 8833

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Consolidated Returns—Consolidated Overall Foreign Losses and Separate Limitation Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final consolidated return regulations relating to the treatment of overall foreign losses and separate limitation losses in the computation of the foreign tax credit limitation. The regulations replace existing guidance with respect to overall foreign losses and provide guidance with respect to separate limitation losses. These regulations affect consolidated groups that compute the foreign tax credit limitation or that dispose of property used in a foreign trade or business.

DATES: *Effective Date:* These regulations are effective August 11, 1999.

Applicability Dates: For dates of applicability of these regulations, see §§1.1502–9A(a)(1) and (b)(1) and 1.1502–9(e).

FOR FURTHER INFORMATION CONTACT: Trina Dang of the Office of Associate Chief Counsel (International), (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under the control number 1545–1634. Responses to this collection of information are mandatory.

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

The estimated annual burden per respondent is 1.5 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained so long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On December 29, 1998, the IRS and Treasury published in the **Federal Register** (REG–106902–98, 63 F.R. 71589 [1999–8 I.R.B. 57]) a notice of proposed rulemaking modifying the rules relating to the treatment of overall foreign loss (OFL) accounts, and providing new rules relating to the treatment of separate limitation loss (SLL) accounts. The regulations proposed to replace the notional account method for allocating a group's consolidated OFL (COFL) account to a departing member of a group with an asset-based method for allocating both OFLs and SLLs. The regulations also proposed to modify the section 904(f)(3) and (5)(F) disposition rules in the case of intercompany transactions, and to provide computational rules and nomenclature for SLLs as well as OFLs.

A public hearing was held on February 17, 1999, and two written comments were received. One commentator recommended the retention of the notional account method because the asset-based method can result in the allocation of a portion of the COFL account to a departing member that did not contribute to the COFL account, a result that the commentator views as arbitrary. To alleviate the tension between the interest allocation and COFL rules, the commentator suggested amending the interest allocation rules instead of the COFL rules.

Treasury and the IRS recognize that, under the asset-based method, a portion of a COFL account can under certain circumstances be allocated to a member that did not directly contribute to the COFL account (because, for example, it was not a member of the group at the time the OFL arose). However, as noted in the preamble to regulations issued in January 1998 that eliminated the limitation on OFL recapture and foreign tax credit utilization with respect to separate return limitation years, any single member's economic "contribution" to a COFL account is difficult to measure since the expense allocation rules require interest and certain other expenses to be allocated to a member's income in separate limitation categories on the basis of the group's assets.

An asset-based method is not arbitrary because it associates a COFL account with assets that will produce income subject to recapture, thereby ensuring the recapture of the COFL account. As explained in the preamble to the proposed regulations, Treasury and the IRS believe that the asset-based method for allocating a COFL account harmonizes the COFL rules with the interest allocation provisions. Those provisions, as required by statute, are designed to prevent corporations from borrowing in ways that inappropriately minimize the amount of interest expense allocated against foreign-source income (thereby inflating the amount of foreign-source income that can be sheltered from U.S. tax by foreign tax credits).

The commentator also criticized the asset-based method for allocating COFL accounts as creating uncertainty and administrative burdens in determining the proper amount of a selling group's COFL account to be apportioned to a departing

member at the time a member is acquired. Treasury and the IRS recognize that the asset-based method may result in greater uncertainty under certain circumstances. It is anticipated that a taxpayer acquiring a member of a consolidated group may address any uncertainties as to the proper allocation of a COFL account by entering into a tax indemnity or similar agreement. It is also noted that, even under the notional account method, a COFL account apportioned to a departing member cannot be determined with certainty at the time of the acquisition because the apportionment is made at the end of the taxable year during which the member departs the group. Treasury and the IRS recognize that the new rules may result in an increased burden for certain taxpayers, but have concluded that the possibility of an increased burden is not sufficient to warrant the retention of the notional account method in light of severe distortions created by the interaction of the notional account method and the interest expense allocation provisions.

Another commentator requested a transition rule under which the notional account method would continue to apply to a group's existing COFL account that would not be a part of the group's account had the asset-based allocation method been in effect in prior years. The commentator argued that a transition rule is necessary because taxpayers can be adversely affected by the transition from the old rules to the new rules.

The final regulations do not adopt this transition rule because of administrative and equity concerns. The rule would be difficult to administer because a taxpayer would be required to ascertain asset values of all members that departed the group (on the date that the member departed) going back a number of years in order to apply the asset-based allocation method. Additionally, keeping track of the grandfathered account on a prospective basis and distinguishing it from non-grandfathered accounts could add significant complexity.

Furthermore, it is not clear whether the commentator's suggested transition rule generally produces equitable results. Under the suggested transition rule, no portion of the group's COFL account that would not be a part of the group's account had the new rules applied in earlier years would be allocated to a departing member that has foreign assets but that does not have a notional account. Treasury and the IRS are not convinced that it would be more equitable for the group to bear the burden of the COFL account under these circumstances.

A question has been raised regarding whether the asset-based method for allocating COFL accounts to a departing member also applies to an affiliated group that does not file a consolidated return. Because the interest expense allocation rules apply to affiliated groups, these rules can result under certain circumstances in the creation of OFL accounts in members with no foreign assets. Section 904(i) is an anti-abuse rule intended to prevent an affiliated group from circumventing the consolidated return rules to avoid the foreign tax credit limitation provisions. Under §1.904(i)–1, each member of an affiliated group determines its taxable income for each separate limitation income category under section 904(d) and then combines those amounts to determine one amount of income for the group in each income category. The consolidated return regulations that apply the principles of sections 904(f) and 907(c)(4) will then be applied to the combined amounts in each separate category as if all affiliates were members of a single consolidated group. By reason of the section 904(i) regulations, the asset-based method for allocating the appropriate portion of a group's COFL account to a departing member applies to an affiliated group of corporations that does not file returns on a consolidated basis.

A question has also been raised as to whether the tax book value of assets is affected for purposes of COFL apportionment if a member's departure from a group causes the group to take into account in computing consolidated taxable income gain or loss on assets transferred in intercompany transactions. To prevent apportionment of a disproportionate amount of the COFL account to a departing member, §1.1502–9(c)(2)(ii) of the final regulations clarifies that the computation of the tax book value of assets for purposes of such apportionment shall be determined without regard to previously deferred gain or loss that is taken into account as a result of the member's departure from the group (because, for example, of the acceleration rule under §1.1502–13(d)).

After full consideration of all questions and comments, the proposed regulations published in the **Federal Register** on December 29, 1998 (REG–106902–98, 63 F.R. 71589) are adopted by this Treasury decision without substantive amendment.

Special Analyses

It has been determined that this regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory impact analysis is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated federal income tax returns that have overall foreign losses or separate limitation losses. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have overall foreign losses or separate limitation losses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of this regulation is Trina Dang of the Office of Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry

for §1.1502–9T and by adding entries in numerical order to read in part as follows:

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

Section 1.1502–9 also issued under 26 U.S.C. 1502. * * *

Section 1.1502–9A also issued under 26 U.S.C. 1502. * * *

Par. 2. In §1.1502–3T, paragraph (c)(4), the first sentence is amended by removing the language "1.1502–9T(b)(1)(v)" and adding "1.1502–9A(b)(1)(v)" in its place, and revising the last sentence to read as follows:

§1.1502–3T Consolidated investment credit (temporary).

* * * * *

(c) * * *

(4) * * * However, a consolidated group making the election provided in §1.1502–9A(b)(1)(vi) (electing not to apply §1.1502–9A(b)(1)(v) to years beginning before January 1, 1998) may nevertheless choose to apply all such paragraphs other than §1.1502–9A(b)(1)(v) for all relevant years.

* * * * *

Par. 3. Immediately following §1.1504–4 an undesignated center heading is added to read as follows:

REGULATIONS APPLICABLE FOR TAX YEARS FOR WHICH A RETURN IS DUE ON OR BEFORE AUGUST 11, 1999

Par. 4. Section 1.1502–9 is redesignated as §1.1502–9A and transferred under the new undesignated center heading set out in Par. 3. above.

Par. 5. Newly designated §1.1502–9A is amended by:

1. Revising the section heading.

2. Redesignating the paragraph heading and text of paragraph (a) as the paragraph heading and text of paragraph (a)(2).

3. Adding a new paragraph heading for paragraph (a), and new paragraphs (a)(1), (b)(1)(v) and (b)(1)(vi).

The revisions and additions read as follows:

§1.1502–9A Application of overall foreign loss recapture rules to corporations filing consolidated returns due on or before August 11, 1999.

(a) *Scope*—(1) *Effective date.* This section applies only to consolidated return years for which the due date of the income tax return (without extensions) is on or before August 11, 1999.

(2) *In general.* * * *

(b) * * *

(1) * * *

(v) *Special effective date for SRLY limitation.* Except as provided in paragraph (b)(1)(vi) of this section, paragraphs (b)(1)(iii) and (iv) of this section apply only to consolidated return years for which the due date of the income tax return (without extensions) is on or before March 13, 1998. For consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, the rules of paragraph (b)(1)(ii) of this section shall apply to overall foreign losses from separate return years that are separate return limitation years. For purposes of applying paragraph (b)(1)(ii) of this section in such years, the group treats a member with a balance in an overall foreign loss account from a separate return limitation year on the first day of the first consolidated return year for which the due date of the income tax return (without extensions) is after March 13, 1998, as a corporation joining the group on such first day. An overall foreign loss that is part of a net operating loss or net capital loss carryover from a separate return limitation year of a member that is absorbed in a consolidated return year for which the due date of the income tax return (without extensions) is after March 13, 1998, shall be added to the appropriate consolidated overall foreign loss account in the year that it is absorbed. For consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, similar principles apply to overall foreign losses when there has been a consolidated return change of ownership (regardless of when the change of ownership occurred). See also §1.1502–3T(c)(4) for an optional effective date rule (generally making this paragraph (b)(1)(v) applicable to a consolidated return year beginning after December 31, 1996, if the due date of the income tax return (without extensions) for such year is on or before March 13, 1998).

(vi) *Election to defer application of special effective date.* A consolidated group may elect not to apply paragraph (b)(1)(v) of this section to consolidated return years beginning before January 1, 1998. To make this election, a consolidated group must write "Election Pursuant to Notice 98–40" across the top of page 1 of an original or amended tax return for each consolidated return year subject to the election. For the first consolidated return year to which the overall foreign loss provisions of paragraph (b)(1)(v) of this section apply (i.e., the first year beginning on or after January 1, 1998), such consolidated group must write "Notice 98-40 Election in Effect in Prior Years" across the top of page 1 of the consolidated tax return for that year. For purposes of applying paragraph (b)(1)(ii) of this section with respect to such year, any member with a balance in an overall foreign loss account from a separate return limitation year on the first day of such year shall be treated as joining the group on such first day.

* * * * *

Par. 6. New §1.1502–9 is added to read as follows:

§1.1502–9 Consolidated overall foreign losses and separate limitation losses.

(a) *In general.* This section provides rules for applying section 904(f) (including its definitions and nomenclature) to a group and its members. Generally, section 904(f) concerns rules relating to overall foreign losses (OFLs) and separate limitation losses (SLLs) and the consequences of such losses. As provided in section 904(f)(5), losses are computed separately in each category of income described in section 904(d)(1) (basket). Paragraph (b) of this section defines terms and provides computational and accounting rules, including rules regarding recapture. Paragraph (c) of this section provides rules that apply to OFLs and SLLs when a member becomes or ceases to be a member of a group. Paragraph (d) of this section provides a predecessor and successor rule. Paragraph (e) of this section provides effective dates.

(b) *Consolidated application of section 904(f).* A group applies section 904(f) for a consolidated return year in accordance with that section, subject to the following rules:

(1) *Computation of CSLI or CSLL and consolidated U.S. source income or loss.*

The group computes its consolidated separate limitation income (CSLI) or consolidated separate limitation loss (CSLL) for each basket under the principles of §1.1502–11 by aggregating each member's foreign-source taxable income or loss in such basket computed under the principles of §1.1502–12, and taking into account the foreign portion of the consolidated items described in §1.1502–11(a)-(2) through (8) for such basket. The group computes its consolidated U.S.-source taxable income or loss under similar principles.

(2) *Netting CSLLs, CSLIs, and consolidated U.S. source taxable income or loss.* The group applies section 904(f)(5) to determine the extent to which a CSLL for a basket reduces CSLI for another basket or consolidated U.S.-source taxable income.

(3) *CSLL and COFL accounts.* To the extent provided in section 904(f), the amount by which a CSLL for a basket (the loss basket) reduces CSLI for another basket (the income basket) shall result in the creation of (or addition to) a CSLL account for the loss basket with respect to the income basket. Likewise, the amount by which a CSLL for a loss basket reduces consolidated U.S.-source income will create (or add to) a consolidated overall foreign loss account (a COFL account).

(4) *Recapture of COFL and CSLL accounts.* In the case of a COFL account for a loss basket, section 904(f)(1) and (3) recharacterizes some or all of the foreign-source income in the loss basket as U.S.-source income. In the case of a CSLL account for a loss basket with respect to an income basket, section 904(f)(5)(C) and (F) recharacterizes some or all of the foreign-source income in the loss basket as foreign-source income in the income basket. The COFL account or CSLL account is reduced to the extent amounts are recharacterized with respect to such account.

(5) *Intercompany transactions*—(i) *Nonapplication of section 904(f) disposition rules.* Neither section 904(f)(3) (in the case of a COFL account) nor (5)(F) (in the case of a CSLL account) applies at the time of a disposition that is an intercompany transaction to which §1.1502–13 applies. Instead, section 904(f)(3) and (5)(F) applies only at such time and only to the extent that the group is required under §1.1502–13 (without regard to section 904(f)(3) and (5)(F)) to take into account any intercompany items resulting from the disposition, based on the COFL or CSLL account existing at the end of the consolidated return year during which the group takes the intercompany items into account.

(ii) *Example.* Paragraph (b)(5)(i) of this section is illustrated by the following examples. The identity of the parties and the basic assumptions set forth in §1.1502–13(c)(7)(i) apply to the examples. Except as otherwise stated, assume further that the consolidated group recognizes no foreign-source income other than as a result of the transactions described. The examples are as follows:

Example 1. (i) On June 10, Year 1, S transfers nondepreciable property with a basis of $100 and a fair market value of $250 to B in a transaction to which section 351 applies. The property was predominantly used without the United States in a trade or business, within the meaning of section 904(f)(3). B continues to use the property without the United States. The group has a COFL account in the relevant loss basket of $120 as of December 31, Year 1.

(ii) Because the contribution from S to B is an intercompany transaction, section 904(f)(3) does not apply to result in any gain recognition in Year 1. See paragraph (b)(5)(i) of this section.

(iii) On January 10, Year 4, B ceases to be a member of the group. Because S did not recognize gain in Year 1 under section 351, no gain is taken into account in Year 4 under §1.1502–13(d). Thus, no portion of the group's COFL account is recaptured in Year 4. For rules requiring apportionment of a portion of the COFL account to B, see paragraph (c)(2) of this section.

Example 2. (i) The facts are the same as in paragraph (i) of *Example 1.* On January 10, Year 4, B sells the property to X for $300. As of December 31, Year 4, the group's COFL account is $40. (The COFL account was reduced between Year 1 and Year 4 due to unrelated foreign-source income taken into account by the group.)

(ii) B takes into account gain of $200 in Year 4. The $40 COFL account in Year 4 recharacterizes $40 of the gain as U.S. source. See section 904(f)(3).

Example 3. (i) On June 10, Year 1, S sells nondepreciable property with a basis of $100 and a fair market value of $250 to B for $250 cash. The property was predominantly used without the United States in a trade or business, within the meaning of section 904(f)(3). The group has a COFL account in the relevant loss basket of $120 as of December 31, Year 1. B predominately uses the property in a trade or business without the United States.

(ii) Because the sale is an intercompany transaction, section 904(f)(3) does not require the group to take into account any gain in Year 1. Thus, under paragraph (b)(5)(i) of this section, the COFL account is not reduced in Year 1.

(iii) On January 10, Year 4, B sells the property to X for $300. As of December 31, Year 4, the group's COFL account is $60. (The COFL account was reduced between Year 1 and Year 4 due to unrelated foreign-source income taken into account by the group.)

(iv) In Year 4, S's $150 intercompany gain and B's $50 corresponding gain are taken into account to produce the same effect on consolidated taxable income as if S and B were divisions of a single corporation. See §1.1502-13(c). All of B's $50 corresponding gain is recharacterized under section 904(f)(3). If S and B were divisions of a single corporation and the intercompany sale were a transfer between the divisions, B would succeed to S's $100 basis in the property and would have $200 of gain ($60 of which would be recharacterized under section 904(f)(3)), instead of a $50 gain. Consequently, S's $150 intercompany gain and B's $50 corresponding gain are taken into account, and $10 of S's gain is recharacterized under section 904(f)(3) as U.S. source to reflect the $10 difference between B's $50 recharacterized gain and the $60 recomputed gain that would have been recharacterized.

(c) *Becoming or ceasing to be a member of a group*—(1) *Adding separate accounts on becoming a member.* At the time that a corporation becomes a member of a group (a new member), the group adds to the balance of its COFL or CSLL account the balance of the new member's corresponding OFL account or SLL account. A new member's OFL account corresponds to a COFL account if the account is for the same loss basket. A new member's SLL account corresponds to a CSLL account if the account is for the same loss basket and with respect to the same income basket. If the group does not have a COFL or CSLL account corresponding to the new member's account, it creates a COFL or CSLL account with a balance equal to the balance of the member's account.

(2) *Apportionment of consolidated account to departing member*—(i) *In general.* A group apportions to a member that ceases to be a member (a departing member) a portion of each COFL and CSLL account as of the end of the year during which the member ceases to be a member and after the group makes the additions or reductions to such account required under paragraphs (b)(3), (b)(4) and (c)(1) of this section (other than an addition under paragraph (c)(1) of this section attributable to a member becoming a member after the departing member ceases to be a member). The group computes such portion under paragraph (c)(2)(ii) of this section, as limited by paragraph (c)(2)(iii) of this section. The departing member carries such portion to

its first separate return year after it ceases to be a member. Also, the group reduces each account by such portion and carries such reduced amount to its first consolidated return year beginning after the year in which the member ceases to be a member. If two or more members cease to be members in the same year, the group computes the portion allocable to each such member (and reduces its accounts by such portion) in the order that the members cease to be members.

(ii) *Departing member's portion of group's account.* A departing member's portion of a group's COFL or CSLL account for a loss basket is computed based upon the member's share of the group's assets that generate income subject to recapture at the time that the member ceases to be a member. Under the characterization principles of §§1.861–9T(g)(3) and 1.861–12T, the group identifies the assets of the departing member and the remaining members that generate foreign-source income (foreign assets) in each basket. The assets are characterized based upon the income that the assets are reasonably expected to generate after the member ceases to be a member. The member's portion of a group's COFL or CSLL account for a loss basket is the group's COFL or CSLL account, respectively, multiplied by a fraction, the numerator of which is the value of the member's foreign assets for the loss basket and the denominator of which is the value of the foreign assets of the group (including the departing member) for the loss basket. The value of the foreign assets is determined under the asset valuation rules of §1.861–9T(g)(1) and (2) using either tax book value or fair market value under the method chosen by the group for purposes of interest apportionment as provided in §1.861–9T(g)(1)(ii). For purposes of this paragraph (c)(2)(ii), §1.861–9T(g)(2)(iv) (assets in intercompany transactions) shall apply, but §1.861–9T(g)(2)(iii) (adjustments for directly allocated interest) shall not apply. If the group uses the tax book value method, the member's portions of COFL and CSLL accounts are limited by paragraph (c)(2)(iii) of this section. In addition, for purposes of this paragraph (c)(2)(ii), the tax book value of assets transferred in intercompany transactions shall be determined without regard to previously deferred gain or loss that is taken into account by the group as a result of the transaction in which the member ceases to be a member. The assets should be valued at the time the member ceases to be a member, but values on other dates may be used unless this creates substantial distortions. For example, if a member ceases to be a member in the middle of the group's consolidated return year, an average of the values of assets at the beginning and end of the year (as provided in §1.861–9T(g)(2)) may be used or, if a member ceases to be a member in the early part of the group's consolidated return year, values at the beginning of the year may be used, unless this creates substantial distortions.

(iii) *Limitation on member's portion for groups using tax book value method.* If a group uses the tax book value method of valuing assets for purposes of paragraph (c)(2)(ii) of this section and the aggregate of a member's portions of COFL and CSLL accounts for a loss basket (with respect to one or more income baskets) determined under paragraph (c)(2)(ii) of this section exceeds 150 percent of the actual fair market value of the member's foreign assets in the loss basket, the member's portion of the COFL or CSLL accounts for the loss basket shall be reduced (proportionately, in the case of multiple accounts) by such excess. This rule does not apply if the departing member and all other members that cease to be members as part of the same transaction own all (or substantially all) the foreign assets in the loss basket.

(iv) *Determination of values of foreign assets binding on departing member.* The group's determination of the value of the member's and the group's foreign assets for a loss basket is binding on the member, unless the Commissioner concludes that the determination is not appropriate. The common parent of the group must attach a statement to the return for the taxable year that the departing member ceases to be a member of the group that sets forth the name and taxpayer identification number of the departing member, the amount of each COFL or CSLL for each loss basket that is apportioned to the departing member under this paragraph (c)(2), the method used to determine the value of the member's and the group's foreign assets in each such loss basket, and the value of the member's and the group's foreign assets in each such loss basket. The common parent must also furnish a copy of the statement to the departing member.

(v) *Anti-abuse rule.* If a corporation becomes a member and ceases to be a member, and a principal purpose of the corporation becoming and ceasing to be a member is to transfer the corporation's OFL account or SLL account to the group or to transfer the group's COFL or CSLL account to the corporation, appropriate adjustments will be made to eliminate the benefit of such a transfer of accounts. Similarly, if any member acquires assets or disposes of assets (including a transfer of assets between members of the group and the departing member) with a principal purpose of affecting the apportionment of accounts under paragraph (c)(2)(i) of this section, appropriate adjustments will be made to eliminate the benefit of such acquisition or disposition.

(vi) *Examples.* The following examples illustrate this paragraph (c):

Example 1. (i) On November 6, Year 1, S, a member of the P group, a consolidated group with a calendar consolidated return year, ceases to be a member of the group. On December 31, Year 1, the P group has a $40 COFL account for the general limitation basket, a $20 CSLL account for the general limitation basket (i.e., the loss basket) with respect to the passive basket (i.e., the income basket), and a $10 CSLL account for the shipping income basket (i.e., the loss basket) with respect to the passive basket (i.e., the income basket). No member of the group has foreign-source income or loss in Year 1. The group apportions its interest expense according to the tax book value method.

(ii) On November 6, Year 1, the group identifies S's assets and its own assets (including S's assets) expected to produce foreign general limitation income. Use of end-of-the-year values will not create substantial distortions in determining the relative values of S's and the group's relevant assets on November 6, Year 1. The group determines that S's relevant assets have a tax book value of $2,000 and a fair market value of $2,200. Also, the group's relevant assets (including S's assets) have a tax book value of $8,000. On November 6, Year 1, S has no assets expected to produce foreign shipping income.

(iii) Under paragraph (c)(2)(ii) of this section, S takes a $10 COFL account for the general limitation basket ($40 × $2000/$8000) and a $5 CSLL account for the general limitation basket with respect to the passive basket ($20 × $2000/$8000). S does not take any portion of the shipping income basket CSLL account. The limitation described in paragraph (c)(2)(iii) of this section does not apply because the aggregate of the COFL and CSLL accounts for the general limitation basket that are apportioned to S ($15) is less than 150 percent of the actual fair market value of S's general limitation foreign assets ($2,200 × 150%).

Example 2. (i) Assume the same facts as in *Example 1*, except that the fair market value of S's general limitation foreign assets is $4 as of November 6, Year 1.

(ii) Under paragraph (c)(2)(iii) of this section, S's COFL and CSLL accounts for the general limitation basket must be reduced by $9, which is the excess of $15 (the aggregate amount of the accounts apportioned under paragraph (c)(2)(ii) of this section) over $6 (150 percent of the $4 actual fair market value of S's general limitation foreign assets). S thus takes a $4 COFL account for the general limitation basket ($10 – ($9 × $10/$15)) and a $2 CSLL account for the general limitation basket with respect to the passive basket ($5 – ($9 × $5/$15)).

(d) *Predecessor and successor.* A reference to a member includes, as the context may require, a reference to a predecessor or successor of the member. See §1.1502-1(f).

(e) *Effective dates.* This section applies to consolidated return years for which the due date of the income tax return (without extensions) is after August 11, 1999. However, paragraph (b)(5) of this section (intercompany transactions) is not applicable for intercompany transactions that occur before January 28, 1999. A group applies the principles of §1.1502–9A(e) to a disposition which is an intercompany transaction to which §1.1502–13 applies and that occurs before January 28, 1999. Also, paragraph (c)(2) of this section (apportionment of consolidated account to departing member) is not applicable for members ceasing to be members of a group before January 28, 1999. A group applies the principles of §1.1502–9A (rather than paragraph (c)(2) of this section) to determine the amount of a consolidated account that is apportioned to a member that ceases to be a member of the group before January 28, 1999 (and reduces its consolidated account by such apportioned amount) before applying paragraph (c)(2) of this section to members that cease to be members on or after January 28, 1999.

§1.1502–9T [Removed]

Par. 7. Section 1.1502–9T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par 9. In §602.101, paragraph (b) is amended in the table by removing the current entry for 1.1502–9 and adding new entries for 1.1502–9 and 1.1502–9A to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–9	1545–1634
* * * * *	
1.1502–9A	1545–0121
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 16, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 10, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 11, 1999, 64 F.R. 43613)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, page 336.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1999. See Rev. Rul. 99–37, page 336.

Part III. Administrative, Procedural, and Miscellaneous

Rule to be Included in Final Regulations Under Section 897(e) of the Code

Notice 99–43

This notice announces a modification of the current rules under Temp. Reg. §1.897–6T(a)(1) regarding transfers, exchanges, and other dispositions of U.S. real property interests in nonrecognition transactions occurring after June 18, 1980. The new rule will be included in regulations finalizing the temporary regulations.

SECTION I. BACKGROUND

Section 897(a) of the Code provides generally that the disposition of a U.S. real property interest by a nonresident alien individual or a foreign corporation is taxable as effectively connected income under section 871(b)(1) or section 882(a)(1), respectively, as if the taxpayer was engaged in a trade or business within the United States and the gain or loss was effectively connected with the trade or business.

Section 897(c)(1) of the Code defines a U.S. real property interest as including an interest (other than an interest solely as a creditor) in any domestic corporation, unless the taxpayer establishes that such corporation was at no time a U.S. real property holding corporation during the shorter of the period the taxpayer held such interest or the 5-year period ending on the date of the disposition of such interest. Under section 897(c)(2), a U.S. real property holding corporation is defined as any corporation if the fair market value of its U.S. real property interests equals or exceeds 50-percent of the sum of (i) its U.S. real property interests, (ii) its real property interests located outside the United States, and (iii) any of its other assets used or held for use in a trade or business.

Section 897(e)(1) of the Code provides generally that a nonrecognition provision applies only in the case of an exchange of a U.S. real property interest for an interest the sale of which would be taxable under Chapter 1 of the Code. Under section 897(e)(2), the Secretary may prescribe regulations providing the extent to which nonrecognition provisions apply to transfers of U.S. real property interests.

Pursuant to the regulatory authority under section 897(e)(2), Temp. Reg. §1.897–6T(a)(1) provides that, subject to certain exceptions, any nonrecognition provision shall apply to a transfer by a foreign person of a U.S. real property interest on which gain is realized only to the extent that the transferred U.S. real property interest is exchanged for a U.S. real property interest which, immediately following the exchange, would be subject to U.S. taxation upon its disposition (and the transferor complies with the filing requirement of Temp. Reg. §1.897–5). In the case of an exchange of a U.S. real property interest for stock in a domestic corporation (that is otherwise treated as a U.S. real property interest), such stock shall not be considered a U.S. real property interest unless the domestic corporation is a U.S. real property holding corporation immediately after the exchange. Thus, if an interest in a U.S. real property holding corporation is exchanged in a nonrecognition transaction for stock of a domestic corporation, that is not a U.S. real property holding corporation immediately after the exchange, the exchange would be taxable under section 897.

Under Temp. Reg. §1.897–6T(a)(2), a nonrecognition provision for purposes of section 897(e) is any provision of the Code which provides that gain or loss is not recognized if the requirements of that provision are met. Thus, section 897(e) applies only to an exchange that receives nonrecognition treatment pursuant to another provision of the Code and does not create (or expand) a nonrecognition provision.

SECTION II. FINALIZATION OF TEMP. REG. §1.897–6T(a)(1)

It is recognized that the requirement in Temp. Reg. §1.897–6T(a)(1), providing that the corporation whose stock is received in a nonrecognition exchange must be a U.S. real property holding corporation immediately after the exchange, may not be appropriate for stock exchanges under section 354(a) in certain reorganizations described in sections 368(a)(1)(E) and (F) of the Code. This may be illustrated by two examples. In both examples, the corporation, the stock of which was received in the exchange, is not a U.S. real property holding corporation immediately after the exchange, but was a U.S. real property holding corporation within the period provided in section 897(c)(1)(A)(ii) (the shorter of five years or the taxpayer's holding period prior to the exchange).

In example one, a domestic corporation engages in a recapitalization, whereby one share of common stock is issued in exchange for two outstanding shares of the existing common stock (in what is commonly referred to as a "reverse stock split"), pursuant to a section 354(a) exchange in a section 368(a)(1)(E) reorganization. The shares received in the exchange are substantially identical to the shares exchanged therefor, possessing (in the aggregate and with respect to any other outstanding stock of the corporation) the same dividend rights, voting power, liquidation preference (if any), convertibility and other legal and economic entitlements as the shares exchanged, and do not contain any additional rights or obligations.

In example two, a domestic corporation changes its state of incorporation from State A to State B, pursuant to a state law merger of the corporation into a corporation newly incorporated in State B solely to facilitate the transaction, and which is the survivor in the merger. In the merger, stock of the merged corporation is exchanged for stock in the surviving corporation, possessing (in the aggregate and with respect to any other outstanding stock of the corporation) substantially identical dividend rights, voting power, liquidation preference (if any), convertibility and other legal and economic entitlements as the shares exchanged, and does not contain any additional rights or obligations. The reincorporation qualifies as a reorganization under section 368(a)(1)(F).

Under Temp. Reg. §1.897–6T(a)(1), the exchange of stock in both examples would be taxable to foreign shareholders because, with respect to the interests exchanged, the domestic corporation whose

stock is received is not a U.S. real property holding corporation immediately after the exchange. Accordingly, when the final regulations under section 897(e) are issued, the regulations will include an exception that will provide that a foreign taxpayer will not recognize gain under section 1.897–6T(a)(1) (as finalized) for a stock exchange under section 354(a) in certain reorganizations described in section 368(a)(1)(E) or (F). The exception will apply where the taxpayer receives stock in the corporation that is substantially identical to the shares exchanged, possessing (in the aggregate and with respect to any other outstanding stock of the corporation) the same dividend rights, voting power, liquidation preferences (if any), and convertibility as the shares exchanged without any additional rights or obligations.

The final regulations will provide, for purposes of section 897(a) and (e), that stock received in a section 368(a)(1)(E) or (F) reorganization qualifying for nonrecognition pursuant to section 354(a) under the examples described above, constitutes the same interest in the corporation whose stock was exchanged for purposes of determining whether the interest received is a U.S. real property interest under section 897(c)(1)(A)(ii). Thus, the determination of whether the interest received in such an exchange is a U.S. real property interest under section 897(c)(1)(A)(ii) will include the period prior to the exchange.

For example, if a foreign person receives substantially identical stock in a section 354(a) exchange pursuant to the recapitalization of a domestic corporation that qualifies as a reorganization within the meaning of section 368(a)(1)(E), and the corporation ceased to be a U.S. real property holding corporation two years prior to the exchange, the sale of the stock by the foreign person two years after the exchange will constitute the disposition of a U.S. real property interest that is subject to tax under section 897(a). If the same interest were to be sold by the foreign person four years after the exchange, the sale would not be subject to tax under section 897(a), because the interest would not have been a U.S. real property interest. In such case, the interest would not have been an interest in a domestic corporation that was a U.S. real property holding corporation during the period specified in section 897(c)(1)(A)(ii).

The rule described in this notice is effective for transfers occurring on or after September 6, 1999 (the date of publication of this notice), although a taxpayer may elect to apply the rule of this notice to transfers occurring after June 18, 1980.

SECTION III. PAPERWORK REDUCTION ACT

The collections of information required by this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1660.

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

The collections of information required by this notice are in Temp. Reg. §1.897–6T(a)(1) and 1.897–5T(d)(1)(iii), Treas. Reg. §1.1445–2(d)(2)(i)(A) and Temp. Reg. §1.1445–9T. This information will be used to obtain exemptions from tax under certain nonrecognition transactions and to satisfy reporting requirements regarding these nonrecognition transactions. This information will be used by the Internal Revenue Service to verify whether a taxpayer is entitled to exemption from tax under a nonrecognition transaction. The likely respondents are individuals, corporations, and business or other for-profit institutions.

The estimated total annual reporting burden is 200 hours. The estimated annual burden per respondent is 2 hours. The estimated number of respondents is 100. The estimated frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION IV. DRAFTING INFORMATION

The principal author of this notice is Robert Lorence of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Lorence at (202) 622-3860 (not a toll-free call). Comments are requested regarding this Notice, including the application of the exception to be provided for in the final regulations as described herein to other nonrecognition transactions.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Purchase Price Allocations in Deemed Actual Asset Acquisitions

REG–107069–97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the allocation of purchase price in deemed and actual asset acquisitions. The proposed regulations determine the amount realized and the amount of basis allocated to each asset transferred in a deemed or actual asset acquisition and affect transactions reported on either Form 8023 or Form 8594.

DATES: Written comments must be received by September 20, 1999. Requests to speak and outlines of topics to be discussed at the hearing scheduled for 10 a.m., October 12, 1999, must be received by September 20, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–107069–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (REG–107069–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Richard Starke, (202) 622-7790 or Stephen R. Wegener, (202) 622-7530; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy R. Traynor (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collections of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by October 12, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the collections will have a practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in §§1.338–2(d), 1.338–2(e)(4), 1.338–5(d)(3), 1.338–10(a)(4), 1.338(h)(10)–1(d)(2), and 1.1060–1(e)(ii)(A) and (B). The collections of information are necessary to make an election to treat a sale of stock as a sale of assets, to calculate and collect the appropriate amount of tax in a deemed or actual asset acquisition, and to determine the bases of assets acquired in a deemed or actual asset acquisition.

These collections of information are required to obtain a benefit. The likely respondents and/or recordkeepers are small businesses or organizations, businesses, or other for-profit institutions, and farms.

The regulation provides that a section 338 election is made by filing Form 8023. The burden for this requirement is reflected in the burden of Form 8023. The regulation also provides that both a seller and a purchaser must each file an asset acquisition statement on Form 8594. The burden for this requirement is reflected in the burden of Form 8594. The burden for the collection of information in §1.338–2(e)(4) is as follows:

Estimated total annual reporting/recordkeeping burden: 25 hours

Estimated average annual burden per respondent/recordkeeper: 0.56 hours

Estimated number of respondents/recordkeepers: 45

Estimated annual frequency of responses: On occasion

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

A. *Evolution of Code and Regulations.*

Section 338 was added to the Internal Revenue Code of 1954 (Code) by section 224(a) of the Tax Equity and Fiscal Responsibility Act of 1982, Public Law 97–248 (96 Stat. 324), and amended by section 306(a)(8) of the Technical Corrections Act of 1982, Public Law 97–448 (96 Stat. 2365), and further amended by section 712(k) of the Tax Reform Act of 1984, Public Law 98–369 (98 Stat. 951).

Section 338 replaces any nonstatutory treatment of a stock purchase as an asset purchase by allowing certain acquiring corporations to elect to treat qualifying stock purchases as asset acquisitions.

General rules for making elections under section 338 were first issued in temporary regulations §§5f.338–1, 5f.338–2, and 5f.338–3 published as T.D. 7942 in the **Federal Register** on February 8, 1984 (49 F.R. 4722 [1984–1 C.B. 93]). Those rules were amended and redesignated as §§1.338–1T, 1.338–2T, and 1.338–3T by temporary regulations published as T.D. 7975 in the **Federal Register** on September 6, 1984 (49 F.R. 35086 [1984–2 C.B. 81]).

Treasury Decision 8021, published in the **Federal Register** on April 25, 1985 (50 F.R. 16402 [1985–1 C.B. 96]), amended §§1.338–1T and 1.338–2T and added §1.338–4T. These regulations provided guidance in a question and answer format, most notably in the areas of asset and stock consistency requirements.

Temporary regulations published as T.D. 8068 in the **Federal Register** on January 8, 1986 (51 F.R. 741 [1986–1 C.B. 165]), amended §§1.338–1T and 1.338–4T. The temporary regulations published on January 8, 1986 also added §1.338(h)(10)–1T to implement section 338(h)(10), under which a selling consolidated group can elect to treat certain stock sales as asset sales.

Sections 1.338–1T and 1.338–4T were again amended by temporary regulations published as T.D. 8072 in the **Federal Register** on January 29, 1986 (51 F.R. 3583 [1986–1 C.B. 111]). (Due to typesetting errors, the **Federal Register** republished T.D. 8072 in its entirety on March 28, 1986 (51 F.R. 10617)). The temporary regulations published on January 29, 1986 also amended §1.338(h)(10)–1T and added §§1.338(b)–1T, 1.338(b)–2T, and 1.338(b)–3T. These regulations required the selling price and basis allocated to each asset to be determined by using a four class residual method.

On February 12, 1986, temporary regulations published as T.D. 8074 in the **Federal Register** (51 F.R. 5163 [1986–1 C.B. 126]), amended §§1.338–1T, 1.338–4T, and 1.338(h)(10)–1T and added §1.338–5T. These regulations provided guidance on international aspects of section 338.

Sections 1.338–1T, 1.338–2T, 1.338–4T, 1.338–5T, and 1.338(h)(10)–1T were amended by temporary regulations published as T.D. 8088 in the **Federal Register** on May 16, 1986 (51 F.R. 17929 [1986–1 C.B. 103]). Sections 1.338–1T, 1.338–3T, 1.338–4T, 1.338–5T, and 1.338(h)(10)–1T were amended by temporary regulations published as T.D. 8092 in the **Federal Register** on July 1, 1986 (51 F.R. 23741 [1986–2 C.B. 49]). The temporary regulations published on July 1, 1986 also added §1.338(b)–4T. These regulations made miscellaneous conforming changes and transitional rules relating to making and filing section 338 elections.

Section 1060 was added by section 641 of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2282). Section 1060 requires both the buyer and the seller of a trade or business to allocate their consideration paid or received to the assets under the same residual method prescribed by the section 338 regulations. Also as part of the 1986 act, miscellaneous changes were made to section 338 by section 631, 1275, 1804(e), and 1899A (100 Stat. 2269, 2598, 2800, 2958). The changes to section 338 were made to conform section 338 with the repeal of the *General Utilities* doctrine and to define a qualified stock purchase by reference to section 1504.

General guidance under section 1060 was provided by §1.1060–1T, added by temporary regulations published as T.D. 8215 on July 18, 1986 (53 F.R. 27035 [1988–2 C.B. 304]). These regulations included direction on the scope of section 1060 and reiterated the four class residual method found in the section 338 regulations.

Section 1060 was amended by section 1006(h) of the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3410). This amendment requires the residual method to be used in the case of a distribution of partnership property or a transfer of an interest in a partnership, but only in determining the value of goodwill or going concern value for purposes of applying section 755. Miscellaneous changes were again made to section 338 by sections 1006(e)(20), 1012(bb)(5)(A), and 1018(d)(9) of the 1988 act (102 Stat. 3403, 3535, 3581).

Sections 338 and 1060 were amended by section 11323 of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388–464). The amendments add certain reporting requirements under sections 338 and 1060. In addition, a provision was added to section 1060 under which parties are bound by written agreements as to allocations or fair market values. The legislative history indicates that the parties are so bound unless the parties can refute the agreement under the standards set forth in *Commissioner v. Danielson,* 378 F.2d 771 (3d Cir.), cert. denied, 389 U.S. 858 (1967) (by presenting proof which in an action between the parties would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc.). See, H.R. Ways and Means Comm., 101st Cong., 2d Sess. (Print No. 101-37, Oct. 15, 1990), at 79 .

Temporary regulations published as T.D. 8339 in the **Federal Register** on March 15, 1991 (56 F.R. 11093 [1991–1 C.B. 52]), added §1.338–6T. The March 15, 1991, temporary regulations provided relief from situations in which a corporation making an election under section 338 could be subjected to multiple taxation on the same gain as a result of the 1986 repeal of the *General Utilities* doctrine.

On January 12, 1992, a notice of proposed rulemaking (CO–111–90) under section 338 was published in the **Federal Register** (57 F.R. 1409 [1992–1 C.B. 1000]). The notice of proposed rulemaking contained proposed regulations to replace the question and answer asset and stock consistency rules of §1.338–4T and the rules relating to the international aspects of section 338 found in §1.338–5T. In addition, the proposed rules restated the remainder of the temporary regulations under section 338, except that only minor conforming changes were made to §§1.338(b)–2T and 1.338(b)–3T.

Section 1060 was again amended by section 13261(e) of the Omnibus Budget Reconciliation Act of 1993, Public Law 103–66 (107 Stat. 539). This amendment made changes to section 1060 to conform the rules for actual asset acquisitions to the amortization of intangibles under section 197. In addition, the legislative history to section 197 suggested that the residual method should be altered to ac-

commodate section 197 intangibles (See H.R. Rep. 111, 103d Cong., 1st Sess. 760 (May 23, 1993 [1993–3 C.B. 336]).

Sections 1.338–1T, 1.338–2T, 1.338–3T, 1.338–4T, 1.338–5T, 1.338(b)–1T, and 1.338(h)(10)–1T were revised and replaced by §§1.338–1, 1.338–2, 1.338–3, 1.338–4, 1.338–5, 1.338(b)–1, and 1.338(h)(10)–1, respectively, by final regulations published as T.D. 8515 in the **Federal Register** on January 20, 1994 (59 F.R. 2958 [1994–1 C.B. 89]). The final regulations published on January 20, 1994 (T.D. 8515) also removed §1.338–6T and added §1.338(i)–1. Also, a new §1.338–4T was added by temporary regulations published as T.D. 8516 on January 20, 1994 in the **Federal Register** (59 F.R. 2956 [1994–1 C.B. 119]). The temporary regulations provided consistency rules applicable to certain cases involving controlled foreign corporations.

Treasury Decision 8626 amended §1.338–2 by final regulations published in the **Federal Register** on October 27, 1995 (60 F.R. 54942 [1995–2 C.B. 34]), providing rules governing the treatment of an intragroup merger following a qualified stock purchase of target stock when a section 338 election is not made for the target.

Section 1.338–4 was amended and §1.338–4T was removed by final regulations published as T.D. 8710 in the **Federal Register** on January 23, 1997 (62 F.R. 3458 [1997–1 C.B. 82]).

Sections 1.338(b)–2T, 1.338(b)–3T, and 1.1060–1T were amended by temporary regulations published as T.D. 8711 in the **Federal Register** on January 16, 1997 (62 F.R. 2267 [1997–1 C.B. 85]). The January 16, 1997, changes to the regulations adapted the residual method to section 197 by adding a fifth class to the residual method prescribed for deemed and actual asset acquisitions.

B. *Current Regulations.*

Section 338 allows certain purchasers of stock to treat the purchases instead as purchases of assets. A purchasing corporation can elect to treat a stock acquisition as an asset acquisition if it acquires 80 percent of the total voting power and 80 percent of the total value of the stock of a target corporation (not taking into account certain preferred stock) by purchase within a 12-month period. If a purchasing corporation makes a section 338 election, the target is treated as if it (as old target) sold all of its assets at the close of the acquisition date at fair market value in a single transaction and (as new target) purchased all of the assets as of the beginning of day after the acquisition date.

If a purchasing corporation acquires the stock of a target corporation in a qualified stock purchase and makes a section 338(g) election (i.e., makes a general section 338 election, not a section 338(h)(10) election), old target's gain or loss from the deemed asset sale is included in old target's final return unless old target is a member of a consolidated group or is an S corporation. In the consolidated and S corporation cases, old target files a special final return including only the items from the deemed asset sale. §1.338–1(e). In the consolidated case, that return is consolidated with neither the selling corporation's nor the purchasing corporation's consolidated group. In the S corporation case, old target must file the special final return as a C corporation. The section 338(g) election (as opposed to a section 338(h)(10) election) generally does not change the tax treatment of the selling shareholders—that is, they are still taxed on their stock sale, notwithstanding the purchasing corporation's section 338(g) election.

In certain cases, the selling shareholders may join with the purchasing corporation in making a section 338(h)(10) election. Until 1994, a section 338(h)(10) election could be made only for target corporations that were members of a consolidated group. The 1994 revisions to the section 338 regulations (effective retroactively to 1992 at taxpayers' election) expanded the eligibility for section 338(h)(10) elections to target corporations that are members of an affiliated group and S corporations. The section 338(h)(10) election changes the tax treatment of old target and the selling shareholders. Old target is deemed to sell all its assets in a single transaction while a member of the selling consolidated group (or while a non-consolidated affiliate, or while an S corporation owned by the selling shareholders) and is deemed immediately thereafter to distribute the proceeds in complete liquidation to the members of the selling consolidated group who sold the target stock (or to the selling affiliate or to all the S corporation shareholders). Thus, under section 338(h)(10), the selling shareholders are not treated as selling stock but instead realize gain or loss, if any, on the stock in the deemed liquidation. §1.338(h)(10)–1(d)(2). Usually, a selling consolidated group or selling affiliate will recognize no stock gain or loss on the deemed liquidation under section 332. S corporation shareholders will include their share of items of income, gain, loss, or deduction on the deemed asset sale passed through to them under section 1366, increase or decrease their basis accordingly under section 1367, and then recognize any remaining gain or loss in their stock under section 331 (the overall effect of which is to recognize net gain or loss equal to the amount of built-in gain or loss in their S corporation stock immediately before the qualified stock purchase).

In the case of a section 338(g) election, old target's total amount realized for the assets it is deemed to sell (aggregate deemed sale price or ADSP) is the sum of (a) the purchasing corporation's grossed-up basis in recently purchased target stock; (b) the liabilities of new target; and (c) other relevant items. This is the amount to be allocated among the assets sold for purposes of determining gain or loss on the assets. §1.338–3(d)(1) and (2). The liabilities referred to in (b) are those liabilities assumed by new target, but the amount thereof taken into account in ADSP is determined as if old target had sold its assets to an unrelated person for consideration that included the liabilities. The liabilities include any tax liability resulting from the deemed asset sale. §§1.338–3(d)(3) and 1.338(b)–1(f). In the case of a section 338(h)(10) election, ADSP is modified. While not stated explicitly, modified ADSP (MADSP) appears to exclude any tax liabilities resulting from the deemed asset sale. §1.338(h)(10)–1(f).

New target's adjusted grossed-up basis in the assets it is deemed to purchase (AGUB) is the sum of (a) the purchasing corporation's grossed-up basis in recently purchased target stock; (b) the purchasing corporation's basis in nonrecently purchased target stock; (c) the liabilities of new target; and (d) other relevant items. This is the amount to be allocated among the assets sold for purposes of determin-

ing the purchaser's basis in the assets. §1.338(b)–1(c)(1).

Section 1060(a) requires a purchaser and a seller to allocate basis for any applicable asset acquisition in the same manner as amounts are allocated to such assets under section 338(b)(5). Section 1060(c) defines an applicable asset acquisition as any transfer of assets that constitute a trade or business where the transferee's basis is determined wholly by reference to the consideration paid for the assets.

Section 338(b)(5) authorizes the Secretary to issue regulations prescribing how the deemed purchase price is to be allocated among the assets. Final and temporary regulations under sections 338(b) and 1060, as amended, implement this authority. The regulations generally require that the basis of the acquired (or deemed acquired) assets will be determined using a five class residual method. Class I consists of cash and cash equivalents; Class II consists of certificates of deposit, U.S. Government securities, readily marketable stock or securities, and foreign currency; Class III includes all assets not included in Class I, Class II, Class IV, or Class V; Class IV consists of section 197 intangible assets except those in the nature of goodwill and going concern value; and Class V consists of section 197 intangible assets in the nature of goodwill and going concern value. The total allocable basis is first decreased by the amount of Class I assets. Any remaining amount is allocated proportionally to Class II assets to the extent of their fair market value. Any remaining amount is then allocated first to Class III assets and then to Class IV assets in the same manner as to Class II assets. Finally, any remaining amount is allocated to the Class V assets. See §§1.338(b)–2T and 1.1060–1T.

Reasons for change

A. *In General.*

The regulations under section 338 have developed, in large part, through a series of small changes and additions according to the priorities of taxpayers' and the government's needs and in response to statutory amendments to section 338 or other relevant Code sections. Most of the regulations under section 338 (§§1.338–1, 1.338–2, 1.338–3, 1.338–4, 1.338–5, 1.338(b)–1, 1.338(h)(10)–1, and 1.338(i)–1) were made final as part of a single package as recently as 1994, but, with the exception of the consistency rules, most of those regulations were largely restatements of the existing temporary regulations that had been developed to that point. The remaining temporary regulations under section 338 and the temporary regulations under section 1060 have been substantively changed only once since 1986 and 1988, respectively, to accommodate the addition of section 197 to the Code. As a result of the ad hoc manner in which the regulations under sections 338 and 1060 have been amended, the current regulations are difficult to follow. Thus the IRS and Treasury determined that a review of the regulations was appropriate.

In addition, the current regulations have proven problematic in three major respects: first, in their statement of tax accounting rules and their relationship to tax accounting rules for asset purchases outside of section 338, second, in the effects of the allocation rules, and, third, in their lack of a statement of a complete model for the deemed asset sale (and, in the case of section 338(h)(10) elections, the deemed liquidation) from which one can determine the tax consequences not specifically set forth in the regulations.

B. *Tax Accounting Rules under Current Regulations.*

The current regulations include certain rules for accounting for items in connection with the deemed asset sale. These tax accounting rules apply for determining the original amounts of and subsequent adjustments to ADSP and AGUB. For example, the regulations provide rules governing the treatment of contingent liabilities deemed assumed by new target. In some respects the tax accounting rules in the current regulations differ considerably from the tax accounting rules applicable to actual asset sales.

Link between old target's and new target's tax accounting

Under the current regulations, ADSP is defined as the sum of (a) the grossed-up basis of the purchasing corporation's recently purchased target stock, (b) the liabilities of new target, and (c) other relevant items. Thus, the calculation of ADSP is linked to the tax accounting treatment of new target or the purchaser of new target in item (a) above. Such link does not exist, however, in the case of an actual asset sale between two parties. In actual asset sales the timing and amount of the seller's amount realized and the timing and amount of the buyer's basis may differ. For example, with respect to the link under (a), the current fair market value of promised future contingent payments that constitute debt is taken into account in amount realized under §1.1001–1(g) unless, in rare and extraordinary circumstances, the fair market value is not reasonably ascertainable. Yet, under §1.1012–1(g), the current fair market value of such future contingent payments is not taken into account currently in the purchaser's basis.

This link between old target's deemed sales price and the purchasing corporation's basis in target stock existed in the original version of section 338, adopted in 1982. In 1984, Congress removed that link from the statute, providing instead that old target should be deemed to sell its assets at fair market value. The regulations originally allowed old target to choose between using the three-part formula (items (a) through (c)) above to calculate ADSP and treating the assets as being sold at their fair market value. In 1994, new regulations eliminated the election, thereafter requiring use of the three-part formula. Under the current regulations, any contingent payments for target stock do not become part of AGUB and ADSP until they become fixed and determinable. However, no rule prevents the seller from using all its basis to offset the amount realized in the year of the deemed sale. As a result of the link between old target's deemed sales price and the purchasing corporation's purchase price, old target receives open transaction treatment on terms broader than those available in an actual asset sale. Compare §15A.453–1(d)(2)(iii) ("Only in those rare and extraordinary cases involving sales for a contingent payment obligation in which the fair market value of the obligation . . . cannot reasonably be ascertained will the taxpayer be entitled to assert that the transaction is 'open.'")

Liabilities assumed

The current regulations specify new target's tax accounting treatment for the

assumption of liabilities. New target takes a liability into account in AGUB only if it is a bona fide liability of target as of that date that would be properly taken into account in basis under principles of tax law if new target had acquired old target's assets from an unrelated person and, as part of the transaction, had assumed, or taken property subject to, the liabilities, and the amount thereof is determined on the same basis. §1.338(b)–1(f)(1) and (2).

Under §1.338(b)–3T(a)(1), AGUB is subsequently redetermined only if an adjustment would be required, under general principles of tax law, in connection with an actual asset purchase by new target from an unrelated person. One of the subsequent events enumerated as an example is the change in a contingent liability of target to one which is fixed and determinable. Section 1.338(b)–3T(c)(1) provides that a contingent amount (including contingent liabilities of old target deemed assumed) is taken into account at the time at which such amount becomes fixed and determinable. The statement of the latter rule suggests to some that it overrides the rules based on general principles of tax law stated in §§1.338(b)–1(f)(2) and 1.338(b)–3T(a)(1). However, interpreting the fixed and determinable rule in this manner would be inconsistent with the economic performance rules of section 461(h), that, in some circumstances, would operate to defer new target's taking an assumed liability into account until some time after the liability becomes fixed and determinable. See §§1.461–4(a) and 1.446–1(c)(1)(ii)(B).

Installment method

The current regulations provide no rules for old target to report its deemed sale gain under the installment method. Because the parties could have structured an actual asset sale to qualify for the installment method, commentators have argued that making the installment method available when a section 338(h)(10) election is made would be consistent with the full asset sale model implied by those rules. Making the installment method available when only a section 338(g) election is made would not be appropriate because the target shareholders are still treated as selling stock and because target would get a step-up in basis of assets before it had borne the tax burden for such step-up.

C. *Allocation Rules under Current Regulations.*

Fast pay assets

The current regulations employ a residual method of allocation. Under the residual method, the amount of basis to be allocated to goodwill and going concern value is based entirely on the amount of basis remaining to be allocated after all other assets have been allocated basis to the extent of their fair market values. Because assets other than goodwill and going concern value tend to be more easily valued, the residual allocation method is intended to result in less controversy over the value of goodwill and going concern value. The legislative history of section 1060, adopted in the Tax Reform Act of 1986, Public Law 99–514, (100 Stat. 2282), noted with approval the use of the residual method under the section 338(b) regulations and required that the same method be used in regulations to be prescribed under section 1060. See S. Rep. No. 313, 99th Cong., 2d Sess., May 29, 1986, at 254. Accordingly, the current regulations place each acquired asset into one of five asset classes. The total allocable basis is allocated among the classes starting with the first class and proceeding to the final, residual class. No asset in any class except for the residual class can be allocated more than its fair market value. If the aggregate basis allocable to a particular class is less than the aggregate fair market value of the assets within the class, each asset is allocated an amount in proportion to its fair market value and nothing is allocated to any junior class.

The residual allocation method presents unique problems when the cost of the assets, and hence the basis to be allocated thereto, is less than the aggregate fair market value of the individual assets. This situation may arise as a result of the use of contingent consideration for target stock or the deemed assumption of liabilities that are not yet taken into account. If this is the case, the basis of the assets is said to be impaired. Under the residual method, the impairment is borne equally by the assets in the first class in which the cumulative fair market value exceeds the remaining aggregate basis available for allocation. As no basis is allocated to assets in junior classes, they are also impaired. If such an asset is sold, the taxpayer will realize a gain on its disposition even if its value has not increased since the acquisition date. Taxpayers may reverse the gain recognized in later years if the purchasing corporation pays or incurs additional amounts for target stock or additional target liabilities deemed assumed are taken into account. For this reason, the gain recognized is often referred to as phantom income.

The problem is most acute with assets that turn over quickly, such as accounts receivable and inventory (fast pay assets). Comments received on the temporary regulations suggested that fast pay assets should be placed in a more senior class to make it more likely that basis is allocated equal to the assets' fair market values in order to alleviate concerns over phantom income.

Top-down allocation

Under the current regulations, stock in a subsidiary is generally a Class III asset. In allocating basis among tiered corporations, an allocation to the stock of a subsidiary becomes the starting point for allocation to the assets inside the subsidiary if a section 338 election is also made for the subsidiary. See, e.g., §1.338–2(b)(4) of the current regulations. One might refer to this as top-down allocation. Under a top-down allocation, the basis of assets of a particular class can be more impaired at one corporate level than at another. For example, Class III assets in the parent target corporation might be allocated some basis while Class II assets in its subsidiary are allocated no basis because Class I assets in the subsidiary have absorbed all the basis allocated to the stock in the subsidiary, a Class III asset. The differences in impairment arising from the differences in the location of assets and liabilities is inconsistent with the residual method (e.g., liabilities secured by an asset support basis of all assets in a single corporation) and can lead to the misallocation of basis.

D. *Statement of Complete Model.*

For purposes of effectuating the statutory purpose of permitting taxpayers to elect to treat a stock acquisition as an

asset acquisition, section 338 and the current regulations deem certain transactions to occur. The current regulations' express statement of these deemed transactions provides the appropriate Federal income tax consequences for most targets for which a section 338 election is made. However, as with the tax accounting rules, some taxpayers interpret the express statements in the current regulations as resulting in tax consequences different from those had they actually engaged in the transactions deemed under the regulations to have occurred or as resulting in the tax consequences specifically stated and not any of the collateral consequences.

Explanation of Provisions

A. *Overview of Changes.*

The proposed regulations are intended to clarify the treatment of, and provide consistent rules (where possible) for, both deemed and actual asset acquisitions under sections 338 and 1060. In addition, the proposed regulations propose changes to the current regulations to take into account changes to the tax law made since the different portions of the current regulations were published. The changes made by the proposed regulations have four major components: organization of the regulations; clarification and modification of the accounting rules applicable to deemed and actual asset acquisitions; modifications to the residual method mandated for allocating consideration and basis; and miscellaneous revisions to the current regulations. These changes are discussed in the order in which they arise in the proposed regulations. The IRS and Treasury did not address any provisions of the regulations relating to the consistency rules or the international aspects of section 338.

B. *Organization of Regulations.*

The proposed regulations change the organization of the regulations in order to make the rules for all asset acquisitions more administrable and provide consistent treatment, when appropriate, for deemed and actual asset acquisitions. In order to make the regulations more administrable, the proposed regulations redesignate certain of the final regulations and reorganize and restate the remaining final and temporary regulations in a manner that is more consistent with the approach the IRS and Treasury has taken to drafting regulations in other areas. The proposed regulations also attempt to provide similar treatment, when appropriate, for deemed and actual asset acquisitions by stating the relevant concepts once in the regulations under section 338 and cross-referencing those rules in §1.1060–1 of the proposed regulations.

New §1.338–1 includes a scope statement. Section 1.338–1 also addresses the question of to what extent the deemed asset sale and other elements of the section 338 regime are considered as actually having occurred for purposes of application of other Code sections, such as those relating to retirement plan sponsors. Terminology and definitions and provisions regarding the mechanics of the section 338 election of current §1.338–1 have been moved to new §1.338–2. The return filing rules of current §1.338–1 have been moved to their own section, §1.338–10. All of the current §1.338–2 rules for qualification for making the section 338 election and rules relating to the effect on continuity of proprietary interest have been moved to new §1.338–3.

The rules defining ADSP, as well as various rules relating to taxation of old target, currently in §1.338–3, are in §1.338–4 of the proposed regulations. The rules defining AGUB, currently in §1.338(b)–1, are in §1.338–5. Current §1.338(b)–3T sets forth the timing of increases or decreases in ADSP and AGUB; these timing rules have been moved to new §1.338–4 (ADSP) and new §1.338–5 (AGUB).

Current §§1.338–4 and 1.338–5, dealing with consistency and with international aspects of section 338, respectively, have been renumbered §§1.338–8 and 1.338–9, respectively. The substance of these rules has not been addressed in connection with these proposed regulations.

Section 1.338–6 of the proposed regulations addresses allocation of ADSP and AGUB among assets, currently covered by §1.338(b)–2T. The rules pertaining to subsequent adjustments to ADSP and AGUB, currently in §1.338(b)–3T, are in §1.338–7 of the proposed regulations.

Section 1.338(h)(10)–1 has not been renumbered.

C. *§1.338–1 General principles; status of old target and new target.*

Regulations' scope statement

The scope statement describes the general model of the deemed asset sale and other aspects of the regulations used as the basis for the rules in the proposed regulations. This statement of the model should assist the reader generally in the correct interpretation and application of the regulations. This section also provides that old target and new target (as well as any other affected parties, for example, when a section 338(h)(10) election is made) are to determine the tax consequences as if they had actually engaged in the transactions deemed under the section 338 regulations to have occurred. Thus, the proposed regulations clarify that old target's deemed asset sale may result in tax consequences for old target and new target (such as income and deduction) in addition to old target's gain or loss realized on its deemed sale of assets. For example, if target is an insurance company for which a section 338 election is made, the deemed asset sale would be characterized and taxed as an assumption-reinsurance transaction under applicable Federal income tax law. See §1.817–4(d).

The proposed regulations make minor amendments to the list of sections in subtitle A for purposes of which old target and new target are considered the same corporation, notwithstanding the deemed asset sale between the two. Such changes generally are with respect to retirement plan and similar provisions.

Anti-abuse rule

The proposed regulations incorporate an anti-abuse rule giving the Commissioner, for purposes of calculating ADSP and AGUB and allocating ADSP and AGUB among assets, the authority under certain circumstances (a) to treat as not being part of target's assets those added to the pool of target's assets before the deemed asset sale and (b) to treat as being part of target's assets those removed from the pool of target's assets before the deemed asset sale. The Commissioner's authority to treat assets added to the pool as not being part of the pool exists when the property is transferred to old target in connection with the transactions resulting

in the application of the residual method if such property is, within 24 months after the deemed asset sale, (a) not owned by new target but owned, directly or indirectly, by a member of the affiliated group of which new target is a member, or (b) owned by new target but held or used to more than an insignificant extent in connection with an activity conducted, directly or indirectly, by another member of the affiliated group of which new target is a member in combination with other property acquired, directly or indirectly, from the transferor of the property to old target. The Commissioner's authority to treat assets removed from the pool as being part of the pool exists where the property is removed in connection with the transactions resulting in the application of the residual method if the removed property, within 24 months after the deemed asset sale, (a) is owned by new target, or (b) is owned, directly or indirectly, by a member of the affiliated group of which new target is a member and continues after the election to be held or used to more than an insignificant extent in connection with one or more of the activities of new target.

D. *§1.338–2 Nomenclature and definitions; mechanics of the section 338 election.*

Definitions

Four definitions of terms already used in the current regulations have been added to the proposed regulations under section 338. These terms are *acquisition date asset, deemed asset sale, deemed sale gain, and deemed sale return.* The scope of some of these terms has been expanded from their usage in the current regulations. For example, *deemed asset sale* refers to the transaction deemed under the section 338 regulations to occur between old target and new target and *deemed sale gain,* refers to, in the aggregate, the Federal income tax consequences (generally, the income, gain, deduction, and loss) of the deemed asset sale. Deemed sale gain can also refer to the Federal income tax consequences of the transfer of a particular individual asset in the deemed asset sale. The expanded definition of deemed sale gain in conjunction with the rules in §1.338–7(c) of the proposed regulations (§1.338(b)–3T(h) of the current regulations) provides a mechanism for target (or, in the case of a section 338(h)(10) election, the member of the selling consolidated group, the selling affiliate, or the S corporation shareholders to which such income, loss, or other amount is attributable) to report items that are properly taken into account after the acquisition date. One such item would be the deduction for an assumed liability of old target that it could not deduct under its method of accounting on or before the acquisition date.

The definition of *purchasing corporation* has been clarified to include new target (new T) with respect to its deemed purchase of stock in its own subsidiary.

The definition of *selling group* in §1.338–2 of the proposed regulations and related provisions in §1.338(h)(10)–1 of the proposed regulations provide that a section 338(h)(10) election may be made for target notwithstanding that it was at some time during the year in which the acquisition date occurs the common parent of its affiliated or consolidated group, so long as it is not the common parent on the acquisition date.

E. *§1.338–3 Qualification for the section 338 election.*

More than a nominal amount paid for purchase of stock

The IRS and Treasury have received many informal comments in which guidance was requested on whether a section 338 election may be made for a target that is insolvent. In order to have a purchase of a share of stock in target, the proposed regulations generally require that more than a nominal amount of consideration be paid for the stock. With respect to target affiliates, one cannot adequately determine whether more than a nominal amount of consideration is paid for the stock because the amount paid is not determined in an arm's length transaction but instead under the allocation rules of the regulations. Consequently, the proposed regulations provide that stock in a target affiliate acquired by new target in the deemed asset sale of target's own assets is considered purchased if, under general principles of tax law, new target is considered to own stock of the target affiliate meeting the requirements of section 1504(a)(2), notwithstanding that no purchase price may be allocated to target's stock in the target affiliate. For a discussion of the tax consequences when a qualified stock purchase is made of an insolvent corporation and a section 338(h)(10) election is made, see the discussion of section 338(h)(10) elections later in this preamble.

Time for testing relationship

A section 338 election may be made only with respect to a transaction that qualifies as a purchase within the meaning of section 338(h)(3). Under section 338(h)(3)(iii), the parties to the transaction must be unrelated in order for a transaction to qualify as a purchase. The statute is unclear, however, as to when the relationship between the parties is tested. The proposed regulation provides that the relationship is tested immediately after the transaction. This rule gives effect to the statutory objective of preventing a transferor from obtaining the benefits of a section 338 election while retaining a significant interest, directly or indirectly, in the property transferred. This rule also furthers the statutory objective of affording similar tax treatment to section 338 deemed asset sales and actual asset sales. For example, under this rule, if an actual sale of assets would qualify as a reorganization under section 368(a)(1)(D) (with a carryover of basis and other attributes), taxpayers are not able to reach a different result by structuring the transaction as a stock sale and electing under section 338.

F. *§§1.338–4 and 1.338–5 Aggregate deemed sale price; various aspects of taxation of the deemed asset sale; adjusted grossed-up basis.*

Breaking the link between ADSP and AGUB

Under the current regulations, the first element in the definition of ADSP is the grossed-up basis of the purchasing corporation's recently purchased target stock. The combination of the link between the definitions of ADSP and AGUB with the rule in the current regulations that contingent payments are taken into account in AGUB as they become fixed and determinable effectively affords old target open-transaction treatment, which treatment generally is inconsistent with

§§15A.453–1(d)(2)(iii) and 1.1001–1(g)-(2). The proposed regulations remove the link in the current regulations between calculation of the first element of ADSP and the purchaser's basis in recently purchased target stock.

The new first element in the calculation of ADSP is the grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock. Amount realized is determined as if old target itself were the selling shareholder. Also, notwithstanding that the sellers of the target shares may use the installment method of section 453 to report their gain on the stock, old target may not use the installment method in the calculation of the first element of ADSP.

Time and amount combined

The proposed regulations provide that general principles of tax law apply in determining the timing and amount of the elements of ADSP, and that ADSP is redetermined at such time and in such amount as an increase or decrease would be required, under general principles of tax law, to the individual constituent elements of the definition of ADSP. The proposed regulations also provide a parallel rule for AGUB. Substantively, the two statements are designed to eliminate special accounting rules included in the current section 338 regulations—such as the current regulations' fixed and determinable rule for the timing of taking into account contingent amounts—and to bring taxation of old target's deemed asset sale closer to the taxation of an actual asset sale. In contrast to the current regulations, the proposed regulations state in one location all the rules for determining ADSP and AGUB.

Both the breaking of the link between the calculation of ADSP and the purchaser's basis in recently purchased stock and the removal of the fixed and determinable rule for contingent liabilities may often result in increased disparities between ADSP and AGUB.

Liabilities

The current regulations appear to presume that any tax liability of old target incurred on its deemed asset sale is a liability assumed by new target if a section 338(h)(10) election is not made but is not a liability assumed by new target if a section 338(h)(10) election is made. These presumptions apparently required that the definition of ADSP be modified in current §1.338(h)(10)–1. The proposed regulations make clear that, whether or not a section 338(h)(10) election is made, old target's tax liability is deemed not assumed by new target only if the parties have agreed that (or the tax or non-tax rules operate such that) the seller, and not target, will bear the economic cost of that tax liability. This is because the legal burden for the tax would otherwise remain with target. Thus, the proposed regulations remove the term *MADSP* from §1.338(h)(10)–1, and extend the use of the term *ADSP* to that regulation.

Under the proposed regulations, the amount of liabilities of old target taken into account to calculate ADSP is determined as if old target had sold its assets to an unrelated person for consideration that included the unrelated person's assumption of, or taking subject to, the liabilities. Similarly, they provide that, in order to be taken into account in AGUB, a liability must be a liability of target that is properly taken into account in basis under general principles of tax law that would apply if new target had acquired its assets from an unrelated person for consideration that included the assumption of, or taking subject to, the liability. Regarding the timing of taking such liabilities into account, the proposed regulations provide that general principles of tax law apply in determining the timing and amount of the elements of ADSP and AGUB. Thus, for example, under general principles of tax law, a particular liability might not be taken into account in basis when a purchaser buys an asset subject to such liability, but might be taken into account at some later date; such timing controls the timing of including the liability in AGUB. Accordingly, the current rule in the regulations that liabilities are taken into account in calculating AGUB, and apparently ADSP, only when such liabilities become fixed and determinable is removed in the proposed regulations.

Costs

The treatment of selling costs for old target and acquisition costs for new target is modified. For old target, it is made clear that when grossing-up the selling shareholders' amount realized where not all the target stock is recently purchased by the purchaser, the amount of selling costs by which that grossed-up amount realized is reduced is not itself grossed-up. For new target, the definition of AGUB is changed such that when the purchaser's basis in recently purchased stock is grossed-up, acquisition costs are no longer also grossed-up. Grossing-up the selling shareholders' selling costs or the purchasing corporation's acquisition costs would result in costs not actually incurred reducing old target's amount realized for the assets or increasing new target's cost basis in the assets. The IRS and Treasury do not believe that these results are appropriate because there is no evidence that the purchasing corporation's costs to acquire an amount of target stock sufficient for there to be a qualified stock purchase would increase proportionately if it acquired all of the target stock and the deemed asset sale mechanism allows taxpayers to avoid many of the costs that would be incurred in an actual asset sale. Accordingly, the IRS and Treasury have exercised the authority under section 338(b)(2) to prevent the grossing-up of selling costs and acquisitions costs.

Other relevant items

The element *other relevant items* is removed from the definitions of both ADSP and AGUB as it no longer serves any function. In the current regulations, this element reduces ADSP for the purchasing corporation's acquisition costs that would otherwise be taken into account because the purchaser's basis in recently purchased stock was an element in calculation of both ADSP and AGUB. This element becomes unnecessary with the removal of the link between ADSP and AGUB.

G. *§1.338–6 Allocation of ADSP and AGUB among target assets.*

Allocation of ADSP and AGUB generally

Apart from a change in the number of classes, the proposed regulations generally do not represent a substantive change in the system of allocation of ADSP and AGUB. The proposed regulation states the allocation rules that apply equally to ADSP and AGUB and then states the modifications to those common allocation rules for AGUB.

Transaction costs

Generally, the definition of fair market value is the price at which a willing seller will transfer an asset to a willing buyer. Therefore, the fair market value of a particular asset to a seller is not different from the fair market value of the same asset to a buyer, even though the economic value of the asset to each would reflect the selling costs or acquisition costs. A seller may reduce its amount realized on an asset and a buyer may increase its cost basis in an asset for the transaction costs specifically allocable to the asset in an actual asset sale. Because the underlying transaction in section 338 is actually a stock sale, the costs incurred are not specifically allocable to any individual asset deemed transferred, but rather to the stock. Therefore, in applying the residual method to a deemed asset sale, transaction costs are accounted for only by decreasing the total amount realized by the seller or increasing the total cost basis of the buyer. In contrast, see the discussion of the treatment of transaction costs in an actual asset acquisition below.

IRS challenges to asset fair market value

Drawing from the existing rules under section 1060, the proposed regulations provide that the IRS may challenge a taxpayer's determination of the fair market value of any asset by any appropriate method and take into account all factors, including any lack of adverse tax interests between the parties.

Number and content of classes

The seven classes under the proposed regulations are as follows: Class I, cash and cash equivalents; Class II, actively traded personal property as defined in section 1092(d), certificates of deposit, and foreign currency; Class III, accounts receivable, mortgages, and credit card receivables which arise in the ordinary course of business; Class IV, stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; Class V, all assets not in Class I, II, III, VI, or VII; Class VI, all section 197 intangibles except goodwill or going concern value; and Class VII, goodwill and going concern value.

AGUB less than the amount of Class I assets

The proposed regulations clarify that, if the total AGUB (or consideration in an applicable asset acquisition under section 1060) to be allocated is less than the amount of Class I assets (i.e., cash and cash equivalents), then new target (or the purchaser in an applicable asset acquisition under section 1060) immediately recognizes ordinary income to that extent.

Marketable securities

The current regulations include marketable stock and securities, as defined in §1.351–1(c)(3), in Class II. Marketable stock and securities are included in Class II because a value can be easily assigned at any given time by looking at the value at which those instruments were trading on a securities exchange. Since the time Class II was first defined, financial markets have evolved and a greater variety of financial instruments can be readily valued in the same manner. The proposed regulations instead defines Class II with respect to actively traded personal property as defined under section 1092(d) because the regulations under that section have a more comprehensive definition of public financial markets.

Fast pay assets

The IRS and Treasury are aware that many taxpayers engage in transactions solely to avoid the impairment problems with fast-pay assets. In addition, the IRS spends time evaluating whether such transactions are subject to challenge under the section 338 regulations or general principles of tax law. In order to address these concerns, the proposed regulations create two new classes of assets between current Classes II and III, one for accounts receivable, mortgages, and credit card receivables which arise in the ordinary course of business and another for stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

Residual class

In the current regulations, Class V, the residual class, is comprised of section 197 intangibles in the nature of goodwill and going concern value. Class IV is comprised of all section 197 intangibles except those in the nature of goodwill and going concern value. Because many section 197 intangibles would have been characterized by the IRS as assets in the nature of goodwill and going concern value prior to the enactment of section 197, the current regulations provide somewhat ambiguous guidance as to the line between current Class IV and current Class V. Accordingly, the proposed regulations remove the phrase "in the nature of." Furthermore, in rare circumstances, goodwill or going concern value is not a section 197 intangible. The residual class should include all goodwill and going concern value to ensure that the residual method serves the purpose of reducing valuation controversies. Therefore, the proposed regulations define the residual class as goodwill and going concern value without any reference to whether those assets would qualify as section 197 assets.

In T.D. 8711, *supra,* the IRS amended the current regulations to adapt the residual method to section 197 by creating a new Class IV for section 197 intangibles other than goodwill or going concern value and providing that goodwill and going concern value would remain in a true residual class. The proposed regulations retain this distinction in renumbered Class VI and Class VII. Allocating goodwill and going concern value to Class VII avoids the need for determining the value of goodwill and going concern value through a non-residual method.

Allocation of AGUB when gain recognition election available but not made

When the purchaser of the target stock holds nonrecently purchased target stock and no section 338(h)(10) election is made, the purchaser has the option of making or not making the gain recognition election. (If a section 338(h)(10) election is made, the making of the gain recognition election is automatic rather than elective.) The proposed regulations retain these rules. The current regulations have a special allocation rule when the

failure to make the gain recognition election leaves AGUB less than ADSP (that is, when the purchaser's nonrecently purchased stock was bought at a lower price than the recently purchased stock). Under the special allocation rule, AGUB, after reduction by the amount of Class I assets, is allocated among all other assets, regardless of their class, in proportion to their fair market values. (For this purpose, the fair market value of assets in the residual class (current Class V) is deemed to be the excess, if any, of the hypothetical purchase price over the sum of the Class I assets and the fair market values of the Class II, III, and IV assets. The hypothetical purchase price is the AGUB that would result if a gain recognition election were made.)

If, looking at the hypothetical purchase price, full fair market value was paid on the acquisition date for assets in each class above the residual class, the current regulation's special allocation rule spreads the impairment that arises because no gain recognition election was made equally among all assets in classes below Class I. However, if, looking at the hypothetical purchase price, full fair market value was not paid on the acquisition date for assets in each class above the residual class, this rule spreads the impairment that arises because no gain recognition election was made as well as the impairment that arises from the bargain purchase equally among all assets in classes below Class I. In the latter case, the prioritization of classes under the residual method becomes irrelevant by the failure to make a gain recognition election. Prior to the enactment of section 197, the effect of the current regulations generally would have been to shift basis from depreciable or amortizable assets to nondepreciable, nonamortizable assets.

The proposed regulations modify the special allocation rule to minimize this effect. Generally, under the modified special allocation rule, the portion of AGUB (after reduction by the amount of Class I assets) to be allocated to each Class II, III, IV, V, VI, and VII asset is determined by multiplying (a) the amount that would be allocated to such asset under the general rules for allocation of AGUB were AGUB increased to equal the hypothetical purchase price by (b) a fraction, the numerator of which is actual AGUB (after reduction by the amount of Class I assets) and the denominator of which is the hypothetical purchase price (after reduction by the amount of Class I assets). The reason for the modification is to spread only the impairment that arises because no gain recognition election was made equally among all assets in classes below Class I.

The IRS and Treasury request comments as to whether any special allocation rule has continuing merit.

H. *§1.338–7 Allocation of redetermined ADSP and AGUB among target assets.*

In general

Section 1.338(b)–3T of the current regulations addresses subsequent adjustments to ADSP and AGUB. In the proposed regulations, these rules, contained in §1.338–7, have been streamlined and some of their content has been moved to the sections defining ADSP and AGUB, §§1.338–4 and 1.338–5 respectively. The proposed regulations eliminate the use of the term *adjustment event* used in certain provisions of the current regulations. Instead, the proposed regulations provide simply that when general principles of tax law require a change in the amount of any of the various elements of ADSP or AGUB (discussed earlier), the new ADSP or AGUB amount is reapplied to produce new allocations to the assets. This generally is not intended as a substantive change to the current rules for subsequent adjustments provided in §1.338(b)–3T.

Item-specific adjustments

The current regulations at §1.338(b)–3T contain special rules for changes to AGUB (and thus, indirectly, to ADSP) that relate to the income produced by intangible assets. The special rules apply for purposes of allocating an increase or decrease in AGUB or ADSP to the extent (a) the contingency that results in the increase or decrease directly relates to income produced by a particular intangible asset (contingent income asset) and (b) the increase or decrease is related to such contingent income asset and not to other target assets. The special rules consist of two provisions that vary from the normal rules of §1.338(b)–3T. Under the first provision, the fair market value of the contingent income asset at the beginning of the day after the acquisition date is redetermined at the time of the increase or decrease in AGUB or ADSP (but only those circumstances that resulted in the increase or decrease to AGUB or ADSP are taken into account in the redetermination). Under the second, the increase or decrease in AGUB or ADSP is allocated first to the contingent income asset, not to all assets generally under the normal allocation rules. Any portion that cannot be so allocated because of the fair market value limitation (as redetermined) is allocated under the normal allocation rules.

The intent of this rule was to accommodate the uncertainties in the valuation of contingent income assets. The rule produces an allocation that would have resulted if the parties had known on the acquisition date the fair market value of the contingent income asset (as determined, with hindsight, on the date of the adjustment event) and paid on the acquisition date the increased or decreased consideration. The IRS and Treasury weighed the usefulness of this rule with its complexity and decided that the proposed regulations should not include any item-specific adjustment rule. Commentators, if they believe that the item-specific adjustment rule continues to serve a useful function that justifies its retention, should identify in their comments in what circumstances the rule has proven useful or could prove useful. Commentators should also identify what provisions would be necessary for an effective item-specific adjustment rule.

I. *§1.338(h)(10)–1 Deemed asset sale and liquidation.*

Model

The proposed regulations explain the effects of the section 338(h)(10) election on the parties involved. The proposed regulations discuss the effects of the section 338(h)(10) election on the purchasing corporation, the effects on new target, the effects on old target, and the effects on old target's shareholders (including nonselling shareholders).

As with the rest of the proposed regulations, proposed §1.338(h)(10)–1 describes the model on which taxation of the section 338(h)(10) election is based. Under the proposed regulations, old target

is treated as transferring all of its assets by sale to an unrelated person. Old target recognizes the deemed sale gain while a member of the selling consolidated group, or owned by the selling affiliate, or owned by the S corporation shareholders (both those who actually sell their shares and any who do not). Old target is then treated as transferring all of its assets to members of the selling consolidated group, the selling affiliate, or S corporation shareholders and ceasing to exist. If target is an S corporation, the deemed asset sale and deemed liquidation are considered as occurring while it is still an S corporation. The proposed regulations treat all parties concerned as if the fictions the section 338(h)(10) regulations deem to occur actually did occur, or as closely thereto as possible. The structure of this model should help taxpayers answer any questions not explicitly addressed by the proposed regulations. Also, old target generally is barred by the proposed regulations from obtaining any tax benefit from the section 338(h)(10) election that it would not obtain if it actually sold its assets and liquidated.

The treatment of S corporation targets which own one or more qualified subchapter S subsidiaries (as defined in section 1361(b)(3)) is also addressed, as is the treatment of tiered targets (i.e., the order of their deemed asset sales and deemed liquidations).

Deemed liquidation

The current regulations provide that, when a section 338(h)(10) election is made, old target is deemed to sell all of its assets and distribute the proceeds in complete liquidation. The term *complete liquidation* is generally considered to be a term of art in tax law. The proposed regulations instead provide that old target transferred all of its assets to members of the selling consolidated group, the selling affiliate, or S corporation shareholders and ceased to exist, making it clear that the transaction following the deemed asset sale does not automatically qualify as a distribution in complete liquidation under either section 331 or 332. This is meant to clarify any inference one might draw from previous regulations that section 332 treatment is automatic under section 338(h)(10) in the case of an affiliated or consolidated group. For example, if S owns all of the stock of T, T is insolvent because of its indebtedness to S, P acquires T from S in a qualified stock purchase, and, as a condition of the sale, S cancels the debt owed it by T, and P and S make a section 338(h)(10) election for target, T's deemed liquidation would not qualify under section 332 because S would not be considered to receive anything in return for its stock in T. Rev. Rul. 68-602 (1968-2 C.B. 135).

Special S corporation issues

The current regulations provide that, notwithstanding the purchase of 80 percent of the shares of an S corporation by a purchasing C corporation, the S corporation continues to be considered an S corporation for purposes of determining the tax effects of the section 338(h)(10) election to old target and its S corporation shareholders. For example, old target reports to its shareholders under section 1366 the tax effects of its deemed asset sale, and the shareholders adjust their stock basis pursuant to section 1367. The proposed regulations clarify that when the target itself is an S corporation immediately before the acquisition date, any direct and indirect subsidiaries of target with respect to which qualified subchapter S subsidiary elections are in effect are considered to remain qualified subchapter S subsidiaries for purposes of target's and its S corporation shareholders' reporting the effects of target's deemed sale of assets and deemed liquidation. No similar rule applies when a qualified subchapter S subsidiary, as opposed to the S corporation that is its owner, is the target corporation. The IRS and Treasury request comments as to whether it would be beneficial to make section 338(h)(10) elections available for acquisitions of qualified subchapter S subsidiaries and as to how the section 338(h)(10) regulations should be modified to accommodate the unique taxation of these entities.

The proposed regulations clarify the effects of the section 338(h)(10) election on both selling and non-selling S corporation shareholders. For example, the proposed regulations clarify that all S corporation shareholders, selling or not, must consent to the making of the section 338(h)(10) election, particularly because the non-selling shareholders have to include their proportionate share of the deemed sale gain under section 1366. Form 8023 will be corrected to reflect this requirement.

Availability of the section 453 installment method

When some or all of the target stock is purchased for an installment obligation and a section 338(h)(10) election is made, the proposed regulations make the section 453 installment method available to old target in its deemed asset sale, as long as the deemed asset sale would otherwise qualify for installment sale reporting. Solely for purposes of the application of section 453 and related provisions to the deemed asset sale and subsequent deemed corporate liquidation under section 338(h)(10), old target generally is considered to receive from new target in the deemed asset sale consideration consisting of the installment obligation given to old target shareholders in exchange for recently purchased stock, the assumption of, or taking subject to, old target liabilities, and cash. Thus, regardless of its actual character, any consideration conveyed by the purchaser to the selling shareholders other than installment obligations is considered to have been in cash, including for instance the purchaser's assumption of, or taking subject to, liabilities of the selling shareholders. In addition, the amount of any grossing-up under §1.338–4(d) of the proposed regulations is deemed to be in the form of cash. For purposes of section 453, new target is considered to be the obligor on the installment obligation the purchasing corporation actually issued. The provisions of sections 453(h), 453B(d), and 453B(h) may then apply to old target and its shareholders with respect to the deemed liquidation of old target following the deemed asset sale. In the deemed liquidation, a selling shareholder who actually received an installment obligation in the stock sale is deemed to receive that installment obligation as part of the liquidating distribution; the other shareholders are deemed to receive none of the installment obligation.

The proposed regulations provide that old target generally is barred from obtaining any tax benefit from the section 338(h)(10) election that it would not obtain if it actually sold its assets and liquidated. This bar extends to the application of section 453. In other words, the results of application of section 453 to old target

should be as close as possible to those that would occur if old target actually sold its assets for an installment obligation of the purchaser. Thus, for example, the installment method of section 453 applies unless old target affirmatively elects out of the installment method.

As another example, §15A.453–1(b)-(2)(iv) provides that any obligation created subsequent to the taxpayer's acquisition of the property and incurred or assumed by the taxpayer or placed as an encumbrance on the property in contemplation of disposition of the property is not qualifying indebtedness if the arrangement results in accelerating recovery of the taxpayer's basis in the installment sale. Old target would be subject to this test with respect to its debts new target is deemed to assume or take subject to.

Further, the rule of section 453A requiring payment of interest will apply in the same manner as it would apply if target actually sold all its assets in return for consideration that included an installment obligation from the purchaser and then distributed in complete liquidation all the consideration received.

Tiered targets

The proposed regulations provide that, in the case of parent-subsidiary chains of corporations making section 338(h)(10) elections, the deemed asset sale at the parent level is considered to precede that at the subsidiary level. The proposed regulations then provide, however, that the deemed liquidation of the subsidiary is considered to precede the deemed liquidation of the parent.

Additional information required

The proposed regulations provide that the Commissioner may exercise the authority granted in section 338(h)(10)-(C)(iii) to require the provision of any information deemed necessary to carry out the provisions of section 338(h)(10) by requiring submission of information on any tax reporting form. The IRS and Treasury are considering requiring that the information about the amount and allocation of AGUB and ADSP currently submitted on the election form (Form 8023) instead be submitted by the purchaser and seller(s) separately on their income tax returns, and is interested in comments on this approach.

J. *§1.1060–1.*

Definition of trade or business

Section 1060 applies to the direct or indirect transfer of a trade or business. Under the current regulations, a group of assets constitutes a trade or business if the use of such assets would constitute an active trade or business for purposes of section 355. Further, even if a group of assets would not qualify as an active trade or business for purposes of section 355, a group of assets will constitute a trade or business for purposes of section 1060 if goodwill or going concern value could attach under any circumstances. The current regulations set out factors that will be considered in determining whether goodwill or going concern could attach.

Although the current regulations set out factors, there are still ambiguities regarding when goodwill or going concern value could attach. For example, §1.1060–1T(b)(2) has been misinterpreted to mean that a trade or business exists only when basis is allocated to goodwill or going concern value under the residual method. Under the misinterpretation, a taxpayer would be required to filter every bulk asset purchase through the residual allocation method in order to determine whether the transaction is subject to section 1060. The proposed regulations clarify that a trade or business is present if goodwill or going concern value could attach to the group of assets, regardless of whether any value will eventually be allocated to the residual class (Class VII).

In addition, the proposed regulations provide that the presence of assets in the nature of section 197 assets is a factor to be considered in determining whether goodwill or going concern value could attach. This clarification recognizes that many section 197 assets would have been considered part of goodwill or going concern value at the time Congress enacted section 1060. However, the proposed regulations make it clear that the transfer of an isolated section 197 asset will not be subject to section 1060.

The proposed regulations clarify that an applicable asset acquisition can occur even if the trade or business is transferred from seller to purchaser in a series of related transactions and that the residual method must be applied once to all of the assets transferred in a series of related transactions. The proposed regulations also incorporate the principles of the anti-abuse rule from §1.338–1(c) of the proposed regulations to determine which assets must be included for purposes of applying the residual method.

Asymmetrical transfers of assets

Section 1060 applies to the direct or indirect acquisition of a trade or business when the purchaser's basis in the assets (other than assets to which section 1031 applies) is determined wholly by reference to the consideration paid by the purchaser. This rule clarifies that a purchaser of assets in an applicable asset acquisition is subject to the allocation rules set out in §§1.338–6 and 1.338–7 even if the transferor in the transaction is treated as transferring something different from the assets the transferee is treated as receiving. For example, Rev. Rul. 99–6 (1999–6 I.R.B. 6) concerns the purchase, by one person, of all of the interests in a limited liability company which is classified as a partnership under §301.7701–3. The revenue ruling sets forth two situations and holds that each seller is treated as having transferred its interests in the partnership, while each purchaser is treated as having purchased the assets of the limited liability company. The proposed regulations make it clear that each purchaser described in Rev. Rul. 99-6 must use the residual method prescribed under §§1.338–6 and 1.338–7 to allocate the consideration paid for the purchased assets (provided that the asset transfer otherwise qualifies as an applicable asset acquisition).

Multiple trades or businesses transferred in a single transaction

The current regulations are silent on the proper application of the residual method to situations when a seller transfers a group of assets that could be categorized as constituting more than one trade or business. The proposed regulations clarify that, as long as any part of the assets are a trade or business, all of the assets are to be treated as a single trade or business for purposes of applying the residual method. Therefore, the residual method should be applied once to all of the assets transferred, rather than to blocks of the assets separately. This rule is intended to reduce valuation conflicts regarding how

much consideration should be allocated to each separate group of assets. By treating all of the assets as a single trade or business, all assets in Classes I through VI can receive full fair market value allocation before the goodwill of any trade or business is allocated basis. In addition, this rule brings actual asset acquisitions into conformity with deemed asset acquisitions by allocating consideration paid across all assets acquired, without looking to the trade or business with which they are associated.

Miscellaneous changes

The proposed regulations incorporate two miscellaneous changes addressing issues that have arisen under the current regulations. First, the proposed regulations include any covenants entered into between the seller and the purchaser in connection with an applicable asset acquisition as an asset transferred as part of a trade or business even though, to the seller, the covenant is a contract for services. As a result, sellers must include any covenants in the asset pool for purposes of applying the residual method, thus allowing for greater symmetry to be achieved between the purchaser and seller.

Second, the like-kind exchange rule in the current regulation has been expanded. Under this expanded rule, if an applicable asset acquisition includes property that is transferred subject to any provision of the Code or regulations that has the tax effect of section 1031, the tax treatment determined under such provision is given effect. The residual method is then applied to the remaining assets and consideration exchanged.

In addition, the proposed regulations no longer separately state the residual allocation method. Instead, proposed §1.1060–1 incorporates the residual method by cross reference to proposed regulations §§1.338–6 and 1.338–7. Proposed regulation §1.1060–1 only sets out rules in which the treatment of an actual asset acquisition differs from the treatment of a deemed asset acquisition. By cross-referencing the section 338 regulations rather than separately stating the residual method, the proposed regulations ensure that deemed and actual asset acquisitions will be treated similarly to the extent possible.

Transaction costs

Under the current regulations, consideration is allocated to each asset to the extent of that asset's fair market value as long as there is sufficient consideration to provide full allocation of basis to each asset in the class. The fair market value limitation and the residual allocation method of the current regulations do not permit costs associated with specific assets to be allocated to those assets. For example, if a purchaser incurred costs to acquire an asset and section 1060 did not apply to the acquisition, the basis of that asset would be increased to reflect those costs. However, the fair market value limitation under the current regulations would limit a purchaser's basis in the asset to its fair market value. The proposed regulations allow the buyer and seller to adjust their allocation of consideration to particular assets for costs incurred which are specifically identified with those assets. Thus, the total amount the seller allocates to an asset for which it incurs specifically identifiable costs would be less than its fair market value and, for the buyer, greater than its fair market value. The parties are not allowed to apportion costs associated generally with the overall transaction to specific assets. A similar rule is not necessary, and therefore not included, under section 338, because the underlying transaction is a stock sale. Any costs associated with a deemed asset sale are of the type generally associated with the overall sale of stock and, therefore, the parties would not be allowed to apportion those costs to specific assets under the rule.

Written allocation agreements

After the current regulations were adopted, Congress amended section 1060 to provide that a written agreement allocating purchase price is binding on both parties. See section 1060(a). The legislative history indicates that parties must report consistent with their agreed-upon allocations, unless the parties are able to refute the agreement under the standards set forth in *Commissioner v. Danielson,* 378 F.2d 771 (3d Cir.), cert. denied, 389 U.S. 858 (1967). The proposed regulations incorporate the Danielson standard by reference.

Specific requests for comments and matters under study

A. *Examples in the Section 338 and Section 1060 Regulations.*

The proposed regulations, for the most part, retain the examples of the current regulations. The retained examples are updated to reflect the changes in the location, terminology, and substance of the regulations which they illustrate. Some examples have been dropped as it was thought that they were unnecessary. Comments are requested as to whether any of the retained examples (or new examples) are superfluous and whether other examples are necessary to illustrate the regulations.

B. *Discharge of Indebtedness Income in the Case of Tiered Targets under Section 338 and the Current Regulations.*

Taxpayers may inadvertently experience adverse tax consequences when there is intercompany indebtedness owing between tiered targets acquired in the same qualified stock purchase. Such consequences might include the realization of discharge of indebtedness income and changes to the issue price of the indebtedness. The latter could affect the total amount of AGUB to be allocated.

For example, assume that T owns 100 percent of the stock of T1, T and T1 do not file a consolidated return, and T is indebted to T1. Assume also that P acquires all the stock of T in a qualified stock purchase and makes section 338 elections for both T and T1. Under §1.338–2(b)(4), first old T is considered to sell its assets to new T, and new T is deemed to assume the debt of old T to old T1. Next, old T1 is deemed to sell its assets to new T1. New T1 thus may be considered to acquire debt owed by new T (to old T1) at a time when new T1 is related to new T.

Under section 108(e)(4), this may trigger discharge of indebtedness income for new T if new T1's adjusted basis in the acquired debt is less than the amount of the debt (see §1.108–2(f)(1)). That might occur when the T stock is purchased partly for contingent consideration not originally taken into account in AGUB. A variety of similar issues may arise under §1.1502–13(g).

The IRS and Treasury solicit comments on whether the application of section 108(e)(4) and §1.1502–13(g) is appropriate in these circumstances and how one might best address these consequences.

C. *Ideas for Revision of Application of the Residual Method of Allocation under Section 338 in the Case of Tiered Targets.*

In general

The IRS and Treasury are studying ways of addressing the allocation of ADSP and AGUB in the case of tiered targets making section 338 elections. Set forth below is the framework for one potential method that would equalize the amount of impairment for assets in a given class without regard to which target corporation owns the assets. This method uses a lookthrough approach. The method is incomplete, raises difficult issues, and is more complicated than the current rules. For these reasons, the proposed regulations do not adopt the method. However, the IRS and Treasury request comments as to the value and feasibility of the method; how best to resolve its issues; and what alternative approaches might be better. For instance, would it be better to have a complicated special method such as that described below that operates in every case of tiered targets or, as the proposed regulations do, retain the approach of the current regulations with the addition of an anti-abuse rule, the goal of which is to restrict movement of assets in advance of the qualified stock purchase undertaken to benefit from the shortcomings of the current top-down rules?

Essentially, the lookthrough approach referred to above would revise the treatment of Classes I through V (referring to the class numbering system of the proposed regulations). In allocating to these senior classes, the tiered targets would be aggregated for purposes of calculating the overall purchase price and allocating that amount among the individual assets. This rule would apply to a target (referred to as the parent target) and to those of its lower tier subsidiaries for which a section 338 election is also made (referred to as subsidiary targets). Stock in subsidiaries for which section 338 elections are not or cannot be made would continue to be treated for all purposes as a Class V asset (or Class II if publicly traded)—in other words, such entities would not participate in the aggregation.

The method would thereafter switch back to the normal top-down system for allocation to assets in Classes VI and VII, because the process of dividing up the amount allocated to the aggregate goodwill of all the targets under the residual method would be antithetical to the notion that goodwill is best valued by looking at what value is left over rather than being separately valued, and because both Class VI and VII assets generally get the same 15 year amortization period pursuant to section 197—hence determining which of those two classes or assets within the classes receives a given dollar of basis is relatively insignificant.

An issue in applying the method is how to treat liabilities owed by one group member to another. The IRS and Treasury request comments as to whether such liabilities should be treated for all allocation purposes as not debt but as stock in the debtor-member held by the creditor-member, and whether to do so even if the creditor-member is a subsidiary of the debtor-member.

One possible method of implementing the method is set forth in greater detail, below.

Possible method of implementation of the lookthrough approach

The first step under the method would be to calculate the total amount to be allocated (ADSP and AGUB). Under the method, this would be the sum of (a) the amount realized or basis, as appropriate, of the parent target stock (grossed-up as appropriate to reflect stock not recently purchased, etc.) and (b) liabilities.

In the second step, all Class I through Class V assets in the parent target and subsidiary targets (other than stock of subsidiary targets) would be combined into aggregate Classes I, II, III, IV, and V. Then, the total basis would be allocated (as basis is under the current system, except that the allocation would be across such joint classes, not merely within individual members) first to Class I assets, then, if there is any remainder, to Class II assets, then, if there is any remainder, to Class III assets, then, if there is any remainder, to Class IV assets, and then, if there is any remainder, to Class V assets. The allocations thus made to individual Class I through V assets would be the final, binding allocations to them.

In the third step, if there were no amount of the total basis remaining to be allocated to Class VI and VII assets, one would proceed to determine the basis in subsidiary target stock. If the aggregate amount assigned to all the subsidiary's Class I through V assets pursuant to the second step above exceeded the amount of the subsidiary's liabilities, then the amount of the excess would become its parent's basis in that subsidiary's stock.

If the aggregate amount were, however, less than the liabilities, then the stock basis would be zero. A subissue is whether in such case other action should also be taken: whether, in the case of a consolidated group, an excess loss account should be created equal to the amount of the shortfall; and whether, if the tiered entities do not join in filing a consolidated return but other nonconsolidated investment adjustment rules apply, future positive basis increases should be denied to the extent of the excess loss account that would have been created under the method had they been filing consolidated. The rule could apply, for example, to increases in basis of controlled foreign corporations for undistributed earnings taxed currently under subpart F.

Under the method, if there were an amount of the total ADSP or AGUB remaining to be allocated to Class VI and VII assets, then one would proceed to allocate basis to Class VI and VII assets. At this point, the aggregating of members' assets into joint classes would be abandoned and the method would revert to a top-down system similar to that of current rules. The process is top-down in that any basis not already allocated to the parent target's Class I through V assets (other than subsidiary target stock) would be allocated among its Class VI and VII assets and subsidiary target stock, then the subsidiary target would in turn make its own allocation of its own basis among its own Class VI and VII assets and any stock it might own in other subsidiary targets.

Certain adjustments, as yet undetermined, would have to be made to this method for minority interests outstanding in subsidiaries.

Possible disadvantages of the method

The method has drawbacks:

(1) *Complexity.* The method is more complicated than the existing rules. When, for example, there is a subsequent change in the amount of a liability of a subsidiary target that changes the amount of AGUB or ADSP, under the method one would recalculate the allocations to all the assets of the parent target and all subsidiary targets, not just the assets of the indebted subsidiary target and its own subsidiary targets.

Also, questions arise regarding subsequent changes in AGUB and ADSP, with respect to subsidiary targets already disposed of. What if, for instance, at the time of a subsequent adjustment to AGUB or ADSP, the group had already disposed of the stock of a particular subsidiary target—should one change the allocation to that former subsidiary's assets? Separately, in determining whether AGUB or ADSP has changed, should one take into account changes in the amount of liabilities of former subsidiary targets? How would the group be made aware of such changes?

(2) *Lack of inside-outside basis conformity.* The current system, although it tolerates large disparities in the allocations to identical assets based on location, assures conformity between stock basis and net asset basis. The look-through approach does so only in a consolidated setting (employing excess loss accounts to do so).

(3) *The method would not eliminate all allocation disparities.* The method would not completely eliminate disparate allocations based on location within the acquired group, because it applies only to tiered targets. Similar disparities can exist in acquisitions of sister corporations or in mixed stock and asset purchases. The method does not include a mechanism for equalizing basis impairment in such cases. Thus, the method would not fully solve the disparity problem. (Note, however, that the new anti-abuse rule included in the proposed regulations may operate in some cases.)

Proposed Effective Date

The regulations are proposed to be effective on the date that final regulations are published in the **Federal Register** and apply to qualified stock purchases or applicable asset acquisitions occurring on or after the date that final regulations are published in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. An initial regulatory flexibility analysis has been prepared pursuant to 5 U.S.C. section 604 for the collections of information in this Treasury Decision. The analysis is set forth below under the heading "Initial Regulatory Flexibility Analysis." Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Initial Regulatory Flexibility Analysis

This regulatory action is intended to simplify and clarify the current rules relating to both deemed and actual asset acquisitions. The current rules were developed over a long period of time and have been repeatedly amended. The IRS and Treasury believe these proposed regulations will significantly improve the clarity of the rules relating to both deemed and actual asset acquisitions.

The major objective of the proposed regulations is to modify the rules for allocating purchase price in both deemed and actual asset acquisitions. In addition, the proposed regulations replace the general rules for electing to treat a stock sale as an asset sale.

These collections of information may affect small businesses if the stock of a corporation which is a small entity is acquired in a qualified stock purchase or if a trade or business which is also a small business is transferred in a taxable transaction. Form 8023 (on which an election to treat a stock sale as an asset sale is filed) has been submitted to and approved by the Office of Management and Budget. With respect to Form 8023, the IRS estimated that 201 forms would be filed each year and that each taxpayer would require 12.98 hours to comply. Form 8594 (on which a sale or acquisition of assets constituting a trade or business is reported) has also been submitted to and approved by the Office of Management and Budget. With respect to Form 8594, the IRS estimated that 20,000 forms would be filed each year and that each taxpayer would require 12.25 hours to comply. These estimates have been made available for public comment and no public comments have been received. These proposed regulations do not impose new requirements on small businesses and, in fact, should lessen any difficulties associated with the existing reporting requirements by clarifying the rules associated with deemed and actual asset acquisitions.

The collections of information require taxpayers to file an election in order to treat a stock sale as an asset sale. In addition, taxpayers must file a statement regarding the amount of consideration allocated to each class of assets under the residual method. The professional skills that would be necessary to make the election or allocate the consideration would be the same as those required to prepare a return for the small business.

Consideration was given to limiting the reporting requirements under section 1060 to trades or businesses meeting a threshold level of business activity. However, any threshold derived without further information would be arbitrary. Instead, the proposed regulations authorize the Commissioner to exclude certain transactions from the reporting requirements.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are timely submitted to the IRS. The IRS and Treasury request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 12, 1999, beginning at 10 a.m. in the NYU Classroom, Room 2615, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identifica-

tion to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The IRS recognizes that persons outside the Washington, DC, area may also wish to testify at the public hearing through teleconferencing. Requests to include teleconferencing sites must be received by September 20, 1999. If the IRS receives sufficient indications of interest to warrant teleconferencing to a particular city, and if the IRS has teleconferencing facilities available in that city on the date the public hearing is to be scheduled, the IRS will try to accommodate the requests. The IRS will publish the locations of any teleconferencing sites in an announcement in the **Federal Register.**

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must request to speak, and submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by September 20, 1999. A period of ten minutes will be allocated to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Richard Starke and Stephen R. Wegener, Office of the Assistant Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are proposed to be amended as follows:

PART 1–INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for 1.338(b)–1, 1.338(b)–3T, and 1.1060–1T and by adding entries in numerical order to read in part as follows:

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

Section 1.338–6 also issued under 26 U.S.C. 337(d), 338, and 1502.

Section 1.338–7 also issued under 26 U.S.C. 337(d), 338, and 1502.

Section 1.338–8 also issued under 26 U.S.C. 337(d), 338, and 1502.

Section 1.338–9 also issued under 26 U.S.C. 337(d), 338, and 1502.

Section 1.338–10 also issued under 26 U.S.C. 337(d), 338, and 1502.* * *

Section 1.1060–1 also issued under 26 U.S.C. 1060.* * *

Par. 2. Sections 1.338–0 through 1.338–3 are revised to read as follows:

§1.338–0 Outline of topics.

This section lists the captions contained in the regulations under section 338 as follows:

§1.338–1 General principles; status of old target and new target.

(a) In general.
(1) Deemed transaction.
(2) Application of other rules of law.
(3) Overview.
(b) Treatment of target under other provisions of the Internal Revenue Code.
(1) General rule for subtitle A.
(2) Exceptions for subtitle A.
(3) General rule for other provisions of the Internal Revenue Code.
(c) Anti-abuse rule.
(1) In general.
(2) Examples.

§1.338–2 Nomenclature and definitions; mechanics of the section 338 election.

(a) Scope.
(b) Nomenclature.
(c) Definitions.
(1) Acquisition date.
(2) Acquisition date assets.
(3) Affiliated group.
(4) Common parent.
(5) Consistency period.
(6) Deemed asset sale.
(7) Deemed sale gain.
(8) Deemed sale return.
(9) Domestic corporation.
(10) Old target's final return.
(11) Purchasing corporation.
(12) Qualified stock purchase.
(13) Related persons.
(14) Section 338 election.
(15) Section 338(h)(10) election.
(16) Selling group.
(17) Target; old target; new target.
(18) Target affiliate.
(19) 12-month acquisition period.
(d) Time and manner of making election.
(e) Special rules for foreign corporations or DISCs.
(1) Elections by certain foreign purchasing corporations.
(i) General rule.
(ii) Qualifying foreign purchasing corporation.
(iii) Qualifying foreign target.
(iv) Triggering event.
(v) Subject to United States tax.
(2) Acquisition period.
(3) Statement of section 338 may be filed by United States shareholders in certain cases.
(4) Notice requirement for U.S. persons holding stock in foreign market.
(i) General rule.
(ii) Limitation.
(iii) Form of notice.
(iv) Timing of notice.
(v) Consequence of failure to comply.
(vi) Good faith effort to comply.

§1.338–3 Qualification for the section 338 election.

(a) Scope.
(b) Rules relating to qualified stock purchases.
(1) Purchasing corporation requirement.
(2) Purchase.
(i) Definition.
(ii) Purchase of target.
(iii) Purchase of target affiliate.
(3) Acquisitions of stock from related corporations.
(i) In general.
(ii) Time for testing relationship.
(iii) Cases where section 338(h)(3)(C) applies—acquisitions treated as purchases.
(iv) Examples.
(4) Acquisition date for tiered targets.
(i) Stock sold in deemed asset sale.
(ii) Examples.
(5) Effect of redemptions.
(i) General rule.
(ii) Redemptions from persons unrelated to the purchasing corporation.

(iii) Redemptions from the purchasing corporation or related persons during 12-month acquisition period.
(A) General rule.
(B) Exception for certain redemptions from related corporations.
(iv) Examples.
(c) Effect of post-acquisition events on eligibility for section 338 election.
(1) Post-acquisition elimination of target.
(2) Post-acquisition elimination of the purchasing corporation.
(3) Consequences of post-acquisition elimination of target.
(i) Scope.
(ii) Continuity of interest.
(iii) Control requirement.
(iv) Example.

§1.338–4 Aggregate deemed sale price; various aspects of taxation of the deemed asset sale.

(a) Scope.
(b) Determination of ADSP.
(1) General rule.
(2) Time and amount of ADSP.
(i) Original determination.
(ii) Redetermination of ADSP.
(iii) Example.
(c) Grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock.
(1) Determination of amount.
(2) Example.
(d) Liabilities of old target.
(1) In general.
(2) Time and amount of liabilities.
(3) Interaction with deemed sale gain.
(e) Calculation of deemed sale gain.
(f) Other rules apply in determining ADSP.
(g) Examples.
(h) Deemed sale of target affiliate stock.
(1) Scope.
(2) In general.
(3) Deemed sale of foreign target affiliate by a domestic target.
(4) Deemed sale producing effectively connected income.
(5) Deemed sale of insurance company target affiliate electing under section 953(d).
(6) Deemed sale of DISC target affiliate.
(7) Anti-stuffing rule.
(8) Examples.

§1.338–5 Adjusted grossed-up basis.

(a) Scope.
(b) Determination of AGUB.
(1) General rule.
(2) Time and amount of AGUB.
(i) Original determination.
(ii) Redetermination of AGUB.
(iii) Examples.
(c) Grossed-up basis of recently purchased stock.
(d) Basis of nonrecently purchased stock; gain recognition election.
(1) No gain recognition election.
(2) Procedure for making gain recognition election.
(3) Effect of gain recognition election.
(i) In general.
(ii) Basis amount.
(iii) Losses not recognized.
(iv) Stock subject to election.
(e) Liabilities of new target.
(1) In general.
(2) Time and amount of liabilities.
(3) Interaction with deemed sale gain.
(f) Adjustments by the Internal Revenue Service.
(g) Examples.

§1.338–6 Allocation of ADSP and AGUB among target assets.

(a) Scope.
(1) In general.
(2) Fair market value.
(i) In general.
(ii) Transaction costs.
(iii) Internal Revenue Service authority.
(b) General rule for allocating ADSP and AGUB.
(1) Reduction in the amount of consideration for Class I assets.
(2) Other assets.
(i) In general.
(ii) Class II assets.
(iii) Class III assets.
(iv) Class IV assets.
(v) Class V assets.
(vi) Class VI assets.
(vii) Class VII assets.
(3) Other items designated by the Internal Revenue Service.
(c) Certain limitations and other rules for allocation to an asset.
(1) Allocation not to exceed fair market value.
(2) Allocation subject to other rules.
(3) Special rule for allocating AGUB when purchasing corporation has nonrecently purchased stock.
(i) Scope.
(ii) Determination of hypothetical purchase price.
(iii) Allocation of AGUB.
(4) Liabilities taken into account in determining amount realized on subsequent disposition.
(d) Examples.

§1.338–7 Allocation of redetermined ADSP and AGUB among target assets.

(a) Scope.
(b) Allocation of redetermined ADSP and AGUB.
(c) Special rules for ADSP.
(1) Increases or decreases in deemed sale gain taxable notwithstanding old target ceases to exist.
(2) Procedure for transactions in which section 338(h)(10) is not elected.
(i) Deemed sale gain included in new target's return.
(ii) Carryovers and carrybacks.
(A) Loss carryovers to new target taxable years.
(B) Loss carrybacks to taxable years of old target.
(C) Credit carryovers and carrybacks.
(3) Procedure for transactions in which section 338(h)(10) is elected.
(d) Special rules for AGUB.
(1) Effect of disposition or depreciation of acquisition date assets.
(2) Section 38 property.
(e) Examples.

§1.338–8 Asset and stock consistency.

(a) Introduction.
(1) Overview.
(2) General application.
(3) Extension of the general rules.
(4) Application where certain dividends are paid.
(5) Application to foreign target affiliates.
(6) Stock consistency.
(b) Consistency for direct acquisitions.
(1) General rule.
(2) Section 338(h)(10) elections.
(c) Gain from disposition reflected in basis of target stock.
(1) General rule.
(2) Gain not reflected if section 338 election made for target.
(3) Gain reflected by reason of distributions.
(4) Controlled foreign corporations.

(5) Gain recognized outside the consolidated group.
(d) Basis of acquired assets.
(1) Carryover basis rule.
(2) Exceptions to carryover basis rule for certain assets.
(3) Exception to carryover basis rule for *de minimis* assets.
(4) Mitigation rule.
(i) General rule.
(ii) Time for transfer.
(e) Examples.
(1) In general.
(2) Direct acquisitions.
(f) Extension of consistency to indirect acquisitions.
(1) Introduction.
(2) General rule.
(3) Basis of acquired assets.
(4) Examples.
(g) Extension of consistency if dividends qualifying for 100 percent dividends received deduction are paid.
(1) General rule for direct acquisitions from target.
(2) Other direct acquisitions having same effect.
(3) Indirect acquisitions.
(4) Examples.
(h) Consistency for target affiliates that are controlled foreign corporations.
(1) In general.
(2) Income or gain resulting from asset dispositions.
(i) General rule.
(ii) Basis of controlled foreign corporation stock.
(iii) Operating rule.
(iv) Increase in asset or stock basis.
(3) Stock issued by target affiliate that is a controlled foreign corporation.
(4) Certain distributions.
(i) General rule.
(ii) Basis of controlled foreign corporation stock.
(iii) Increase in asset or stock basis.
(5) Examples.
(i) [Reserved]
(j) Anti-avoidance rules.
(1) Extension of consistency rules.
(2) Qualified stock purchase and 12-month acquisition period.
(3) Acquisitions by conduits.
(i) Asset ownership.
(A) General rule.
(B) Application of carryover basis rule.
(ii) Stock acquisitions.
(A) Purchase by conduit.
(B) Purchase of conduit by corporation.
(C) Purchase of conduit by conduit.
(4) Conduit.
(5) Existence of arrangement.
(6) Predecessor and successor.
(i) Persons.
(ii) Assets.
(7) Examples.

§1.338–9 International aspects of section 338.

(a) Scope.
(b) Application of section 338 to foreign targets.
(1) In general.
(2) Ownership of FT stock on the acquisition date.
(3) Carryover FT stock.
(i) Definition.
(ii) Carryover of earnings and profits.
(iii) Cap on carryover of earnings and profits.
(iv) Post-acquisition date distribution of old FT earnings and profits.
(v) Old FT earnings and profits unaffected by post-acquisition date deficits.
(vi) Character of FT stock as carryover FT stock eliminated upon disposition.
(4) Passive foreign investment company stock.
(c) Dividend treatment under section 1248(e).
(d) Allocation of foreign taxes.
(e) Operation of section 338(h)(16). [Reserved]
(f) Examples.

§1.338–10 Filing of returns.

(a) Returns including tax liability from deemed asset sale.
(1) In general.
(2) Old target's final taxable year otherwise included in consolidated return of selling group.
(i) General rule.
(ii) Separate taxable year.
(iii) Carryover and carryback of tax attributes.
(iv) Old target is a component member of purchasing corporation's controlled group.
(3) Old target is an S corporation.
(4) Combined deemed sale return.
(i) General rule.
(ii) Gain and loss offsets.
(iii) Procedure for filing a combined return.
(iv) Consequences of filing a combined return.
(5) Deemed sale excluded from purchasing corporation's consolidated return.
(6) Due date for old target's final return.
(i) General rule.
(ii) Application of §1.1502–76(c).
(A) In general.
(B) Deemed extension.
(C) Erroneous filing of deemed sale return.
(D) Erroneous filing of return for regular tax year.
(E) Last date for payment of tax.
(7) Examples.
(b) Waiver.
(1) Certain additions to tax.
(2) Notification.
(3) Elections or other actions required to be specified on a timely filed return.
(i) In general.
(ii) New target in purchasing corporation's consolidated return.
(4) Examples.

§1.338(h)(10)–1 Deemed asset sale and liquidation.

(a) Scope.
(b) Definitions.
(1) Consolidated target.
(2) Selling consolidated group.
(3) Selling affiliate; affiliated target.
(4) S corporation target
(5) S corporation shareholders.
(6) Liquidation.
(c) Section 338(h)(10) election.
(1) In general.
(2) Simultaneous joint election requirement.
(3) Irrevocability.
(4) Effect of invalid election.
(d) Certain consequences of section 338(h)(10) election.
(1) P.
(2) New T.
(3) Old T—deemed sale.
(i) In general.
(ii) Tiered targets.
(4) Old T and selling consolidated group, selling affiliate, or S corporation shareholders—deemed liquidation; tax characterization.
(i) In general.

(ii) Tiered targets.
(5) Selling consolidated group, selling affiliate, or S corporation shareholders.
(i) In general.
(ii) Basis and holding period of T stock not acquired.
(iii) T stock sale.
(6) Nonselling minority shareholders other than nonselling S corporation shareholders.
(i) In general.
(ii) T stock sale.
(iii) T stock not acquired.
(7) Consolidated return of selling consolidated group.
(8) Availability of the section 453 installment method.
(i) In deemed asset sale.
(ii) In deemed liquidation.
(9) Treatment consistent with an actual asset sale.
(e) Examples.
(f) Inapplicability of provisions.
(g) Required information.

§1.338(i)–1 Effective dates.

§1.338–1 General principles; status of old target and new target.

(a) *In general*—(1) *Deemed transaction.* Elections are available under section 338 when a purchasing corporation acquires the stock of another corporation (the target) in a qualified stock purchase. One type of election, under section 338(g), is available to the purchasing corporation. Another type of election, under section 338(h)(10), is, in more limited circumstances, available jointly to the purchasing corporation and the sellers of the stock. (Rules concerning eligibility for these elections are contained in §§ 1.338–2, 1.338–3, and 1.338(h)(10)–1.) Although target is a single corporation under corporate law, if a section 338 election is made, then two separate corporations, old target and new target, generally are considered to exist for purposes of subtitle A of the Internal Revenue Code. Old target is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the assumption of, or taking subject to, liabilities, and new target is treated as acquiring all of its assets from an unrelated person in exchange for consideration that includes the assumption of or taking subject to liabilities. (Such transaction is, without regard to its characterization for Federal income tax purposes, referred to as the deemed asset sale and the income tax consequences thereof as the deemed sale gain.) If a section 338(h)(10) election is made, old target is also deemed to liquidate following the deemed asset sale.

(2) *Application of other rules of law.* Other rules of law apply to determine the tax consequences to the parties as if they had actually engaged in the transactions deemed to occur under section 338 and the regulations hereunder except to the extent otherwise provided in the regulations hereunder. See also §1.338–6(c)(2). Other rules of law may characterize the transaction as something other than or in addition to a sale and purchase of assets; however, it must be a taxable transaction. For example, if target is an insurance company for which a section 338 election is made, the deemed asset sale would be characterized and taxed as an assumption-reinsurance transaction under applicable Federal income tax law. See §1.817–4(d).

(3) *Overview.* Definitions and special nomenclature and rules for making the section 338 election are provided in §1.338–2. Qualification for the section 338 election is addressed in §1.338–3. The amount for which old target is treated as selling all of its assets (the aggregate deemed sale price, or ADSP) is addressed in §1.338–4. The amount for which new target is deemed to have purchased all its assets (the adjusted grossed-up basis, or AGUB) is addressed in §1.338–5. Section 1.338–6 addresses allocation both of ADSP among the assets old target is deemed to have sold and of AGUB among the assets new target is deemed to have purchased. Section 1.338–7 addresses allocation of ADSP or AGUB when those amounts change after the close of new target's first taxable year. Asset and stock consistency are addressed in §1.338–8. International aspects of section 338 are covered in §1.338–9. Rules for the filing of returns are provided in §1.338–10. Eligibility for and treatment of section 338(h)(10) elections is addressed in §1.338(h)(10)–1.

(b) *Treatment of target under other provisions of the Internal Revenue Code*—(1) *General rule for subtitle A.* Except as provided in this section, new target is treated as a new corporation that is unrelated to old target for purposes of subtitle A of the Internal Revenue Code. Thus—

(i) New target is not considered related to old target for purposes of section 168 and may make new elections under section 168 without taking into account the elections made by old target; and

(ii) 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. Notwithstanding §1.441–1T(b)(2), a new target may adopt a taxable year on or before the last day for making the election under section 338 by filing its first return for the desired taxable year on or before that date.

(2) *Exceptions for subtitle A.* New target and old target are treated as the same corporation for purposes of—

(i) The rules applicable to employee benefit plans (including those plans described in sections 79, 104, 105, 106, 125, 127, 129, 132, 137, and 220), qualified pension, profit-sharing, stock bonus and annuity plans (sections 401(a) and 403(a)), simplified employee pensions (section 408(k)), tax qualified stock option plans (sections 422 and 423), welfare benefit funds (sections 419, 419A, 512(a)(3), and 4976), voluntary employee benefit associations (section 501(c)(9) and the regulations thereunder);

(ii) Sections 1311 through 1314 (relating to the mitigation of the effect of limitations) if a section 338(h)(10) election is not made for target;

(iii) Section 108(e)(5) (relating to the reduction of purchase money debt);

(iv) Section 45A (relating to the Indian Employment Credit), section 51 (relating to the Work Opportunity Credit), section 51A (relating to the Welfare to Work Credit), and section 1396 (relating to the Empowerment Zone Act);

(v) Sections 401(h) and 420 (relating to medical benefits for retirees);

(vi) Section 414 (relating to definitions and special rules); and

(vii) Any other provision designated in the Internal Revenue Bulletin by the Internal Revenue Service. See §601.601(d)(2)(ii) of this chapter (relating to the Internal Revenue Bulletin). See §1.1001–3(e)(4)(F) providing that an election under section 338 does not result in the substitution of a new obligor on target's debt.

(3) *General rule for other provisions of the Internal Revenue Code.* Except as provided in the regulations under section 338 or in the Internal Revenue Bulletin by the Internal Revenue Service (see §601.601(d)(2)(ii) of this chapter), new target is treated as a continuation of old target for purposes other than subtitle A of the Internal Revenue Code. For example—

(i) New target is liable for old target's Federal income tax liabilities, including the tax liability for the deemed sale gain and those tax liabilities of the other members of any consolidated group that included old target that are attributable to taxable years in which those corporations and old target joined in the same consolidated return (see §1.1502–6(a));

(ii) Wages earned by the employees of old target are considered wages earned by such employees from new target for purposes of sections 3101 and 3111 (Federal Insurance Contributions Act) and section 3301 (Federal Unemployment Tax Act); and

(iii) Old target and new target must use the same employer identification number.

(c) *Anti-abuse rule*—(1) *In general.* For purposes of applying the residual method of §§1.338–0 through 1.338–10, 1.338(h)(10)–1, and 1.338(i)–1, the Commissioner is authorized to treat any property (including cash) transferred by old target in connection with the transactions resulting in the application of the residual method as, nonetheless, property of target at the close of the acquisition date if the property so transferred, within 24 months after the deemed asset sale, is owned by new target, or is owned, directly or indirectly, by a member of the affiliated group of which new target is a member and continues after the election to be held or used to more than an insignificant extent in connection with one or more of the activities of new target. The Commissioner is authorized to treat any property (including cash) transferred to old target in connection with the transactions resulting in the application of the residual method as, nonetheless, not being property of target at the close of the acquisition date if the property so transferred by the transferor is, within 24 months after the deemed asset sale, not owned by new target but owned, directly or indirectly, by a member of the affiliated group of which new target is a member or owned by new target but held or used to more than an insignificant extent in connection with an activity conducted, directly or indirectly, by another member of the affiliated group of which new target is a member in combination with other property acquired, directly or indirectly, from the transferor of the property (or a member of the same affiliated group) to old target. For purposes of this paragraph (c)(1), an interest in an entity is considered held or used in connection with an activity if property of the entity is so held or used. The authority under this paragraph (c)(1) includes the making of any necessary correlative adjustments.

(2) *Examples.* The following examples illustrate this paragraph (c):

Example 1. Prior to a qualified stock purchase under section 338, target transfers one of its assets to a related party. The purchasing corporation then purchases the target stock and also purchases the transferred asset from the related party. After its purchase of target, the purchasing corporation and target are members of the same affiliated group. A section 338 election is made. Under an arrangement with the purchaser, target continues to use the separately transferred asset to more than an insignificant extent in connection with its own activities. Applying the anti-abuse rule of this paragraph (c), the Commissioner may consider target to own the transferred asset for purposes of applying section 338 and its allocation rules.

Example 2. Target (T) owns all the stock of T1. T1 leases intellectual property to T, which T uses in connection with its own activities. P, a purchasing corporation, wishes to buy the T-T1 chain of corporations. P, in connection with its planned purchase of the T stock, contracts to consummate a purchase of all the stock of T1 on March 1 and of all the stock of T on March 2. Section 338 elections are thereafter made for both T and T1. Immediately after the purchases, P, T and T1 are members of the same affiliated group. T continues to lease the intellectual property from T1 and to use the property to more than an insignificant extent in connection with its own activities. Thus, an asset of T, the T1 stock, was removed from T 's own assets prior to the qualified stock purchase of the T stock, T1's own assets are used after the deemed asset sale in connection with T's own activities, and the T1 stock is after the deemed asset sale owned by P, a member of the same affiliated group of which T is a member. Applying the anti-abuse rule of this paragraph (c), the Commissioner may, for purposes of application of section 338 both to T and to T1, consider P to have bought only the stock of T, with T at the time of the qualified stock purchases of both T and T1 (the qualified stock purchase of T1 being triggered by the deemed sale under section 338 of T's assets) owning T1. The Commissioner would accordingly apply section 338 first at the T level and then at the T1 level.

§1.338–2 Nomenclature and definitions; mechanics of the section 338 election.

(a) *Scope.* This section prescribes rules relating to elections under section 338.

(b) *Nomenclature.* For purposes of the regulations under section 338 (except as otherwise provided):

(1) T is a domestic target corporation that has only one class of stock outstanding. Old T refers to T for periods ending on or before the close of T's acquisition date; new T refers to T for subsequent periods.

(2) P is the purchasing corporation.

(3) The P group is an affiliated group of which P is a member.

(4) P1, P2, etc., are domestic corporations that are members of the P group.

(5) T1, T2, etc., are domestic corporations that are target affiliates of T. These corporations (T1, T2, etc.) have only one class of stock outstanding and may also be targets.

(6) S is a domestic corporation (unrelated to P and B) that owns T prior to the purchase of T by P. (S is referred to in cases in which it is appropriate to consider the effects of having all of the outstanding stock of T owned by a domestic corporation.)

(7) A, a U.S. citizen or resident, is an individual (unrelated to P and B) who owns T prior to the purchase of T by P. (A is referred to in cases in which it is appropriate to consider the effects of having all of the outstanding stock of T owned by an individual who is a U.S. citizen or resident. Ownership of T by A and ownership of T by S are mutually exclusive circumstances.)

(8) B, a U.S. citizen or resident, is an individual (unrelated to T, S, and A) who owns the stock of P.

(9) F, used as a prefix with the other terms in this paragraph (b), connotes foreign, rather than domestic, status. For example, FT is a foreign corporation (as defined in section 7701(a)(5)) and FA is an individual other than a U.S. citizen or resident.

(10) CFC, used as a prefix with the other terms in this paragraph (b) referring to a corporation, connotes a controlled foreign corporation (as defined in section 957, taking into account section 953(c)). A corporation identified with the prefix F may be a controlled foreign corporation.

The prefix CFC is used when the corporation's status as a controlled foreign corporation is significant.

(c) *Definitions.* For purposes of the regulations under section 338 (except as otherwise provided):

(1) *Acquisition date.* The term *acquisition date* has the same meaning as in section 338(h)(2).

(2) *Acquisition date assets. Acquisition date assets* are the assets of the target held at the beginning of the day after the acquisition date (other than assets that were not assets of old target).

(3) *Affiliated group.* The term *affiliated group* has the same meaning as in section 338(h)(5). Corporations are affiliated on any day they are members of the same affiliated group.

(4) *Common parent.* The term *common parent* has the same meaning as in section 1504.

(5) *Consistency period.* The *consistency period* is the period described in section 338(h)(4)(A) unless extended pursuant to §1.338–8(j)(1).

(6) *Deemed asset sale.* The *deemed asset sale* is the transaction described in §1.338–1(a)(1) that is deemed to occur for purposes of subtitle A of the Internal Revenue Code if a section 338 election is made.

(7) *Deemed sale gain. Deemed sale gain* refers to, in the aggregate, the Federal income tax consequences (generally, the income, gain, deduction, and loss) of the deemed asset sale. *Deemed sale gain* also refers to the Federal income tax consequences of the transfer of a particular asset in the deemed asset sale.

(8) *Deemed sale return.* The *deemed sale return* is the return on which target's deemed sale gain is reported that does not include any other items of target. Target files a deemed sale return when a section 338 election (but not a section 338(h)(10) election) is filed for target and target is a member of a selling group (defined in paragraph (c)(16) of this section) that files a consolidated return for the period that includes the acquisition date or is an S corporation. See §1.338–10.

(9) *Domestic corporation.* A *domestic corporation* is a corporation—

(i) That is domestic within the meaning of section 7701(a)(4) or that is treated as domestic for purposes of subtitle A of the Internal Revenue Code (e.g., to which an election under section 953(d) or 1504(d) applies); and

(ii) That is not a DISC, a corporation described in section 1248(e), or a corporation to which an election under section 936 applies.

(10) *Old target's final return. Old target's final return* is the income tax return of old target for the taxable year ending at the close of the acquisition date that includes the deemed sale gain. If the disaffiliation rule of §1.338–10(a)(2)(i) applies or if target is an S corporation, target's deemed sale return is considered old target's final return.

(11) *Purchasing corporation.* The term *purchasing corporation* has the same meaning as in section 338(d)(1). The purchasing corporation may also be referred to as purchaser. Unless otherwise provided, any reference to the purchasing corporation is a reference to all members of the affiliated group of which the purchasing corporation is a member. See sections 338(h)(5) and (8). Also, unless otherwise provided, any reference to the purchasing corporation is, with respect to a deemed purchase of stock under section 338(a)(2), a reference to new target with respect to its own deemed purchase of stock in another target.

(12) *Qualified stock purchase.* The term *qualified stock purchase* has the same meaning as in section 338(d)(3).

(13) *Related persons.* Two persons are related if stock in a corporation owned by one of the persons would be attributed under section 318(a) (other than section 318(a)(4)) to the other.

(14) *Section 338 election.* A *section 338 election* is an election to apply section 338(a) to target. A section 338 election is made by filing a statement of section 338 election pursuant to §1.338–2(d). The form on which this statement is filed is referred to in the regulations under section 338 as the Form 8023 Elections Under Section 338 for Corporations Making Qualified Stock Purchases.

(15) *Section 338(h)(10) election.* A *section 338(h)(10) election* is an election to apply section 338(h)(10) to target. A section 338(h)(10) election is made by making a joint election for target under §1.338(h)(10)–1.

(16) *Selling group.* The *selling group* is the affiliated group (as defined in section 1504) eligible to file a consolidated return that includes target for the taxable period in which the acquisition date occurs. However, a selling group is not an affiliated group of which target is the common parent on the acquisition date.

(17) *Target; old target; new target. Target* is the target corporation as defined in section 338(d)(2). *Old target* refers to target for periods ending on or before the close of target's acquisition date. *New target* refers to target for subsequent periods.

(18) *Target affiliate.* The term *target affiliate* has the same meaning as in section 338(h)(6) (applied without section 338(h)(6)(B)(i)). Thus, a corporation described in section 338(h)(6)(B)(i) is considered a target affiliate for all purposes of section 338. If a target affiliate is acquired in a qualified stock purchase, it is also a target.

(19) *12-Month acquisition period.* The *12-month acquisition period* is the period described in section 338(h)(1), unless extended pursuant to §1.338–8(j)(2).

(d) *Time and manner of making election.* The purchasing corporation makes a section 338 election for target by filing a statement of section 338 election on Form 8023 in accordance with the instructions to the form. The section 338 election must be made not later than the 15th day of the 9th month beginning after the month in which the acquisition date occurs. A section 338 election is irrevocable. See §1.338(h)(10)–1(c)(2) for section 338(h)(10) elections.

(e) *Special rules for foreign corporations or DISCs*—(1) *Elections by certain foreign purchasing corporations*—(i) *General rule.* A qualifying foreign purchasing corporation is not required to file a statement of section 338 election for a qualifying foreign target before the earlier of 3 years after the acquisition date and 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 are foreign corporations that are not subject to United States tax.

(iii) *Qualifying foreign target.* A target is a *qualifying foreign target* only if target and its target affiliates are foreign corpo-

rations that, during target's acquisition period, are not subject to United States tax (and will not become subject to United States tax during such period because of a section 338 election). A target affiliate is taken into account for purposes of the preceding sentence only if, during target's 12-month acquisition period, it is or becomes a member of the affiliated group that includes the purchasing corporation.

(iv) *Triggering event.* A *triggering event* occurs in the taxable year of the qualifying foreign purchasing corporation in which either that corporation or any corporation in its affiliated group becomes subject to United States tax.

(v) *Subject to United States tax.* For purposes of this paragraph (e)(1), a foreign corporation is considered subject to United States tax—

(A) For the taxable year for which that corporation is required under §1.6012–2(g) (other than §1.6012–2(g)(2)(i)-(B)(2)) to file a United States income tax return; or

(B) For the period during which that corporation is a controlled foreign corporation, a passive foreign investment company for which an election under section 1295 is in effect, a foreign investment company, or a foreign corporation the stock ownership of which is described in section 552(a)(2).

(2) *Acquisition period.* For purposes of this paragraph (e), the term acquisition period means the period beginning on the first day of the 12-month acquisition period and ending on the acquisition date.

(3) *Statement of section 338 election may be filed by United States shareholders in certain cases.* The United States shareholders (as defined in section 951(b)) of a foreign purchasing corporation that is a controlled foreign corporation (as defined in section 957 (taking into account section 953(c))) may file a statement of section 338 election on behalf of the purchasing corporation if the purchasing corporation is not required under §1.6012–2(g) (other than §1.6012–2(g)-(2)(i)(B)(2)) to file a United States income tax return for its taxable year that includes the acquisition date. Form 8023 must be filed as described in the form and its instructions and also 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 (e)(1)(i) 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.

(4) *Notice requirement for U.S. persons holding stock in foreign market*—(i) *General rule.* If a target subject to a section 338 election was a controlled foreign corporation, a passive foreign investment company, or a foreign personal holding company at any time during the portion of its taxable year that ends on its acquisition date, the purchasing corporation must deliver written notice of the election (and a copy of Form 8023, its attachments and instructions) to—

(A) Each U.S. person (other than a member of the affiliated group of which the purchasing corporation is a member (the purchasing group member)) that, on the acquisition date of the foreign target, holds stock in the foreign target; and

(B) Each U.S. person (other than a purchasing group member) that sells stock in the foreign target to a purchasing group member during the foreign target's 12-month acquisition period.

(ii) *Limitation.* The notice requirement of this paragraph (e)(4) applies only where the section 338 election for the foreign target affects income, gain, loss, deduction, or credit of the U.S. person described in paragraph (e)(4)(i) of this section under section 551, 951, 1248, or 1293.

(iii) *Form of notice.* The notice to U.S. persons must be identified prominently as a notice of section 338 election and must—

(A) Contain the name, address, and employer identification number (if any) of, and the country (and, if relevant, the lesser political subdivision) under the laws of which is organized, the purchasing corporation and the relevant target (i.e., target the stock of which the particular U.S. person held or sold under the circumstances described in paragraph (e)(4)(i) of this section);

(B) Identify those corporations as the purchasing corporation and the foreign target, respectively; and

(C) Contain the following declaration (or a substantially similar declaration): THIS DOCUMENT SERVES AS NOTICE OF AN ELECTION UNDER SECTION 338 FOR THE ABOVE CITED FOREIGN TARGET THE STOCK OF WHICH YOU EITHER HELD OR SOLD UNDER THE CIRCUMSTANCES DESCRIBED IN TREASURY REGULATIONS SECTION 1.338–2(e)(4). FOR POSSIBLE UNITED STATES FEDERAL INCOME TAX CONSEQUENCES UNDER SECTION 551, 951, 1248, OR 1293 OF THE INTERNAL REVENUE CODE OF 1986 THAT MAY APPLY TO YOU, SEE TREASURY REGULATIONS SECTION 1.338–9(b). YOU MAY BE REQUIRED TO ATTACH THE INFORMATION ATTACHED TO THIS NOTICE TO CERTAIN RETURNS.

(iv) *Timing of notice.* The notice required by this paragraph (e) (4) must be delivered to the U.S. person on or before the later of the 120th day after the acquisition date of the particular target or the day on which Form 8023 is filed. The notice is considered delivered on the date it is mailed to the proper address (or an address similar enough to complete delivery), unless the date it is mailed cannot be reasonably determined. The date of mailing will be determined under the rules of section 7502. For example, the date of mailing is the date of U.S. postmark or the applicable date recorded or marked by a designated delivery service.

(v) *Consequence of failure to comply.* A statement of section 338 election is not valid if timely notice is not given to one or more U.S. persons described in this paragraph (e)(4). If the form of notice fails to comply with all requirements of this paragraph (e)(4), the section 338 election is valid, but the waiver rule of §1.338–10(b)(1) does not apply.

(vi) *Good faith effort to comply.* The purchasing corporation will be considered to have complied with this paragraph (e)(4), even though it failed to provide notice or provide timely notice to each person described in this paragraph (e)(4), if the Commissioner determines that the purchasing corporation made a good faith effort to identify and provide timely notice to those U.S. persons.

§1.338–3 Qualification for the section 338 election.

(a) *Scope.* This section provides rules on whether certain acquisitions of stock are qualified stock purchases and on other miscellaneous issues under section 338.

(b) *Rules relating to qualified stock purchases*—(1) *Purchasing corporation requirement.* An individual cannot make a qualified stock purchase of target. Section 338(d)(3) requires, as a condition of a qualified stock purchase, that a corporation purchase the stock of target. If an individual forms a corporation (new P) to acquire target stock, new P can make a qualified stock purchase of target if new P is considered for tax purposes to purchase the target stock. Facts that may indicate that new P does not purchase the target stock include new P merging downstream into target, liquidating, or otherwise disposing of the target stock following the purported qualified stock purchase.

(2) *Purchase*—(i) *Definition.* The term purchase has the same meaning as in section 338(h)(3).

(ii) *Purchase of target.* A purchase of a share of target stock occurs so long as more than a nominal amount is paid for such share.

(iii) *Purchase of target affiliate.* Stock in a target affiliate acquired by new target in the deemed asset sale of target's assets is considered purchased if, under general principles of tax law, new target is considered to own stock of the target affiliate meeting the requirements of section 1504(a)(2), notwithstanding that no amount may be allocated to target's stock in the target affiliate.

(3) *Acquisitions of stock from related corporations*—(i) *In general.* Stock acquired by a purchasing corporation from a related corporation (R) is generally not considered acquired by purchase. See section 338(h)(3)(A)(iii).

(ii) *Time for testing relationship.* For purposes of section 338(h)(3)(A)(iii), a purchasing corporation is treated as related to another person if the relationship specified in section 338(h)(3)(A)(iii) exists—

(A) In the case of a single transaction, immediately after the purchase of Target stock;

(B) In the case of a series of acquisitions otherwise constituting a qualified stock purchase within the meaning of section 338(d)(3), immediately after the last acquisition in such series; and

(C) In the case of a series of transactions effected pursuant to an integrated plan to dispose of Target stock, immediately after the last transaction in such series.

(iii) *Cases where section 338(h)(3)(C) applies—acquisitions treated as purchases.* If section 338(h)(3)(C) applies and the purchasing corporation is treated as acquiring stock by purchase from R, solely for purposes of determining when the stock is considered acquired, target stock acquired from R is considered to have been acquired by the purchasing corporation on the day on which the purchasing corporation is first considered to own that stock under section 318(a) (other than section 318(a)(4)).

(iv) *Examples.* The following examples illustrate this paragraph (b)(3):

Example 1. (i) S is the parent of a group of corporations that are engaged in various businesses. Prior to January 1, Year 1, S decided to discontinue its involvement in one line of business. To accomplish this, S forms a new corporation, Newco, with a nominal amount of cash. Shortly thereafter, on January 1, Year 1, S transfers all the stock of the subsidiary conducting the unwanted business (Target) to Newco in exchange for 100 shares of Newco common stock. Prior to January 1, Year 1, S and Underwriter (U) had entered into a binding agreement pursuant to which U would purchase 60 shares of Newco common stock from S and then sell those shares in an Initial Public Offering (IPO). On January 6, Year 1, the IPO closes.

(ii) Newco's acquisition of Target stock is one of a series of transactions undertaken pursuant to one integrated plan. The series of transactions ends with the closing of the IPO and the transfer of all the shares of stock in accordance with the agreements. Immediately after the last transaction effected pursuant to the plan, S owns 40 percent of Newco, which does not give rise to a relationship described in section 338(h)(3)(A)(iii). See §1.338–3(b)(3)(ii)(C). Accordingly, S and Newco are not related for purposes of section 338(h)(3)(A)(iii).

(iii) Further, because Newco's basis in the Target stock is not determined by reference to S's basis in the Target stock and because the transaction is not an exchange to which section 351, 354, 355, or 356 applies, Newco's acquisition of the Target stock is a purchase within the meaning of section 338(h)(3).

Example 2. (i) On January 1 of Year 1, P purchases 75 percent in value of the R stock. On that date, R owns 4 of the 100 shares of T stock. On June 1 of Year 1, R acquires an additional 16 shares of T stock. On December 1 of Year 1, P purchases 70 shares of T stock from an unrelated person and 12 of the 20 shares of T stock held by R.

(ii) Of the 12 shares of T stock purchased by P from R on December 1 of Year 1, 3 of those shares are deemed to have been acquired by P on January 1 of Year 1, the date on which 3 of the 4 shares of T stock held by R on that date were first considered owned by P under section 318(a)(2)(C) (i.e., 4 × .75). The remaining 9 shares of T stock purchased by P from R on December 1 of Year 1, are deemed to have been acquired by P on June 1 of Year 1, the date on which an additional 12 of the 20 shares of T stock owned by R on that date were first considered owned by P under section 318(a)(2)(C) (i.e., (20 × .75) –3). Because stock acquisitions by P sufficient for a qualified stock purchase of T occur within a 12-month period (i.e., 3 shares constructively on January 1 of Year 1, 9 shares constructively on June 1 of Year 1, and 70 shares actually on December 1 of Year 1), a qualified stock purchase is made on December 1 of Year 1.

Example 3. (i) On February 1 of Year 1, P acquires 25 percent in value of the R stock from B (the sole shareholder of P). That R stock is not acquired by purchase. See section 338(h)(3)(A)(iii). On that date, R owns 4 of the 100 shares of T stock. On June 1 of Year 1, P purchases an additional 25 percent in value of the R stock, and on January 1 of Year 2, P purchases another 25 percent in value of the R stock. On June 1 of Year 2, R acquires an additional 16 shares of the T stock. On December 1 of Year 2, P purchases 68 shares of the T stock from an unrelated person and 12 of the 20 shares of the T stock held by R.

(ii) Of the 12 shares of the T stock purchased by P from R on December 1 of Year 2, 2 of those shares are deemed to have been acquired by P on June 1 of Year 1, the date on which 2 of the 4 shares of the T stock held by R on that date were first considered owned by P under section 318(a)(2)(C) (i.e., 4 × .5). For purposes of this attribution, the R stock need not be acquired by P by purchase. See section 338(h)(1). (By contrast, the acquisition of the T stock by P from R does not qualify as a purchase unless P has acquired at least 50 percent in value of the R stock by purchase. Section 338(h)(3)(C)(i).) Of the remaining 10 shares of the T stock purchased by P from R on December 1 of Year 2, 1 of those shares is deemed to have been acquired by P on January 1 of Year 2, the date on which an additional 1 share of the 4 shares of the T stock held by R on that date was first considered owned by P under section 318(a)(2)(C) (i.e., (4 × .75) –2). The remaining 9 shares of the T stock purchased by P from R on December 1 of Year 2, are deemed to have been acquired by P on June 1 of Year 2, the date on which an additional 12 shares of the T stock held by R on that date were first considered owned by P under section 318(a)(2)(C) (i.e., (20 × .75) –3). Because a qualified stock purchase of T by P is made on December 1 of Year 2, only if all 12 shares of the T stock purchased by P from R on that date are considered acquired during a 12-month period ending on that date (so that, in conjunction with the 68 shares of the T stock P purchased on that date from the unrelated person, 80 of T's 100 shares are acquired by P during a 12-month period) and because 2 of those 12 shares are considered to have been acquired by P more than 12 months before December 1 of Year 2 (i.e., on June 1 of Year 1), a qualified stock purchase is not made. (Under §1.338–8(j)(2), for purposes of applying the consistency rules, P is treated as making a qualified stock purchase of T if, pursuant to an arrangement, P purchases T stock satisfying the re-

quirements of section 1504(a)(2) over a period of more than 12 months.)

Example 4. Assume the same facts as in *Example 3*, except that on February 1 of Year 1, P acquires 25 percent in value of the R stock by purchase. The result is the same as in *Example 3*.

(4) *Acquisition date for tiered targets*—(i) *Stock sold in deemed asset sale.* If an election under section 338 is made for target, old target is deemed to sell target's assets and new target is deemed to acquire those assets. Under section 338(h)(3)(B), new target's deemed purchase of stock of another corporation is a purchase for purposes of section 338(d)(3) on the acquisition date of target. If new target's deemed purchase causes a qualified stock purchase of the other corporation and if a section 338 election is made for the other corporation, the acquisition date for the other corporation is the same as the acquisition date of target. However, the deemed sale and purchase of the other corporation's assets is considered to take place after the deemed sale and purchase of target's assets.

(ii) *Examples.* The following examples illustrate this paragraph (b)(4):

Example 1. A owns all of the T stock. T owns 50 of the 100 shares of X stock. The other 50 shares of X stock are owned by corporation Y, which is unrelated to A, T, or P. On January 1 of Year 1, P makes a qualified stock purchase of T from A and makes a section 338 election for T. On December 1 of Year 1, P purchases the 50 shares of X stock held by Y. A qualified stock purchase of X is made on December 1 of Year 1, because the deemed purchase of 50 shares of X stock by new T because of the section 338 election for T and the actual purchase of 50 shares of X stock by P are treated as purchases made by one corporation. Section 338(h)(8). For purposes of determining whether those purchases occur within a 12-month acquisition period as required by section 338(d)(3), T is deemed to purchase its X stock on T's acquisition date, i.e., January 1 of Year 1.

Example 2. On January 1 of Year 1, P makes a qualified stock purchase of T and makes a section 338 election for T. On that day, T sells all of the stock of T1 to A. Although T held all of the T1 stock on T's acquisition date, T is not considered to have purchased the T1 stock because of the section 338 election for T. In order for T to be treated as purchasing the T1 stock, T must hold the T1 stock when T's deemed asset sale occurs. The deemed asset sale is considered the last transaction of old T at the close of T's acquisition date. Accordingly, the T1 stock actually disposed of by T on the acquisition date is not included in the deemed asset sale. Thus, T does not make a qualified stock purchase of T1.

(5) *Effect of redemptions*—(i) *General rule.* Except as provided in this paragraph (b)(5), a qualified stock purchase is made on the first day on which the percentage ownership requirements of section 338(d)(3) are satisfied by reference to target stock that is both—

(A) Held on that day by the purchasing corporation; and

(B) Purchased by the purchasing corporation during the 12-month period ending on that day.

(ii) *Redemptions from persons unrelated to the purchasing corporation.* Target stock redemptions from persons unrelated to the purchasing corporation that occur during the 12-month acquisition period are taken into account as reductions in target's outstanding stock for purposes of determining whether target stock purchased by the purchasing corporation in the 12-month acquisition period satisfies the percentage ownership requirements of section 338(d)(3).

(iii) *Redemptions from the purchasing corporation or related persons during 12-month acquisition period*—(A) *General rule.* For purposes of the percentage ownership requirements of section 338(d)(3), a redemption of target stock during the 12-month acquisition period from the purchasing corporation or from any person related to the purchasing corporation is not taken into account as a reduction in target's outstanding stock.

(B) *Exception for certain redemptions from related corporations.* A redemption of target stock during the 12-month acquisition period from a corporation related to the purchasing corporation is taken into account as a reduction in target's outstanding stock to the extent that the redeemed stock would have been considered purchased by the purchasing corporation (because of section 338(h)(3)(C)) during the 12-month acquisition period if the redeemed stock had been acquired by the purchasing corporation from the related corporation on the day of the redemption. See paragraph (b)(3) of this section.

(iv) *Examples.* The following examples illustrate this paragraph (b)(5):

Example 1. QSP on stock purchase date; redemption from unrelated person during 12-month period. A owns all 100 shares of T stock. On January 1 of Year 1, P purchases 40 shares of the T stock from A. On July 1 of Year 1, T redeems 25 shares from A. On December 1 of Year 1, P purchases 20 shares of the T stock from A. P makes a qualified stock purchase of T on December 1 of Year 1, because the 60 shares of T stock purchased by P within the 12-month period ending on that date satisfy the 80-percent ownership requirements of section 338(d)(3) (i.e., 60/75 shares), determined by taking into account the redemption of 25 shares.

Example 2. QSP on stock redemption date; redemption from unrelated person during 12-month period. The facts are the same as in *Example 1*, except that P purchases 60 shares of T stock on January 1 of Year 1 and none on December 1 of Year 1. P makes a qualified stock purchase of T on July 1 of Year 1, because that is the first day on which the T stock purchased by P within the preceding 12-month period satisfies the 80-percent ownership requirements of section 338(d)(3) (i.e., 60/75 shares), determined by taking into account the redemption of 25 shares.

Example 3. Redemption from purchasing corporation not taken into account. On December 15 of Year 1, T redeems 30 percent of its stock from P. The redeemed stock was held by P for several years and constituted P's total interest in T. On December 1 of Year 2, P purchases the remaining T stock from A. P does not make a qualified stock purchase of T on December 1 of Year 2. For purposes of the 80-percent ownership requirements of section 338(d)(3), the redemption of P's T stock on December 15 of Year 1 is not taken into account as a reduction in T's outstanding stock.

Example 4. Redemption from related person taken into account. On January 1 of Year 1, P purchases 60 of the 100 shares of X stock. On that date, X owns 40 of the 100 shares of T stock. On April 1 of Year 1, T redeems X's T stock and P purchases the remaining 60 shares of T stock from an unrelated person. For purposes of the 80-percent ownership requirements of section 338(d)(3), the redemption of the T stock from X (a person related to P) is taken into account as a reduction in T's outstanding stock. If P had purchased the 40 redeemed shares from X on April 1 of Year 1, all 40 of the shares would have been considered purchased (because of section 338(h)(3)(C)(i)) during the 12-month period ending on April 1 of Year 1 (24 of the 40 shares would have been considered purchased by P on January 1 of Year 1 and the remaining 16 shares would have been considered purchased by P on April 1 of Year 1). See paragraph (b)(3) of this section. Accordingly, P makes a qualified stock purchase of T on April 1 of Year 1, because the 60 shares of T stock purchased by P on that date satisfy the 80-percent ownership requirements of section 338(d)(3) (i.e., 60/60 shares), determined by taking into account the redemption of 40 shares.

(c) *Effect of post-acquisition events on eligibility for section 338 election*—(1) *Post-acquisition elimination of target.* (i) The purchasing corporation may make an election under section 338 for target even though target is liquidated on or after the acquisition date. If target liquidates on the acquisition date, the liquidation is considered to occur on the following day and immediately after new target's deemed purchase of assets. The purchasing corporation may also make an election under section 338 for target even

though target is merged into another corporation, or otherwise disposed of by the purchasing corporation provided that, under the facts and circumstances, the purchasing corporation is considered for tax purposes as the purchaser of the target stock.

(ii) The following examples illustrate this paragraph (c)(1):

Example 1. On January 1 of Year 1, P purchases 100 percent of the outstanding common stock of T. On June 1 of Year 1, P sells the T stock to an unrelated person. Assuming that P is considered for tax purposes as the purchaser of the T stock, P remains eligible, after June 1 of Year 1, to make a section 338 election for T that results in a deemed asset sale of T's assets on January 1 of Year 1.

Example 2. On January 1 of Year 1, P makes a qualified stock purchase of T. On that date, T owns the stock of T1. On March 1 of Year 1, T sells the T1 stock to an unrelated person. On April 1 of Year 1, P makes a section 338 election for T. Notwithstanding that the T1 stock was sold on March 1 of Year 1, the section 338 election for T on April 1 of Year 1 results in a qualified stock purchase by T of T1 on January 1 of Year 1. See paragraph (b)(4)(i) of this section.

(2) *Post-acquisition elimination of the purchasing corporation.* An election under section 338 may be made for target after the acquisition of assets of the purchasing corporation by another corporation in a transaction described in section 381(a), provided that the purchasing corporation is considered for tax purposes as the purchaser of the target stock. The acquiring corporation in the section 381(a) transaction may make an election under section 338 for target.

(3) *Consequences of post-acquisition elimination of target*—(i) *Scope.* The rules of this paragraph (c)(3) apply to the transfer of target assets to the purchasing corporation (or another member of the same affiliated group as the purchasing corporation) (the transferee) following a qualified stock purchase of target stock, if the purchasing corporation does not make a section 338 election for target. Notwithstanding the rules of this paragraph (c)(3), section 354(a) (and so much of section 356 as relates to section 354) cannot apply to any person other than the purchasing corporation or another member of the same affiliated group as the purchasing corporation unless the transfer of target assets is pursuant to a reorganization as determined without regard to this paragraph (c)(3).

(ii) *Continuity of interest.* By virtue of section 338, in determining whether the continuity of interest requirement of §1.368–1(b) is satisfied on the transfer of assets from target to the transferee, the purchasing corporation's target stock acquired in the qualified stock purchase represents an interest on the part of a person who was an owner of the target's business enterprise prior to the transfer that can be continued in a reorganization.

(iii) *Control requirement.* By virtue of section 338, the acquisition of target stock in the qualified stock purchase will not prevent the purchasing corporation from qualifying as a shareholder of the target transferor for the purpose of determining whether, immediately after the transfer of target assets, a shareholder of the transferor is in control of the corporation to which the assets are transferred within the meaning of section 368(a)(1)(D).

(iv) *Example.* The following example illustrates this paragraph (c)(3):

Example. (i) *Facts.* P, T, and X are domestic corporations. T and X each operate a trade or business. A and K, individuals unrelated to P, own 85 and 15 percent, respectively, of the stock of T. P owns all of the stock of X. The total adjusted basis of T's property exceeds the sum of T's liabilities plus the amount of liabilities to which T's property is subject. P purchases all of A's T stock for cash in a qualified stock purchase. P does not make an election under section 338(g) with respect to its acquisition of T stock. Shortly after the acquisition date, and as part of the same plan, T merges under applicable state law into X in a transaction that, but for the question of continuity of interest, satisfies all the requirements of section 368(a)(1)(A). In the merger, all of T's assets are transferred to X. P and K receive X stock in exchange for their T stock. P intends to retain the stock of X indefinitely.

(ii) *Status of transfer as a reorganization.* By virtue of section 338, for the purpose of determining whether the continuity of interest requirement of §1.368–1(b) is satisfied, P's T stock acquired in the qualified stock purchase represents an interest on the part of a person who was an owner of T's business enterprise prior to the transfer that can be continued in a reorganization through P's continuing ownership of X. Thus, the continuity of interest requirement is satisfied and the merger of T into X is a reorganization within the meaning of section 368(a)(1)(A). Moreover, by virtue of section 338, the requirement of section 368(a)(1)(D) that a target shareholder control the transferee immediately after the transfer is satisfied because P controls X immediately after the transfer. In addition, all of T's assets are transferred to X in the merger and P and K receive the X stock exchanged therefor in pursuance of the plan of reorganization. Thus, the merger of T into X is also a reorganization within the meaning of section 368(a)(1)(D).

(iii) *Treatment of T and X.* Under section 361(a), T recognizes no gain or loss in the merger. Under section 362(b), X's basis in the assets received in the merger is the same as the basis of the assets in T's hands. X succeeds to and takes into account the items of T as provided in section 381.

(iv) *Treatment of P.* By virtue of section 338, the transfer of T assets to X is a reorganization. Pursuant to that reorganization, P exchanges its T stock solely for stock of X, a party to the reorganization. Because P is the purchasing corporation, section 354 applies to P's exchange of T stock for X stock in the merger of T into X. Thus, P recognizes no gain or loss on the exchange. Under section 358, P's basis in the X stock received in the exchange is the same as the basis of P's T stock exchanged therefor.

(v) *Treatment of K.* Because K is not the purchasing corporation (or an affiliate thereof), section 354 cannot apply to K's exchange of T stock for X stock in the merger of T into X unless the transfer of T's assets is pursuant to a reorganization as determined without regard to §1.338–3(c)(3). Under general principles of tax law applicable to reorganizations, the continuity of interest requirement is not satisfied because P's stock purchase and the merger of T into X are pursuant to an integrated transaction in which A, the owner of 85 percent of the stock of T, received solely cash in exchange for A's T stock. See, e.g., *Yoc Heating v. Commissioner,* 61 T.C. 168 (1973); *Kass v. Commissioner,* 60 T.C. 218 (1973), aff'd, 491 F.2d 749 (3d Cir. 1974). Thus, the requisite continuity of interest under §1.368–1(b) is lacking and section 354 does not apply to K's exchange of T stock for X stock. K recognizes gain or loss, if any, pursuant to section 1001(c) with respect to its T stock.

§§1.338–4 and 1.338–5 [Redesignated as §§1.338–8 and 1.338–9]

Par. 3. Sections 1.338–4 and 1.338–5 are redesignated as §§1.338–8 and 1.338–9, respectively.

Par. 4. New §§1.338–4 and 1.338–5 are added to read as follows:

§1.338–4 Aggregate deemed sale price; various aspects of taxation of the deemed asset sale.

(a) *Scope.* This section provides rules under section 338(a)(1) to determine the aggregate deemed sale price (ADSP) for target. ADSP is the amount for which old target is deemed to have sold all of its assets in the deemed asset sale. ADSP is allocated among target's assets in accordance with §1.338–6 to determine the amount for which each asset is deemed to have been sold. When an increase or decrease with respect to an element of ADSP is required, under general principles of tax law, after the close of new target's first taxable year, redetermined

ADSP is allocated among target's assets in accordance with §1.338–7. This section also provides rules regarding the recognition of gain or loss on the deemed sale of target affiliate stock. Notwithstanding section 338(h)(6)(B)(ii), stock held by a target affiliate in a foreign corporation or in a corporation that is a DISC or that is described in section 1248(e) is not excluded from the operation of section 338.

(b) *Determination of ADSP*—(1) *General rule.* ADSP is the sum of—

(i) The grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock (as defined in section 338(b)(6)(A)); and

(ii) The liabilities of old target.

(2) *Time and amount of ADSP*—(i) *Original determination.* ADSP is initially determined at the beginning of the day after the acquisition date of target. General principles of tax law apply in determining the timing and amount of the elements of ADSP.

(ii) *Redetermination of ADSP.* ADSP is redetermined at such time and in such amount as an increase or decrease would be required, under general principles of tax law, for the elements of ADSP. For example, ADSP is redetermined because of an increase or decrease in the amount realized for recently purchased stock or because liabilities not originally taken into account in determining ADSP are subsequently taken into account. An increase or decrease to one element of ADSP may cause an increase or decrease to the other element of ADSP. For example, if an increase in the amount realized for recently purchased stock of target is taken into account after the acquisition date, any increase in the tax liability of target for the deemed sale gain is also taken into account when ADSP is redetermined. Increases or decreases with respect to the elements of ADSP that are taken into account before the close of new target's first taxable year are taken into account for purposes of determining ADSP and the deemed sale gain as if they had been taken into account at the beginning of the day after the acquisition date. Increases or decreases with respect to the elements of ADSP that are taken into account after the close of new target's first taxable year result in the reallocation of ADSP among target's assets under §1.338–7.

(iii) *Example.* The following example illustrates this paragraph (b)(2):

Example. In Year 1, T, a manufacturer, purchases a customized delivery truck from X with purchase money indebtedness having a stated principal amount of $100,000. P acquires all of the stock of T in Year 3 for $700,000 and makes a section 338 election for T. Assume T has no liabilities other than its purchase money indebtedness to X. In Year 4, when T is neither insolvent nor in a title 11 case, T and X agree to reduce the amount of the purchase money indebtedness to $80,000. Assume further that the reduction would be a purchase price reduction under section 108(e)(5). T and X's agreement to reduce the amount of the purchase money indebtedness would not, under general principles of tax law that would apply if the deemed asset sale had actually occurred, change the amount of liabilities of old target taken into account in determining its amount realized. Accordingly, ADSP is not redetermined at the time of the reduction. See §1.338–5(b)(2)(iii) *Example 1* for the effect on AGUB.

(c) *Grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock*—(1) *Determination of amount.* The grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock is an amount equal to—

(i) The amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock determined as if old target were the selling shareholder and the installment method were not available and determined without regard to the selling costs taken into account in paragraph (c)(1)(iii) of this section;

(ii) Divided by the percentage of target stock (by value, determined on the acquisition date) attributable to that recently purchased target stock;

(iii) Less the selling costs incurred by the selling shareholders in connection with the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock that reduce their amount realized on the sale of the stock (e.g., brokerage commissions and any similar costs to sell the stock).

(2) *Example.* The following example illustrates this paragraph (c):

Example. T has two classes of stock outstanding, voting common stock and preferred stock not taken into account for purposes of section 1504(a)(2). On March 1 of Year 1, P purchases 40 percent of the outstanding T stock from S1 for $500, 20 percent of the outstanding T stock from S2 for $225, and 20 percent of the outstanding T stock from S3 for $275. On that date, the fair market value of all the T voting common stock is $1,250 and the preferred stock $750. S1, S2, and S3 respectively incur $40, $35, and $25 of selling costs. S1 continues to own the remaining 20 percent of the outstanding T stock. The grossed-up amount realized on the sale to P of P's recently purchased T stock is calculated as follows: The total amount realized (without regard to selling costs) is $1,000 (500 + 225 + 275). The percentage of T stock by value on the acquisition date attributable to the recently purchased T stock is 50% (1,000/(1,250 + 750)). The selling costs are $100 (40 + 35 + 25). The grossed-up amount realized is $1,900 (1,000/.5 – 100).

(d) *Liabilities of old target*—(1) *In general.* The liabilities of old target are the liabilities of target (and the liabilities to which target's assets are subject) as of the beginning of the day after the acquisition date (other than liabilities that were neither liabilities of old target nor liabilities to which old target's assets were subject). In order to be taken into account in ADSP, a liability must be a liability of target that is properly taken into account in amount realized under general principles of tax law that would apply if old target had sold its assets to an unrelated person for consideration that included that person's assumption of, or taking subject to, the liability. Thus, ADSP takes into account both tax credit recapture liability arising because of the deemed asset sale and the tax liability for the deemed sale gain unless the tax liability is borne by some person other than the target. For example, ADSP would not take into account the tax liability for the deemed sale gain when a section 338(h)(10) election is made for a target S corporation because the S corporation shareholders bear that liability. However, if a target S corporation is subject to a tax under section 1374 or 1375, the liability for tax imposed by those sections is a liability of target taken into account in ADSP (unless the S corporation shareholders expressly assume that liability).

(2) *Time and amount of liabilities.* The time for taking into account liabilities of old target in determining ADSP and the amount of the liabilities taken into account is determined as if old target had sold its assets to an unrelated person for consideration that included the unrelated person's assumption of or taking subject to the liabilities. For example, if no

amount of a target liability is properly taken into account in amount realized as of the beginning of the day after the acquisition date, the liability is not initially taken into account in determining ADSP (although it may be taken into account at some later date). As a further example, an increase or decrease in a liability that does not affect the amount of old target's basis, deductions, or noncapital nondeductible items arising from the incurrence of the liability is not taken into account in redetermining ADSP.

(3) *Interaction with deemed sale gain.* Though deemed sale gain increases or decreases ADSP by creating or reducing a tax liability, the amount of the tax liability itself is a function of the size of the deemed sale gain. Thus, the determination of ADSP may require trial and error computations.

(e) *Calculation of deemed sale gain.* Deemed sale gain on each asset is computed by reference to the ADSP allocated to that asset.

(f) *Other rules apply in determining ADSP.* ADSP may not be applied in such a way as to contravene other applicable rules. For example, a capital loss cannot be applied to reduce ordinary income in calculating the tax liability on the deemed sale for purposes of determining ADSP.

(g) *Examples.* The following examples illustrate this section. For purposes of the examples in this paragraph (g), unless otherwise stated, T is a calendar year taxpayer that files separate returns and that has no loss, tax credit, or other carryovers to Year 1. Depreciation for Year 1 is not taken into account. T has no liabilities other than the Federal income tax liability resulting from the deemed asset sale, and the T shareholders have no selling costs. Assume that T's tax rate for any ordinary income or net capital gain resulting from the deemed sale of assets is 34 percent and that any capital loss is offset by capital gain. On July 1 of Year 1, P purchases all of the stock of T and makes a section 338 election for T. The examples are as follows:

Example 1. One class. (i) On July 1 of Year 1, T's only asset is an item of section 1245 property with an adjusted basis to T of $50,400, a recomputed basis of $80,000, and a fair market value of $100,000. P purchases all of the T stock for $75,000, which also equals the amount realized for the stock determined as if old target were the selling shareholder.

(ii) ADSP is determined as follows (In the following formula, G is the grossed-up amount realized on the sale to P of P's recently purchased T stock, L is T's liabilities other than T's tax liability for the deemed sale gain, TR is the applicable tax rate, and B is the adjusted basis of the asset deemed sold):

$$ADSP = G + L + T_R \times (ADSP - B)$$

$$ADSP = (\$75,000/1) + \$0 + .34 \times (ADSP - \$50,400)$$

$$ADSP = \$75,000 + .34ADSP - \$17,136$$

$$66ADSP = \$57,864$$

$$ADSP = \$87,672.72$$

(iii) Because ADSP for T ($87,672.72) does not exceed the fair market value of T's asset ($100,000), a Class V asset, T's entire ADSP is allocated to that asset. Thus, T has deemed sale gain of $37,272.72 (consisting of $29,600 of ordinary income and $7,672.72 of capital gain).

(iv) The facts are the same as in paragraph (i) of this Example 1, except that on July 1 of Year 1, P purchases only 80 of the 100 shares of T stock for $60,000. The grossed-up amount realized on the sale to P of P's recently purchased T stock (G) is $75,000 ($60,000/.8). Consequently, ADSP and deemed sale gain are the same as in paragraphs (ii) and (iii) of this Example 1.

(v) The facts are the same as in paragraph (i) of this Example 1, except that T also has goodwill (a Class VII asset) with an appraised value of $10,000. The results are the same as in paragraphs (ii) and (iii) of this Example 1. Because ADSP does not exceed the fair market value of the Class V asset, no amount is allocated to the Class VII assets (goodwill and going concern value).

Example 2. More than one class. (i) P purchases all of the T stock for $140,000, which also equals the amount realized for the stock determined as if old target were the selling shareholder. On July 1 of Year 1, T has liabilities (not including the tax liability for the deemed sale gain) of $50,000, cash (a Class I asset) of $10,000, actively traded securities (a Class II asset) with a basis of $4,000 and a fair market value of $10,000, goodwill (a Class VII asset) with a basis of $3,000, and the following Class V assets:

Asset	*Basis*	*FMV*	*Ratio of asset fmv to total Class V fmv*
Land	$ 5,000	$ 35,000	.14
Building	10,000	50,000	.20
Equipment A (Recomputed basis $80,000)	5,000	90,000	.36
Equipment B (Recomputed basis $20,000)	10,000	75,000	.30
Totals	$ 30,000	$ 250,000	1.00

(ii) ADSP exceeds $20,000. Thus, $10,000 of ADSP is allocated to the cash and $10,000 to the actively traded securities. The amount allocated to an asset (other than a Class VII asset) cannot exceed its fair market value (however, the fair market value of any property subject to nonrecourse indebtedness is treated as being not less than the amount of such indebtedness; see §1.338–6(a)(2)). See §1.338–6(c)(1) (relating to fair market value limitation).

(iii) The portion of ADSP allocable to the Class V assets is preliminarily determined as follows (in the formula, the amount allocated to the Class I assets is referred to as I and the amount allocated to the Class II assets as II):

$$ADSP_V = (G - (I + II)) + L + T_R\,([(II - B_{II}) + (ADSP_V - B_V)]$$

$$ADSP_V = (\$140,000 - (\$10,000 + \$10,000)) + \$50,000 + .34 \times [(\$10,000 - \$4,000) + (ADSP_V - (\$5,000 + \$10,000 + \$5,000 + \$10,000))]$$

$$ADSP_V = \$161,840 + .34\,ADSP_V$$

$$.66\,ADSP_V = \$161,840$$

$$ADSP_V = \$245,212.12$$

(iv) Because, under the preliminary calculations of ADSP, the amount to be allocated to the Class I, II, III, IV, V, and VI assets does not exceed their aggregate fair market value, no ADSP amount is allocated to goodwill. Accordingly, the deemed sale of the goodwill results in a capital loss of $3,000. The portion of ADSP allocable to the Class V assets is finally determined by taking into account this loss as follows:

$ADSP_V = (G - (I + II)) + L + T_R ([(II - B_{II}) + (ADSP_V - B_V) + (ADSP_{VII} - B_{VII})]$

$ADSP_V = (\$140,000 - (\$10,000 + \$10,000)) + \$50,000 + .34 \times [(\$10,000 - \$4,000) + (ADSP_V - \$30,000) + (\$0 - \$3,000)]$

$ADSP_V = \$160,820 + .34\ ADSP_V$

$.66\ ADSP_V = \$160,820$

$ADSP_V = \$243,666.67$

(v) The allocation of ADSPV among the Class V assets is in proportion to their fair market values, as follows:

Asset	*ADSP*	*Gain*
Land	$ 34,113.33	$ 29,113.33 (capital gain)
Building	48,733.34	38,733.34 (capital gain)
Equipment A	87,720.00	82,720.00 (75,000 ordinary income 7,720 capital gain)
Equipment B	73,100.00	63,100.00 (10,000 ordinary income 53,100 capital gain)
Totals	$ 243,666.67	$ 213,666.67

Example 3. More than one class. (i) The facts are the same as in *Example 2*, except that P purchases the T stock for $150,000, rather than $140,000. The amount realized for the stock determined as if old target were the selling shareholder is also $150,000.

(ii) As in *Example 2*, ADSP exceeds $20,000. Thus, $10,000 of ADSP is allocated to the cash and $10,000 to the actively traded securities.

(iii) The portion of ADSP allocable to the Class V assets as preliminarily determined under the formula set forth in paragraph (iii) of *Example 2* is $260,363.64. The amount allocated to the Class V assets cannot exceed their aggregate fair market value ($250,000). Thus, preliminarily, the ADSP amount allocated to Class V assets is $250,000.

(iv) Based on the preliminary allocation, the ADSP is determined as follows (in the formula, the amount allocated to the Class I assets is referred to as I, the amount allocated to the Class II assets as II, and the amount allocated to the Class V assets as V):

$ADSP = G + L + T_R ([(II - B_{II}) + (V - B_V) + (ADSP - (I + II + V + B_{VII}))]$

$ADSP = \$150,000 + \$50,000 + .34 \times [(\$10,000 - \$4,000) + (\$250,000 - \$30,000) + (ADSP - (\$10,000 + \$10,000 + \$250,000 + \$3,000))]$

$ADSP = \$200,000 + .34ADSP - \$15,980$

$.66ADSP = \$184,020$

$ADSP = \$278,818.18$

(v) Because ADSP as determined exceeds the aggregate fair market value of the Class I, II, III, IV, V, and VI assets, the $250,000 amount preliminarily allocated to the Class V assets is appropriate. Thus, the amount of ADSP allocated to Class V assets equals their aggregate fair market value ($250,000), and the allocated ADSP amount for each Class V asset is its fair market value. Further, because there are no Class VI assets, the allocable ADSP amount for the Class VII asset (goodwill) is $8,818.18 (the excess of ADSP over the aggregate ADSP amounts for the Class I, II, III, IV, V and VI assets).

Example 4. Amount allocated to T1 stock. (i) The facts are the same as in *Example 2*, except that T owns all of the T1 stock (instead of the building), and T1's only asset is the building. The T1 stock and the building each have a fair market value of $50,000, and the building has a basis of $10,000. A section 338 election is made for T1 (as well as T), and T1 has no liabilities other than the tax liability for the deemed sale gain. T is the common parent of a consolidated group filing a final consolidated return described in §1.338–10(a)(1).

(ii) ADSP exceeds $20,000. Thus, $10,000 of ADSP is allocated to the cash and $10,000 to the actively traded securities.

(iii) Because T does not recognize any gain on the deemed sale of the T1 stock under paragraph (h)(2) of this section, appropriate adjustments must be made to reflect accurately the fair market value of the T and T1 assets in determining the allocation of ADSP among T's Class V assets (including the T1 stock). In preliminarily calculating ADSPV in this case, the T1 stock can be disregarded and, because T owns all of the T1 stock, the T1 asset can be treated as a T asset. Under this assumption, ADSPV is $243,666.67. See paragraph (iv) of *Example 2*.

(iv) Because the portion of the preliminary ADSP allocable to Class V assets ($243,666.67) does not exceed their fair market value ($250,000), no amount is allocated to Class VII assets for T. Further, this amount ($243,666.67) is allocated among T's Class V assets in proportion to their fair market values. See paragraph (v) of *Example 2*. Tentatively, $48,733.34 of this amount is allocated to the T1 stock.

(v) The amount tentatively allocated to the T1 stock, however, reflects the tax incurred on the deemed sale of the T1 asset equal to $13,169.34 (.34 × ($48,733.34 – $10,000)). Thus, the ADSP allocable to the Class V assets of T, and the ADSP allocable to the T1 stock, as preliminarily calculated, each must be reduced by $13,169.34. Consequently, these amounts, respectively, are $230,497.33 and $35,564.00. In determining ADSP for T1, the grossed-up amount realized on the deemed sale to new T of new T's recently purchased T1 stock is $35,564.00.

(vi) The facts are the same as in paragraph (i) of this Example 4, except that the T1 building has a $12,500 basis and a $62,500 value, all of the outstanding T1 stock has a $62,500 value, and T owns 80 percent of the T1 stock. In preliminarily calculating ADSPV, the T1 stock can be disregarded but, because T owns only 80 percent of the T1 stock, only 80 percent of T1 asset basis and value should be taken into account in calculating T's ADSP. By taking into account 80 percent of these amounts, the remaining calculations and results are the same as in paragraphs (ii), (iii), (iv), and (v) of this Example 4, except that the grossed-up amount realized on the sale of the recently purchased T1 stock is $44,455.00 ($35,564.00/0.8).

(h) *Deemed sale of target affiliate stock*—(1) *Scope.* This paragraph (h) prescribes rules relating to the treatment of gain or loss realized on the deemed sale of stock of a target affiliate when a section 338 election (but not a section 338(h)(10) election) is made for the target affiliate. For purposes of this paragraph (h), the definition of domestic corporation in §1.338–2(c)(9) is applied without the exclusion therein for DISCs, corporations described in section 1248(e), and corporations to which an election under section 936 applies.

(2) *In general.* Except as otherwise provided in this paragraph (h), if a section 338 election is made for target, target rec-

ognizes no gain or loss on the deemed sale of stock of a target affiliate having the same acquisition date and for which a section 338 election is made if—

(i) Target directly owns stock in the target affiliate satisfying the requirements of section 1504(a)(2);

(ii) Target and the target affiliate are members of a consolidated group filing a final consolidated return described in §1.338–10(a)(1); or

(iii) Target and the target affiliate file a combined return under §1.338–10(a)(4).

(3) *Deemed sale of foreign target affiliate by a domestic target.* A domestic target recognizes gain or loss on the deemed sale of stock of a foreign target affiliate. For the proper treatment of such gain or loss, see, e.g., sections 1246, 1248, 1291 et seq., and 338(h)(16) and §1.338–9.

(4) *Deemed sale producing effectively connected income.* A foreign target recognizes gain or loss on the deemed sale of stock of a foreign target affiliate to the extent that such gain or loss is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States.

(5) *Deemed sale of insurance company target affiliate electing under section 953(d).* A domestic target recognizes gain (but not loss) on the deemed sale of stock of a target affiliate that has in effect an election under section 953(d) in an amount equal to the lesser of the gain realized or the earnings and profits described in section 953(d)(4)(B).

(6) *Deemed sale of DISC target affiliate.* A foreign or domestic target recognizes gain (but not loss) on the deemed sale of stock of a target affiliate that is a DISC or a former DISC (as defined in section 992(a)) in an amount equal to the lesser of the gain realized or the amount of accumulated DISC income determined with respect to such stock under section 995(c). Such gain is included in gross income as a dividend as provided in sections 995(c)(2) and 996(g).

(7) *Anti-stuffing rule.* If an asset the adjusted basis of which exceeds its fair market value is contributed or transferred to a target affiliate as transferred basis property (within the meaning of section 7701(a)(43)) and a purpose of such transaction is to reduce the gain (or increase the loss) recognized on the deemed sale of such target affiliate's stock, the gain or loss recognized by target on the deemed sale of stock of the target affiliate is determined as if such asset had not been contributed or transferred.

(8) *Examples.* The following examples illustrate this paragraph (h):

Example 1. (i) P makes a qualified stock purchase of T and makes a section 338 election for T. T's sole asset, all of the T1 stock, has a basis of $50 and a fair market value of $150. T's deemed purchase of the T1 stock results in a qualified stock purchase of T1 and a section 338 election is made for T1. T1's assets have a basis of $50 and a fair market value of $150.

(ii) T realizes $100 of gain on the deemed sale of the T1 stock, but the gain is not recognized because T directly owns stock in T1 satisfying the requirements of section 1504(a)(2) and a section 338 election is made for T1.

(iii) T1 recognizes gain of $100 on the deemed sale of its assets.

Example 2. The facts are the same as in Example 1, except that P does not make a section 338 election for T1. Because a section 338 election is not made for T1, the $100 gain realized by T on the deemed sale of the T1 stock is recognized.

Example 3. (i) P makes a qualified stock purchase of T and makes a section 338 election for T. T owns all of the stock of T1 and T2. T's deemed purchase of the T1 and T2 stock results in a qualified stock purchase of T1 and T2 and section 338 elections are made for T1 and T2. T1 and T2 each own 50 percent of the vote and value of T3 stock. The deemed purchases by T1 and T2 of the T3 stock result in a qualified stock purchase of T3 and a section 338 election is made for T3. T is the common parent of a consolidated group and all of the deemed asset sales are reported on the T group's final consolidated return. See §1.338–10(a)(1).

(ii) Because T, T1, T2 and T3 are members of a consolidated group filing a final consolidated return, no gain or loss is recognized by T, T1 or T2 on their respective deemed sales of target affiliate stock.

Example 4. (i) T's sole asset, all of the FT1 stock, has a basis of $25 and a fair market value of $150. FT1's sole asset, all of the FT2 stock, has a basis of $75 and a fair market value of $150. FT1 and FT2 each have $50 of accumulated earnings and profits for purposes of section 1248(c) and (d). FT2's assets have a basis of $125 and a fair market value of $150, and their sale would not generate subpart F income under section 951. The sale of the FT2 stock or assets would not generate income effectively connected with the conduct of a trade or business within the United States. FT1 does not have an election in effect under section 953(d) and neither FT1 nor FT2 is a passive foreign investment company.

(ii) P makes a qualified stock purchase of T and makes a section 338 election for T. T's deemed purchase of the FT1 stock results in a qualified stock purchase of FT1 and a section 338 election is made for FT1. Similarly, FT1's deemed purchase of the FT2 stock results in a qualified stock purchase of FT2 and a section 338 election is made for FT2.

(iii) T recognizes $125 of gain on the deemed sale of the FT1 stock under paragraph (h)(3) of this section. FT1 does not recognize $75 of gain on the deemed sale of the FT2 stock under paragraph (h)(2) of this section. FT2 recognizes $25 of gain on the deemed sale of its assets. The $125 gain T recognizes on the deemed sale of the FT1 stock is included in T's income as a dividend under section 1248, because FT1 and FT2 have sufficient earnings and profits for full recharacterization ($50 of accumulated earnings and profits in FT1, $50 of accumulated earnings and profits in FT2, and $25 of deemed sale earnings and profits in FT2). §1.338–9(b). For purposes of sections 901 through 908, the source and foreign tax credit limitation basket of $25 of the recharacterized gain on the deemed sale of the FT1 stock is determined under section 338(h)(16).

§1.338–5 Adjusted grossed-up basis.

(a) *Scope.* This section provides rules under section 338(b) to determine the adjusted grossed-up basis (AGUB) for target. AGUB is the amount for which new target is deemed to have purchased all of its assets in the deemed purchase under section 338(a)(2). AGUB is allocated among target's assets in accordance with §1.338–6 to determine the price at which the assets are deemed to have been purchased. When an increase or decrease with respect to an element of AGUB is required, under general principles of tax law, after the close of new target's first taxable year, redetermined AGUB is allocated among target's assets in accordance with §1.338–7.

(b) *Determination of AGUB*—(1) *General rule.* AGUB is the sum of—

(i) The grossed-up basis in the purchasing corporation's recently purchased target stock;

(ii) The purchasing corporation's basis in nonrecently purchased target stock; and

(iii) The liabilities of new target.

(2) *Time and amount of AGUB*—(i) *Original determination.* AGUB is initially determined at the beginning of the day after the acquisition date of target. General principles of tax law apply in determining the timing and amount of the elements of AGUB.

(ii) *Redetermination of AGUB.* AGUB is redetermined at such time and in such amount as an increase or decrease would be required, under general principles of tax law, with respect to an element of AGUB. For example, AGUB is redetermined because of an increase or decrease in the amount paid or incurred for recently purchased stock or nonrecently purchased stock or because liabilities not originally taken into account in determining AGUB are subsequently taken into ac-

count. An increase or decrease to an element of ADSP may cause an increase or decrease to an element of AGUB. For example, if an increase in the amount realized for recently purchased stock of target is taken into account after the acquisition date, any increase in tax liability of target for the deemed sale gain is also taken into account when AGUB is redetermined. An increase or decrease to one element of AGUB may also cause an increase or decrease to another element of AGUB. For example, if there is an increase in the amount paid or incurred for recently purchased stock after the acquisition date, any increase in the basis of nonrecently purchased stock because a gain recognition election was made is also taken into account when AGUB is redetermined. Increases or decreases with respect to the elements of AGUB that are taken into account before the close of new target's first taxable year are taken into account for purposes of determining AGUB and the basis of target's assets as if they had been taken into account at the beginning of the day after the acquisition date. Increases or decreases with respect to the elements of AGUB that are taken into account after the close of new target's first taxable year result in the reallocation of AGUB among target's assets under §1.338–7.

(iii) *Examples.* The following examples illustrate this paragraph (b)(2):

Example 1. In Year 1, T, a manufacturer, purchases a customized delivery truck from X with purchase money indebtedness having a stated principal amount of $100,000. P acquires all of the stock of T in Year 3 for $700,000 and makes a section 338 election for T. Assume T has no liabilities other than its purchase money indebtedness to X. In Year 4, when T is neither insolvent nor in a title 11 case, T and X agree to reduce the amount of the purchase money indebtedness to $80,000. Assume that the reduction would be a purchase price reduction under section 108(e)(5). T and X's agreement to reduce the amount of the purchase money indebtedness would, under general principles of tax law that would apply if the deemed asset sale had actually occurred, change the amount of liabilities of old target taken into account in determining its basis. Accordingly, AGUB is redetermined at the time of the reduction. See paragraph (e)(2) of this section. Thus the purchase price reduction affects the basis of the truck only indirectly, through the mechanism of §§1.338–6 and 1.338–7. See §1.338–4(b)(2)(iii) *Example* for the effect on ADSP.

Example 2. T, an accrual basis taxpayer, is a chemical manufacturer. In Year 1, T is obligated to remediate environmental contamination at the site of one of its plants. Assume that all the events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy but economic performance has not occurred with respect to the liability within the meaning of section 461(h). P acquires all of the stock of T in Year 1 and makes a section 338 election for T. Assume that, if a corporation unrelated to T had actually purchased T's assets and assumed T's obligation to remediate the contamination, the corporation would not satisfy the economic performance requirements until Year 5. Under section 461(h), the assumed liability would not be treated as incurred and taken into account in basis until that time. The incurrence of the liability in Year 5 under the economic performance rules is an increase in the amount of liabilities properly taken into account in basis and results in the redetermination of AGUB. (Respecting ADSP, compare §1.461–4(d)(5), which provides that economic performance occurs for old T as the amount of the liability is properly taken into account in amount realized on the deemed asset sale. Thus ADSP is not redetermined when new T satisfies the economic performance requirements.)

(c) *Grossed-up basis of recently purchased stock.* The purchasing corporation's grossed-up basis of recently purchased target stock (as defined in section 338(b)(6)(A)) is an amount equal to—

(1) The purchasing corporation's basis in recently purchased target stock at the beginning of the day after the acquisition date determined without regard to the acquisition costs taken into account in paragraph (c)(3) of this section;

(2) Multiplied by a fraction, the numerator of which is 100 percent minus the percentage of target stock (by value, determined on the acquisition date) attributable to the purchasing corporation's nonrecently purchased target stock, and the denominator of which is the percentage of target stock (by value, determined on the acquisition date) attributable to the purchasing corporation's recently purchased target stock;

(3) Plus the acquisition costs the purchasing corporation incurred in connection with its purchase of the recently purchased stock that are capitalized in the basis of such stock (e.g., brokerage commissions and any similar costs incurred by the purchasing corporation to acquire the stock).

(d) *Basis of nonrecently purchased stock; gain recognition election*—(1) *No gain recognition election.* In the absence of a gain recognition election under section 338(b)(3) and this section, the purchasing corporation retains its basis in the nonrecently purchased stock.

(2) *Procedure for making gain recognition election.* A gain recognition election may be made for nonrecently purchased stock of target (or a target affiliate) only if a section 338 election is made for target (or the target affiliate). The gain recognition election is made by attaching a gain recognition statement to a timely filed Form 8023 for target. The gain recognition statement must contain the information specified in the form and its instructions. The gain recognition election is irrevocable. If a section 338(h)(10) election is made for target, see §1.338(h)(10)–1(d)(1) (providing that the purchasing corporation is automatically deemed to have made a gain recognition election for its nonrecently purchased T stock).

(3) *Effect of gain recognition election*—(i) *In general.* If the purchasing corporation makes a gain recognition election, then for all purposes of the Internal Revenue Code—

(A) The purchasing corporation is treated as if it sold on the acquisition date the nonrecently purchased target stock for the basis amount determined under paragraph (d)(3)(ii) of this section; and

(B) The purchasing corporation's basis on the acquisition date in nonrecently purchased target stock immediately following the deemed sale in paragraph (d)(3)(i)(A) of this section is the basis amount.

(ii) *Basis amount.* The basis amount is equal to the amount in paragraph (c)(1) of this section (the purchasing corporation's basis in recently purchased target stock at the beginning of the day after the acquisition date determined without regard to the acquisition costs taken into account in paragraph (c)(3) of this section) multiplied by a fraction the numerator of which is the percentage of target stock (by value, determined on the acquisition date) attributable to the purchasing corporation's nonrecently purchased target stock and the denominator of which is 100 percent minus the numerator amount. Thus, if target has a single class of outstanding stock, the purchasing corporation's basis in each share of nonrecently purchased target stock after the gain recognition election is equal to the average price per share of the purchasing corporation's recently purchased target stock.

(iii) *Losses not recognized.* Only gains (unreduced by losses) on the nonrecently purchased target stock are recognized.

(iv) *Stock subject to election.* The gain recognition election applies to—

(A) All nonrecently purchased target stock; and

(B) Any nonrecently purchased stock in a target affiliate having the same acquisition date as target if such target affiliate stock is held by the purchasing corporation on such date.

(e) *Liabilities of new target*—(1) *In general.* The liabilities of new target are the liabilities of target (and the liabilities to which target's assets are subject) as of the beginning of the day after the acquisition date (other than liabilities that were neither liabilities of old target nor liabilities to which old target's assets were subject). In order to be taken into account in AGUB, a liability must be a liability of target that is properly taken into account in basis under general principles of tax law that would apply if new target had acquired its assets from an unrelated person for consideration that included the assumption of, or taking subject to, the liability. See §1.338–4(d)(1) for examples of when tax liabilities are considered liabilities assumed by new target.

(2) *Time and amount of liabilities.* The time for taking into account liabilities of old target in determining AGUB and the amount of the liabilities taken into account is determined as if new target had acquired its assets from an unrelated person for consideration that included the assumption of, or taking subject to, the liabilities. For example, an increase or decrease in a liability that does not affect the amount of new target's basis arising from the assumption of, or taking subject to, the liability is not taken into account in redetermining AGUB.

(3) *Interaction with deemed sale gain.* See §1.338–4(d)(3).

(f) *Adjustments by the Internal Revenue Service.* In connection with the examination of a return, the District Director may increase (or decrease) AGUB under the authority of section 338(b)(2) and allocate such amounts to target's assets under the authority of section 338(b)(5) so that AGUB and the basis of target's assets properly reflect the cost to the purchasing corporation of its interest in target's assets. Such items may include distributions from target to the purchasing corporation, capital contributions from the purchasing corporation to target during the 12-month acquisition period, or acquisitions of target stock by the purchasing corporation after the acquisition date from minority shareholders.

(g) *Examples.* The following examples illustrate this section. For purposes of the examples in this paragraph (g), T has no liabilities other than the tax liability for the deemed sale gain, T shareholders incur no costs in selling the T stock, and P incurs no costs in acquiring the T stock. The examples are as follows:

Example 1. (i) Before July 1 of Year 1, P purchases 10 of the 100 shares of T stock for $5,000. On July 1 of Year 2, P purchases 80 shares of T stock for $60,000 and makes a section 338 election for T. As of July 1 of Year 2, T's only asset is raw land with an adjusted basis to T of $50,400 and a fair market value of $100,000. T has no loss or tax credit carryovers to Year 2. T's marginal tax rate for any ordinary income or net capital gain resulting from the deemed asset sale is 34 percent. The 10 shares purchased before July 1 of Year 1 constitute nonrecently purchased T stock with respect to P's qualified stock purchase of T stock on July 1 of Year 2.

(ii) The ADSP formula as applied to these facts is the same as in §1.338–4(g) *Example 1.* Accordingly, the ADSP for T is $87,672.72. The existence of nonrecently purchased T stock is irrelevant for purposes of the ADSP formula, because that formula treats P's nonrecently purchased T stock in the same manner as T stock not held by P.

(iii) The total tax liability resulting from T's deemed asset sale, as calculated under the ADSP formula, is $12,672.72.

(iv) If P does not make a gain recognition election, the AGUB of new T's assets is $85,172.72, determined as follows (In the following formula, GRP is the grossed-up basis in P's recently purchased T stock, BNP is P's basis in nonrecently purchased T stock, L is T's liabilities, and X is P's acquisition costs for the recently purchased T stock):

AGUB = GRP + BNP + L + X

AGUB = $60,000 × [(1 − .1)/.8] + $5,000 + $12,672.72 + 0

AGUB = $85,172.72

(v) If P makes a gain recognition election, the AGUB of new T's assets is $87,672.72, determined as follows:

AGUB = $60,000 ([(1 − .1)/.8] + $60,000 ([(1 − .1)/.8] × [.1/(1 − .1)] + $12,672.72

AGUB = $87,672.72

(vi) The calculation of AGUB if P makes a gain recognition election may be simplified as follows:

AGUB = $60,000/.8 + $12,672.72

AGUB = $87,672.72

(vii) As a result of the gain recognition election, P's basis in its nonrecently purchased T stock is increased from $5,000 to $7,500 (i.e., $60,000 ([(1 − .1)/.8] × [.1/(1 − .1)]). Thus, P recognizes a gain in Year 2 with respect to its nonrecently purchased T stock of $2,500 (i.e., $7,500 − $5,000).

Example 2. On January 1 of Year 1, P purchases one-third of the T stock. On March 1 of Year 1, T distributes a dividend to all of its shareholders. On April 15 of Year 1, P purchases the remaining T stock and makes a section 338 election for T. In appropriate circumstances, the District Director may decrease the AGUB of T to take into account the payment of the dividend and properly reflect the fair market value of T's assets deemed purchased.

Example 3. (i) T's sole asset is a building worth $100,000. At this time, T has 100 shares of stock outstanding. On August 1 of Year 1, P purchases 10 of the 100 shares of T stock for $8,000. On June 1 of Year 2, P purchases 50 shares of T stock for $50,000. On June 15 of Year 2, P contributes a tract of land to the capital of T and receives 10 additional shares of T stock as a result of the contribution. Both the basis and fair market value of the land at that time are $10,800. On June 30 of Year 2, P purchases the remaining 40 shares of T stock for $40,000 and makes a section 338 election for T. The AGUB of T is $108,800.

(ii) To prevent the shifting of basis from the contributed property to other assets of T, the District Director may allocate $10,800 of the AGUB to the land, leaving $98,000 to be allocated to the building. See paragraph (f) of this section. Otherwise, applying the allocation rules of §1.338–6 would, on these facts, result in an allocation to the recently contributed land of an amount less than its value of $10,800, with the difference being allocated to the building already held by T.

Par. 5. Sections 1.338–6 and 1.338–7 are added to read as follows:

§1.338–6 Allocation of ADSP and AGUB among target assets.

(a) *Scope*—(1) *In general.* This section prescribes rules for allocating ADSP and AGUB among the acquisition date assets of a target for which a section 338 election is made.

(2) *Fair market value*—(i) *In general.* Generally, the fair market value of an asset is its gross fair market value (i.e., fair market value determined without regard to mortgages, liens, pledges, or other liabilities). However, for purposes of determining the amount of old target's deemed sale gain, the fair market value of any property

subject to a nonrecourse indebtedness will be treated as being not less than the amount of such indebtedness. (For purposes of the preceding sentence, a liability that was incurred because of the acquisition of the property is disregarded to the extent that such liability was not taken into account in determining old target's basis in such property.)

(ii) *Transaction costs.* Transaction costs are not taken into account in allocating ADSP or AGUB to assets in the deemed sale (except indirectly through their effect on the total ADSP or AGUB to be allocated).

(iii) *Internal Revenue Service authority.* In connection with the examination of a return, the Internal Revenue Service may challenge the taxpayer's determination of the fair market value of any asset by any appropriate method and take into account all factors, including any lack of adverse tax interests between the parties. For example, in certain cases the Internal Revenue Service may make an independent showing of the value of goodwill and going concern value as a means of calling into question the validity of the taxpayer's valuation of other assets.

(b) *General rule for allocating ADSP and AGUB*—(1) *Reduction in the amount of consideration for Class I assets.* Both ADSP and AGUB, in the respective allocation of each, are first reduced by the amount of Class I acquisition date assets. Class I assets are cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions. If the amount of Class I assets exceeds AGUB, new target will immediately realize ordinary income in an amount equal to such excess. The amount of ADSP or AGUB remaining after the reduction is to be allocated to the remaining acquisition date assets.

(2) *Other assets*—(i) *In general.* Subject to the limitations and other rules of paragraph (c) of this section, ADSP and AGUB (as reduced by the amount of Class I assets) are allocated among Class II acquisition date assets of target in proportion to the fair market values of such Class II assets at such time, then among Class III assets so held in such proportion, then among Class IV assets so held in such proportion, then among Class V assets so held in such proportion, then among Class VI assets so held in such proportion, and finally to Class VII assets.

(ii) *Class II assets.* Class II assets are actively traded personal property within the meaning of section 1092(d)(1) and §1.1092(d)–1 (determined without regard to section 1092(d)(3)). In addition, Class II assets include certificates of deposit and foreign currency even if they are not actively traded personal property. Examples of Class II assets include U.S. government securities and publicly traded stock.

(iii) *Class III assets.* Class III assets are accounts receivable, mortgages, and credit card receivables from customers which arise in the ordinary course of business.

(iv) *Class IV assets.* Class IV assets are stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

(v) *Class V assets.* Class V assets are all assets other than Class I, II, III, IV, VI, and VII assets.

(vi) *Class VI assets.* Class VI assets are all section 197 intangibles, as defined in section 197, except goodwill and going concern value.

(vii) *Class VII assets.* Class VII assets are goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a section 197 intangible).

(3) *Other items designated by the Internal Revenue Service.* Similar items may be added to any class described in this paragraph (b) by designation in the Internal Revenue Bulletin by the Internal Revenue Service.

(c) *Certain limitations and other rules for allocation to an asset*—(1) *Allocation not to exceed fair market value.* The amount of ADSP or AGUB allocated to an asset (other than Class VII assets) cannot exceed the fair market value of that asset at the beginning of the day after the acquisition date.

(2) *Allocation subject to other rules.* The amount of ADSP or AGUB allocated to an asset is subject to other provisions of the Internal Revenue Code or general principles of tax law in the same manner as if such asset were transferred to or acquired from an unrelated person in a sale or exchange. For example, if the deemed asset sale is a transaction described in section 1056(a) (relating to basis limitation for player contracts transferred in connection with the sale of a franchise), the amount of AGUB allocated to a contract for the services of an athlete cannot exceed the limitation imposed by that section. As another example, the amount of AGUB allocated to an amortizable section 197 intangible resulting from an assumption-reinsurance transaction is determined under section 197(f)(5).

(3) *Special rule for allocating AGUB when purchasing corporation has nonrecently purchased stock*—(i) *Scope.* This paragraph (c)(3) applies if at the beginning of the day after the acquisition date—

(A) The purchasing corporation holds nonrecently purchased stock for which a gain recognition election under section 338(b)(3) and §1.338–5(d) is not made; and

(B) The hypothetical purchase price determined under paragraph (c)(3)(ii) of this section exceeds the AGUB determined under §1.338–5(b).

(ii) *Determination of hypothetical purchase price.* Hypothetical purchase price is the AGUB that would result if a gain recognition election were made.

(iii) *Allocation of AGUB.* Subject to the limitations in paragraphs (c)(1) and (2) of this section, the portion of AGUB (after reduction by the amount of Class I assets) to be allocated to each Class II, III, IV, V, VI, and VII asset of target held at the beginning of the day after the acquisition date is determined by multiplying—

(A) The amount that would be allocated to such asset under the general rules of this section were AGUB equal to the hypothetical purchase price; by

(B) A fraction, the numerator of which is actual AGUB (after reduction by the amount of Class I assets) and the denominator of which is the hypothetical purchase price (after reduction by the amount of Class I assets).

(4) *Liabilities taken into account in determining amount realized on subsequent disposition.* In determining the amount realized on a subsequent sale or other disposition of property deemed purchased by new target, the entire amount of any liability taken into account in AGUB is considered to be an amount taken into account in determining new target's basis in

property that secures the liability for purposes of applying §1.1001–2(a). Thus, if a liability is taken into account in AGUB, §1.1001–2(a)(3) does not prevent the amount of such liability from being treated as discharged within the meaning of §1.1001–2(a)(4) as a result of new target's sale or disposition of the property which secures such liability.

(d) *Examples.* The following examples illustrate §§1.338–4, 1.338–5, and this section:

Example 1. (i) T owns 90 percent of the outstanding T1 stock. P purchases 100 percent of the outstanding T stock for $2,000. There are no acquisition costs. P makes a section 338 election for T and, as a result, T1 is considered acquired in a qualified stock purchase. A section 338 election is made for T1. The grossed-up basis of the T stock is $2,000 (i.e., $2,000 (1/1).

(ii) The liabilities of T as of the beginning of the day after the acquisition date (including the tax liability for the deemed sale gain) that would, under general principles of tax law, be properly taken into account before the close of new T's first taxable year, are as follows:

Liabilities (nonrecourse mortgage plus unsecured liabilities)	$ 700
Taxes Payable	300
Total	$ 1,000

(iii) The AGUB of T is determined as follows:

Grossed-up basis	$2,000
Total liabilities	1,000
AGUB	$ 3,000

(iv) Assume that ADSP is also $3,000.

(v) Assume that, at the beginning of the day after the acquisition date, T's cash and the fair market values of T's Class II, III, IV, and V assets are as follows:

Asset Class	*Asset*	*Fair market value*
I	Cash	$ 200*
II	Portfolio of actively traded securities	300
III	Accounts receivable	600
IV	Inventory	300
V	Building	800
V	Land	200
V	Investment in T1	450
	Total	$ 2,850

*Amount

(vi) Under paragraph (b)(1) of this section, the amount of ADSP and AGUB allocable to T's Class II, III, IV, and V assets is reduced by the amount of cash to $2,800, i.e., $3,000 – $200. $300 of ADSP and of AGUB is then allocated to actively traded securities. $600 of ADSP and of AGUB is then allocated to accounts receivable. $300 of ADSP and of AGUB is then allocated to the inventory. Since the remaining amount of ADSP and of AGUB is $1,600 (i.e., $3,000 – ($200 + $300 + $600 + $300)), an amount which exceeds the sum of the fair market values of T's Class V assets, the amount of ADSP and of AGUB allocated to each Class V asset is its fair market value:

Building	800
Land	200
Investment in T1	450
Total	$ 1,450

(vii) T has no Class VI assets. The amount of ADSP and of AGUB allocated to T's Class VII assets (goodwill and going concern value) is $150, i.e., $1,600 – $1,450.

(viii) The grossed-up basis of the T1 stock is $500, i.e., $450 (1/.9.

(ix) The liabilities of T as of the beginning of the day after the acquisition date (including the tax liability for the deemed sale gain) that would, under general principles of tax law, be properly taken into account before the close of new T's first taxable year, are as follows:

General Liabilities	$ 100
Taxes Payable	20
Total	$ 120

(x) The AGUB of T1 is determined as follows:

Grossed-up basis of T1 Stock	$ 500
Liabilities	120
AGUB	$ 620

(xi) Assume that ADSP is also $620.

(xii) Assume that at the beginning of the day after the acquisition date, T1's cash and the fair market values of its Class IV and VI assets are as follows:

Asset Class	*Asset*	*Fair market value*
I	Cash	$ 50*
IV	Inventory	200
VI	Patent	350
	Total	$ 600

*Amount

(xiii) The amount of ADSP and of AGUB allocable to T1's Class IV and VI assets is first reduced by the $50 of cash.

(xiv) Because the remaining amount of ADSP and of AGUB ($570) is an amount which exceeds the fair market value of T1's only Class IV asset, the inventory, the amount allocated to the inventory is its fair market value ($200). After that, the remaining amount of ADSP and of AGUB ($370) exceeds the fair market value of T1's only Class VI asset, the patent. Thus, the amount of ADSP and of AGUB allocated to the patent is its fair market value ($350).

(xv) The amount of ADSP and of AGUB allocated to T1's Class VII assets (goodwill and going concern value) is $20, i.e., $570 – $550.

Example 2. (i) Assume that the facts are the same as in *Example 1* except that P has, for five years, owned 20 percent of T's stock, which has a basis in P's hands at the beginning of the day after the acquisition date of $100, and P purchases the remaining 80 percent of T's stock for $1,600. P does not make a gain recognition election under section 338(b)(3).

(ii) Under §1.338–5(c), the grossed-up basis of recently purchased T stock is $1,600, i.e., $1,600 × (1 – .2)/.8.

(iii) The AGUB of T is determined as follows:

Grossed-up basis of recently purchased stock as determined under §1.338–5(c) ($1,600 × (1 – .2)/.8)	$ 1,600
Basis of nonrecently purchased stock	100
Liabilities	1,000
AGUB	$ 2,700

(iv) Since P holds nonrecently purchased stock, the hypothetical purchase price of the T stock must be computed and is determined as follows:

Grossed-up basis of recently purchased stock as determined under §1.338–5(c) ($1,600 × (1 – .2)/.8)	$ 1,600
Basis of nonrecently purchased stock as if the gain recognition election under §1.338–5(d)(2) had been made ($1,600 × .2/(1 – .2))	400
Liabilities	1,000
Total	$ 3,000

(v) Since the hypothetical purchase price ($3,000) exceeds the AGUB ($2,700) and no gain recognition election is made under section 338(b)(3), AGUB is allocated under paragraph (c)(3) of this section.

(vi) First, an AGUB amount equal to the hypothetical purchase price ($3,000) is allocated among the assets under the general rules of this section. The allocation is set forth in the column below entitled *Original Allocation.* Next, the allocation to each asset in Class II through Class VII is multiplied by a fraction having a numerator equal to the actual AGUB reduced by the amount of Class I assets ($2,700 – $200 = $2,500) and a denominator equal to the hypothetical purchase price reduced by the amount of Class I assets ($3,000 – $200 = $2,800), or 2,500/2,800. This produces the *Final Allocation:*

Class	*Asset*	*Original Allocation*	*Final Allocation*
I	Cash	$ 200	$ 200
II	Portfolio of actively traded securities	300	268*
III	Accounts receivable	600	536
IV	Inventory	300	268
V	Building	800	714
V	Land	200	178
V	Investment in T1	450	402
VII	Goodwill and going concern value	150	134
	Total	$ 3,000	$ 2,700

* All numbers rounded for convenience.

§1.338–7 Allocation of redetermined ADSP and AGUB among target assets.

(a) *Scope.* ADSP and AGUB are redetermined at such time and in such amount as an increase or decrease would be required under general principles of tax law for the elements of ADSP or AGUB. This section provides rules for allocating redetermined ADSP or AGUB when increases or decreases with respect to the elements of ADSP or AGUB are required after the close of new target's first taxable year. For determining and allocating ADSP or

AGUB when increases or decreases are required with respect to the elements of ADSP or AGUB before the close of new target's first taxable year, see §§1.338–4, 1.338–5, and 1.338–6.

(b) *Allocation of redetermined ADSP and AGUB.* When ADSP or AGUB is redetermined, a new allocation of ADSP or AGUB is made by allocating the redetermined ADSP or AGUB amount under the rules of §1.338–6. If the allocation of the redetermined ADSP or AGUB amount under §1.338–6 to a given asset is different from the original allocation to it, the difference is added to or subtracted from the original allocation to the asset, as appropriate. Amounts allocable to an acquisition date asset (or with respect to a disposed-of acquisition date asset) are subject to all the asset allocation rules (for example, the fair market value limitation in §1.338–6(c)(1)) as if the redetermined ADSP or AGUB were the ADSP or AGUB on the acquisition date.

(c) *Special rules for ADSP*—(1) *Increases or decreases in deemed sale gain taxable notwithstanding old target ceases to exist.* To the extent general principles of tax law would require a seller in an actual asset sale to account for events relating to the sale that occur after the sale date, target must make such an accounting. Target is not precluded from realizing additional deemed sale gain because the target is treated as a new corporation after the acquisition date.

(2) *Procedure for transactions in which section 338(h)(10) is not elected*—(i) *Deemed sale gain included in new target's return.* If an election under section 338(h)(10) is not made, any additional deemed sale gain of old target resulting from an increase or decrease in the ADSP is included in new target's income tax return for new target's taxable year in which the increase or decrease is taken into account. For example, if after the acquisition date there is an increase in the allocable ADSP of section 1245 property for which the recomputed basis (but not the adjusted basis) exceeds the portion of the ADSP allocable to that particular asset on the acquisition date, the additional gain is treated as ordinary income to the extent it does not exceed such excess amount. See paragraph (c)(2)(ii) of this section for the special treatment of old target's carryovers and carrybacks. Although included in new target's income tax return, the deemed sale gain is separately accounted for as an item of old target and may not be offset by income, gain, deduction, loss, credit, or other amount of new target. The amount of tax on income of old target resulting from an increase or decrease in the ADSP is determined as if such deemed sale gain had been recognized in old target's taxable year ending at the close of the acquisition date.

(ii) *Carryovers and carrybacks*—(A) *Loss carryovers to new target taxable years.* A net operating loss or net capital loss of old target may be carried forward to a taxable year of new target, under the principles of section 172 or 1212, as applicable, but is allowed as a deduction only to the extent of any recognized income of old target for such taxable year, as described in paragraph (c)(2)(i) of this section. For this purpose, however, taxable years of new target are not taken into account in applying the limitations in section 172(b)(1) or 1212(a)(1)(B) (or other similar limitations). In applying sections 172(b) and 1212(a)(1), only income, gain, loss, deduction, credit, and other amounts of old target are taken into account. Thus, if old target has an unexpired net operating loss at the close of its taxable year in which the deemed asset sale occurred that could be carried forward to a subsequent taxable year, such loss may be carried forward until it is absorbed by old target's income.

(B) *Loss carrybacks to taxable years of old target.* An ordinary loss or capital loss accounted for as a separate item of old target under paragraph (c)(2)(i) of this section may be carried back to a taxable year of old target under the principles of section 172 or 1212, as applicable. For this purpose, taxable years of new target are not taken into account in applying the limitations in section 172(b) or 1212(a) (or other similar limitations).

(C) *Credit carryovers and carrybacks.* The principles described in paragraphs (c)(2)(ii)(A) and (B) of this section apply to carryovers and carrybacks of amounts for purposes of determining the amount of a credit allowable under part IV, subchapter A, chapter 1 of the Internal Revenue Code. Thus, for example, credit carryovers of old target may offset only income tax attributable to items described in paragraph (c)(2)(i) of this section.

(3) *Procedure for transactions in which section 338(h)(10) is elected.* If an election under section 338(h)(10) is made, any additional deemed sale gain resulting from an increase or decrease in the ADSP is accounted for in determining the taxable income (or other amount) of the member of the selling consolidated group, the selling affiliate, or the S corporation shareholders to which such income, loss, or other amount is attributable for the taxable year in which such increase or decrease is taken into account.

(d) *Special rules for AGUB*—(1) *Effect of disposition or depreciation of acquisition date assets.* If an acquisition date asset has been disposed of, depreciated, amortized, or depleted by new target before an amount is added to the original allocation to the asset, the increased amount otherwise allocable to such asset is taken into account under general principles of tax law that apply when part of the cost of an asset not previously taken into account in basis is paid or incurred after the asset has been disposed of, depreciated, amortized, or depleted. A similar rule applies when an amount is subtracted from the original allocation to the asset. For purposes of the preceding sentence, an asset is considered to have been disposed of to the extent that its allocable portion of the decrease in AGUB would reduce its basis below zero.

(2) *Section 38 property.* Section 1.47–2(c) applies to a reduction in basis of section 38 property under this section.

(e) *Examples.* The following examples illustrate this section. Any amount described in the following examples is exclusive of interest. For rules characterizing deferred contingent payments as principal or interest, see §§1.483–4, 1.1274–2(g), and 1.1275–4(c). The examples are as follows:

Example 1. (i)(A) T's assets other than goodwill and going concern value, and their fair market values at the beginning of the day after the acquisition date, are as follows:

Asset Class	*Asset*	*Fair Market Value*
V	Building	$100
V	Stock of X (not a target)	200
	Total	$300

(B) T has no liabilities other than a contingent liability that would not be taken into account under general principles of tax law in an asset sale between

unrelated parties when the buyer assumed the liability or took property subject to it.

(ii)(A) On September 1, 2000, P purchases all of the outstanding stock of T for $270 and makes a section 338 election for T. The grossed-up basis of the T stock and T's AGUB are both $270. The AGUB is ratably allocated among T's Class V assets in proportion to their fair market values as follows:

Asset	*Basis*
Building ($270 (100/300)	$ 90
Stock ($270 (200/300)	180
Total	$270

(B) No amount is allocated to the Class VII assets. New T is a calendar year taxpayer. Assume that the X stock is a capital asset in the hands of new T.

(iii) On January 1, 2001, new T sells the X stock and uses the proceeds to purchase inventory.

(iv) Pursuant to events on June 30, 2002, the contingent liability of old T is at that time properly taken into account under general principles of tax law. The amount of the liability is $60.

(v) T's AGUB increases by $60 from $270 to $330. This $60 increase in AGUB is first allocated among T's acquisition date assets in accordance with the provisions of §1.338–6. Because the redetermined AGUB for T ($330) exceeds the sum of the fair market values at the beginning of the day after the acquisition date of the Class V acquisition date assets ($300), AGUB allocated to those assets is limited to those fair market values under §1.338–6(c)(1). As there are no Class VI assets, the remaining AGUB of $30 is allocated to goodwill and going concern value (Class VII assets). The amount of increase in AGUB allocated to each acquisition date asset is determined as follows:

Asset	*Original AGUB*	*Redetermined AGUB*	*Increase*
Building	$ 90	$ 100	$ 10
X Stock	180	200	20
Goodwill and going concern value	0	30	30
Total	$ 270	$ 330	$ 60

(vi) Since the X stock was disposed of before the contingent liability was properly taken into account for tax purposes, no amount of the increase in AGUB attributable to such stock may be allocated to any T asset. Rather, such amount ($20) is allowed as a capital loss to T for the taxable year 2002 under the principles of *Arrowsmith v. Commissioner,* 344 U.S. 6 (1952). In addition, the $10 increase in AGUB allocated to the building and the $30 increase in AGUB allocated to the goodwill and going concern value are treated as basis redeterminations in 2002. See paragraph (d)(1) of this section.

Example 2. (i) On January 1, 2002, P purchases all of the outstanding stock of T and makes a section 338 election for T. Assume that ADSP and AGUB of T are both $500 and are allocated among T's acquisition date assets as follows:

Asset Class	*Asset*	*Basis*
V	Machinery	$ 150
V	Land	250
VII	Goodwill and going concern value	100
	Total	$ 500

(ii) On September 30, 2004, P filed a claim against the selling shareholders of T in a court of appropriate jurisdiction alleging fraud in the sale of the T stock.

(iii) On January 1, 2007, the former shareholders refund $140 of the purchase price to P in a settlement of the lawsuit. Assume that, under general principles of tax law, both the seller and the buyer properly take into account such refund when paid. Assume also that the refund has no effect on the tax liability for the deemed sale gain. This refund results in a decrease of T's ADSP and AGUB of $140, from $500 to $360.

(iv) The redetermined ADSP and AGUB of $360 is allocated among T's acquisition date assets. Because ADSP and AGUB do not exceed the fair market value of the Class V assets, the ADSP and AGUB amounts are allocated to the Class V assets in proportion to their fair market values at the beginning of the day after the acquisition date. Thus, $135 ($150 × ($360/($150 + $250))) is allocated to the machinery and $225 ($250 × ($360/($150 + $250))) is allocated to the land. Accordingly, the basis of the machinery is reduced by $15 ($150 original allocation – $135 redetermined allocation) and the basis of the land is reduced by $25 ($250 original allocation – $225 redetermined allocation). No amount is allocated to the Class VII assets. Accordingly, the basis of the goodwill and going concern value is reduced by $100 ($100 original allocation – $0 redetermined allocation).

(v) Assume that, as a result of deductions under section 168, the adjusted basis of the machinery immediately before the decrease in AGUB is zero. The machinery is treated as if it were disposed of before the decrease is taken into account. In 2007, T recognizes income of $15, the character of which is determined under the principles of *Arrowsmith v. Commissioner,* 344 U.S. 6 (1952), and the tax benefit rule. No adjustment to the basis of T's assets is made for any tax paid on this amount. Assume also that, as a result of amortization deductions, the adjusted basis of the goodwill and going concern value immediately before the decrease in AGUB is $40. A similar adjustment to income is made in 2007 with respect to the $60 of previously amortized goodwill and going concern value.

(vi) In summary, the basis of T's acquisition date assets, as of January 1, 2007, is as follows:

Asset	*Basis*
Machinery	$ 0
Land	225
Goodwill and going concern value	0

Example 3. (i) Assume that the facts are the same as §1.338–6(d) *Example 2* except that the recently purchased stock is acquired for $1,600 plus additional payments that are contingent upon T's future earnings. Assume that, under general principles of tax law, such later payments are properly taken into account when paid. Thus, T's AGUB, determined as of the beginning of the day after the acquisition date (after reduction by T's cash of $200), is $2,500 and is allocated among T's acquisition date assets under §1.338–6(c)(3)(iii) as follows:

Class	*Asset*	*Final Allocation*
I	Cash	$ 200
II	Portfolio of actively traded securities	268*
III	Accounts receivable	536
IV	Inventory	268
V	Building	714
V	Land	178
V	Investment in T1	402
VII	Goodwill and going concern value	134
	Total	$ 2,700

* All numbers rounded for convenience.

(ii) After the close of new target's first taxable year, P pays an additional $200 for its recently purchased T stock. Assume that the additional consideration paid would not increase T's tax liability for the deemed sale gain.

(iii) T's AGUB increases by $200, from $2,700 to $2,900. This $200 increase in AGUB is accounted for in accordance with the provisions of §1.338–6(c)(3)(iii).

(iv) The hypothetical purchase price of the T stock is redetermined as follows:

Grossed-up basis of recently purchased stock as determined under §1.338–5(c) ($1,800 × (1 – .2)/.8)	$ 1,800
Basis of nonrecently purchased stock as if the gain recognition election under §1.338–5(d)(2) had been made ($1,800 × .2/(1 – .2))	450
Liabilities	1,000
Total	$ 3,250

(v) Since the redetermined hypothetical purchase price ($3,250) exceeds the redetermined AGUB ($2,900) and no gain recognition election was made under section 338(b)(3), the rules of §1.338–6(c)(3)(iii) are reapplied using the redetermined hypothetical purchase price and the redetermined AGUB.

(vi) First, an AGUB amount equal to the redetermined hypothetical purchase price ($3,250) is allo-

cated among the assets under the general rules of §1.338–6. The allocation is set forth in the column below entitled *Hypothetical Allocation.* Next, the allocation to each asset in Class II through Class VII is multiplied by a fraction with a numerator equal to the actual redetermined AGUB reduced by the amount of Class I assets ($2,900 – $200 = $2,700) and a denominator equal to the redetermined hypothetical purchase price reduced by the amount of Class I assets ($3,250 – $200 = $3,050), or 2,700/3,050. This produces the *Final Allocation*:

Class	*Asset*	*Hypothetical Allocation*	*Final Allocation*
I	Cash	$ 200	$ 200
II	Portfolio of actively traded securities	300	266*
III	Accounts receivable	600	531
IV	Inventory	300	266
V	Building	800	708
V	Land	200	177
V	Investment in T1	450	398
VII	Goodwill and going concern value	400	354
	Total	$ 3,250	$ 2900

* All numbers rounded for convenience.

(vii) As illustrated by this example, reapplying §1.338–6(c)(3) results in a basis increase for some assets and a basis decrease for other assets. The amount of redetermined AGUB allocated to each acquisition date asset is determined as follows:

Asset	*Original (c)(3) allocation*	*Redetermined (c)(3) allocation*	*Increase (decrease)*
Portfolio of actively traded securities	$ 268	$ 266	$ (2)
Accounts receivable	536	531	(5)
Inventory	268	266	(2)
Building	714	708	(6)
Land	178	177	(1)
Investment in T1	402	398	(4)
Goodwill and going concern value	134	354	220
Total	$ 2,500	$ 2,700	$ 200

Example 4. (i) On January 1, 2001, P purchases all of the outstanding T stock and makes a section 338 election for T. P pays $700 of cash and promises also to pay a maximum $300 of contingent consideration at various times in the future. Assume that, under general principles of tax law, such later payments are properly taken into account by P when paid. Assume also, however, that the current fair market value of the contingent payments is reasonably ascertainable. The fair market value of T's assets (other than goodwill and going concern value) as of the beginning of the following day is as follows:

Asset Class	*Assets*	*Fair market value*
V	Equipment	$ 200
V	Non-actively traded securities	100
V	Building	500
	Total	800

(ii) T has no liabilities. The AGUB is $700. In calculating ADSP, assume that, under §1.1001–1, the current amount realized attributable to the contingent consideration is $200. ADSP is therefore $900 ($700 cash plus $200).

(iii) (A) The AGUB of $700 is ratably allocated among T's Class V acquisition date assets in proportion to their fair market values as follows:

Asset	*Basis*
Equipment ($700 × 200/800)	$175.00
Non-actively traded securities ($700 × 100/800)	87.50
Building ($700 × 500/800)	437.50
Total	$700.00

(B) No amount is allocated to goodwill or going concern value.

(iv) (A) The ADSP of $900 is ratably allocated among T's Class V acquisition date assets in proportion to their fair market values as follows:

Asset	*Basis*
Equipment	$200
Non-actively traded securities	100
Building	500
Total	$800

(B) The remaining ADSP, $100, is allocated to goodwill and going concern value (Class VII).

(v) P and T file a consolidated return for 2001 and each following year with P as the common parent of the affiliated group.

(vi) In 2004, a contingent amount of $120 is paid by P. Assume that, under general principles of tax law, the payment is properly taken into account by P at the time made. In 2004, there is an increase in T's AGUB of $120. The amount of the increase allocated to each acquisition date asset is determined as follows:

Asset	*Original AGUB*	*Redetermined AGUB*	*Increase*
Equipment	$ 175.00	$ 200.00	$ 25.00
Land	87.50	100.00	12.50
Building	437.50	500.00	62.50
Goodwill and going concern value	0.00	20.00	20.00
Total	$ 700.00	$ 820.00	$ 120.00

Par. 6. Section 1.338–10 is added to read as follows:

§1.338–10 Filing of returns.

(a) *Returns including tax liability from deemed asset sale*—(1) *In general.* Except as provided in paragraphs (a)(2) and (3) of this section, any deemed sale gain is reported on the final return of old target filed for old target's taxable year that ends at the close of the acquisition date. If old target is the common parent of an affiliated group, the final return may be a consolidated return (any such consolidated return must also include any deemed sale gain of any members of the consolidated group that are acquired by the purchasing corporation on the same acquisition date as old target).

(2) *Old target's final taxable year otherwise included in consolidated return of*

selling group—(i) *General rule.* If the selling group files a consolidated return for the period that includes the acquisition date, old target is disaffiliated from that group immediately before the deemed asset sale and must file a deemed sale return separate from the group that includes only the deemed sale gain and the carryover items specified in paragraph (a)(2)(iii) of this section. The deemed asset sale occurs at the close of the acquisition date and is the last transaction of old target. Any transactions of old target occurring on the acquisition date other than the deemed asset sale are included in the selling group's consolidated return. A deemed sale return includes a combined deemed sale return as defined in paragraph (a)(4) of this section.

(ii) *Separate taxable year.* The deemed asset sale included in the deemed sale return under this paragraph (a)(2) occurs in a separate taxable year, except that old target's taxable year of the sale and the consolidated year of the selling group that includes the acquisition date are treated as the same year for purposes of determining the number of years in a carryover or carryback period.

(iii) *Carryover and carryback of tax attributes.* Target's attributes may be carried over to, and carried back from, the deemed sale return under the rules applicable to a corporation that ceases to be a member of a consolidated group.

(iv) *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).

(3) *Old target is an S corporation.* If target is an S corporation for the period that ends on the day before the acquisition date, old target must file a deemed sale return as a C corporation. For this purpose, the principles of paragraph (a)(2) of this section apply. This paragraph (a)(3) does not apply if an election under section 338(h)(10) is made for the S corporation.

(4) *Combined deemed sale return*—(i) *General rule.* Under section 338(h)(15), a combined deemed sale return (combined return) may be filed for all targets from a single selling consolidated group (as defined in §1.338(h)(10)–1(b)(3)) that are acquired by the purchasing corporation on the same acquisition date and that otherwise would be required to file separate deemed sale returns. The combined return must include all such targets. For example, T and T1 may be included in a combined return if—

(A) T and T1 are directly owned subsidiaries of S;

(B) S is the common parent of a consolidated group; and

(C) P makes qualified stock purchases of T and T1 on the same acquisition date.

(ii) *Gain and loss offsets.* Gains and losses recognized on the deemed asset sales by targets included in a combined return are treated as the gains and losses of a single target. In addition, loss carryovers of a target that were not subject to the separate return limitation year restrictions (SRLY restrictions) of the consolidated return regulations while that target was a member of the selling consolidated group may be applied without limitation to the gains of other targets included in the combined return. If, however, a target has loss carryovers that were subject to the SRLY restrictions while that target was a member of the selling consolidated group, the use of those losses in the combined return continues to be subject to those restrictions, applied in the same manner as if the combined return were a consolidated return. A similar rule applies, when appropriate, to other tax attributes.

(iii) *Procedure for filing a combined return.* A combined return is made by filing a single corporation income tax return in lieu of separate deemed sale returns for all targets required to be included in the combined return. The combined return reflects the deemed asset sales of all targets required to be included in the combined return. If the targets included in the combined return constitute a single affiliated group within the meaning of section 1504(a), the income tax return is signed by an officer of the common parent of that group. Otherwise, the return must be signed by an officer of each target included in the combined return. Rules similar to the rules in §1.1502–75(j) apply for purposes of preparing the combined return. The combined return must include an attachment prominently identified as an ELECTION TO FILE A COMBINED RETURN UNDER SECTION 338(h)(15). The attachment must—

(A) Contain the name, address, and employer identification number of each target required to be included in the combined return;

(B) Contain the following declaration (or a substantially similar declaration): EACH TARGET IDENTIFIED IN THIS ELECTION TO FILE A COMBINED RETURN CONSENTS TO THE FILING OF A COMBINED RETURN;

(C) For each target, be signed by a person who states under penalties of perjury that he or she is authorized to act on behalf of such target.

(iv) *Consequences of filing a combined return.* Each target included in a combined return is severally liable for any tax associated with the combined return. See §1.338–1(b)(3).

(5) *Deemed sale excluded from purchasing corporation's consolidated return.* Old target may not be considered a member of any affiliated group that includes the purchasing corporation with respect to its deemed asset sale.

(6) *Due date for old target's final return*—(i) *General rule.* Old target's final return is generally due on the 15th day of the third calendar month following the month in which the acquisition date occurs. See section 6072 (time for filing income tax returns).

(ii) *Application of §1.1502–76(c)*—(A) *In general.* Section 1.1502–76(c) applies to old target's final return if old target was a member of a selling group that did not file consolidated returns for the taxable year of the common parent that precedes the year that includes old target's acquisition date. If the selling group has not filed a consolidated return that includes old target's taxable period that ends on the acquisition date, target may, on or before the final return due date (including extensions), either—

(*1*) File a deemed sale return on the assumption that the selling group will file the consolidated return; or

(*2*) File a return for so much of old target's taxable period as ends at the close of the acquisition date on the assumption that the consolidated return will not be filed.

(B) *Deemed extension.* For purposes of applying §1.1502–76(c)(2), an extension of time to file old target's final return is considered to be in effect until the last date for making the election under section 338.

(C) *Erroneous filing of deemed sale return.* If, under this paragraph (a)(6)(ii), target files a deemed sale return but the selling group does not file a consolidated return, target must file a substituted return for old target not later than the due date (including extensions) for the return of the common parent with which old target would have been included in the consolidated return. The substituted return is for so much of old target's taxable year as ends at the close of the acquisition date. Under §1.1502–76(c)(2), the deemed sale return is not considered a return for purposes of section 6011 (relating to the general requirement of filing a return) if a substituted return must be filed.

(D) *Erroneous filing of return for regular tax year.* If, under this paragraph (a)(6)(ii), target files a return for so much of old target's regular taxable year as ends at the close of the acquisition date but the selling group files a consolidated return, target must file an amended return for old target not later than the due date (including extensions) for the selling group's consolidated return. (The amended return is a deemed sale return.)

(E) *Last date for payment of tax.* If either a substituted or amended final return of old target is filed under this paragraph (a)(6)(ii), the last date prescribed for payment of tax is the final return due date (as defined in paragraph (a)(6)(i) of this section).

(7) *Examples.* The following examples illustrate this paragraph (a):

Example 1. (i) S is the common parent of a consolidated group that includes T. The S group files calendar year consolidated returns. At the close of June 30 of Year 1, P makes a qualified stock purchase of T from S. P makes a section 338 election for T, and T's deemed asset sale occurs as of the close of T's acquisition date (June 30).

(ii) T is considered disaffiliated for purposes of reporting the deemed sale gain. Accordingly, T is included in the S group's consolidated return through T's acquisition date except that the tax liability for the deemed sale gain is reported in a separate deemed sale return of T. 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 of the deemed asset sale, and the taxable income bracket amounts available in calculating tax on the deemed sale return must be limited accordingly.

(iii) If P purchased the stock of T at 10 a.m. on June 30 of Year 1, the results would be the same. See paragraph (a)(2)(i) of this section.

Example 2. The facts are the same as in *Example 1*, except that the S group does not file consolidated returns. T must file a separate return for its taxable year ending on June 30 of Year 1, which return includes the deemed asset sale.

(b) *Waiver*—(1) *Certain additions to tax.* An addition to tax or additional amount (addition) under subchapter A of chapter 68 of the Internal Revenue Code arising on or before the last day for making the election under section 338 because 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 last day.

(2) *Notification.* The Internal Revenue 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 (b) is being asserted.

(3) *Elections or other actions required to be specified on a timely filed return*—(i) *In general.* If paragraph (b)(1) of this section applies or would apply if there were an underpayment, any election or other action that must be specified on a timely filed return for the taxable period covered by the late filed return described in paragraph (b)(1) of this section is considered timely if specified on a late-filed return filed on or before the last day for making the election under section 338.

(ii) *New target in purchasing corporation's consolidated return.* If new target is includible for its first taxable year in a consolidated return filed by the affiliated group of which the purchasing corporation is a member on or before the last day for making the election under section 338, 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) is considered timely if specified in an amended return filed on or before such last day, at the place where the consolidated return was filed.

(4) *Examples.* The following examples illustrate this paragraph (b):

Example 1. T is an unaffiliated corporation with a tax year ending March 31. At the close of September 20 of Year 1, P makes a qualified stock purchase of T. P does not join in filing a consolidated return. P makes a section 338 election for T on or before June 15 of Year 2, which causes T's taxable year to end as of the close of September 20 of Year 1. An income tax return for T's taxable period ending on September 20 of Year 1 was due on December 15 of Year 1. 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 June 15 of Year 2. (This waiver applies even if the acquisition date coincides with the last day of T's former taxable year, i.e., March 31 of Year 2.) Interest on any underpayment of tax for old T's short taxable year ending September 20 of Year 1 runs from December 15 of Year 1. A statement indicating that the waiver rule of this paragraph 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 by filing, on or before June 15 of Year 2, its first return (for the period beginning on September 21 of Year 1 and ending on December 31 of Year 1) indicating that a calendar year is chosen. See §1.338–1(b)(1). Any additions to tax or amounts described in this paragraph (b) that arise because of the late filing of a return for the period ending on December 31 of Year 1 are waived, because 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 March 15 of Year 2, and interest on any underpayment runs from that date.

Example 3. Assume the same facts as in *Example 2*, except that T's former taxable year ends on October 31. Although prior to the election old T had a return due on January 15 of Year 2 for its year ending October 31 of Year 1, that return need not be filed because a timely election under section 338 was made. Instead, old T must file a final return for the period ending on September 20 of Year 1, which is due on December 15 of Year 1.

§§1.338(b)–1, 1.338(b)–2T, and 1.338(b)–3T [Removed]

Par. 7. Sections 1.338(b)–1, 1.338(b)–2T, and 1.338(b)–3T, are removed.

Par. 8. Section 1.338(h)(10)–1 is revised to read as follows.

§1.338(h)(10)–1 Deemed asset sale and liquidation.

(a) *Scope.* This section prescribes rules for qualification for a section 338(h)(10) election and for making a section 338(h)(10) election. This section also prescribes the consequences of such election. The rules of this section are in addition to the rules of §§1.338–0 through 1.338–10 and 1.338(i)–1 and, in appropriate cases, apply instead of the rules of §§1.338–0 through 1.338–10 and 1.338(i)–1.

(b) *Definitions*—(1) *Consolidated target.* A *consolidated target* is a target that is a member of a consolidated group within the meaning of §1.1502–1(h) on the acquisition date and is not the common parent of the group on that date.

(2) *Selling consolidated group.* A *selling consolidated group* is the consolidated group of which the consolidated target is a member on the acquisition date.

(3) *Selling affiliate; affiliated target.* A *selling affiliate* is a domestic corporation that owns on the acquisition date an amount of stock in a domestic target, which amount of stock is described in section 1504(a)(2), and does not join in filing a consolidated return with the target. In such case, the target is an *affiliated target.*

(4) *S corporation target.* An *S corporation target* is a target that is an S corporation immediately before the acquisition date.

(5) *S corporation shareholders. S corporation shareholders* are the S corporation target's shareholders. Unless otherwise indicated, a reference to S corporation shareholders refers both to S corporation shareholders who do and those who do not sell their target stock.

(6) *Liquidation.* Any reference in this section to a liquidation is treated as a reference to the transfer described in paragraph (d)(4) of this section notwithstanding its ultimate characterization for Federal income tax purposes.

(c) *Section 338(h)(10) election*—(1) *In general.* A section 338(h)(10) election may be made for T if P acquires stock meeting the requirements of section 1504(a)(2) from a selling consolidated group, a selling affiliate, or the S corporation shareholders in a qualified stock purchase.

(2) *Simultaneous joint election requirement.* A section 338(h)(10) election is made jointly by P and the selling consolidated group (or the selling affiliate or the S corporation shareholders) on Form 8023 in accordance with the instructions to the form. S corporation shareholders who do not sell their stock must also consent to the election. The section 338(h)(10) election must be made not later than the 15th day of the 9th month beginning after the month in which the acquisition date occurs.

(3) *Irrevocability.* A section 338(h)(10) election is irrevocable. If a section 338(h)(10) election is made for T, a section 338 election is deemed made for T.

(4) *Effect of invalid election.* If a section 338(h)(10) election for T is not valid, the section 338 election for T is also not valid.

(d) *Certain consequences of section 338(h)(10) election.* For purposes of subtitle A of the Internal Revenue Code (except as provided in §1.338–1(b)(2)), the consequences to the parties of making a section 338(h)(10) election for T are as follows:

(1) *P.* P is automatically deemed to have made a gain recognition election for its nonrecently purchased T stock, if any. The effect of a gain recognition election includes a taxable deemed sale by P on the acquisition date of any nonrecently purchased target stock. See §1.338–5(d).

(2) *New T.* The AGUB for new T's assets is determined under §1.338–5 and is allocated among the acquisition date assets under §§1.338–6 and 1.338–7. Notwithstanding paragraph (d)(4) of this section (deemed liquidation of old T), new T remains liable for the tax liabilities of old T (including the tax liability for the deemed sale gain). For example, new T remains liable for the tax liabilities of the members of any consolidated group that are attributable to taxable years in which those corporations and old T joined in the same consolidated return. See §1.1502–6(a).

(3) *Old T—deemed sale*—(i) *In general.* Old T is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the assumption of or taking subject to liabilities in a single transaction at the close of the acquisition date (but before the deemed liquidation). See §1.338–1(a) regarding the tax characterization of the deemed asset sale. ADSP for old T is determined under §1.338–4 and allocated among the acquisition date assets under §§1.338–6 and 1.338–7. Old T realizes the deemed sale gain from the deemed asset sale before the close of the acquisition date while old T is a member of the selling consolidated group (or owned by the selling affiliate or owned by the S corporation shareholders). If T is an affiliated target, or an S corporation target, the principles of §§1.338–2(c)(10) and 1.338–10(a)(1), (5), and (6)(i) apply to the return on which the deemed sale gain is reported. When T is an S corporation target, T's S election continues in effect through the close of the acquisition date (including the time of the deemed asset sale and the deemed liquidation) notwithstanding section 1362(d)(2)(B). Also, when T is an S corporation target, any direct and indirect subsidiaries of T which T has elected to treat as qualified subchapter S subsidiaries under section 1361(b)(3) remain qualified subchapter S subsidiaries through the close of the acquisition date. No similar rule applies when a qualified subchapter S subsidiary, as opposed to the S corporation that is its owner, is the target the stock of which is actually purchased.

(ii) *Tiered targets.* In the case of parent-subsidiary chains of corporations making elections under section 338(h)(10), the deemed asset sale of a parent corporation is considered to precede that of its subsidiary. See §1.338–3(4)(i).

(4) *Old T and selling consolidated group, selling affiliate, or S corporation shareholders—deemed liquidation; tax characterization*—(i) *In general.* Old T is treated as if, before the close of the acquisition date, after the deemed asset sale in paragraph (d)(3) of this section, and while old T is a member of the selling consolidated group (or owned by the selling affiliate or owned by the S corporation shareholders), it transferred all of its assets to members of the selling consolidated group, the selling affiliate, or S corporation shareholders and ceased to exist. The transfer from old T is characterized for Federal income tax purposes in the same manner as if the parties had actually engaged in the transactions deemed to occur because of this section and taking into account other transactions that actually occurred or are deemed to occur. For example, the transfer may be treated as a distribution in pursuance of a plan of reorganization, a distribution in complete cancellation or redemption of all its stock, one of a series of distributions in complete cancellation or redemption of all its stock in accordance with a plan of liquidation, or part of a circular flow of cash. In most cases, the transfer will be treated as a distribution in complete liquidation to which section 336 or 337 applies.

(ii) *Tiered targets.* In the case of parent-subsidiary chains of corporations making elections under section 338(h)(10), the deemed liquidation of a subsidiary corporation is considered to

precede the deemed liquidation of its parent.

(5) *Selling consolidated group, selling affiliate, or S corporation shareholders*—(i) *In general.* If T is an S corporation target, S corporation shareholders (whether or not they sell their stock) take their pro rata share of the deemed sale gain into account under section 1366 and increase or decrease their basis in T stock under section 1367. Members of the selling consolidated group, the selling affiliate, or S corporation shareholders are treated as if, after the deemed asset sale in paragraph (d)(3) of this section and before the close of the acquisition date, they received the assets transferred by old T in the transaction described in paragraph (d)(4)(i) of this section. In most cases, the transfer will be treated as a distribution in complete liquidation to which section 331 or 332 applies.

(ii) *Basis and holding period of T stock not acquired.* A member of the selling consolidated group (or the selling affiliate or an S corporation shareholder) retaining T stock is treated as acquiring the stock so retained on the day after the acquisition date for its fair market value. The holding period for the retained stock starts on the day after the acquisition date. For purposes of this paragraph, the fair market value of all of the T stock equals the grossed-up amount realized on the sale to P of P's recently purchased target stock. See §1.338–4(c).

(iii) *T stock sale.* Members of the selling consolidated group (or the selling affiliate or S corporation shareholders) recognize no gain or loss on the sale or exchange of T stock included in the qualified stock purchase (although they may recognize gain or loss on the T stock in the deemed liquidation).

(6) *Nonselling minority shareholders other than nonselling S corporation shareholders*—(i) *In general.* This paragraph (d)(6) describes the treatment of shareholders of old T other than the following: members of the selling consolidated group, the selling affiliate, S corporation shareholders (whether or not they sell their stock), and P. For a description of the treatment of S corporation shareholders, see paragraph (d)(5) of this section. A shareholder to which this paragraph (d)(6) applies is called a minority shareholder.

(ii) *T stock sale.* A minority shareholder recognizes gain or loss on the shareholder's sale or exchange of T stock included in the qualified stock purchase.

(iii) *T stock not acquired.* A minority shareholder does not recognize gain or loss under this section with respect to shares of T stock retained by the shareholder. The shareholder's basis and holding period for that T stock is not affected by the section 338(h)(10) election.

(7) *Consolidated return of selling consolidated group.* If P acquires T in a qualified stock purchase from a selling consolidated group—

(i) The selling consolidated group must file a consolidated return for the taxable period that includes the acquisition date;

(ii) A consolidated return for the selling consolidated group for that period may not be withdrawn on or after the day that a section 338(h)(10) election is made for T; and

(iii) Permission to discontinue filing consolidated returns cannot be granted for, and cannot apply to, that period or any of the immediately preceding taxable periods during which consolidated returns continuously have been filed.

(8) *Availability of the section 453 installment method.* Solely for purposes of applying sections 453, 453A, and 453B, and the regulations thereunder (the installment method) to determine the consequences to old T in the deemed asset sale and to old T (and its shareholders, if relevant) in the deemed liquidation, the rules in paragraphs (d)(1) through (7) of this section are modified as follows:

(i) *In deemed asset sale.* Old T is treated as receiving in the deemed asset sale new T installment obligations, the terms of which are identical (except as to the obligor) to P installment obligations issued in exchange for recently purchased stock of T. Old T is treated as receiving in cash all other consideration in the deemed asset sale other than the assumption of, or taking subject to, old T liabilities. For example, old T is treated as receiving in cash any amounts attributable to the grossing-up of amount realized under §1.338–4(c). The amount realized for recently purchased stock taken into account in determining ADSP is adjusted (and, thus, ADSP is redetermined) to reflect the amounts paid under an installment obligation for the stock when the total payments under the installment obligation are greater or less than the amount realized.

(ii) *In deemed liquidation.* Old T is treated as distributing in the deemed liquidation the new T installment obligations that it is treated as receiving in the deemed asset sale. The members of the selling consolidated group, the selling affiliate, or the S corporation shareholders are treated as receiving in the deemed liquidation the new T installment obligations that correspond to the P installment obligations they actually received individually in exchange for their recently purchased stock. The new T installment obligations may be recharacterized under other rules. See for example §1.453–11(a)(2) which, in certain circumstances, treats the new T installment obligations deemed distributed by old T as if they were issued by new T in exchange for the members' of the selling consolidated group, the selling affiliate's, or the S corporation shareholders' stock in old T. The members of the selling consolidated group, the selling affiliate, or the S corporation shareholders are treated as receiving all other consideration in the deemed liquidation in cash.

(9) *Treatment consistent with an actual asset sale.* Old T may not assert any provision in section 338(h)(10) or this section to obtain a tax result that would not be obtained if the parties had actually engaged in the transactions deemed to occur because of this section and taking into account other transactions that actually occurred or are deemed to occur.

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

Example 1. (i) S1 owns all of the T stock and T owns all of the stock of T1 and T2. S1 is the common parent of a consolidated group that includes T, T1, and T2. P makes a qualified stock purchase of all of the T stock from S1. S1 joins with P in making a section 338(h)(10) election for T and for the deemed purchase of T1. A section 338 election is not made for T2.

(ii) S1 does not recognize gain or loss on the sale of the T stock and T does not recognize gain or loss on the sale of the T1 stock because section 338(h)(10) elections are made for T and T1. Thus, for example, gain or loss realized on the sale of the T or T1 stock is not taken into account in earnings and profits. However, because a section 338 election is not made for T2, T must recognize any gain or loss realized on the deemed sale of the T2 stock. See §1.338–4(h).

(iii) The results would be the same if S1, T, T1, and T2 are not members of any consolidated group, because S1 and T are selling affiliates.

Example 2. (i) S and T are solvent corporations. S owns all of the outstanding stock of T. S and P agree to undertake the following transaction: T will distribute half its assets to S, and S will assume half of T's liabilities. Then, P will purchase the stock of T from S. S and P will jointly make a section 338(h)(10) election with respect to the sale of T. The corporations then complete the transaction as agreed.

(ii) Under section 338(a), the assets present in T at the close of the acquisition date are deemed sold by old T to new T. Under paragraph (d)(4) of this section, the transactions described in paragraph (d) of this section are treated in the same manner as if they had actually occurred. Because S and P had agreed that, after T's actual distribution to S of part of its assets, S would sell T to P pursuant to an election under section 338(h)(10), and because paragraph (d)(4) of this section deems T subsequently to have transferred all its assets to its shareholder, T is deemed to have adopted a plan of complete liquidation under section 332. T's actual transfer of assets to S is treated as a distribution pursuant to that plan of complete liquidation.

Example 3. (i) S1 owns all of the outstanding stock of both T and S2. All three are corporations. S1 and P agree to undertake the following transaction. T will transfer substantially all of its assets and liabilities to S2, with S2 issuing no stock in exchange therefor, and retaining its other assets and liabilities. Then, P will purchase the stock of T from S1. S1 and P will jointly make a section 338(h)(10) election with respect to the sale of T. The corporations then complete the transaction as agreed.

(ii) Under section 338(a), the assets present in T at the close of the acquisition date are deemed sold by old T to new T. Under paragraph (d)(4) of this section, the transactions described in this section are treated in the same manner as if they had actually occurred. Because old T transferred substantially all of its assets to S2, and is deemed to have distributed all its remaining assets and gone out of existence, the transfer of assets to S2, taking into account the related transfers, deemed and actual, qualifies as a reorganization under section 368(a)(1)(D). Section 361(c)(1) and not section 332 applies to T's deemed liquidation.

Example 4. (i) T owns two assets: an actively traded security (Class II) with a fair market value of $100 and an adjusted basis of $100, and inventory (Class IV) with a fair market value of $100 and an adjusted basis of $100. T has no liabilities. S is negotiating to sell all the stock in T to P for $100 cash and contingent consideration. Assume that under generally applicable tax accounting rules, P's adjusted basis in the T stock immediately after the purchase would be $100, because the contingent consideration is not taken into account. Thus, under the rules of §1.338–5, AGUB would be $100. Under the allocation rules of §1.338–6, the entire $100 would be allocated to the Class II asset, the actively traded security, and no amount would be allocated to the inventory. P, however, plans immediately to cause T to sell the inventory, but not the actively traded security, so it requests that, prior to the stock sale, S cause T to create a new subsidiary, Newco, and contribute the actively traded security to the capital of Newco. Because the stock in Newco, which would not be actively traded, is a Class V asset, under the rules of §1.338–6 $100 of AGUB would be allocated to the inventory and no amount of AGUB would be allocated to the Newco stock. Newco's own AGUB, $0 under the rules of §1.338–5, would be allocated to the actively traded security. When P subsequently causes T to sell the inventory, T would realize no gain or loss instead of realizing gain of $100.

(ii) Assume that, if the T stock had not itself been sold but T had instead sold both its inventory and the Newco stock to P, T would for tax purposes be deemed instead to have sold both its inventory and actively traded security directly to P, with P deemed then to have created Newco and contributed the actively traded security to the capital of Newco. Section 338, if elected, generally recharacterizes a stock sale as a deemed sale of assets. The tax results of the deemed sale of assets should, where possible, be like those of an actual asset sale. Hence, the deemed sale of assets under section 338(h)(10) should be treated as one of the inventory and actively traded security themselves, not of the inventory and Newco stock. That is the substance of the transaction. The anti-abuse rule of §1.338–1(c) does not apply, because the substance of the deemed sale of assets is a sale of the inventory and the actively traded security themselves, not of the inventory and the Newco stock. Otherwise, the anti-abuse rule might apply.

Example 5. (i) T, a member of a selling consolidated group, has only one class of stock, all of which is owned by S1. On March 1 of Year 2, S1 sells its T stock to P for $80,000, and joins with P in making a section 338(h)(10) election for T. There are no selling costs or acquisition costs. On March 1 of Year 2, T owns land with a $50,000 basis and $75,000 fair market value and equipment with a $30,000 adjusted basis, $70,000 recomputed basis, and $60,000 fair market value. T also has a $40,000 liability. S1 pays old T's allocable share of the selling group's consolidated tax liability for Year 2 including the tax liability for the deemed sale gain (a total of $13,600).

(ii) ADSP of $120,000 ($80,000 + $40,000 + 0) is allocated to each asset as follows:

Assets	*Basis*	*FMV*	*Fraction*	*Allocable ADSP*
Land	$ 50,000	$ 75,000	5/9	$ 66,667
Equipment	30,000	60,000	4/9	53,333
Total	$ 80,000	$ 135,000	1	$ 120,000

(iii) Under paragraph (d)(3) of this section, old T has gain on the deemed sale of $40,000 (consisting of $16,667 of capital gain and $23,333 of ordinary income).

(iv) Under paragraph (d)(5)(iii) of this section, S1 recognizes no gain or loss upon its sale of the old T stock to P. S1 also recognizes no gain or loss upon the deemed liquidation of T. See paragraph (d)(4) of this section and section 332.

(v) P's basis in new T stock is P's cost for the stock, $80,000. See section 1012.

(vi) Under §1.338–5, the AGUB for new T is $120,000, i.e., P's cost for the old T stock ($80,000) plus T's liability ($40,000). This AGUB is allocated as basis among the new T assets under §§1.338–6 and 1.338–7.

Example 6. (i) The facts are the same as in *Example 5,* except that S1 sells 80 percent of the old T stock to P for $64,000, rather than 100 percent of the old T stock for $80,000.

(ii) The consequences to P, T, and S1 are the same as in Example 5, except that:

(A) P's basis for its 80-percent interest in the new T stock is P's $64,000 cost for the stock. See section 1012.

(B) Under §1.338–5, the AGUB for new T is $120,000 (i.e., $64,000/.8 + $40,000 + $0).

(C) Under paragraph (d)(4) of this section, S1 recognizes no gain or loss with respect to the retained stock in T. See section 332.

(D) Under paragraph (d)(5)(ii) of this section, the basis of the T stock retained by S1 is $16,000 (i.e., $120,000 – $40,000 (the ADSP amount for the old T assets over the sum of new T's liabilities immediately after the acquisition date) × .20 (the proportion of T stock retained by S1)).

Example 7. (i) The facts are the same as in *Example 6,* except that K, a shareholder unrelated to T or P, owns the 20 percent of the T stock that is not acquired by P in the qualified stock purchase. K's basis in its T stock is $5,000.

(ii) The consequences to P, T, and S1 are the same as in *Example 6.*

(iii) Under paragraph (d)(6)(iii) of this section, K recognizes no gain or loss, and K's basis in its T stock remains at $5,000.

Example 8. (i) The facts are the same as in *Example 5,* except that the equipment is held by T1, a wholly-owned subsidiary of T, and a section 338(h)(10) election is also made for T1. The T1 stock has a fair market value of $60,000. T1 has no assets other than the equipment and no liabilities. S1 pays old T's and old T1's allocable shares of the selling group's consolidated tax liability for Year 2 including the tax liability for T and T1's deemed sale gain.

(ii) ADSP for T is $120,000, allocated $66,667 to the land and $53,333 to the stock. Old T's deemed sale gain is $16,667 (the capital gain on its deemed sale of the land). Under paragraph (d)(5)(iii) of this section, old T does not recognize gain or loss on its deemed sale of the T1 stock. See section 332.

(iii) ADSP for T1 is $53,333 (i.e., $53,333 + $0 + $0). On the deemed sale of the equipment, T1 recognizes ordinary income of $23,333.

(iv) Under paragraph (d)(5)(iii) of this section, S1 does not recognize gain or loss upon its sale of the old T stock to P.

Example 9. (i) The facts are the same as in *Example 8,* except that P already owns 20 percent of the T stock, which is nonrecently purchased stock with a basis of $6,000, and that P purchases the remaining 80 percent of the T stock from S1 for $64,000.

(ii) The results are the same as in *Example 8,* except that under paragraph (d)(1) of this section and

§1.338–5(d), P is deemed to have made a gain recognition election for its nonrecently purchased T stock. As a result, P recognizes gain of $10,000 and its basis in the nonrecently purchased T stock is increased from $6,000 to $16,000. P's basis in all the T stock is $80,000 (i.e., $64,000 + $16,000). The computations are as follows:

(A) P's grossed-up basis for the recently purchased T stock is $64,000 (i.e., $64,000 (the basis of the recently purchased T stock) × (1 – .2)/(.8) (the fraction in section 338(b)(4))).

(B) P's basis amount for the nonrecently purchased T stock is $16,000 (i.e., $64,000 (the grossed-up basis in the recently purchased T stock) × (.2)/(1.0 – .2) (the fraction in section 338(b)(3)(B))).

(C) The gain recognized on the nonrecently purchased stock is $10,000 (i.e., $16,000 – $6,000).

Example 10. (i) T is an S corporation whose sole class of stock is owned 40 percent each by A and B and 20 percent by C. A and B each has an adjusted basis of $10,000 in the stock. C has an adjusted basis of $5,000 in the stock. A, B, and C hold no installment obligations to which section 453A applies. On March 1 of Year 1, A sells its stock to P for $40,000 in cash and B sells its stock to P for a $25,000 note issued by P and real estate having a fair market value of $15,000. The $25,000 note, due in full in Year 7, is not publicly traded and bears adequate stated interest. A and B have no selling expenses. T's sole asset is real estate, which has a value of $110,000 and an adjusted basis of $35,000. Also, T's real estate is encumbered by long-outstanding purchase-money indebtedness of $10,000. The real estate does not have built-in gain subject to section 1374. A, B, and C join with P in making a section 338(h)(10) election for T.

(ii) Solely for purposes of application of sections 453, 453A, and 453B, old T is considered in its deemed asset sale to receive back from new T the $25,000 note (considered issued by new T) and $75,000 of cash (total consideration of $80,000 paid for all the stock sold, which is then divided by .80 in the grossing-up, with the resulting figure of $100,000 then reduced by the amount of the installment note). Absent an election under section 453(d), gain is reported by old T under the installment method.

(iii) In applying the installment method to old T's deemed asset sale, the contract price for old T's assets deemed sold is $100,000, the $110,000 selling price reduced by the indebtedness of $10,000 to which the assets are subject. (The $110,000 selling price is itself the sum of the $80,000 grossed-up in paragraph (ii) above to $100,000 and the $10,000 liability.) Gross profit is $75,000 ($110,000 selling price – old T's basis of $35,000). Old T's gross profit ratio is 0.75 (gross profit of $75,000 â $100,000 contract price). Thus, $56,250 (0.75 (the $75,000 cash old T is deemed to receive in Year 1) is Year 1 gain attributable to the sale, and $18,750 ($75,000 – $56,250) is recovery of basis.

(iv) In its liquidation, old T is deemed to distribute the $25,000 note to B, since B actually sold the stock partly for that consideration. To the extent of the remaining liquidating distribution to B, it is deemed to receive, along with A and C, the balance of old T's liquidating assets in the form of cash. Under section 453(h), B, unless it makes an election under section 453(d), is not required to treat the receipt of the note as a payment for the T stock; P's payment of the $25,000 note in Year 7 to B is a payment for the T stock. Because section 453(h) applies to B, old T's deemed liquidating distribution of the note is, under section 453B(h), not treated as a taxable disposition by old T.

(v) Under section 1366, A reports 40 percent, or $22,500, of old T's $56,250 gain recognized in Year 1. Under section 1367, this increases A's $10,000 adjusted basis in the T stock to $32,500. Next, in old T's deemed liquidation, A is considered to receive $40,000 for its old T shares, causing it to recognize an additional $7,500 gain in Year 1.

(vi) Under section 1366, B reports 40 percent, or $22,500, of old T's $56,250 gain recognized in Year 1. Under section 1367, this increases B's $10,000 adjusted basis in its T stock to $32,500. Next, in old T's deemed liquidation, B is considered to receive the $25,000 note and $15,000 of other consideration. Applying section 453, including section 453(h), to the deemed liquidation, B's selling price and contract price are both $40,000. Gross profit is $7,500 ($40,000 selling price – B's basis of $32,500). B's gross profit ratio is 0.1875 (gross profit of $7,500 â $40,000 contract price). Thus, $2,812.50 (0.1875 ($15,000) is Year 1 gain attributable to the deemed liquidation. In Year 7, when the $25,000 note is paid, B has $4,687.50 (0.1875 × $25,000) of additional gain.

(vii) Under section 1366, C reports 20 percent, or $11,250, of old T's $56,250 gain recognized in Year 1. Under section 1367, this increases C's $5,000 adjusted basis in its T stock to $16,250. Next, in old T's deemed liquidation, C is considered to receive $20,000 for its old T shares, causing it to recognize an additional $3,750 gain in Year 1. Finally, under paragraph (d)(5)(ii) of this section, C is considered to acquire its stock in T on the day after the acquisition date for $20,000 (fair market value = grossed-up amount realized of $100,000 (20%). C's holding period in the stock deemed received in new T begins at that time.

(f) *Inapplicability of provisions.* The provisions of section 6043, §1.331–1(d), and §1.332–6 (relating to information returns and recordkeeping requirements for corporate liquidations) do not apply to the deemed liquidation of old T under paragraph (d)(4) of this section.

(g) *Required information.* The Commissioner may exercise the authority granted in section 338(h)(10)(C)(iii) to require provision of any information deemed necessary to carry out the provisions of section 338(h)(10) by requiring submission of information on any tax reporting form.

Par. 9. Section 1.338(i)–1 is revised to read as follows:

§1.338(i)–1 Effective dates.

The provisions of §§1.338–0 through 1.338–10 and 1.338(h)(10)–1 apply to any qualified stock purchase occurring after the date that final regulations are published in the **Federal Register.** For rules applicable to qualified stock purchases before the date that final regulations are published in the **Federal Register,** see §§1.338–0 through 1.338–5, 1.338(b)–1, 1.338(b)–2T, 1.338(b)–3T, 1.338(h)(10)–1, and 1.338(i)–1 as contained in 26 CFR part 1 revised April 1, 1999.

Par. 10. Section 1.1060–1 is added to read as follows:

§1.1060–1 Special allocation rules for certain asset acquisitions.

(a) *Scope*—(1) *In general.* This section prescribes rules relating to the requirements of section 1060, which, in the case of an applicable asset acquisition, requires the transferor (the seller) and the transferee (the purchaser) each to allocate the consideration paid or received in the transaction among the assets transferred in the same manner as amounts are allocated under section 338(b)(5) (relating to the allocation of adjusted grossed-up basis among the assets of the target corporation when a section 338 election is made). In the case of an applicable asset acquisition described in paragraph (b)(1) of this section, sellers and purchasers must allocate the consideration under the residual method as described in §§1.338–6 and 1.338–7 in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets. For rules relating to distributions of partnership property or transfers of partnership interests which are subject to section 1060(d), see §1.755–2T.

(2) *Effective date.* The provisions of this section apply to any asset acquisition occurring after the date that final regulations are published in the **Federal Register.**

(3) *Outline of topics.* In order to facilitate the use of this section, this paragraph (a)(3) lists the major paragraphs in this section as follows:

(a) Scope.
(1) In general.
(2) Effective date.
(3) Outline of topics.
(b) Applicable asset acquisition.
(1) In general.
(2) Assets constituting a trade or business.
(i) In general.

(ii) Goodwill or going concern value.
(iii) Factors indicating goodwill or going concern value.
(3) Examples.
(4) Asymmetrical transfers of assets.
(5) Related transactions.
(6) More than a single trade or business.
(7) Covenant entered into by the seller.
(8) Partial non-recognition exchanges.
(c) Allocation of consideration among assets under the residual method.
(1) Consideration.
(2) Allocation of consideration among assets.
(3) Certain costs.
(4) Effect of agreement between parties.
(d) Examples.
(e) Reporting requirements.
(1) Applicable asset acquisitions.
(i) In general.
(ii) Time and manner of reporting.
(A) In general.
(B) Additional reporting requirement.
(2) Transfers of interests in partnerships.

(b) *Applicable asset acquisition*—(1) *In general.* An applicable asset acquisition is any transfer, whether direct or indirect, of a group of assets if the assets transferred constitute a trade or business in the hands of either the seller or the purchaser and, except as provided in paragraph (b)(8) of this section, the purchaser's basis in the transferred assets is determined wholly by reference to the purchaser's consideration.

(2) *Assets constituting a trade or business*—(i) *In general.* For purposes of this section, a group of assets constitutes a trade or business if—

(A) The use of such assets would constitute an active trade or business under section 355; or

(B) Its character is such that goodwill or going concern value could under any circumstances attach to such group.

(ii) *Goodwill or going concern value.* Goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor. Going concern value is the additional value that attaches to property because of its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership. It also includes the value that is attributable to the immediate use or availability of an acquired trade or business, such as, for example, the use of the revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

(iii) *Factors indicating goodwill or going concern value.* In making the determination in paragraph (b)(2) of this section, all the facts and circumstances surrounding the transaction are taken into account. Whether sufficient consideration is available to allocate to goodwill or going concern value after the residual method is applied is not relevant in determining whether goodwill or going concern value could attach to a group of assets. Factors to be considered include—

(A) The presence of any intangible assets (whether or not those assets are section 197 intangibles), provided, however, that the transfer of such an asset in the absence of other assets will not be a trade or business for purposes of section 1060;

(B) The existence of an excess of the total consideration over the aggregate book value of the tangible and intangible assets purchased (other than goodwill and going concern value) as shown in the financial accounting books and records of the purchaser; and

(C) Related transactions, including lease agreements, licenses, or other similar agreements between the purchaser and seller (or managers, directors, owners, or employees of the seller) in connection with the transfer.

(3) *Examples.* The following examples illustrate paragraphs (b)(1) and (2) of this section:

Example 1. S is a high grade machine shop that manufactures microwave connectors in limited quantities. It is a successful company with a reputation within the industry and among its customers for manufacturing unique, high quality products. Its tangible assets consist primarily of ordinary machinery for working metal and plating. It has no secret formulas or patented drawings of value. P is a company that designs, manufactures, and markets electronic components. It wants to establish an immediate presence in the microwave industry, an area in which it previously has not been engaged. P is acquiring assets of a number of smaller companies and hopes that these assets will collectively allow it to offer a broad product mix. P acquires the assets of S in order to augment its product mix and to promote its presence in the microwave industry. P will not use the assets acquired from S to manufacture microwave connectors. The assets transferred are assets that constitute a trade or business in the hands of the seller. Thus, P's purchase of S's assets is an applicable asset acquisition. The fact that P will not use the assets acquired from S to continue the business of S does not affect this conclusion.

Example 2. S, a sole proprietor who operates a car wash, both leases the building housing the car wash and sells all of the car wash equipment to P. S's use of the building and the car wash equipment constitute a trade or business. P begins operating a car wash in the building it leases from S. Because the assets transferred together with the asset leased are assets which constitute a trade or business, P's purchase of S's assets is an applicable asset acquisition.

Example 3. S, a corporation, owns a retail store business in State X and conducts activities in connection with that business enterprise that meet the active trade or business requirement of section 355. P is a minority shareholder of S. S distributes to P all the assets of S used in S's retail business in State X in complete redemption of P's stock in S held by P. The distribution of S's assets in redemption of P's stock is treated as a sale or exchange under sections 302(a) and 302(b)(3), and P's basis in the assets distributed to it is determined wholly by reference to the consideration paid, the S stock. Thus, S's distribution of assets constituting a trade or business to P is an applicable asset acquisition.

Example 4. S is a manufacturing company with an internal financial bookkeeping department. P is in the business of providing a financial bookkeeping service on a contract basis. As part of an agreement for P to begin providing financial bookkeeping services to S, P agrees to buy all of the assets associated with S's internal bookkeeping operations and provide employment to any of S's bookkeeping department employees who choose to accept a position with P. In addition to selling P the assets associated with its bookkeeping operation, S will enter into a long term contract with P for bookkeeping services. Because assets transferred from S to P, along with the related contract for bookkeeping services, are a trade or business in the hands of P, the sale of the bookkeeping assets from S to P is an applicable asset acquisition.

(4) *Asymmetrical transfers of assets.* If, under general principles of tax law, a seller is not treated as transferring the same assets as the purchaser is treated as acquiring, the assets acquired by the purchaser constitute a trade or business, and, except as provided in paragraph (b)(8) of this section, the purchaser's basis in the transferred assets is determined wholly by reference to the purchaser's consideration, then the purchaser is subject to section 1060.

(5) *Related transactions.* Whether the assets transferred constitute a trade or business is determined by aggregating all transfers from the seller to the purchaser in a series of related transactions. Except

as provided in paragraph (b)(8) of this section, all assets transferred from the seller to the purchaser in a series of related transactions are included in the group of assets among which the consideration paid or received in such series is allocated under the residual method. The principles of §1.338–1(c) are also applied in determining which assets are included in the group of assets among which the consideration paid or received is allocated under the residual method.

(6) *More than a single trade or business.* If the assets transferred from a seller to a purchaser include more than one trade or business, then, in applying this section, all of the assets transferred (whether or not transferred in one transaction or a series of related transactions and whether or not part of a trade or business) are treated as a single trade or business.

(7) *Covenant entered into by the seller.* If, in connection with an applicable asset acquisition, the seller enters into a covenant (e.g., a covenant not to compete) with the purchaser, that covenant is treated as an asset transferred as part of a trade or business.

(8) *Partial non-recognition exchanges.* A transfer may constitute an applicable asset acquisition notwithstanding the fact that no gain or loss is recognized with respect to a portion of the group of assets transferred. All of the assets transferred, including the non-recognition assets, are taken into account in determining whether the group of assets constitutes a trade or business. The allocation of consideration under paragraph (c) of this section is done without taking into account either the non-recognition assets or the amount of money or other property that is treated as transferred in exchange for the non-recognition assets (together, the non-recognition exchange property). The basis in and gain or loss recognized with respect to the non-recognition exchange property are determined under such rules as would otherwise apply to an exchange of such property. The amount of the money and other property treated as exchanged for non-recognition assets is the amount by which the fair market value of the non-recognition assets transferred by one party exceeds the fair market value of the non-recognition assets transferred by the other (to the extent of the money and the fair market value of property transferred in the exchange). The money and other property that are treated as transferred in exchange for the non-recognition assets (and which are not included among the assets to which section 1060 applies) are considered to come from the following assets in the following order: first from Class I assets, then from Class II assets, then from Class III assets, then from Class IV assets, then from Class V assets, then from Class VI assets, and then from Class VII assets. For this purpose, liabilities assumed (or to which a non-recognition exchange property is subject) are treated as Class I assets. See *Example 1* in paragraph (d) of this section for an example of the application of section 1060 to a single transaction which is, in part, a non-recognition exchange.

(c) *Allocation of consideration among assets under the residual method* —(1) *Consideration.* The seller's consideration is the amount, in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). The purchaser's consideration is the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis.

(2) *Allocation of consideration among assets.* For purposes of determining the seller's amount realized for each of the assets sold in an applicable asset acquisition, the seller allocates consideration to all the assets sold by using the residual method under §§1.338–6 and 1.338–7, substituting consideration for ADSP. For purposes of determining the purchaser's basis in each of the assets purchased in an applicable asset acquisition, the purchaser allocates consideration to all the assets purchased by using the residual method under §§1.338–6 and 1.338–7, substituting consideration for AGUB. In allocating consideration, the rules set forth in paragraphs (c)(3) and (4) of this section apply in addition to the rules in §§1.338–6 and 1.338–7.

(3) *Certain costs.* The seller and purchaser each adjusts the amount allocated to an individual asset to take into account the specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (e.g., real estate transfer costs or security interest perfection costs). Costs so allocated increase, or decrease, as appropriate, the total consideration that is allocated under the residual method. No adjustment is made to the amount allocated to an individual asset for general costs associated with the applicable asset acquisition as a whole or with groups of assets included therein (e.g., non-specific appraisal fees or accounting fees). These latter amounts are taken into account only indirectly through their effect on the total consideration to be allocated.

(4) *Effect of agreement between parties.* If, in connection with an applicable asset acquisition, the seller and purchaser agree in writing as to the allocation of any amount of consideration to, or as to the fair market value of, any of the assets, such agreement is binding on them to the extent provided in this paragraph (c)(4). Nothing in this paragraph (c)(4) restricts the Commissioner's authority to challenge the allocations or values arrived at in an allocation agreement. This paragraph (c)(4) does not apply if the parties are able to refute the allocation or valuation under the standards set forth in *Commissioner v. Danielson,* 378 F.2d 771 (3d Cir.), *cert. denied,* 389 U.S. 858 (1967) (a party wishing to challenge the tax consequences of an agreement as construed by the Commissioner must offer proof that, in an action between the parties to the agreement, would be admissible to alter that construction or show its unenforceability because of mistake, undue influence, fraud, duress, etc.).

(d) *Examples.* The following examples illustrate this section:

Example 1. (i) On January 1, 2001, A transfers assets X, Y, and Z to B in exchange for assets D, E, and F plus $1,000 cash.

(ii) Assume the exchange of assets constitutes an exchange of like-kind property to which section 1031 applies. Assume also that goodwill or going concern value could under any circumstances attach to each of the DEF and XYZ groups of assets and, therefore, each group constitutes a trade or business under section 1060.

(iii) Assume the fair market values of the assets and the amount of money transferred are as follows:

By A	
Asset	*Fair Market Value*
X	$ 400
Y	400
Z	200
Total	$ 1,000

By B	
Asset	*Fair Market Value*
D	$ 40
E	30
F	30
Cash (amount)	1,000
Total	$ 1,100

(iv) Under paragraph (b)(8) of this section, for purposes of allocating consideration under paragraph (c) of this section, the like-kind assets exchanged and any money or other property that are treated as transferred in exchange for the like-kind property are excluded from the application of section 1060.

(v) Since assets X, Y, and Z are like-kind property, they are excluded from the application of the section 1060 allocation rules.

(vi) Since assets D, E, and F are li[illegible]-kind property, they are excluded from the application of the section 1060 allocation rules. In addition, $900 of the $1,000 cash B gave to A for A's like-kind assets is treated as transferred in exchange for the like-kind property in order to equalize the fair market values of the like-kind assets. Therefore, $900 of the cash is excluded from the application of the section 1060 allocation rules.

(vii) $100 of the cash is allocated under section 1060 and paragraph (c) of this section.

(viii) A, as transferor of assets X, Y, and Z, received $100 that must be allocated under section 1060 and paragraph (c) of this section. Since A transferred no Class I, II, III, IV, V, or VI assets to which section 1060 applies, in determining its amount realized for the part of the exchange to which section 1031 does not apply, the $100 is allocated to Class VII assets (goodwill and going concern value).

(ix) A, as transferee of assets D, E, and F, gave consideration only for assets to which section 1031 applies. Therefore, the allocation rules of section 1060 and paragraph (c) of this section are not applied to determine the bases of the assets A received.

(x) B, as transferor of assets D, E, and F, received consideration only for assets to which section 1031 applies. Therefore, the allocation rules of section 1060 do not apply in determining B's gain or loss.

(xi) B, as transferee of assets X, Y, and Z, gave A $100 that must be allocated under section 1060 and paragraph (c) of this section. Since B received from A no Class I, II, III, IV, V, or VI assets to which section 1060 applies, the $100 consideration is allocated by B to Class VII assets (goodwill and going concern value).

Example 2. (i) On January 1, 2001, S, a sole proprietor, sells to P, a corporation, a group of assets that constitutes a trade or business under paragraph (b)(2) of this section. S, who plans to retire immediately, also executes in P's favor a covenant not to compete. P pays S $3,000 in cash and assumes $1,000 in liabilities. Thus, the total consideration is $4,000.

(ii) On the purchase date, P and S also execute a separate agreement that states that the fair market values of the Class II, Class III, Class V, and Class VI assets S sold to P are as follows:

Asset Class	*Asset*	*Fair Market Value*
II	Actively traded securities	$ 500
	Total Class II	500
III	Accounts receivable	200
	Total Class III	200
V	Furniture and fixtures	800
	Building	800
	Land	200
	Equipment	400
	Total Class V	2,200
VI	Covenant not to compete	900
	Total Class VI	900

(iii) P and S each allocate the consideration in the transaction among the assets transferred under paragraph (c) of this section in accordance with the agreed upon fair market values of the assets, so that $500 is allocated to Class II assets, $200 is allocated to the Class III asset, $2,200 is allocated to Class V assets, $900 is allocated to Class VI assets, and $200 ($4,000 total consideration less $3,800 allocated to assets in Classes II, III, V, and VI) is allocated to the Class VII assets (goodwill and going concern value).

(iv) In connection with the examination of P's return, the District Director, in determining the fair market values of the assets transferred, may disregard the parties' agreement. Assume that the District Director correctly determines that the fair market value of the covenant not to compete was $500. Since the allocation of consideration among Class II, III, V, and VI assets results in allocation up to the fair market value limitation, the $600 of unallocated consideration resulting from the District Director's redetermination of the value of the covenant not to compete is allocated to Class VII assets (goodwill and going concern value).

(e) *Reporting requirements*—(1) *Applicable asset acquisitions*—(i) *In general.* Unless otherwise excluded from this requirement by the Commissioner, the seller and the purchaser in an applicable asset acquisition each must report information concerning the amount of consideration in the transaction and its allocation among the assets transferred. They also must report information concerning subsequent adjustments to consideration.

(ii) *Time and manner of reporting*—(A) *In general.* The seller and the purchaser each must file asset acquisition statements on Form 8594 with their income tax returns or returns of income for the taxable year that includes the first date assets are sold pursuant to an applicable asset acquisition. This reporting requirement applies to all asset acquisitions described in this section. For reporting requirements relating to asset acquisitions occurring before the date final regulations are published in the Federal Register, as described in paragraph (a)(2) of this section, see the temporary regulations under section 1060 in effect prior to the date final regulations are published in the Federal Register (§1.1060–1T as contained in 26 CFR part 1 revised April 1, 1999).

(B) *Additional reporting requirement.* When an increase or decrease in consideration is taken into account after the close of first taxable year that includes the first date assets are sold in an applicable asset acquisition, the seller and the purchaser each must file a supplemental asset acquisition statement on Form 8594 with the income tax return or return of income for the taxable year in which the increase (or decrease) is properly taken into account.

(2) *Transfers of interests in partnerships.* For reporting requirements relating to the transfer of the partnership interest, see §1.755–2T(c).

§1.1060–1T [Removed]

Par. 11. Section 1.1060–1T is removed.

PART 602–OMB CONTROL NUMBERS UNDER PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 13. In §602.101, paragraph (b) is amended by removing the entries for 1.338(b)–1 and 1.1060–1T from the table.

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 4, 1999, 9:14 a.m., and published in the issue of the Federal Register for August 10, 1999, 64 F.R. 43461)

Guidance Relating to Article XXI of the United States-Canada Income Tax Convention

Notice 99–47

PURPOSE

This notice provides guidance concerning a competent authority agreement between the United States and Canada that implements Article XXI (Exempt Organizations) of the United States-Canada Income Tax Convention (Treaty).

BACKGROUND

Article XXI of the Treaty generally provides for deduction of cross-border charitable contributions, and reciprocal recognition of exemption for religious, scientific, literary, educational, or charitable organizations. Diplomatic notes that accompany the Treaty provide that the competent authorities of each of the Contracting States shall review the procedures and requirements for an organization of the other Contracting State to establish its status as a religious, scientific, literary, educational, or charitable organization entitled to exemption under paragraph 1 of Article XXI, or as an eligible recipient of the charitable contributions referred to in paragraphs 5 and 6 of Article XXI, with a view to avoiding duplicate application by such organizations to the administering agencies of both Contracting States. The diplomatic notes also provide that if a Contracting State determines that the other Contracting State maintains procedures to determine such status and rules for qualification that are compatible with such procedures and rules of the first-mentioned Contracting State, it is contemplated that such first-mentioned Contracting State shall accept the certification of the other administering agency of the other Contracting State as to such status for the purpose of making the necessary determinations under paragraphs 1, 5 and 6 of Article XXI.

SCOPE OF TREATY RELIEF

The U.S. and Canadian Competent Authorities, pursuant to Article XXVI (Mutual Agreement Procedure) of the Treaty, have entered into a mutual agreement that implements Article XXI as contemplated by the diplomatic notes. Under the terms of the agreement, recognized religious, scientific, literary, educational, or charitable organizations that are organized under the laws of either the U.S. or Canada will automatically receive recognition of exemption without application in the other country. U.S. organizations must be recognized as exempt under section 501(c)(3) of the Code in order to qualify for this treatment. Similarly, Revenue Canada must recognize Canadian organizations as Canadian registered charities.

Moreover, recognized charitable organizations resident in one country will be eligible to receive deductible charitable contributions from residents of the other country. However, in the case of a contribution (or contributions) by a resident or citizen of the United States (other than a contribution to a college or university at which the citizen or resident or a member of his family is or was enrolled), U.S. law requires that the amount of deductions in the aggregate for a taxable year may not exceed a certain percentage of the donor's Canadian source income. Any excess contribution that is not deductible as a result of this limitation may be carried over and deducted in subsequent taxable years, subject to the same limitations.

Furthermore, the U.S. will presume, in the absence of receiving certain financial information, that all Canadian registered charities are private foundations. Accordingly, if a Canadian registered charity does not provide the U.S. with the financial information needed to determine its foundation classification, the organization will be presumed to be a private foundation under U.S. law, the donor's deductible contributions will be limited to 30 percent of the donor's Canadian source income, and the organization will not have the benefit of being listed in Publication 78, Cumulative List of Organizations. Moreover, although the Canadian registered charity will not be required to apply for exemption, a donor claiming a charitable contribution deduction will be required to show that the organization is a Canadian registered charity.

Alternatively, if a Canadian registered charity provides the U.S. with the information needed to determine its foundation classification, aside from automatic recognition of exemption, the organization will be listed in Publication 78, as a foreign organization, and will be eligible to receive contributions deductible up to 50 percent of the donor's Canadian source income, assuming it is determined not to be a private foundation. If the Canadian registered charity submits information that establishes that it is a private foundation, it will nevertheless be listed in Publication 78, but deductible contributions will be limited to 30 percent of the donor's Canadian source income.

Under the agreement, recognition of exemption by the U.S. of a Canadian registered charity will remain in effect until the U.S. determines that the organization fails to satisfy the requirements for exempt status under U.S. law. Further, Canadian organizations will be required to file the applicable Form 990, Return of Organizations Exempt From Income Tax, or Form 990-PF, Return of Private Foundation, unless they receive less than $25,000 of U.S. source income.

DISCLOSURE REQUIREMENT

Section 6114(a) of the Code requires that taxpayers taking the position that a U.S. treaty overrules a general U.S. tax principle or law must disclose such position on a return of tax or, if no return of tax is required to be filed, as the Internal Revenue Service may prescribe. Accordingly, taxpayers claiming exemption or charitable contribution deductions pursuant to this agreement must disclose this position on their income tax return for the year in which the charitable contribution deduction or claim for exemption is made. Taxpayers may use Form 8833 for this purpose, or they may attach to their return a separate statement indicating that they are claiming exemption or a charitable contribution deduction pursuant to Article XXI of the Treaty. Taxpayers may make reference to this Notice 99–47 in their disclosure statement.

DRAFTING INFORMATION

The principal author of this notice is Patrick Kevin Orzel of the Office of Assistant Commissioner (International). For further information regarding this notice, contact Mr. Orzel at (202) 874-1550 (not a toll-free number).

Notice of Proposed Rulemaking and Notice of Public Hearing

Guidance under section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition.

REG–116733–98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These proposed regulations affect corporations and are necessary to provide them with guidance needed to comply with these changes. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 5, 2000. Outlines of topics to be discussed at the public hearing scheduled for January 26, 2000, at 10 a.m. must be received by January 5, 2000.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–116733–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–116733–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brendan O'Hara, (202) 622-7530; concerning submissions of comments, delivering comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

A. *State of the Law Before Section 355(e)*

Section 355 generally provides that, if a corporation distributes to its shareholders stock of a corporation which it controls immediately before the distribution and certain other conditions are met, neither the distributing corporation nor its shareholders recognize gain or loss. A number of the conditions for tax free treatment (for example, the continuity of interest requirement of §1.355–2(c), the "no device" requirement of section 355(a)(1)(B), the five-year active business requirement of section 355(b), and the limitation on disqualified stock under section 355(d)) operate to limit the circumstances in which the distributing or controlled corporation can undergo changes of control in conjunction with a distribution that qualifies for corporate and shareholder-level nonrecognition under section 355. Nevertheless, prior to the enactment of section 355(e), it was possible for such changes to occur, for example, in the context of tax free reorganizations, while qualifying for tax free treatment under section 355. *See, e.g., Commissioner v. Mary Archer W. Morris Trust,* 367 F.2d 794 (4th Cir. 1966).

B. *Legislative Proposals Leading to Section 355(e)*

As part of its Fiscal Year 1997 Budget, the Administration proposed a provision that would require a distributing corporation to recognize gain on the distribution of a controlled corporation's stock unless the direct and indirect shareholders of the distributing corporation, as a group, controlled at least 50 percent of the vote and value of both corporations at all times during the 4-year period beginning 2 years before the distribution. *See* Department of the Treasury, *General Explanation of the Administration's Revenue Proposals,* p. 86 (March 1996) (hereinafter referred to as the "Administration Proposal"). Under the Administration Proposal, the retained 50-percent interest must consist of "permissible stock," which includes, in addition to stock retained over the 4-year period, stock of the distributing or controlled corporation "received by the shareholder in a transaction which is unrelated to the distribution . . . ." Revenue Proposals Contained in President Clinton's Budget Plan as Released on Mar. 19, 1996, §9522, [1996] 83 Stand. Fed. Tax Rep. (CCH) No. 15A.

The Administration Proposal described an unrelated transaction as, "[a] transaction that is not pursuant to a common plan or arrangement that includes the distribution," and cited a hostile acquisition of the distributing or controlled corporation commencing after the distribution as an example of an unrelated transaction. The Administration Proposal contrasted this with a friendly acquisition, which generally would be considered related to the distribution if the acquisition was pursuant to an arrangement negotiated prior to the distribution, even if the acquisition was subject to various conditions at the time of the distribution.

On April 17, 1997, House Ways and Means Committee Chairman Archer and Senate Finance Committee Chairman Roth and Ranking Member Moynihan introduced identical bills (H.R. 1365, 105th Cong. (1997) and S. 612, 105th Cong. (1997), hereinafter referred to as the "Bills") that provided for a new section 355(e) that is similar to the enacted version. The Bills were concerned with a "plan (or series of related transactions) pursuant to which a person acquires stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation . . . ." S. 612, 105th Cong. (1997). The introductory statement to the legislation contained a

reference to acquisitions "pursuant to a plan or arrangement in existence on the date of distribution . . . ." The statement further explained: "Whether a corporation is acquired would be determined under rules similar to those of present-law section 355(d), except that acquisitions would not be restricted to purchase transactions. Thus an acquisition would occur if a person-or persons acting in concert-... acquired . . . stock . . . pursuant to a plan or arrangement." See 143 Cong. Rec. E703 (Apr. 17, 1997) (introductory statement of Chairman Archer); 143 Cong. Rec. S3360 (Apr. 17, 1997) (introductory statement of Chairman Roth).

C. *Enactment of Section 355(e)*

Section 355(e) was enacted in 1997. Public Law 105-34, section 1012(a) (1997). The committee reports state that section 355 was intended to permit the tax free division of existing business arrangements among existing shareholders. The reports state that "[i]n cases in which it is intended that new shareholders will acquire ownership of a business in connection with a spin off, the transaction more closely resembles a corporate level disposition of the portion of the business that is acquired" and provide that gain is recognized "if, pursuant to a plan or arrangement in existence on the date of distribution, either the controlled or distributing corporation is acquired . . . ." H.R. Rep. No. 105-148, at 462 (1997); *see also* S. Rep. No. 105-33, at 139-40 (1997) (slight variation in language). The Conference Report adds, "[a]s under the House bill and Senate amendment, a public offering of sufficient size can result in an acquisition that causes gain recognition under the provision." H.R. Conf. Rep. No. 105-220, at 533 (1997).

The statute as enacted contained two important changes from the Administration Proposal and Bills relevant to determining whether an acquisition is part of a plan (or series of related transactions) that includes the distribution. In the Bills, proposed sections 355(e)(2)(A)(ii) and (4)(C)(i) provided that a "person," as modified by section 355(d)(7), must acquire 50 percent or more of the distributing or controlled corporation. The term "plan or arrangement" used in section 355(d)(7)(B) treats two or more persons acting "pursuant to a plan or arrangement" with regard to a stock acquisition as one person. However, when section 355(e) was enacted, the reference in section 355(e)(2)(A)(ii) to acquisitions by a "person" was changed to "1 or more persons." In addition, the reference to section 355(d)(7)(B) (treating two or more persons acting "pursuant to a plan or arrangement" as one person) was deleted from section 355(e)(4)(C)(i). The effect of these two changes is to remove the requirement that 50 percent or more of the stock of the distributing or controlled corporation must be acquired by acquirors acting in concert for section 355(e) to apply.

In addition, the reference in the Conference Report to public offerings as transactions that could cause gain to be recognized under section 355(e) indicates Congress did not believe negotiations between the distributing corporation and an acquiror were necessary in order for an acquisition to be pursuant to a plan that included the distribution. Thus, to determine whether a plan of acquisition exists, one must look at all parties to the transaction, including the distributing and controlled corporations and their shareholders, not just the potential acquirors.

As enacted, section 355(e)(1) provides that the stock of a controlled corporation will not be qualified property under section 355(c)(2) or section 361(c)(2) if, under section 355(e)(2)(A), the stock is distributed as "part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation." Thus, if section 355(e)(1) applies to a distribution, the distributing corporation is taxed on the amount by which the distributed stock's fair market value exceeds its basis. Distributee shareholders receive the controlled corporation stock tax free, but do not increase their bases to reflect the corporate level gain recognized by the distributing corporation on the distribution.

Explanation of Provisions

The proposed regulations under section 355(e) provide guidance concerning the interpretation of the phrase "plan (or series of related transactions)." The proposed regulations also address the determination of the distributing corporation's gain when multiple controlled corporations are distributed and the distributions are part of a plan (or series of related transactions) pursuant to which a 50-percent or greater interest in one or more, but not all, of the distributed controlled corporations is acquired. The Department of the Treasury and the IRS plan to issue regulations addressing other issues arising under section 355(e), including aggregation and attribution rules (including provisions for public trading) and the administration of the statute of limitations provision of section 355(e)(4)(E). Comments concerning the proposed regulations and additional issues that should be addressed in regulations are welcome.

A. *Plan or Series of Related Transactions*

Whether two transactions are part of the same "plan (or series of related transactions)" under section 355(e)(2)(A) is a subjective test, depending ultimately on the intentions and expectations of the relevant parties. As discussed above, indications are that Congress intended "plan (or series of related transactions)" to be interpreted broadly. Unlike the Administration Proposal and the Bills, which utilized the section 355(d) concept of "a person" (with aggregation) as the reference for relevant acquirors, the statute, as enacted, expanded the universe of transactions to which section 355(e) potentially applies by providing that the relevant acquirors could be "1 or more persons." Also, the guidance in the Conference Report that public offerings of a sufficient size could trigger section 355(e) suggests that there does not necessarily have to be an identified acquiror on the date of the distribution for section 355(e) to apply, nor is the intent of the acquiror at the time of the distribution necessarily relevant in determining whether there is a plan.

The proposed regulations rely on a variety of factors to determine the existence of a plan (or series of related transactions) (hereinafter referred to as a "plan"). These factors include the business purpose or purposes for the distribution; the intentions of the parties; the existence of agreements, understandings, arrangements, or substantial negotiations; the timing of the transactions; the likelihood of an acquisition; and the causal connection between the distribution and the acquisition.

Congress specified one factor, temporal proximity, as affecting the determination of whether a plan exists. Specifically, section 355(e)(2)(B) provides a presumption that a plan exists if "1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation during the 4-year period beginning on the date which is 2 years before the date of the distribution." Accordingly, the proposed regulations provide that distributions within 2 years of an acquisition of the distributing corporation or a controlled corporation are presumed to be part of a plan. The proposed regulations outline the elements the distributing corporation must establish to rebut the statutory presumption.

1. Acquisitions on or After a Distribution

General rebuttal

In the case of an acquisition occurring within 2 years after a distribution, the proposed regulations allow the distributing corporation to rebut the presumption by establishing by clear and convincing evidence that (i) the distribution was motivated in whole or substantial part by a corporate business purpose (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired) and (ii) the acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter. Decreasing "the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired" generally refers to transactions in which one business, a perceived takeover target, is separated from another via a stock distribution in an attempt to spare the other business from acquisition. Distributions intended to "decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired" are often difficult to differentiate from those intended to "facilitate an acquisition." Both relate to a perceived possibility of acquisition and should receive similar treatment.

In this general rebuttal, the proposed regulations rely on corporate business purpose as a key factor indicating whether a distribution and an acquisition are part of a plan. Corporate business purpose is an important concept in the overall administration of section 355. The existence of a nonacquisition related corporate business purpose that prompted, in whole or substantial part, the distributing corporation to make the stock distribution suggests there is not a significant causal connection between the distribution and acquisition. The intent of the distributing corporation, the controlled corporation, or the controlling shareholders of either the distributing or controlled corporation to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired is relevant in determining the extent to which the distribution was motivated in whole or substantial part by another corporate business purpose within the meaning of §1.355–2. Analyzing whether there is another substantial corporate business purpose for the distribution in light of an acquisition-related purpose is similar to analyzing whether there is a corporate business purpose for a distribution in light of the potential avoidance of federal taxes. See §1.355–2(b)(1) and (5), Example 8. Thus, another business purpose must be real and substantial even in light of the acquisition business purpose.

The reliance on business purpose in the general rebuttal is consistent with the suggestions of many commentators writing about section 355(e), who identified corporate business purpose as an important factor in determining whether an acquisition and distribution are part of a plan.

Alternative rebuttal

Reliance on a substantial nonacquisition business purpose as proof of no "plan" is appropriate when the distribution and acquisition are separated by a sufficient amount of time. Thus, the general rebuttal is not satisfied in certain cases, including where an acquisition occurs within 6 months after a distribution or where a distribution was not substantially motivated by a corporate business purpose other than an intention to facilitate (or decrease the likelihood of) an acquisition. These acquisitions occur in circumstances more likely to indicate the existence of a plan at the time of the distribution. Thus, these acquisitions are subject to heightened scrutiny and will be considered part of a plan unless taxpayers satisfy a more stringent alternative rebuttal.

Unlike the general rebuttal, a nonacquisition business purpose alone is not sufficient under the alternative rebuttal. Rather, taxpayers must satisfy all prongs of a three-prong test.

The first prong of the alternative rebuttal may be satisfied in either of two ways. The distributing corporation must establish by clear and convincing evidence either that (i) at the time of the distribution, the distributing corporation, the controlled corporation, and their controlling shareholders did not intend that one or more persons would acquire a 50-percent or greater interest in the distributing or any controlled corporation during the statutory presumption period (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter) or (ii) the distribution was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in the distributing or controlled corporation. Clause (i) may be satisfied even in situations where one or more of the relevant parties intend that the distribution will facilitate an acquisition or acquisitions, so long as the parties do not intend that there be a 50-percent or greater change in ownership during the statutory presumption period. Alternatively, clause (ii) may be satisfied where the parties intend a 50-percent or greater change in ownership during the presumption period, provided that the parties do not intend that the distribution will facilitate any part of the acquisitions.

Under the second prong of the alternative rebuttal, the distributing corporation must establish by clear and convincing evidence that, at the time of the distribution, neither the distributing corporation, the controlled corporation, nor their controlling shareholders reasonably would have anticipated that it was more likely

than not that one or more persons would acquire a 50-percent or greater interest in the distributing corporation or the controlled corporation within 2 years after the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter) who would not have acquired such interests if the distribution had not occurred.

This prong of the alternative rebuttal (hereinafter referred to as the "reasonable anticipation" test) incorporates two important concepts. First, it identifies reasonably anticipated acquisitions of the distributing or controlled corporation that would not have occurred but for the distribution and, because a causal connection exists between the two transactions, treats them as part of a plan. Second, it reflects the idea that reasonable anticipation, not just the presence of negotiations, is important in determining whether a plan exists. Considering reasonable anticipation of certain acquisitions is consistent with the legislative history. Though descriptions of the Administration Proposal included references to negotiations and distinctions between hostile and friendly acquisitions, the focus of section 355(e), as enacted, is whether a relationship exists between the distribution and the fact that persons other than the existing shareholders became owners of the distributing or controlled corporation.

A reasonable anticipation standard is necessary to implement section 355(e). Otherwise, a distributing corporation could attempt to avoid section 355(e) by distributing a controlled corporation under circumstances that virtually assure an acquisition of the distributing or controlled corporation, but arguing that, despite the imminence of the acquisition, effectuating the acquisition was not a motive for the distribution. A part of planning any transaction includes attempting to foresee actions others might take in response. Consistent with this business practice, it is appropriate, especially for acquisitions subject to heightened scrutiny, to require the distributing corporation to take into account the reasonably anticipated, likely actions of others to demonstrate that a distribution and acquisition are not part of a plan.

The second prong of the alternative rebuttal is not satisfied if, at the time of the distribution, the relevant parties would reasonably anticipate that the distribution would give rise to *all of* an acquisition of a 50 percent interest in the distributing or controlled corporation. (The rebuttal is satisfied if the distributing corporation establishes by clear and convincing evidence that the relevant parties would not reasonably anticipate an acquisition of a 50 percent or greater interest *by persons who would not acquire such interests absent the distribution.*) This standard is to be contrasted with the first prong of the rebuttal, which is not satisfied if one or more of the relevant parties intended that there be a 50 percent or greater acquisition of distributing or controlled during the applicable time period, and the distribution is intended to facilitate *all or any part of* that acquisition. Because some acquisitions might be reasonably anticipated to occur without regard to whether the distribution takes place, the Department of the Treasury and the IRS believe that the distribution must be directly linked to all 50 percent of the acquisition to fail the "reasonable anticipation" test. However, a different result is called for where the relevant parties *intend* a 50 percent acquisition. In that case, it would appear that the aggregation of the various acquisitions comprising the 50 percent acquisition are themselves part of a single plan, so a distribution intended to facilitate only some of those acquisitions would be part of a plan also involving those other acquisitions not directly facilitated by the acquisition.

In developing the reasonable anticipation test, the Department of the Treasury and the IRS rejected suggestions by some commentators that serious negotiations or agreement with an acquiror need to have taken place at the time of distribution for a plan to exist. Requiring mutual agreement or negotiation is inappropriate because Congress intended the statute to apply in situations beyond those in which a distribution is made prior to and as part of an acquisition by a specifically identified acquiror. Section 355(e)(2)(B) makes clear that the section is intended to apply to acquisitions before and after a distribution. The legislative history also clarifies that a public offering after a distribution can trigger section 355(e) even though presumably no public buyer would have been negotiated with or even identified at the time of the distribution. Because Congress intended distributions designed to facilitate public offerings to be covered, other transactions that are economically similar also should be covered. These transactions include a private placement of the distributing or controlled corporation's stock or an auction of such stock by an investment banker. Like public offerings, these transactions do not necessarily involve predistribution negotiations or agreements regarding subsequent acquisitions and yet may still be part of the distributing or controlled corporation's plan.

Thus, we believe that section 355(e) was intended to apply to a range of transactions, not limited to those in which a mutual agreement or negotiations relating to the acquisition occurred prior to the distribution. To require negotiations or agreements to be present prior to a distribution either would inappropriately exclude certain transactions from the coverage of the statute or would create a higher threshold for the existence of a plan in certain acquisitions than in other acquisitions.

The third prong of the alternative rebuttal reiterates a requirement in the general rebuttal. The distributing corporation must establish by clear and convincing evidence that the distribution was not motivated in whole or substantial part by an intention to decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired.

For purposes of applying the alternative rebuttal, the consequences of the application of section 355(e), directly or by indemnity, are disregarded in determining the intentions, motivations, and reasonable anticipations of the relevant parties. To do otherwise might give rise to a circularity in the application of the rules. If the consequences of the application of section 355(e) were relevant in determining such intentions, motivations, and reasonable anticipations, the distributing corporation could argue that objective evidence indicated that it would satisfy the alternative rebuttal, since arguably it would not be reasonable for an acquiror to act in a manner that would cause liability for tax under section 355(e). Conversely, the IRS could argue that the presence of an indemnity agreement indicated that the parties anticipated liability for tax under section 355(e).

Acquisitions more than 2 years after a distribution

To prevent taxpayers from attempting to avoid the presumption period by delaying a planned acquisition beyond 2 years from the date of distribution, the proposed regulations provide that an acquisition occurring more than 2 years after the distribution is presumed part of a plan if there was an agreement, understanding, or arrangement concerning the acquisition at the time of the distribution or within 2 years thereafter. The distributing corporation may rebut the presumption using the general or alternative rebuttal discussed above. To provide certainty for transactions that, because of their separation in time, are unlikely to be part of a plan, the proposed regulations provide that, if there was no agreement, understanding, or arrangement concerning the acquisition at the time of the distribution or within 2 years thereafter, a distribution and an acquisition occurring more than 2 years afterwards are not part of a plan.

2. Acquisitions Before a Distribution

Acquisitions within 2 years before a distribution

Section 355(e) also applies to transactions in which an acquisition of the distributing or controlled corporation's stock precedes a distribution of the controlled corporation. When the transactions being tested as part of a plan occur in this order, the most reliable indicators that a plan exists are an intent to make the distribution at the time of the acquisition and a causal connection between the acquisition and the distribution. In particular, if a person becomes a controlling shareholder by acquisition, that person's intention becomes the single best indicator of whether a later distribution was part of a plan. The proposed regulations allow a distributing corporation to rebut the presumption by establishing by clear and convincing evidence that, at the time of the acquisition, the distributing corporation and its controlling shareholders (determined immediately after the acquisition) did not intend to effectuate a distribution. Alternatively, the distributing corporation can rebut the presumption by establishing by clear and convincing evidence that the distribution would have occurred at approximately the same time and under substantially the same terms regardless of the acquisition (and, in the case of an issuance of stock, all acquisitions that are part of such issuance), unless a person acquiring an interest becomes a controlling shareholder by reason of the acquisition or at any point thereafter and before the end of the 2-year period beginning on the date of the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter).

Acquisitions more than 2 years before a distribution

If an acquisition of an interest in the distributing corporation or the controlled corporation occurs more than 2 years before a distribution, the presumption shifts in favor of the taxpayer. The acquisition and the distribution are presumed not to be part of a plan unless the Commissioner can establish by clear and convincing evidence that, at the time of the acquisition, (i) the distributing corporation or its controlling shareholders intended to effectuate the distribution and (ii) that the distribution would not have occurred at approximately the same time and under substantially the same terms regardless of that acquisition (and, in the case of an issuance of stock, all acquisitions that are part of such issuance) or that a person acquiring an interest in that acquisition becomes a controlling shareholder by reason of that acquisition or at any point thereafter and before the end of the 2-year period beginning on the date of the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within six months thereafter). Because the passage of time makes it less likely that an acquisition and distribution are part of a plan, after two years the proposed regulations shift the burden of proof to the IRS to prove the existence of a plan. However, the proposed regulations do not allow a taxpayer to avoid section 355(e) by delaying the distribution when the distribution clearly was intended at the time of the acquisition.

3. Agreement, Understanding, Arrangement, or Substantial Negotiations

The proposed regulations do not define with precision the terms *agreement, understanding, arrangement, or substantial negotiations.* A binding contract is clearly included as an agreement, but, depending on all relevant facts and circumstances, parties can have an agreement, understanding, or arrangement even though they have not reached agreement on all terms. Under certain circumstances, such as in public offerings or auctions of the distributing or controlled corporation's stock by an investment banker, an agreement, understanding, arrangement, or substantial negotiations can take place regarding an acquisition even if the acquiror has not been specifically identified. The Department of the Treasury and the IRS are particularly interested in receiving comments regarding transactions that involve an investment banker and when contacts by the distributing corporation or the controlled corporation with an investment banker or contacts with potential acquirors by an investment banker on behalf of the distributing corporation or the controlled corporation should or should not be considered an agreement, understanding, arrangement, or substantial negotiations.

4. Options

The proposed regulations also treat certain options as agreements. If stock of the distributing or controlled corporation is acquired pursuant to an option, the option is treated as an agreement unless the distributing corporation establishes by clear and convincing evidence that, on the later of the date of distribution or issuance, the option was not more likely than not to be exercised. Generally, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements, restricted stock, and any other instruments that provide for the right or possibility to issue, redeem, or transfer stock, cash settlement options, and other similar interests are treated as options. An option on an option is treated as an option under the proposed regulations. If there is an agreement, understanding, or arrangement to issue an option before the end of the 6 month period beginning on the date of the distribution, the option will be treated as issued on the date of the agreement, understanding, or arrangement. If an agreement, understanding, or arrangement to issue an

option is reached, or an option is issued, more than 6 months but not more than 2 years after the distribution, and there were substantial negotiations regarding the issuance of the option or the acquisition of the stock underlying the option before the end of the 6 month period beginning on the date of the distribution, the option will be treated as issued 6 months after the distribution. If there is an agreement, understanding, or an arrangement to issue an option more than 6 months but not more than 2 years after the distribution, and there were no substantial negotiations regarding the issuance of the option or the acquisition of the stock underlying the option before the end of the 6 month period beginning on the date of the distribution, the option will be treated as issued on the date of the agreement, understanding, or arrangement. The proposed regulations exempt certain options from treatment as options unless they are issued, transferred, or listed with a principal purpose of avoiding the application of section 355(e) or the proposed regulations. The enumerated exceptions cover certain commercially customary options unlikely to be used to avoid section 355(e) or the proposed regulations.

5. Aggregating Acquisitions That are Pursuant to a Plan

Under the proposed regulations, each acquisition of stock of a distributing or controlled corporation must be tested to determine whether the acquisition is pursuant to a plan involving a distribution. Each acquisition of stock of a corporation acquired pursuant to a plan involving a distribution is aggregated with all acquisitions of stock of that corporation acquired pursuant to a plan involving that distribution to determine whether an acquisition of a 50-percent or greater interest as proscribed in section 355(e)(2)(A)(ii) has occurred.

B. *Any Controlled Corporation*

Section 355(e)(2)(A)(ii) provides that section 355(e)(1), which causes the distributing corporation to recognize its gain in the controlled corporation stock as if the distributing corporation had sold the stock for its fair market value, applies to any distribution to which section 355 applies and "which is part of a plan . . . pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation *or any controlled corporation*" (emphasis added). A question has arisen concerning the measure of gain to the distributing corporation if, pursuant to a plan, the stock of more than one controlled corporation is distributed and stock representing a 50-percent or greater interest is acquired in some, but not all, of the distributed controlled corporations. The proposed regulations clarify that under those circumstances, the distributing corporation only recognizes gain on the stock of the distributed controlled corporations that were subject to 50-percent or greater acquisitions. If the distributing corporation is the acquired corporation, it must recognize gain on all of the distributed controlled corporations.

Proposed Effective Date

The regulations in this section are proposed to apply to distributions occurring after the regulations in this section are published as final regulations in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) and comments sent via the Internet that are submitted timely to the IRS. The IRS and the Department of the Treasury specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 26, 2000, beginning at 10 a.m. in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by January 5, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Brendan O'Hara, Office of the Assistant Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.355–7 also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355–0 is amended by revising the section heading and adding introductory text and an entry for §1.355–7 to read in part as follows:

§1.355–0 Outline of sections.

In order to facilitate the use of §§1.355–1 through 1.355–7, this section lists the major paragraphs in those sections as follows:

* * * * *

§1.355–7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition.

(a) Plan or series of related transactions.
(1) In general.
(2) Distributions within 2 years of an acquisition.
(i) Presumption.
(ii) Rebuttal for acquisitions after a distribution.
(iii) Alternative rebuttal for acquisitions on or after a distribution.
(iv) Operating rules for paragraph (a)(2)(iii) of this section.
(v) Rebuttals for acquisitions before a distribution.
(A) General rebuttal.
(B) Alternative rebuttal.
(3) Distributions more than 2 years from an acquisition.
(i) Acquisitions after a distribution.
(ii) Acquisitions before a distribution.
(4) Controlling shareholder.
(5) Agreement, understanding, or arrangement.
(6) Multiple acquisitions.
(7) Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests.
(i) Treatment of options.
(A) General rule.
(B) Agreement, understanding, arrangement, or substantial negotiations to issue an option.
(ii) Instruments treated as options.
(iii) Instruments generally not treated as options.
(A) Escrow, pledge, or other security agreements.
(B) Compensatory options.
(C) Options exercisable only upon death, disability, mental incompetency, or retirement.
(D) Rights of first refusal.
(E) Other enumerated instruments.
(8) Examples.
(b) Multiple controlled corporations.
(c) Valuation.
(d) Effective date.

Par. 3. Section 1.355–7 is added to read as follows:

§1.355–7 Recognition of gain on certain distributions of stock or securities in connection with an acquisition—(a) *Plan or series of related transactions*—(1) *In general.* (i) Except as provided in section 355(e) and in this section, section 355(e) applies to any distribution–

(A) To which section 355 (or so much of section 356 as relates to section 355) applies; and

(B) Which is part of a plan (or series of related transactions) pursuant to which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.

(ii) For purposes of this section, a controlled corporation is a corporation the stock of which is distributed in a distribution to which section 355 applies.

(iii) The existence of a plan (or series of related transactions) does not depend on whether or not more than one person acts in concert.

(2) *Distributions within 2 years of an acquisition*—(i) *Presumption.* If a distribution occurs within 2 years of an acquisition by one or more persons of an interest in the distributing corporation or any controlled corporation, the distribution and that acquisition are presumed to be part of a plan (or series of related transactions).

(ii) Rebuttal for acquisitions after a distribution. (A) In the case of an acquisition occurring after a distribution, the distributing corporation may rebut the presumption of paragraph (a)(2)(i) of this section by establishing by clear and convincing evidence that–

(*1*) The distribution was motivated in whole or substantial part by a corporate business purpose within the meaning of §1.355–2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired); and

(*2*) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter.

(B) The intent of the distributing corporation, the controlled corporation, or the controlling shareholders of either the distributing or controlled corporation to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired is relevant in determining the extent to which the distribution was motivated by a corporate business purpose within the meaning of §1.355–2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired).

(iii) *Alternative rebuttal for acquisitions on or after a distribution.* In the case of an acquisition occurring on or after a distribution, the distributing corporation also may rebut the presumption of paragraph (a)(2)(i) of this section by establishing by clear and convincing evidence that–

(A)(*1*) At the time of the distribution, the distributing corporation, the controlled corporation, and their controlling shareholders did not intend that one or more persons would acquire a 50-percent or greater interest in the distributing or any controlled corporation during the 2-year period beginning on the date of the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter); or

(*2*) The distribution was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in the distributing or controlled corporation; and

(B) At the time of the distribution, neither the distributing corporation, the controlled corporation, nor their controlling shareholders would reasonably have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in the distributing corporation or the controlled corporation within 2 years after the distribution (or later pursuant to an agreement, understanding, or arrangement existing at

the time of the distribution or within 6 months thereafter) who would not have acquired such interests if the distribution had not occurred; and

(C) The distribution was not motivated in whole or substantial part by an intention to decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired.

(iv) *Operating rules for paragraph (a)(2)(iii) of this section.* (A) For purposes of paragraph (a)(2)(iii)(A)(*1*) of this section, if an acquisition by one or more persons of an interest in the distributing corporation or any controlled corporation before the distribution is part of a plan (or series of related transactions) involving the distribution, the distributing corporation, the controlled corporation, and their controlling shareholders must include the amount of stock acquired in that acquisition as an amount they intended at the time of the distribution to be acquired during the 2-year period beginning on the date of the distribution.

(B) For purposes of paragraph (a)(2)-(iii)(B) of this section, persons who more likely than not would have acquired interests in the distributing corporation if the distribution had not occurred are also treated as persons who more likely than not would have acquired proportionate interests in the controlled corporation if the distribution had not occurred. No other persons are treated as persons who would have acquired interests in the controlled corporation if the distribution had not occurred.

(C) For purposes of paragraph (a)(2)-(iii)(B) of this section, if an acquisition by one or more persons of an interest in the distributing corporation or any controlled corporation before the distribution is part of a plan (or series of related transactions) involving the distribution, the distributing corporation, the controlled corporation, and their controlling shareholders must treat the amount of stock acquired in that acquisition as an amount they would reasonably have anticipated was more likely than not to be acquired within 2 years after the distribution that would not have been acquired if the distribution had not occurred.

(D) For purposes of determining the intentions, motivations, and reasonable anticipations of the relevant parties under paragraph (a)(2)(iii) of this section, the consequences of the application of section 355(e), directly or by indemnity, are disregarded.

(v) *Rebuttals for acquisitions before a distribution*–(A) *General rebuttal.* In the case of an acquisition occurring before a distribution, the distributing corporation may rebut the presumption of paragraph (a)(2)(i) of this section by establishing by clear and convincing evidence that, at the time of the acquisition, the distributing corporation and its controlling shareholders (determined immediately after the acquisition) did not intend to effectuate a distribution.

(B) *Alternative rebuttal.* In the case of an acquisition occurring before a distribution, the distributing corporation may rebut the presumption of paragraph (a)(2)(i) of this section by establishing by clear and convincing evidence that the distribution would have occurred at approximately the same time and under substantially the same terms regardless of that acquisition (and, in the case of an issuance of stock, all acquisitions that are part of such issuance), provided no person acquiring an interest in that acquisition becomes a controlling shareholder by reason of that acquisition or at any point thereafter and before the end of the 2-year period beginning on the date of the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter).

(3) *Distributions more than 2 years from an acquisition*—(i) *Acquisitions after a distribution.* (A) If an acquisition by one or more persons of an interest in the distributing corporation or any controlled corporation occurs more than 2 years after a distribution, the distribution and that acquisition are presumed part of a plan (or series of related transactions) only if there was an agreement, understanding, or arrangement concerning the acquisition at the time of the distribution or within 2 years thereafter. The distributing corporation may rebut the presumption under paragraph (a)(2)(ii) or (a)(2)(iii) of this section.

(B) If an acquisition by one or more persons of an interest in the distributing corporation or any controlled corporation occurs more than 2 years after a distribution, and there was no agreement, understanding, or arrangement concerning the acquisition at the time of the distribution or within 2 years thereafter, the acquisition and the distribution are not part of a plan (or series of related transactions).

(ii) *Acquisitions before a distribution.* If an acquisition by one or more persons of an interest in the distributing corporation or the controlled corporation occurs more than 2 years before a distribution, the acquisition and the distribution are not part of a plan (or series of related transactions) unless the Commissioner can establish by clear and convincing evidence that—

(A) At the time of the acquisition, the distributing corporation or its controlling shareholders (determined immediately after the acquisition) intended to effectuate the distribution; and

(B)(*1*) The distribution would not have occurred at approximately the same time and under substantially the same terms regardless of that acquisition (and, in the case of an issuance of stock, all acquisitions that are part of such issuance); or

(*2*) A person acquiring an interest in that acquisition becomes a controlling shareholder by reason of that acquisition or at any point thereafter and before the end of the 2-year period beginning on the date of the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter).

(4) *Controlling shareholder.* For purposes of paragraphs (a)(2) and (3) of this section, a controlling shareholder is any person who, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)), possesses voting power in the distributing or controlled corporation representing a meaningful voice in the governance of the corporation. A controlling shareholder of a publicly traded corporation is any person who, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)), owns 5 percent or more of any class of stock of the distributing or controlled corporation and who actively participates in the management or operation of the corporation. If a distribution precedes an acquisition, the controlled corporation's controlling

shareholders immediately after the distribution are considered the controlled corporation's controlling shareholders at the time of the distribution.

(5) *Agreement, understanding, or arrangement.* For purposes of this section, the parties do not necessarily have to have entered into a binding contract or have reached agreement on all terms to have an "agreement, understanding, or arrangement."

(6) *Multiple acquisitions.* Each acquisition of stock of a corporation acquired pursuant to a plan (or series of related transactions) involving a distribution will be aggregated with all acquisitions of stock of that corporation acquired pursuant to a plan (or series of related transactions) involving that distribution to determine whether an acquisition described in section 355(e)(2)(A)(ii) occurred. The appropriate presumption and rules for rebuttal will be applied to each acquisition depending on when the acquisition occurred.

(7) *Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests*—(i) *Treatment of options*—(A) *General rule.* For purposes of this section, if stock of the distributing or controlled corporation is acquired pursuant to an option, the option will be treated as an agreement on the date of issuance unless the distributing corporation establishes by clear and convincing evidence that, on the later of the date of distribution or date of issuance, the option was not more likely than not to be exercised. The determination of whether an option was more likely than not to be exercised is based on all the facts and circumstances. In applying the previous sentence, the fair market value of stock underlying an option is determined by taking into account control premiums and minority and blockage discounts.

(B) *Agreement, understanding, arrangement, or substantial negotiations to issue an option.* If there is an agreement, understanding, or arrangement to issue an option before the end of the 6-month period beginning on the date of the distribution, the option will be treated as issued on the date of the agreement, understanding, or arrangement. If an agreement, understanding, or arrangement to issue an option is reached, or an option is issued, more than 6 months but not more than 2 years after the distribution, and there were substantial negotiations regarding the issuance of the option or the acquisition of the stock underlying the option before the end of the 6-month period beginning on the date of the distribution, the option will be treated as issued 6 months after the distribution. If there is an agreement, understanding, or an arrangement to issue an option more than 6 months but not more than 2 years after the distribution, and there were no substantial negotiations regarding the issuance of the option or the acquisition of the stock underlying the option before the end of the 6 month period beginning on the date of the distribution, the option will be treated as issued on the date of the agreement, understanding, or arrangement.

(ii) *Instruments treated as options.* For purposes of this paragraph (a)(7), except to the extent provided in paragraph (a)(7)(iii) of this section, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements (including rights to cause the redemption of stock), restricted stock, any other instruments that provide for the right or possibility to issue, redeem, or transfer stock (including an option on an option), cash settlement options, or any other similar interests are treated as options.

(iii) *Instruments generally not treated as options.* For purposes of this paragraph (a)(7), the following are not treated as options unless issued, transferred (directly or indirectly), or listed with a principal purpose of avoiding the application of section 355(e) or this section:

(A) *Escrow, pledge, or other security agreements.* An option that is part of a security arrangement in a typical lending transaction (including a purchase money loan), if the arrangement is subject to customary commercial conditions. For this purpose, a security arrangement includes, for example, an agreement for holding stock in escrow or under a pledge or other security agreement, or an option to acquire stock contingent upon a default under a loan.

(B) *Compensatory options.* An option to acquire stock in the distributing or controlled corporation with customary terms and conditions provided to an employee or director in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) and that immediately after the distribution and within 6 months thereafter–

(1) Is nontransferable within the meaning of §1.83–3(d); and

(2) Does not have a readily ascertainable fair market value as defined in §1.83–7(b).

(C) *Options exercisable only upon death, disability, mental incompetency, or retirement.* Any option entered into between stockholders of a corporation (or a stockholder and the corporation) that is exercisable only upon the death, disability, or mental incompetency of the stockholder, or, in the case of stock acquired in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), the stockholder's retirement.

(D) *Rights of first refusal.* A bona fide right of first refusal regarding the corporation's stock with customary terms, entered into between stockholders of a corporation (or between the corporation and a stockholder).

(E) *Other enumerated instruments.* Any other instruments specified in regulations, a revenue ruling, or a revenue procedure. See §601.601(d)(2) of this chapter.

(8) *Examples.* The following examples illustrate this paragraph (a). Throughout these examples, assume that the distributing corporation (D) owns all of the stock of the controlled corporation (C). Assume further that D distributes the stock of C in a distribution to which section 355 applies and to which section 355(d) does not apply. For purposes of these examples, unless otherwise stated, assume that all transactions described are respected under applicable general tax principles. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

Example 1. To facilitate a stock offering by D of 50 percent of its stock, D distributes C pro rata to its shareholders. D issues new shares amounting to 50 percent of its stock to the public in a public offering within 6 months of the distribution. Under paragraph (a)(2)(i) of this section, the distribution and acquisition are presumed to be part of a plan (or series of related transactions) because the acquisition occurred within 2 years of the distribution. Because

the acquisition occurred within 6 months after the distribution, D must rely on the rules of paragraph (a)(2)(iii) of this section to rebut the presumption. D will not be able to rebut the presumption because D cannot establish either that D did not intend that one or more persons would acquire a 50-percent or greater interest in D during the relevant period under paragraph (a)(2)(iii)(A)(1) of this section or that the distribution was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in D under paragraph (a)(2)(iii)(A)(2) of this section. Because the presumption of paragraph (a)(2)(i) of this section cannot be rebutted regarding the acquisition of a 50-percent or greater interest in D, section 355(e) applies to the distribution of C.

Example 2. (i) X corporation announces an intention to acquire D, principally to acquire C's business. Due to market conditions, X's available capital, and X's success in acquiring other corporations, D would reasonably anticipate that an acquisition of a 50-percent or greater interest in D is more likely than not to occur within 2 years. To lower its financing costs and, in substantial part, to deter the acquisition of D (by separating it from the more attractive C), D distributes C pro rata to the D shareholders. X acquires C within 6 months of the distribution.

(ii) Under paragraph (a)(2)(i) of this section, the distribution and acquisition are presumed to be part of a plan (or series of related transactions) because the acquisition occurred within 2 years of the distribution. Because the acquisition occurred within 6 months after the distribution, D must rely on the rules of paragraph (a)(2)(iii) of this section to rebut the presumption. Under paragraph (a)(2)(iii)(A)(2) of this section, D will be able to establish that the distribution was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in D or C. Under paragraph (a)(2)(iv)(B) of this section, for purposes of paragraph (a)(2)-(iii)(B) of this section, persons who more likely than not would have acquired interests in D if the distribution had not occurred are also treated as persons who more likely than not would have acquired proportionate interests in C if the distribution had not occurred. Therefore, under paragraph (a)(2)(iii)(B) of this section, D will be able to establish that, at the time of the distribution, neither D, C, nor their controlling shareholders would reasonably have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in D or C within 2 years after the distribution who would not have acquired such interests if the distribution had not occurred.

(iii) Under paragraph (a)(2)(iii)(C) of this section, D will not be able to establish that the distribution was not motivated in whole or substantial part by an intention to decrease the likelihood of the acquisition of D's business by separating it from the C business that was likely to be acquired. Because the presumption of paragraph (a)(2)(i) of this section cannot be rebutted regarding the acquisition by X of a 50-percent or greater interest in C, section 355(e) applies to the distribution of C.

Example 3. The facts are the same as *Example 2* except the acquisition takes place 1 year after the distribution. The parties had not reached an agreement, understanding, or arrangement concerning, and had not substantially negotiated, the acquisition of C stock within 6 months after the distribution. Under paragraph (a)(2)(i) of this section, the distribution and acquisition are presumed to be part of a plan (or series of related transactions) because the acquisition occurred within 2 years of the distribution. Under paragraph (a)(2)(ii)(B) of this section, D's intent to deter an acquisition of D is a factor tending to disprove that the distribution was motivated in substantial part by the desire to lower its financing costs. If D can establish by clear and convincing evidence that the distribution was nonetheless motivated in substantial part by the need to lower its financing costs, D can rebut the presumption using paragraph (a)(2)(ii) of this section. D will not be able to rebut the presumption by using the alternative rebuttal under paragraph (a)(2)(iii) of this section for the same reason as in *Example 2*.

Example 4. D is a widely held, publicly traded corporation. D distributes C pro rata to D's shareholders. By contract, C agrees to indemnify D for any imposition of tax under section 355(e). The distribution is motivated solely by a corporate business purpose within the meaning of §1.355–2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired). At the time of the distribution, although D has not been approached by any potential acquirors of C, D would reasonably anticipate that, under current market conditions, if C is separated from D, an acquisition of a 50-percent or greater interest in C is more likely than not to occur within 2 years by persons who would not have acquired a proportionate interest in D if the distribution of C had not occurred. C is acquired within 6 months after the distribution. Under paragraph (a)(2)(i) of this section, the distribution and acquisition are presumed to be part of a plan (or series of related transactions) because the acquisition occurred within 2 years of the distribution. Because the acquisition occurred within 6 months after the distribution, D must rely on the rules of paragraph (a)(2)(iii) of this section to rebut the presumption. D will be able to establish that the distribution was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in D or C under paragraph (a)(2)(iii)(A)(2) of this section. However, D will not be able to establish the requirements of paragraph (a)(2)(iii)(B) of this section. Under paragraph (a)(2)(iv)(B) of this section, for purposes of paragraph (a)(2)(iii)(B) of this section, only persons who more likely than not would have acquired interests in D if the distribution had not occurred are treated as persons who more likely than not would have acquired proportionate interests in C if the distribution had not occurred. Therefore, under paragraph (a)(2)(iii)(B) of this section, D will not be able to establish that, at the time of the distribution, neither D, C, nor their controlling shareholders would reasonably have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in D or C within 2 years after the distribution who would not have acquired such interests if the distribution had not occurred. Under paragraph (a)(2)(iv)(D) of this section, the consequences of the indemnity agreement are disregarded for purposes of applying paragraph (a)(2)(iii)(B) of this section. Because the presumption of paragraph (a)(2)(i) of this section cannot be rebutted regarding the acquisition of a 50-percent or greater interest in C, section 355(e) applies to the distribution of C.

Example 5. (i) D believes it would be a more attractive acquisition candidate if it did not own C. To achieve significant nontax cost savings and, in substantial part, to maximize the possibility of D's acquisition, D distributes C pro rata. At the time of the distribution, D has not, directly or indirectly, solicited or received any indication of interest from potential acquirors. At the end of 6 months after the distribution, no agreement, arrangement, understanding, or substantial negotiations regarding the acquisition of D have taken place. Seven months after the distribution, D engages an investment banker to conduct an auction of D. One of the bidders acquires D 1 year after the distribution. Under paragraph (a)(2)(i) of this section, the distribution and acquisition are presumed to be part of a plan (or series of related transactions) because the acquisition occurred within 2 years of the distribution. Because there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter, D can use the rebuttal under paragraph (a)(2)(ii) of this section if D can establish that the distribution was motivated in whole or substantial part by the corporate business purpose of achieving significant nontax cost savings. Under paragraph (a)(2)(ii)(B) of this section, D's intent to facilitate an acquisition of D is a factor tending to disprove that the distribution was motivated in substantial part by the desire to achieve nontax cost savings. If D can establish by clear and convincing evidence that the distribution was nonetheless motivated in substantial part by the need to achieve nontax cost savings for D and C, D can rebut the presumption using paragraph (a)(2)(ii) of this section.

(ii) D cannot rebut the presumption using the rules of paragraph (a)(2)(iii) of this section because D cannot establish either that D did not intend that one or more persons would acquire a 50-percent or greater interest in D during the relevant period under paragraph (a)(2)(iii)(A)(*1*) of this section or that the distribution was not motivated in whole or substantial part by an intention to facilitate an acquisition of an interest in D under paragraph (a)(2)(iii)(A)(2) of this section.

Example 6. D announces that it will distribute C pro rata to D's shareholders. The distribution is motivated solely by a corporate business purpose within the meaning of §1.355–2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired). After the announcement but before the distribution, D acquires X, a widely held corporation. The X shareholders receive D stock in exchange for their X stock. No person who acquired D stock in the X acquisition became a controlling shareholder of D, as defined in paragraph (a)(4) of this section, within the time period described in paragraph (a)(2)(v)(B) of this section. Under paragraph (a)(2)(i) of this section, the distribution and the acquisition of D stock by the X shareholders are presumed to be part of a plan (or series of related transactions) because the acquisition occurred within 2 years of the distribution. If D can establish by clear and convincing evidence that the distribution of C would have occurred at approximately the same time and under substantially the same terms regardless of the acquisition of X, D may rebut the presumption under paragraph (a)(2)(v)(B) of this section.

Example 7. (i) D engages in business 1. C engages in business 2. D is interested in expanding business 1 through acquisitions, but D's ownership of C has been an impediment to acquisitions using D stock. On the advice of its investment banker, D plans to distribute its C stock to its shareholders solely to facilitate acquisitions by D. D has no specific goals regarding how much D stock will be acquired after the distribution. D and its investment banker have identified X and Y as potential acquisition targets. After D decides to distribute its C stock, but before the distribution date, D negotiates with and acquires X, but has no contact with Y. A, X's sole shareholder, receives 30 percent of D's stock, becoming a controlling shareholder of D within the meaning of paragraph (a)(4) of this section. One year after the distribution, D acquires Y. Y's shareholders receive 19 percent of D's stock. After the distribution, D and its investment banker identify Z as another desirable target. Eighteen months after the distribution, D acquires Z. Z's shareholders receive 17 percent of D's stock.

(ii) Under paragraph (a)(2)(i) of this section, the distribution and each acquisition are presumed to be part of a plan (or series of related transactions) because each acquisition occurred within 2 years of the distribution. In addition, under paragraph (a)(6) of this section, all acquisitions for which the presumption is not rebutted are aggregated to determine whether an acquisition described in section 355(e)(2)(A)(ii) has occurred.

(iii) Regarding the acquisition of X, D will not be able to rebut the presumption under paragraph (a)(2)(v)(A) of this section because D cannot establish that at the time A acquired D stock, D did not intend to effectuate a distribution. In addition, D cannot rebut the presumption under paragraph (a)(2)(v)(B) of this section because that paragraph does not apply to an acquisition in which a person becomes a controlling shareholder.

(iv) Regarding the acquisitions of Y and Z, D will not be able to rebut the presumption under paragraph (a)(2)(ii)(A) of this section because D cannot establish that the distribution was motivated in whole or substantial part by a corporate business purpose within the meaning of §1.355-2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired).

(v) To rebut the presumption with regard to each acquisition of Y and Z using the alternative rebuttal of paragraph (a)(2)(iii) of this section, D must establish three facts. First, under paragraph (a)(2)(iii)-(A)(*1*) of this section, D must establish that, at the time of the distribution, D and its controlling shareholders did not intend that one or more persons would acquire a 50-percent or greater interest in D or C during the presumption period described in that paragraph. For that purpose, the interests intended to be acquired in D or C will include A's acquisition of D stock under paragraph (a)(2)(iv)(A) of this section. Second, under paragraph (a)(2)(iii)(B) of this section, D must establish that, at the time of the distribution, neither D, C, nor their controlling shareholders would reasonably have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in D or C within 2 years after the distribution (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter) who would not have acquired such interests if the distribution had not occurred. Under paragraph (a)(2)(iv)(C) of this section, D, C, and their controlling shareholders must treat the amount of D stock acquired by A as an amount they would reasonably have anticipated was more likely than not to be acquired within 2 years after the distribution that would not have been acquired if the distribution had not occurred. Third, under paragraph (a)(2)(iii)(C) of this section, D will be able to establish that the distribution was not motivated in whole or substantial part by an intention to decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired.

Example 8. D plans to distribute C pro rata to its shareholders. The distribution is substantially motivated by a corporate business purpose within the meaning of §1.355–2(b) (other than an intent to facilitate an acquisition or decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired). After the announcement date, D's investment banker informs D's management that there is a lot of interest in new investment in D now that it will no longer own C. At the time of the distribution, D would reasonably anticipate that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in D within 2 years (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter) who would not acquire such interests absent the distribution. Three months after the distribution, D issues an option to X to purchase 50 percent of the D stock. At the time of issuance, the facts and circumstances indicate that the option is more likely than not to be exercised. Two years after issuance, X exercises the option and purchases 50 percent of the D stock. Under paragraph (a)(7)(i)(A) of this section, the option is treated as an agreement on the date it is issued. Under paragraph (a)(3)(i)(A) of this section, the distribution and the acquisition are presumed to be part of a plan (or series of related transactions) because there was an agreement concerning the acquisition within 2 years of the distribution. D will not be able to rebut the presumption using the rebuttals of paragraphs (a)(2)(ii) or (a)(2)(iii) of this section. The rebuttal of paragraph (a)(2)(ii) of this section is unavailable because there was an agreement concerning the acquisition within 6 months of the distribution. The rebuttal of paragraph (a)(2)(iii) of this section is unavailable because D cannot establish that, at the time of the distribution, neither D, C, nor their controlling shareholders would reasonably have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in D within 2 years (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter) who would not have acquired such interests absent the distribution. Because the presumption relating to the acquisition of a 50-percent interest in D cannot be rebutted, section 355(e) applies to the distribution of C.

Example 9. (i) D distributes C pro rata to its shareholders solely to facilitate a stock offering by C. To take advantage of favorable market conditions, C issues new shares amounting to 20 percent of its stock in a public offering followed 1 month later by the distribution. The public offering documents disclosed the intended distribution of C. Neither D, C, nor their controlling shareholders intended any further transactions involving D or C stock. In addition, at the time of the distribution, neither D, C, nor their controlling shareholders would reasonably anticipate that it was more likely than not that one or more persons would acquire a 50-percent interest in D or C within 2 years (or later pursuant to an agreement, understanding, or arrangement existing at the time of the distribution or within 6 months thereafter) who would not have acquired such interests absent the distribution. Two months after the distribution, C is approached unexpectedly regarding an opportunity to acquire X. Five months after the distribution, C acquires X in exchange for 40 percent of the C stock. Under paragraph (a)(2)(i) of this section, the distribution and each acquisition are presumed to be part of a plan (or series of related transactions) because each acquisition occurred within 2 years of the distribution.

(ii) Regarding the public offering, D cannot rebut the presumption using paragraph (a)(2)(v) of this section. At the time of the acquisition, D and its controlling shareholders intended to effectuate the distribution. Also, the distribution would not have occurred at approximately the same time and under substantially the same terms regardless of the public offering.

(iii) Regarding C's acquisition of X, D will not be able to rebut the presumption using paragraph (a)(2)(ii) of this section because the acquisition occurred within 6 months after the distribution. However, D will be able to rebut the presumption regarding the acquisition of X using paragraph (a)(2)(iii) of this section. Neither D, C, nor their controlling shareholders intended that one or more persons would acquire a 50-percent or greater interest in D or C during the relevant period under paragraph (a)(2)(iii)(A)(*1*) of this section. Under paragraph (a)(2)(iii)(B) of this section, at the time of the distribution, neither D, C, nor their controlling shareholders would reasonably have anticipated that it was more likely than not that one or more persons would acquire a 50-percent or greater interest in C within 2 years who would not have acquired such interests if the distribution had not occurred. Under paragraph (a)(2)(iii)(C) of this section, the distribution was not motivated in whole or substantial part by an intention to decrease the likelihood of the acquisition of one or more businesses by separating those businesses from others that are likely to be acquired. Because only the 20-percent acquisition by public offering is part of a plan (or series of related transactions) involving the distribution, section 355(e) does not apply.

(b) *Multiple controlled corporations.* Only the stock or securities of a controlled corporation in which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest as part of a plan (or series of related transactions) involving the distribution of that corporation will be treated as

not qualified property under section 355(e)(1) if–

(1) The stock or securities of more than one controlled corporation are distributed in distributions to which section 355 applies; and

(2) One or more persons do not acquire, directly or indirectly, stock representing a 50-percent or greater interest in the distributing corporation pursuant to a plan (or series of related transactions) involving any of those distributions.

(c) *Valuation.* Except as provided in paragraph (a)(7)(i)(A) of this section, for purposes of section 355(e) and this section, all shares of stock within a single class are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(d) Effective date. The regulations in this section apply to distributions occurring after the regulations in this section are published as final regulations in the **Federal Register.**

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 19, 1999, 1:37 p.m., and published in the issue of the Federal Register for August 24, 1999, 64 F.R. 46155)

Notice of Proposed Rulemaking

Private Foundation Disclosure Rules

REG–121946–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations relating to the public disclosure requirements described in section 6104(d) of the Internal Revenue Code. The proposed regulations implement changes made by the Tax and Trade Relief Extension Act of 1998, which extended fully to private foundations the same rules regarding public disclosure of annual information returns that apply to other tax-exempt organizations. The proposed regulations provide guidance for private foundations required to make copies of applications for tax exemption and annual information returns available for public inspection and to comply with requests for copies of those documents. Final regulations relating to the public disclosure requirements applicable to tax-exempt organizations other than private foundations were issued on April 9, 1999.

DATES: Written or electronic comments and requests for a public hearing must be received by October 12, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–121946–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–121946–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax regs/reglist.html.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michael B. Blumenfeld, (202) 622-6070 (not a toll-free number); concerning submissions of comments, LaNita Van Dyke (202) 622-7190 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by October 12, 1999. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collections of information in these proposed regulations are in §§301.6104(d)–1, 301.6104(d)–2, and 301.6104(d)–3. This information is required to enable a private foundation to comply with section 6104(d) of the Internal Revenue Code (Code). Under section 6104(d), a private foundation is required to make its application for tax exemption and its annual information returns available for public inspection. In addition, a private foundation is required to comply with requests made in person or in writing from individuals who seek a copy of those documents or, in the alternative, to make its documents widely available. The requirement that a private foundation make its application for tax exemption and annual information returns available for public inspection and comply with requests made in person or in writing from individuals who seek a copy of those documents or, in the alternative, make the documents widely available, will enable the public to obtain information about the private foundation. Under section 6104(d), a private foundation is permitted to file an application for relief from the requirement to provide copies if the private foundation reasonably believes it is the subject of a harassment campaign. The information a private foundation provides when filing an application for a de-

termination that it is subject to a harassment campaign will be used by the IRS to make such determination. The collection of information is required to obtain relief from the requirement to comply with requests for copies if such requests are part of the harassment campaign. The likely respondents and/or recordkeepers are private foundations. The burden for recordkeeping and for reporting is reflected below.

Estimated total annual recordkeeping burden: 32,565 hours.

Estimated average annual burden per recordkeeper: 30 minutes.

Estimated number of recordkeepers: 65,065.

Estimated total annual reporting burden: 31 hours.

Estimated average annual reporting burden per respondent: 27 minutes.

Estimated number of respondents: 68.

Estimated annual frequency of responses: on occasion.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document proposes to amend §§301.6104(d)–1 through 301.6104(d)–5 of the Procedure and Administration Regulations (26 CFR Part 301) relating to the section 6104(d) public disclosure requirements applicable to tax-exempt organizations (organizations described in section 501(c) or (d) and exempt from taxation under section 501(a)). The proposed amendments would remove existing §301.6104(d)–1 (relating to public inspection of private foundation annual information returns). The proposed amendments also would revise §§301.6104(d)–2 through 301.6104(d)–5 to apply the provisions to all tax-exempt organizations, including private foundations, and redesignate existing §§301.6104(d)–2 through 301.6104(d)–5 as §§301.6104(d)–0 through 301.6104(d)–3, respectively. This regulation is not subject to the Unfunded Mandates Reform Act of 1995 because the regulation is an interpretive regulation.

Description of Current Law Disclosure Requirements Applicable to Private Foundations

Section 6104(d), as in effect prior to the effective date of the Tax and Trade Relief Extension Act of 1998 (Division J of H.R. 4328, the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999)(Public Law 105-277, 112 Stat 2681) (with respect to private foundations), requires a private foundation to make its annual information returns available for public inspection at its principal office during regular business hours for a period of 180 days after the foundation publishes notice of the availability of its return. A private foundation must publish such notice not later than the due date of the return (determined with regard to any extension of time for filing) in a newspaper having general circulation in the county in which the principal office of the foundation is located. Section 6104(e), as in effect prior to the effective date of the Tax and Trade Relief Extension Act of 1998 (with respect to private foundations), requires a private foundation to allow public inspection of the foundation's application for recognition of exemption at the foundation's principal office (and certain regional or district offices). Section 6104(e) also requires a private foundation to provide copies of its exemption application upon request. However, the requirement to provide copies of an exemption application upon request becomes effective only after the Secretary of the Treasury issues regulations applicable to private foundations describing how a private foundation may be relieved of the obligation to provide copies in response to requests by making its exemption application widely available or by obtaining an IRS determination that a particular request is part of a harassment campaign.

Amendments Made by the Tax and Trade Relief Extension Act of 1998

The Tax and Trade Relief Extension Act of 1998, which was enacted on October 21, 1998, amended section 6104(e) of the Code to subject the annual information returns filed by private foundations to the same rules regarding public disclosure that apply to other tax-exempt organizations. In addition, the Tax and Trade Relief Extension Act of 1998 repealed existing section 6104(d), and redesignated section 6104(e), as amended, as new section 6104(d). Section 6104(d), as amended by the Tax and Trade Relief Extension Act of 1998, requires each tax-exempt organization, including one that is a private foundation, to allow public inspection at its principal office (and at certain regional or district offices) and to comply with requests, made either in person or in writing, for copies of the organization's application for recognition of exemption and the organization's three most recent annual information returns. Congress appears to have intended that nonexempt charitable trusts described in section 4947(a)(1) and nonexempt private foundations comply with the expanded public disclosure requirements, just as such entities are subject to the information reporting requirements of section 6033 pursuant to section 6033(d). See Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1998 (JCS-6-98), November 24, 1998, at 242, fn. 102.

The Tax and Trade Relief Extension Act of 1998 amendments apply to requests made after the later of December 31, 1998, or the 60th day after the Secretary of the Treasury issues regulations referred to in section 6104(d)(4) (relating to when documents are made widely available and when a particular request is considered part of a harassment campaign). On April 9, 1999, the IRS published in the **Federal Register** (64 F.R. 17279 [T.D. 8818, 1999–17 I.R.B. 3]) final regulations under section 6104(d) applicable to tax-exempt organizations other than private foundations. Accordingly, section 6104(d), as amended by the Tax and Trade Relief Extension Act of 1998, became effective with respect to tax-exempt organizations other than private foundations on June 8, 1999.

Explanation of Provisions

The proposed amendments extend the recently-published final regulations under section 6104(d) to apply to private foun-

dations. The proposed amendments also modify those regulations in several respects. The proposed amendments state that the term annual information return includes any return that is required to be filed under section 6033. For a private foundation, such returns include Form 990-PF and Form 4720. Consistent with the statute, the proposed amendments provide that, unlike other tax-exempt organizations, a private foundation is required to disclose to the general public the names and addresses of its contributors. The proposed amendments also clarify that, for purposes of section 6104(d), the terms tax-exempt organization and private foundation include nonexempt private foundations and nonexempt charitable trusts described in section 4947(a)(1) that are subject to the information reporting requirements of section 6033. Finally, the proposed amendments remove existing §301.6104(d)–1 and redesignate existing §§301.6104–2 through 301.6104(d)–5, as §§301.6104(d)–0 through 301.6104(d)-3, respectively.

Until 60 days after these proposed amendments are published as final regulations in the **Federal Register,** private foundations continue to be subject to section 6104(d) and section 6104(e), as in effect prior to the Tax and Trade Relief Extension Act of 1998, and existing §301.6104(d)–1. Thereafter, private foundations will continue to be subject to the public inspection requirements of section 6104(d), as in effect prior to the Tax and Trade Relief Extension Act of 1998, and existing §301.6104(d)–1 with respect to any annual information return the due date (determined with regard to any extension of time for filing) for which is prior to the effective date of the final regulations.

Proposed Effective Date

The amendments made by these regulations are proposed to be effective 60 days after the date these regulations are published as final regulations in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to sections 603(a) and 605(b) of the Regulatory Flexibility Act, it is certified that the collection of information referenced in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities. Although a substantial number of small entities will be subject to the collection of information requirements in these regulations, the requirements will not have a significant economic impact on these entities. The average time required to maintain and disclose the information required under these regulations is estimated to be 30 minutes for each private foundation. This estimate is based on the assumption that, on average, a private foundation will receive one request per year to inspect or provide copies of its application for tax exemption and its annual information returns. Approximately 0.1 percent of the private foundations affected by these regulations will be subject to the reporting requirements contained in the regulations. It is estimated that annually, approximately 65 private foundations will make its documents widely available by posting them on the Internet. In addition, it is estimated that annually, approximately 3 private foundations will file an application for a determination that they are the subject of a harassment campaign such that a waiver of the obligation to provide copies of their applications for tax exemption and their annual information returns is in the public interest. The average time required to complete, assemble and file an application describing a harassment campaign is expected to be 5 hours. Because applications for a harassment campaign determination will be filed so infrequently, they will have no effect on the average time needed to comply with the requirements in these regulations. In addition, a private foundation is allowed in these regulations to charge a reasonable fee for providing copies to requesters. Therefore, it is estimated that it will cost a private foundation less than $10 per year to comply with these regulations, which is not a significant economic impact.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by a person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Michael B. Blumenfeld, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. Other personnel from the IRS and Treasury Department also participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301-PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding entries in numerical order to read as follows:

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

Section 301.6104(d)–2 also issued under 26 U.S.C. 6104(d)(3);

Section 301.6104(d)–3 also issued under 26 U.S.C. 6104(d)(3); * * *

§301.6104(d)–1 [Removed]

Par. 2. Section 301.6104(d)–1 is removed.

§301.6104(d)–2 [Redesignated as §301.6104(d)–0]

Par. 3. Section 301.6104(d)–2 is redesignated as §301.6104(d)–0.

Par. 4. Newly designated §301.6104(d)–0 is revised to read as follows:

§301.6104(d)–0 Table of contents.

This section lists the major captions contained in §§301.6104(d)–1 through 301.6104(d)–3 as follows:

§301.6104(d)–1 Public inspection and distribution of applications for tax exemption and annual information returns of tax-exempt organizations.

(a) In general.
(b) Definitions.
(1) Tax-exempt organization.
(2) Private foundation.
(3) Application for tax exemption.
(i) In general.
(ii) No prescribed application form.
(iii) Exceptions.
(iv) Local or subordinate organizations.
(4) Annual information return.
(i) In general.
(ii) Exceptions.
(iii) Returns more than 3 years old.
(iv) Local or subordinate organizations.
(5) Regional or district offices.
(i) In general.
(ii) Site not considered a regional or district office.
(c) Special rules relating to public inspection.
(1) Permissible conditions on public inspection.
(2) Organizations that do not maintain permanent offices.
(d) Special rules relating to copies.
(1) Time and place for providing copies in response to requests made in person.
(i) In general.
(ii) Unusual circumstances.
(iii) Agents for providing copies.
(2) Request for copies in writing.
(i) In general.
(ii) Time and manner of fulfilling written requests.
(A) In general.
(B) Request for a copy of parts of document.
(C) Agents for providing copies.
(3) Fees for copies.
(i) In general.
(ii) Form of payment.
(A) Request made in person.
(B) Request made in writing.
(iii) Avoidance of unexpected fees.
(iv) Responding to inquiries of fees charged.
(e) Documents to be provided by regional and district offices.
(f) Documents to be provided by local and subordinate organizations.
(1) Applications for tax exemption.
(2) Annual information returns.
(3) Failure to comply.
(g) Failure to comply with public inspection or copying requirements.
(h) Effective date.
(1) In general.
(2) Private foundation annual information returns.

§301.6104(d)–2 Making applications and returns widely available.

(a) In general.
(b) Widely available.
(1) In general.
(2) Internet posting.
(i) In general.
(ii) Transition rule.
(iii) Reliability and accuracy.
(c) Discretion to prescribe other methods for making documents widely available.
(d) Notice requirement.
(e) Effective date.

§301.6104(d)–3 Tax-exempt organization subject to harassment campaign.

(a) In general.
(b) Harassment.
(c) Special rule for multiple requests from a single individual or address.
(d) Harassment determination procedure.
(e) Effect of a harassment determination.
(f) Examples.
(g) Effective date.

§301.6104(d)–3 [Redesignated as §301.6104(d)–1]

Par. 5. Section 301.6104(d)–3 is redesignated as §301.6104(d)–1.

Par. 6. Newly designated §301.6104(d)–1 is amended as follows:

1. Revise the section heading.

1a. Paragraph (a) is amended as follows:

a. Remove the language ", other than a private foundation (as defined in paragraph (b)(2) of this section)," from the first sentence.

b. Remove the language ", other than a private foundation," from the second sentence.

c. Remove the language "§§301.6104(d)–4 and 301.6104(d)–5" from the fourth sentence and add "§§301.6104(d)–2 and 301.6104(d)–3" in its place.

2. In paragraph (b) introductory text, remove the language "§§301.6104(d)–4 and 301.6104(d)–5" and add "§§301.6104(d)–2 and 301.6104(d)–3" in its place.

3. In paragraph (b)(1), add a sentence at the end of the paragraph.

4. In paragraph (b)(2), add the language "or a nonexempt charitable trust described in section 4947(a)(1) or a nonexempt private foundation subject to the information reporting requirements of section 6033 pursuant to section 6033(d)" at the end of the sentence.

5. In paragraph (b)(3)(iii)(B), remove the word "or" at the end of the paragraph.

6. Redesignate paragraph (b)(3)(iii)(C) as paragraph (b)(3)(iii)(D) and add a new paragraph (b)(3)(iii)(C).

7. In paragraph (b)(4)(i), remove the last two sentences and add three sentences in their place.

8. Paragraph (b)(4)(ii) is amended as follows:

a. Remove the language ", and the return of a private foundation" from the first sentence.

b. Revise the last sentence.

9. Revise paragraph (h).

The revisions and additions read as follows:

§301.6104(d)–1 Public inspection and distribution of applications for tax exemption and annual information returns of tax-exempt organizations.

* * * * *

(b) * * *

(1) * * * The term tax-exempt organization also includes any nonexempt charitable trust described in section 4947(a)(1) or nonexempt private foundation that is subject to the reporting requirements of section 6033 pursuant to section 6033(d).

* * * * *

(3)* * *

(iii) * * *

(C) In the case of a tax-exempt organization other than a private foundation, the name and address of any contributor to the organization; or

* * * * *

(4) * * * (i) * * * Returns filed pursuant to section 6033 include Form 990, Return of Organization Exempt From Income Tax, Form 990-PF, Return of Private Foundation, or any other version of Form 990 (such as Forms 990-EZ or 990-BL, except Form 990-T) and Form 1065. Each copy of a return must include all information furnished to the Internal Revenue Service on the return, as well as all schedules, attachments and supporting documents. For example, in the case of a Form 990, the copy must include Schedule A of Form 990 (containing supplementary information on section 501(c)(3) organizations), and those parts of the return that show compensation paid to specific persons (currently, Part V of Form 990 and Parts I and II of Schedule A of Form 990).

(ii) * * * In the case of a tax-exempt organization other than a private foundation, the term *annual information return* does not include the name and address of any contributor to the organization.

* * * * *

(h) *Effective date*—(1) *In general.* For a tax-exempt organization, other than a private foundation, this section is applicable June 8, 1999. Except as provided in paragraph (h)(2) of this section, for a private foundation, this section is applicable beginning 60 days after these regulations are published as final regulations in the **Federal Register.**

(2) *Private foundation annual information returns.* This section applies to any private foundation return the due date for which (determined with regard to any extension of time for filing) is after the applicable date for private foundations specified in paragraph (h)(1) of this section.

§301.6104(d)–4 [Redesignated as §301.6104(d)–2]

Par. 7. Section 301.6104(d)–4 is redesignated as §301.6104(d)-2.

Par. 8. Newly designated §301.6104(d)–2 is amended as follows:

1. In paragraph (a), remove the language "§301.6104(d)–3(a)" from each place it appears and add "§301.6104(d)–1(a)" in each place, respectively.

2. Revise paragraph (e).

The revision reads as follows:

§301.6104(d)–2 Making applications and returns widely available.

* * * * *

(e) *Effective date.* For a tax-exempt organization, other than a private foundation, this section is applicable June 8, 1999. For a private foundation, this section is applicable beginning 60 days after these regulations are published as final regulations in the **Federal Register.**

§301.6104(d)–5 [Redesignated as §301.6104(d)–3]

Par. 9. Section 301.6104(d)–5 is redesignated as §301.6104(d)–3.

Par. 10. Newly designated §301.6104(d)–3 is amended as follows:

1. In paragraph (a), remove the language "§301.6104(d)–3(a)" and add "§301.6104(d)–1(a)" in its place.

2. Revise paragraph (g).

The revision reads as follows:

§301.6104(d)–3 Tax-exempt organization subject to harassment campaign.

* * * * *

(g) *Effective date.* For a tax-exempt organization, other than a private foundation, this section is applicable June 8, 1999. For a private foundation, this section is applicable beginning 60 days after these regulations are published as final regulations in the **Federal Register.**

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 9, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 10, 1999, 64 F.R. 43324)

Foundations Status of Certain Organizations

Announcement 99–88

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

African-American Youth Baseball Association, Desoto, TX
American Friends of Kollel Beth Hatalmud of Melbourne Australia, Brooklyn, NY
Arbor Hills Parent Organization, Sylvania, OH
Arizona Flairs Boosters Inc., Mesa, AZ
Armenian International Sports Foundation, Woodside, NY
Arts Pack Inc., Racine, WI
Association of Rape and Assault Prevention Inc., Silver Spring, MD
Bone Marrow Lifeline Inc., Greensboro, NC
Broadhead Mannor Resident Council, Pittsburgh, PA
Center for Cultural Education Inc., Acton, MA
CHHS Debate Team Booster Club, Troy, AL
Childrens Museum of Dayton Inc., Dayton, OH
Childrens Safety Bureau Inc., San Antonio, TX
Christian Youth Network of Utah, Sandy, UT
Coalition for Positive Change, Huntington, WV
Colorado Gymnastics Parents, Longmont, CO
Columbus Roadrunners, Columbus, OH
Concerned Citizens Enterprises Inc., Middletown, OH
Deaf Childrens Association of America, Saddle Brook, NJ
Doo Rae Foundation Inc., Flushing, NY
Each One Teach One, Clarksdale, AZ
East Marietta Basketball Inc., Marietta, GA

Empowering Parents for Troubled Times Inc., Greensboro, GA
Epiphany Enterprises Inc., Jacksonville, FL
Family Community Development Corporation, Pine Bluff, AR
Filipino-American Law Enforcement Association of Illinois Inc., Chicago, IL
Fort Bragg Swim Club, Ft. Bragg, NC
Four Season Choral Society Inc., Richardson, TX
Franciscan Servants of Divine Mercy Inc., Jackson, MI
Gaden Jangtse Monastery, Anaheim, CA
Geoff Carroll Memorial Fund, Boston, MA
George Foster Foundation Inc., Greenwich, CT
Greencastle Antrim Primary School PTO, Greencastle, PA
Hidden Talent Theater Inc. C/O Bobbie Flowers, Shreveport, LA
Hispanic Mathematical Association of Minnesota Inc., St. Paul, MN
International Center for the Deaf, New York, NY
Jackson Art Association, Jackson, TN
Judy Aaron Ministries, Phoenix, AZ
Kangaroo Pouch Day Care & Learning Center, Jayess, MS
Kids N Christmas of Arizona, Tempe, AZ
Kiwanis Horses for Handicapped Foundation of Pinellas County Inc., Seminole, FL
Largo-Tibet Parent Teacher Organization, Savannah, GA
Licking County Crime Stoppers Inc., Newark, OH
Lighthouse Institute for Public Policy Inc., Cochituate, MA
Lineville Band Boosters Inc., Lineville, AL
Living Hope International, Clackamas, OR
Lone Star Youth Council Inc., Jasper, TX
Magnolia Opera Festival Inc., Carrboro, NC
Marshall County Educational Resource Center Inc., Benton, KY
Marshall Education Trust Fund, Marshall, IL
Mid-City Community Development Corporation, New Orleans, LA
Multi-Media Resource Center, Lansing, MI
Multicultural Alliance of Ponca City Incorporated, Ponca City, OK
Multicultural Committee of Ocean County Inc., Toms River, NJ
Needy People Foundation Inc., Brooklyn, NY
New Life Academy Inc., Macon, GA
New York Coastal Partnership Inc., Babylon, NY
Oaks Youth Project Inc., Tahlequah, OK
Onward Paterson Through the 90s Inc., Paterson, NJ
Organization for the Betterment of Youth, Las Vegas, NV
Peninsula Little League, San Diego, CA
Polliwog Place Child Development Center, Metropolis, IL
Poultney Project Care, Poultney, VT
Preschool Services Inc., Scottsdale, AZ
Progressive Youth Services Inc., Houston, TX
Romanian Childrens Aid Inc., Dallas, TX
Ryan Scherbel Foundation, Willis, TX
Safekeeping, Denmark, ME
Sandwich Home Nursing and Health Association, Center Sandwich, NH
Sharks Foundation, San Jose, CA
Sheridan All Seasons Center Association, Sheridan, WY
Sibley County Coral Society Inc., Arlington, MN
Silent Servants, Redford, MI
South Carolina Traditional Jazz Foundation, Gadsden, SC
Southwest Juniors Volleyball Association Inc., Tempe, AZ
Spark, Nashville, TN
Sportsfest Inc., Bronxville, NY
Tabernacle of Praise Ministries, Sacramento, CA
Texas Association for Spiritual Knowledge, Dallas, TX
Texas Celebration 150 Inc., Irving, TX
The American Aesthetic Institute, Minneapolis, MN
The Juniper Foundation Inc., Albany, NY
The Starfire Booster Club Inc., Carrollton, TX
Time-Out for Youth Inc., Rutherfordton, NC
Unified and Involved Community Action Network U & I Can, Bryan, TX
Union Park-N-Play Committee, Union, ME
Voices of Kentuckiana Inc., Louisville, KY
Volunteer Action Center of Greater Lorain County, Elyria, OH
W O C T Inc., Arlington, TX
West Side Cares Inc., New York, NY
Whaz-Up Productions Inc., Lithonia, GA
Williams Community Center Association, Williams, CA
Women of Color Inc., Chicago, IL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Section 195—Start-up Expenditures

Announcement 99–89

This announcement reflects corrections of typographical errors and omissions in Rev. Rul. 99–23, 1999–20 I.R.B. 3, dated May 17, 1999.

In the LAW AND ANALYSIS section of Rev. Rul. 99–23 (ninth paragraph), the quoted language from the legislative history of § 195 of the Internal Revenue Code is corrected to read as follows:

> . . . [E]ligible expenses consist of investigatory costs incurred in reviewing a prospective business prior to reaching a final decision to acquire or to enter that business. These costs include expenses incurred for the analysis or survey of potential markets, products, labor supply, transportation facilities, etc. . . .
>
> . . .
>
> Startup expenditures eligible for amortization do not include any amount with respect to which a deduction would not be allowable to an existing trade or business for the taxable year in which the expenditure was paid or incurred.... In addition, the amortization election for startup expenditures does not apply to amounts paid or incurred as part of the acquisition cost of a trade or business. Also, startup expenditures do not include amounts paid or incurred for the acquisition of property to be held for sale or property which may be de-

preciated or amortized based on its useful life. . . . Whether an amount is consideration paid to acquire a business . . . depends upon the facts and circumstances of the situation.

In the last sentence of the LAW AND ANALYSIS section, "*T*'s" is corrected to read "*Z*'s" before the words "internal documents."

Form 10318, Deduction for Depletion on Ground Water Used for Irrigation, Obsolete

Announcement 99–90

Form 10318, Deduction for Depletion on Ground Water Used for Irrigation, is obsolete. It was previously used by taxpayers who extracted ground water from the Ogallala geological formation for irrigation. Taxpayers claiming this depletion should continue to deduct it on the depletion line of their tax returns. No attachment is necessary. See Rev. Proc. 66–11, 1966–1 C.B. 624 and Rev. Rul. 82–214, 1982–2 C.B. 115.

Reporting of Earnings on Excess Contributions to Medical Savings Accounts (MSAs)

Announcement 99–93

The 1998 Instructions for Form 8853, Medical Savings Accounts and Long-Term Care Insurance Contracts, and Form 5329, Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs, contain an error. The instructions for Form 8853, line 7, and Form 5329, Part VI, state that the income earned on certain excess contributions withdrawn from an MSA must be included in gross income for the year in which the MSA participant or the employer made the contribution. Instead, the earnings must be included in gross income for the year in which the earnings and the excess contributions are withdrawn.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The July 1999 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 1999.

Rev. Rul. 99–31

The following Department Store Inventory Price Indexes for July 1999 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, 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, July 31, 1999.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	July 1998	July 1999	Percent Change from July 1998 to July 1999[1]
1. Piece Goods	547.7	551.4	0.7
2. Domestics and Draperies	626.7	632.6	0.9
3. Women's and Children's Shoes	642.3	635.4	–1.1
4. Men's Shoes	906.5	874.8	–3.5
5. Infants' Wear	606.8	615.1	1.4
6. Women's Underwear	573.1	560.8	–2.1
7. Women's Hosiery	307.6	321.3	4.5
8. Women's and Girls' Accessories	539.3	532.8	–1.2
9. Women's Outerwear and Girls' Wear	389.3	367.0	–5.7
10. Men's Clothing	613.4	616.1	0.4
11. Men's Furnishings	589.3	618.8	5.0
12. Boys' Clothing and Furnishings	489.4	470.9	–3.8
13. Jewelry	981.5	962.1	–2.0
14. Notions	767.3	794.3	3.5
15. Toilet Articles and Drugs	947.6	967.1	2.1
16. Furniture and Bedding	683.7	685.0	0.2
17. Floor Coverings	602.1	602.2	0.0
18. Housewares	825.5	792.6	–4.0
19. Major Appliances	238.3	235.0	–1.4
20. Radio and Television	71.6	65.7	–8.2
21. Recreation and Education[2]	104.3	98.1	–5.9
22. Home Improvements[2]	131.2	128.1	–2.4
23. Auto Accessories[2]	107.5	106.5	–0.9
Groups 1 – 15: Soft Goods	592.1	588.1	–0.7
Groups 16 – 20: Durable Goods	464.9	449.3	–3.4
Groups 21 – 23: Misc. Goods[2]	108.4	103.7	–4.3
Store Total[3]	545.9	536.7	–1.7

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Richard C. Farley, Jr. of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Farley on (202) 622-4970 (not a toll-free call).

Section 453.—Installment Method

26 CFR 1.453.12: Allocation of unrecaptured section 1250 gain reported on the installment method.

T.D. 8836

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Capital Gains, Installment Sales, Unrecaptured Section 1250 Gain

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the taxation of capital gains on installment sales of depreciable real property. The regulations interpret changes made by the Taxpayer Relief Act of 1997, as amended by the Internal Revenue Service Restructuring and Reform Act of 1998 and the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999. The regulations affect persons required to report capital gain from an installment sale where a portion of the capital gain is unrecaptured section 1250 gain and a portion is adjusted net capital gain.

DATES: *Effective Date:* These regulations are effective August 23, 1999.

Applicability Date: These regulations apply to installment payments properly taken into account after August 23, 1999.

FOR FURTHER INFORMATION CONTACT: Susan Kassell, (202) 622-4930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1). On January 22, 1999, a notice of proposed rulemaking (REG–110524–98, 1999–10 I.R.B. 55) relating to the taxation of capital gains on installment sales of depreciable real property was published in the **Federal Register** (64 F.R. 3457). No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held. The proposed regulations are adopted without substantive change by this Treasury decision.

Explanation of Provisions

In 1997 Congress amended section 1(h) generally to reduce the maximum capital gain tax rates for individuals. As amended, section 1(h) generally divides a taxpayer's net capital gain into several rate groups. A maximum marginal rate of 28 percent applies to 28-percent rate gain, which is not pertinent to these final regulations. A maximum marginal rate of 25 percent applies to unrecaptured section 1250 gain (25-percent gain), which is defined in section 1(h)(7)(A) as the amount of long-term capital gain (not otherwise treated as ordinary income) that would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, reduced by any net loss in the 28-percent rate category. A maximum marginal rate of 20 percent applies to adjusted net capital gain (20/10-percent gain), defined in section 1(h)(4) as the portion of net capital gain that is not taxed at the 28-percent or 25-percent rates. A reduced rate of 10 percent is applied to the portion of the taxpayer's adjusted net capital gain that would otherwise be taxed at a 15-percent rate.

Under the final regulations, if a portion of the capital gain from an installment sale of real depreciable property consists of 25-percent gain, and a portion consists of 20/10-percent gain, the taxpayer is required to take the 25-percent gain into account before the 20/10-percent gain, as payments are received. In addition, an example in the regulations illustrates that section 1231 gain from an installment sale that is recharacterized as ordinary gain under section 1231(c) is deemed to consist first of 25-percent gain, and then 20/10-percent gain. Consistent with this treatment and with the general rule that 25-percent gain is taken into account first, another example in the regulations illustrates that, where there is installment gain that is characterized as ordinary gain under section 1231(a) because there is a net section 1231 loss for the year, the gain is treated as consisting of 25-percent gain first, before 20/10-percent gain, for purposes of determining how much 25-percent gain remains to be taken into account in later payments.

The final regulations also provide that the capital gain rates applicable to installment payments that are received on or after the effective date of the 1997 Act from sales prior to the effective date are determined as if, for all payments received after the date of sale but before the effective date, 25-percent gain had been taken into account before 20/10-percent gain. The regulations further provide that, in the event the cumulative amount of 25-percent gain actually reported in installment payments received during the period between the effective date of section 1(h) and the effective date of these regulations was less than the amount that would have been reported using the front-loaded allocation method of the regulations, the amount of 25-percent gain actually reported, rather than an amount determined under a front-loaded allocation method, must be used in determining the amount of 25-percent gain that remains to be reported.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal

Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Susan Kassell and Rob Laudeman, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.453–12 is added to read as follows:

§1.453–12 Allocation of unrecaptured section 1250 gain reported on the installment method.

(a) *General rule.* Unrecaptured section 1250 gain, as defined in section 1(h)(7), is reported on the installment method if that method otherwise applies under section 453 or 453A and the corresponding regulations. If gain from an installment sale includes unrecaptured section 1250 gain and adjusted net capital gain (as defined in section 1(h)(4)), the unrecaptured section 1250 gain is taken into account before the adjusted net capital gain.

(b) *Installment payments from sales before May 7, 1997.* The amount of unrecaptured section 1250 gain in an installment payment that is properly taken into account after May 6, 1997, from a sale before May 7, 1997, is determined as if, for all payments properly taken into account after the date of sale but before May 7, 1997, unrecaptured section 1250 gain had been taken into account before adjusted net capital gain.

(c) *Installment payments received after May 6, 1997, and on or before August 23, 1999.* If the amount of unrecaptured section 1250 gain in an installment payment that is properly taken into account after May 6, 1997, and on or before August 23, 1999, is less than the amount that would have been taken into account under this section, the lesser amount is used to determine the amount of unrecaptured section 1250 gain that remains to be taken into account.

(d) *Examples.* In each example, the taxpayer, an individual whose taxable year is the calendar year, does not elect out of the installment method. The installment obligation bears adequate stated interest, and the property sold is real property held in a trade or business that qualifies as both section 1231 property and section 1250 property. In all taxable years, the taxpayer's marginal tax rate on ordinary income is 28 percent. The following examples illustrate the rules of this section:

Example 1. General rule. This example illustrates the rule of paragraph (a) of this section as follows:

(i) In 1999, A sells property for $10,000, to be paid in ten equal annual installments beginning on December 1, 1999. A originally purchased the property for $5000, held the property for several years, and took straight-line depreciation deductions in the amount of $3000. In each of the years 1999-2008, A has no other capital or section 1231 gains or losses.

(ii) A's adjusted basis at the time of the sale is $2000. Of A's $8000 of section 1231 gain on the sale of the property, $3000 is attributable to prior straight-line depreciation deductions and is unrecaptured section 1250 gain. The gain on each installment payment is $800.

(iii) As illustrated in the table in this paragraph (iii) of this *Example 1.*, A takes into account the unrecaptured section 1250 gain first. Therefore, the gain on A's first three payments, received in 1999, 2000, and 2001, is taxed at 25 percent. Of the $800 of gain on the fourth payment, received in 2002, $600 is taxed at 25 percent and the remaining $200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1999	2000	2001	2002	2003	2004-2008	Total gain
Installment gain	800	800	800	800	800	4000	8000
Taxed at 25%	800	800	800	600			3000
Taxed at 20%				200	800	4000	5000
Remaining to be taxed at 25%	2200	1400	600				

Example 2. Installment payments from sales prior to May 7, 1997. This example illustrates the rule of paragraph (b) of this section as follows:

(i) The facts are the same as in *Example 1* except that A sold the property in 1994, received the first of the ten annual installment payments on December 1, 1994, and had no other capital or section 1231 gains or losses in the years 1994-2003.

(ii) As in *Example 1*, of A's $8000 of gain on the sale of the property, $3000 was attributable to prior straight-line depreciation deductions and is unrecaptured section 1250 gain.

(iii) As illustrated in the following table, A's first three payments, in 1994, 1995, and 1996, were received before May 7, 1997, and taxed at 28 percent. Under the rule described in paragraph (b) of this section, A determines the allocation of unrecaptured section 1250 gain for each installment payment after May 6, 1997, by taking unrecaptured section 1250 gain into account first, treating the general rule of paragraph (a) of this section as having applied since the time the property was sold, in 1994. Consequently, of the $800 of gain on the fourth payment, received in 1997, $600 is taxed at 25 percent and the remaining $200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1994	1995	1996	1997	1998	1999-2003	Total gain
Installment gain	800	800	800	800	800	4000	8000
Taxed at 28%	800	800	800				2400
Taxed at 25%				600			600
Taxed at 20%				200	800	4000	5000
Remaining to be taxed at 25%	2200	1400	600				

Example 3. Effect of section 1231(c) recapture. This example illustrates the rule of paragraph (a) of this section when there are non-recaptured net section 1231 losses, as defined in section 1231(c)(2), from prior years as follows:

(i) The facts are the same as in *Example 1,* except that in 1999 A has non-recaptured net section 1231 losses from the previous four years of $1000.

(ii) As illustrated in the table in paragraph (iv) of this *Example 3,* in 1999, all of A's $800 installment gain is recaptured as ordinary income under section 1231(c). Under the rule described in paragraph (a) of this section, for purposes of determining the amount of unrecaptured section 1250 gain remaining to be taken into account, the $800 recaptured as ordinary income under section 1231(c) is treated as reducing unrecaptured section 1250 gain, rather than adjusted net capital gain. Therefore, A has $2200 of unrecaptured section 1250 gain remaining to be taken into account.

(iii) In the year 2000, A's installment gain is taxed at two rates. First, $200 is recaptured as ordinary income under section 1231(c). Second, the remaining $600 of gain on A's year 2000 installment payment is taxed at 25 percent. Because the full $800 of gain reduces unrecaptured section 1250 gain, A has $1400 of unrecaptured section 1250 gain remaining to be taken into account.

(iv) The gain on A's installment payment received in 2001 is taxed at 25 percent. Of the $800 of gain on the fourth payment, received in 2002, $600 is taxed at 25 percent and the remaining $200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1999	2000	2001	2002	2003	2004-2008	Total gain
Installment gain	800	800	800	800	800	4000	8000
Taxed at ordinary rates under section 1231(c)	800	200					1000
Taxed at 25%		600	800	600			2000
Taxed at 20%				200	800	4000	5000
Remaining non-recaptured net section 1231 losses	200						
Remaining to be taxed at 25%	2200	1400	600				

Example 4. Effect of a net section 1231 loss. This example illustrates the application of paragraph (a) of this section when there is a net section 1231 loss as follows:

(i) The facts are the same as in *Example 1* except that A has section 1231 losses of $1000 in 1999.

(ii) In 1999, A's section 1231 installment gain of $800 does not exceed A's section 1231 losses of $1000. Therefore, A has a net section 1231 loss of $200. As a result, under section 1231(a) all of A's section 1231 gains and losses are treated as ordinary gains and losses. As illustrated in the following table, A's entire $800 of installment gain is ordinary gain. Under the rule described in paragraph (a) of this section, for purposes of determining the amount of unrecaptured section 1250 gain remaining to be taken into account, A's $800 of ordinary section 1231 installment gain in 1999 is treated as reducing unrecaptured section 1250 gain. Therefore, A has $2200 of unrecaptured section 1250 gain remaining to be taken into account.

(iii) In the year 2000, A has $800 of section 1231 installment gain, resulting in a net section 1231 gain of $800. A also has $200 of non-recaptured net section 1231 losses. The $800 gain is taxed at two rates. First, $200 is taxed at ordinary rates under section 1231(c), recapturing the $200 net section 1231 loss sustained in 1999. Second, the remaining $600 of gain on A's year 2000 installment payment is taxed at 25 percent. As in *Example 3,* the $200 of section 1231(c) gain is treated as reducing unrecaptured section 1250 gain, rather than adjusted net capital gain. Therefore, A has $1400 of unrecaptured section 1250 gain remaining to be taken into account.

(iv) The gain on A's installment payment received in 2001 is taxed at 25 percent, reducing the remaining unrecaptured section 1250 gain to $600. Of the $800 of gain on the fourth payment, received in 2002, $600 is taxed at 25 percent and the remaining $200 is taxed at 20 percent. The gain on A's remaining six installment payments is taxed at 20 percent. The table is as follows:

	1999	2000	2001	2002	2003	2004-2008	Total gain
Installment gain	800	800	800	800	800	4000	8000
Ordinary gain under section 1231(a)	800						800
Taxed at ordinary rates under section 1231(c)		200					200
Taxed at 25%		600	800	600			2000
Taxed at 20%				200	800	4000	5000
Net section 1231 loss	200						
Remaining to be taxed at 25%	2200	1400	600				

(e) *Effective date.* This section applies to installment payments properly taken into account after August 23, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 20, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 23, 1999, 64 F.R. 45874)

Approved August 9, 1999.

Part III. Administrative, Procedural, and Miscellaneous

1999 Section 43 Inflation Adjustment

Notice 99–45

Section 43(b)(3)(B) of the Internal Revenue Code requires the Secretary to publish an inflation adjustment factor. The enhanced oil recovery credit under § 43 for any taxable year is reduced if the "reference price," determined under § 29(d)(2)(C), for the calendar year preceding the calendar year in which the taxable year begins is greater than $28 multiplied by the inflation adjustment factor for that year.

The term "inflation adjustment factor" means, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990.

Because the reference price for the 1998 calendar year ($10.88) does not exceed $28 multiplied by the inflation adjustment factor for the 1999 calendar year, the enhanced oil recovery credit for qualified costs paid or incurred in 1999 is determined without regard to the phase-out for crude oil price increases.

Table 1 contains the GNP implicit price deflator used for the 1999 calendar year, as well as the previously published GNP implicit price deflators used for the 1991 through 1998 calendar years.

Notice 99–45 TABLE 1

GNP IMPLICIT PRICE DEFLATORS

Calendar Year	*GNP Implicit Price Deflator*
1990	112.9 (used for 1991)
1991	117.0 (used for 1992)
1992	120.9 (used for 1993)
1993	124.1 (used for 1994)
1994	126.0 (used for 1995)
1995	107.5 (used for 1996)*
1996	109.7 (used for 1997)
1997	112.35 (used for 1998)**
1998	112.64 (used for 1999)

*Beginning in 1995, the GNP implicit price deflator was rebased relative to 1992. The 1990 GNP implicit price deflator used to compute the 1996 § 43 inflation adjustment factor is 93.6.

**Beginning in 1997, two digits follow the decimal point in the GNP implicit price deflator. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 1999 calendar year as well as the previously published inflation adjustment factors and phase-out amounts for the 1991 through 1998 calendar years.

Notice 9–45 TABLE 2

INFLATION ADJUSTMENT FACTORS AND PHASE-OUT AMOUNTS

Calendar Year	*Inflation Adjustment Factor*	*Phase-out Amount*
1991	1.0000	0
1992	1.0363	0
1993	1.0708	0
1994	1.0992	0
1995	1.1160	0
1996	1.1485	0
1997	1.1720	0
1998	1.1999	0
1999	1.2030	0

DRAFTING INFORMATION

The principal author of this notice is Brenda M. Stewart of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Stewart on (202) 622-3120 (not a toll-free call).

1999 Marginal Production Rates

Notice 99–46

Section 613A(c)(6)(C) of the Internal Revenue Code defines the term "applicable percentage" for purposes of determining percentage depletion for oil and gas produced from marginal properties. The applicable percentage is the percentage (not greater than 25 percent) equal to the sum of 15 percent, plus one percentage point for each whole dollar by which $20 exceeds the reference price (determined under § 29(d)(2)(C)) for crude oil for the calendar year preceding the calendar year in which the taxable year begins. The reference price determined under § 29(d)-

(2)(C) for the 1998 calendar year is $10.88.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 1999.

The principal author of this notice is Brenda M. Stewart of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

Notice 99–46 TABLE 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION

Calendar Year	*Applicable Percentage*
1991	15 percent
1992	18 percent
1993	19 percent
1994	20 percent
1995	21 percent
1996	20 percent
1997	16 percent
1998	17 percent
1999	24 percent

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Arbitrage and Related Restrictions Applicable to Tax-exempt Bonds Issued by State and Local Governments, Investment-Type Property

REG–113526–98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations on the arbitrage and related restrictions applicable to tax-exempt bonds issued by State and local governments. The proposed amendments affect issuers of tax-exempt bonds and provide guidance on the definition of investment-type property to help issuers comply with the arbitrage and related restrictions.

DATES: Written comments must be received by December 23, 1999. Outlines of topics to be discussed at the public hearing scheduled for January 12, 2000, at 10 a.m. must be received by December 15, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–113526–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (REG–113526–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing is in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Barbara Jane League, (202) 622-3980; concerning submissions of comments, the hearing, and/or requests to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 148 of the Internal Revenue Code provides rules addressing the use of proceeds of tax-exempt State and local bonds to acquire higher-yielding investments. On June 18, 1993, final regulations (T.D. 8476, 1993–2 C.B. 13) relating to the arbitrage restrictions and related rules under sections 103, 148, 149, and 150 were published in the **Federal Register** (58 F.R. 33510). Corrections to these regulations were published in the **Federal Register** on August 23, 1993 (58 F.R. 44451), May 11, 1994 (59 F.R. 24350), and July 9, 1999 (64 F.R. 37037). On May 9, 1997, additional final regulations (T.D. 8718, 1997–1 C.B. 47) relating to the arbitrage restrictions and related rules under sections 103, 148, 149, and 150 were published in the **Federal Register** (62 F.R. 25502). This document proposes to modify §1.148–1(e) to clarify which prepayments are investment-type property under section 148(b)(2)(D).

Explanation of Provisions

The current regulations, at §1.148–1(e)(2), provide that prepayments for property or services give rise to investment-type property if a principal purpose for prepaying is to obtain an investment return from the time that the payment is made until the time that payment otherwise would be made. A prepayment does not give rise to investment-type property if (1) the prepayment is made for a substantial business purpose other than investment return and the issuer has no commercially reasonable alternative to the prepayment, or (2) prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing.

Recently, an issue arose about whether investment-type property includes the prepayment of a contract for property or services after the date that the contract is entered into. In *City of Columbus v. Commissioner,* 112 F.3d 1201 (D.C. Cir. 1997), the court held that a prepayment for property cannot occur after the property is acquired. The court's holding suggests that an issuer could avoid investment-type property by entering into a contract for property or services and, at a later date, prepaying that contract. This result is inconsistent with the intent of section 148. The legislative history indicates that Congress intended that the arbitrage rules apply broadly. For example, the Conference Report to the Tax Reform Act of 1986 provides that investment property includes the acquisition of any property held for investment (other than another tax-exempt bond). H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-747, 1986–3 C.B. (Vol.4) 747.

This document proposes modifications to the regulations to establish that prepayments that give rise to investment-type property can occur after the contract for property or services is entered into and to make other non-substantive, clarifying changes. It is intended that these regulations address only the potential issue created by the *City of Columbus* opinion as noted above. Comments are requested on whether the affect of the changes proposed in this document is broader than intended.

In addition to comments on the proposed regulations, comments are requested on whether additional guidance is needed to clarify other aspects of the investment-type property definition. For example, comments are requested on whether clarification is needed on which prepayments of an obligation will be treated as a prepayment for property or services that gives rise to investment-type property, and whether a contract under which property or services are to be provided over time and the payments for those property or services are to be made

over time gives rise to investment-type property when the payment schedule does not match the schedule for the provision of the property or services.

Finally, Treasury and the IRS have become aware of certain transactions involving prepayments for the purchase of a commodity. In these transactions, an issuer generally enters into a long-term contract with a supplier (for example, a natural gas supply company) to supply over a number of years a fixed amount of the commodity to the issuer at a fixed price (the "supply contract"). In return, the issuer makes a single lump-sum prepayment for the commodity to the supplier. The prepayment is financed through the issuance of bonds. The amount of the prepayment is determined in a manner that permits the issuer to obtain an investment return from the prepayment. The issuer also enters into other agreements, including one or more swap agreements, that result in the issuer converting substantially all of the issuer's cost for the commodity under the supply contract into a variable cost that approximates the then current price of the commodity when the issuer takes delivery.

Based on the information received, and viewing the transaction as a whole, it appears that a principal purpose of the prepayment for the supply contract was to earn an investment return. If so, the supply contract is investment-type property unless the requirement of §1.148–1(e)(2)(i) or (ii) are met. Treasury and the IRS are concerned that the supply contract may be investment-type property and request comments on these transactions.

The regulations, when finalized, will apply to bonds issued after a date of applicability that will be set forth in the final regulations. Treasury and the IRS have not yet determined such date of applicability other than to have made the determination that the date of applicability will not be before August 25, 1999. Treasury and the IRS request comments as to the date of applicability of the final regulations. No inference is intended as to the treatment of bonds issued prior to the date of applicability of the final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies, if written) that are submitted timely to the IRS. In particular, the IRS and Department of Treasury specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, January 12, 2000, beginning at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "For Further Information Contact" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by December 23, 1999, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 15, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Rebecca L. Harrigal and Barbara Jane League, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.148–1(e) is amended as follows:

1. Paragraph (e)(1) is revised.

2. Paragraphs (e)(2) introductory text, (e)(2)(i) and (e)(2)(ii) are redesignated as paragraphs (e)(2)(i) introductory text, (e)(2)(i)(A), and (e)(2)(i)(B), respectively.

3. Paragraph (e)(2) the heading is revised.

4. Newly designated paragraph (e)(2)(i) introductory text is revised.

5. New paragraph (e)(2)(ii) is added.

The revisions and addition read as follows:

§1.148–1 Definitions and elections.

* * * * *

(e) *Investment-type property*—(1) *In general.* Investment- type property includes any property, other than property described in section 148(b)(2)(A), (B),(C) or (E), that is held principally as a passive vehicle for the production of income. For this purpose, production of income includes any benefit based on the time value of money.

(2) *Prepayments.* (i) Except as otherwise provided in this paragraph (e), a prepayment for property or services, includ-

ing a prepayment of a contract for property or services that is made after the date that the contract is entered into, also gives rise to investment-type property if a principal purpose for prepaying is to receive an investment return from the time the prepayment is made until the time payment otherwise would be made. A prepayment does not give rise to investment type property if—

* * * * *

(ii) *Example.* The following example illustrates an application of paragraph (e)(2)(i) of this section:

Example. In 1996, City A entered into a ten-year contract with Company Y. Under the contract, Company Y is to provide services to City A and in return City A will make fixed annual payments to Company Y. In 1998, Company Y and City A agree that City A will prepay its obligation under the contract. To finance the prepayment, City A will issue bonds. The amount of the prepayment is determined in a manner that permits City A to obtain an investment return from the prepayment. A principal purpose for City A agreeing to make the prepayment is to obtain an investment return from the time of the prepayment until the time payment otherwise would be made. The prepayment is not made for a substantial business purpose other than to obtain the investment return and City A had a commercially reasonably alternative to the prepayment. In addition, prepayments on substantially the same terms are not made by a substantial percentage of persons who are similarly situated to City A but who are not beneficiaries of tax-exempt financing. When the prepayment is made, City A will have acquired investment-type property. It does not matter that the prepayment occurred after the date that the contract was entered into.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 24, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 25, 1999, 64 F.R. 46320)

Notice of Proposed Rulemaking and Notice of Public Hearing

Arbitrage Restrictions Applicable to Tax-exempt Bonds Issued by State and Local Governments

REG–105565–99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations on the arbitrage restrictions applicable to tax-exempt bonds issued by State and local governments. The proposed amendments affect issuers of tax-exempt bonds and provide a safe harbor for qualified administrative costs for brokers' commissions and similar fees incurred in connection with the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow.

DATES: Written comments must be received by November 26, 1999. Outlines of topics to be discussed at the public hearing scheduled for December 14, 1999, at 10 a.m. must be received by Tuesday, November 23, 1999.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG–105565–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (REG–105565–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing is in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Rose M. Weber, (202) 622-3980; concerning submissions of comments, the hearing, and/or requests to be placed on the building access list to attend the hearing, Michael Slaughter, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 148 of the Internal Revenue Code provides rules addressing the use of proceeds of tax-exempt State and local bonds to acquire higher-yielding investments. On May 9, 1997, final regulations (T.D. 8718, 1997–1 C.B. 47) relating to the arbitrage restrictions and related rules under sections 103, 148, 149, and 150 were published in the **Federal Register** (62 F.R. 25502). The final regulations (T.D. 8718) were amended on December 30, 1998 (63 F.R. 71748 [T.D. 8801, 1999–4 I.R.B. 5]). This document proposes to modify §1.148–5(e)(2) to provide a safe harbor for determining whether brokers' commissions and similar fees incurred in connection with the acquisition of guaranteed investment contracts or investments purchased for a yield restricted defeasance escrow are treated as qualified administrative costs.

Explanation of Provisions

Section 1.148–5(e)(2)(iii) and (iv) of the regulations provides rules for determining whether a broker's commission or similar fee is treated as a qualified administrative cost. Section 1.148–5(e)(2)(iii) provides that, for a guaranteed investment contract, a broker's commission or similar fee paid on behalf of either an issuer or the provider is treated as an administrative cost and, generally, is a qualified administrative cost to the extent that the present value of the commission, as of the date the contract is allocated to the issue, does not exceed the lesser of a reasonable amount or the present value of annual payments equal to .05 percent of the weighted average amount reasonably expected to be invested each year of the term of the contract. Present value is computed using the taxable discount rate used by the parties to compute the commission, or if not readily ascertainable, the yield to the issuer on the investment contract or other reasonable taxable discount rate.

Section 1.148–5(e)(2)(iv) provides that, for investments purchased for a yield restricted defeasance escrow, a fee paid to a bidding agent is a qualified administrative cost only if the fee is comparable to a fee that would be charged for a reasonably comparable investment if acquired with a source of funds other than gross proceeds of tax-exempt bonds, and it is reasonable. The fee is deemed to meet both the comparability and reasonableness requirements if it does not exceed the lesser of $10,000 and .1 percent of the ini-

tial principal amount of investments deposited in the yield restricted defeasance escrow.

Unlike §1.148–5(e)(2)(iv), §1.148–5(e)(2)(iii) does not provide parameters under which the reasonableness test will be deemed to have been met. Practitioners have noted that they are uncertain about how to determine reasonableness and whether the .05% test may be used as a safe harbor without regard to whether the resulting amount is a reasonable fee.

Practitioners have also noted that the computation required by §1.148–5(e)(2)(iii) is too complex and results in different fees being paid for the same services provided.

Finally, having different rules for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow provides an unnecessary tax incentive to structure investments in a certain manner.

To eliminate these complexities and to provide a rule that is easily administered by issuers, the proposed regulations create a single rule for qualified administrative costs that applies to a broker's commission or similar fee incurred in connection with a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow. The proposed regulations also set forth a safe harbor, which allows a broker's commission or similar fee incurred in connection with the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow to be treated as a qualified administrative cost. To fairly compensate most brokers, the proposed safe harbor provides a higher safe harbor limit than is currently provided for in §1.148–5(e)(2)(iv).

The proposed safe harbor sets forth two requirements. Under the first requirement, the amount of the broker's commission or similar fee incurred in connection with the acquisition of a guaranteed investment contract or other investments purchased for a yield restricted defeasance escrow and treated by the issuer as a qualified administrative cost cannot exceed the lesser of $25,000 and .2 percent of the computational base. For guaranteed investment contracts, the computational base is the aggregate amount reasonably expected to be deposited over the term of the contract. For investments, other than guaranteed investment contracts, deposited in a yield restricted defeasance escrow, the computational base is the initial amount invested in those investments. For example, for a guaranteed investment contract purchased for a debt service fund, the aggregate amount reasonably expected to be deposited includes all periodic deposits reasonably expected to be made pursuant to the terms of the contract. Under the second requirement, for any issue of bonds, the issuer cannot treat as qualified administrative costs more than $75,000 in brokers' commissions and similar fees with respect to all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue.

The proposed regulations eliminate the special rule in §1.148–5(e)(2)(iii) for issues that meet section 148(f)(4)(D)(i). These bond issues will be permitted to use the safe harbor.

These regulations are proposed to apply to bonds sold on or after the date 90 days after the issuance of the final regulations.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies, if written) that are submitted timely to the IRS. In particular, the IRS and Department of Treasury specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Tuesday, December 14, 1999, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments by November 26, 1999, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by November 23, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these proposed regulations are Rose M. Weber and Rebecca L. Harrigal, Office of the Assistant Chief Counsel (Financial Institutions & Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1–INCOME TAXES

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

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

Par. 2. In §1.148–5, paragraph (e) is amended as follows:

1. Paragraph (e)(2)(iii) is revised.

2. Paragraph (e)(2)(iv) is removed.

The revision reads as follows:

§1.148–5 Yield and valuation of investments.

* * * * *

(e) * * *

(2) * * *

(iii) *Special rule for guaranteed investment contracts and investments purchased for a yield restricted defeasance escrow—*

(A) *In general.* An amount paid for a broker's commission or similar fee with respect to a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is a qualified administrative cost if the fee is reasonable within the meaning of paragraph (e)(2)(i) of this section.

(B) *Safe harbor.* (*1*) A broker's commission or similar fee with respect to the acquisition of a guaranteed investment contract or investments purchased for a yield restricted defeasance escrow is reasonable within the meaning of paragraph (e)(2)(i) of this section if—

(*i*) The amount of the fee that the issuer treats as a qualified administrative cost does not exceed the lesser of $25,000 and .2% of the computational base; and

(*ii*) For any issue, the issuer does not treat as qualified administrative costs more than $75,000 in brokers' commissions or similar fees with respect to all guaranteed investment contracts and investments for yield restricted defeasance escrows purchased with gross proceeds of the issue.

(2) For purposes of paragraph (e)(2)-(iii)(B)(1) of this section, computational base shall mean—

(*i*) For a guaranteed investment contract, the amount the issuer reasonably expects as of the issue date to be deposited in the guaranteed investment contract over the term of the contract; and

(*ii*) For investments (other than guaranteed investment contracts) to be deposited in a yield restricted defeasance escrow, the amount of gross proceeds initially invested in those investments.

(C) *Example.* The following example illustrates an application of the safe harbor in paragraph (e)(2)(iii)(B) of this section:

Example. The issuer of a multipurpose issue uses brokers to purchase the following investments with gross proceeds of the issue: a guaranteed investment contract for amounts to be deposited in a debt service fund (debt service GIC), a guaranteed investment contract for amounts to be deposited in a construction fund (construction GIC), Treasury securities to be deposited in a yield restricted defeasance escrow (Treasury investments) and a guaranteed investment contract that will be used to earn a return on what would otherwise be idle cash balances from maturing investments in the yield restricted defeasance escrow (the float GIC). The issuer uses $8,040,000 of the proceeds to purchase the Treasury investments and deposits $14,000,000 into the construction GIC. Over the term of the construction GIC, the issuer reasonably expects that no further deposits will be made. Over the term of the float GIC, the issuer reasonably expects that aggregate deposits of $600,000 will be made to the float GIC. Over the term of the debt service GIC, the issuer reasonably expects that it will make aggregate deposits of $22,000,000, plus interest on the bond issue. The brokers' fees do not exceed $16,080 for the Treasury investments, $25,000 for the construction GIC, $1,200 for the float GIC, and $25,000 for the debt service GIC. Assuming the issuer claims no further brokerage or similar fees, the issuer can claim all $67,280 in brokerage fees for these investments as qualified administrative costs because the fees do not exceed the limitations described in paragraph (e)(2)(iii)(B) of this section.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 26, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 27, 1999, 64 F.R. 46876)

Foundations Status of Certain Organizations

Announcement 99–91

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

6th Kentucky Volunteer Cavalry, Frankfort, KY
501C3 Inc., New York, NY
AAWARE, Gaithersburg, MD
A C E-Out Inc., New York, NY
A Dying Childs Last Wish, San Antonio, TX
ABRAXAS Inc., Milford, DE
Academic Athletic Arts Achievements Association, Springfield, MA
Academy Charter PTO, Castle Rock, CO
Accessible Resources, Minneapolis, MN
Achieve the Dream Foundation Inc., Randallstown, MD
Acton Chamber Orchestra, Acton, MA
Ad Council of Buffalo, Inc., Buffalo, NY
Adele Hardison Hands Heart and Mind Inc., New York, NY
African Initiative for Community Development Inc., Malden, MA
Agape Care Facilities Incorporated, Jacksonville, FL
Agape Community Services Inc., Benton, KY
Agape Group Home Inc., Washington, NC
AIDS Council in Oswego County Inc., Fulton, NY
AIDS Futures Initiative Inc., Roosevelt Island, NY
AIDS Infoshare Russia Inc., Berkeley, CA
AIDS of the Treasure Coast Corporation, Fort Pierce, FL
Albanian-American Cultural Foundation, New York, NY
Albuquerque Police Department Crime Prevention Unit, Albuquerque, NM
Algonquin-Lake in the Hills Rotary Charitable Fund, Algonquin, IL
Algonquin Project Playground, Algonquin, IL
Alle-Kiski Arts Consortium, New Kensington, PA
Alliance Community Outreach Program Inc., Warren, OH

Alliance for Curriculum Reform, Arlington, VA
Alverda Reed Elementary Parent Teacher Organization, Georgetown, OH
Amateur Gymnastics Association of Florida Inc., Boca Raton, FL
Amazon Community Housing, Eugene, OR
Ambridge-Baden-Economy Soccer Association, Baden, PA
American Angels for Romanian Orphans, Manchester, NH
American Association for Home-Based Early Interventionists Nonprofit, Logan, UT
American Breast Cancer Foundation, Tucson, AZ
American Friends of the Hanover Band Inc., Brown Summit, NC
American Indian AIDS Institute Inc., San Francisco, CA
American Museum of Modern Military Vehicles Inc., Hartford, CT
Americana Community Center Inc., Louisville, KY
Amputee Education Foundation, Homestead, FL
Anderson Care Facility Inc., Memphis, TN
Angoon Resource Coalition, Angoon, AK
Anthony J. Hyde Parent Teacher Association, Washington, DC
Antique Tractor Museum Inc., Dallas, TX
Arc-en-Ciel Dhaiti, Chicago, IL
Arizona Adult Literacy and Technology Resource Center Inc., Phoenix, AZ
Arizona People for Animal Rights, Gilbert, AZ
Arkansas Ballet Theatre Inc., Rogers, AR
Arlington Host Lions Charities Inc., Arlington, VA
Arvada Eagles Soccer Club, Arvada, CO
Ashland Area Foundation, Ashland, NE
Asian Pacific Foundation for Culture and Education, Denver, CO
Asociacion del Instituto Dominicano de Enfermedades Respiratorias Inc., New York, NY
Association of Massachusetts Parents Aide Programs, Inc., Taunton, MA
Aspen-Institute Inc., Park City, UT
Assessment Consultation and Training Inc., Chicago, IL
Association House Holding Corporation, Chicago, IL
Association of Ethiopian Community in Fresno Inc., Fresno, CA
Association of Massachusetts Parent Aide Programs Inc., Taunton, MA
Atlanta CSI Foundation Inc., Marietta, GA
Auburn Education Foundation Inc., Auburn, MA
Augusta Childrens Chorale Inc., Augusta, GA
Bahini Foundation Inc., New York, NY
Baltimore-Washington Metropolitan Repertory Opera Company Inc., Laurel, MD
Barney Oldfield Transportation Museum Inc., Wauseon, OH
Bay Area Accordion Club, San Francisco, CA
BCI Homes Inc., Moncks Corner, SC
Beaufort County 2000 Inc., Hilton Head Island, SC
Beechwood Center of New Jersey Inc., Langhorne, PA
Bel Canto Singers Inc., Hilliard, OH
Beloved Community Center of Greensboro Inc., Greensboro, NC
Benefactors of Schwab Rehabilitation Hospital and Care Network, Naperville, IL
Bethlehem House Inc., Conway, AR
Between Friends Inc., N. Conway, NH
BHP Community Housing Inc., Baltimore, MD
Big Bend Rural Health Network Inc., Panama City, FL
Big Waters Federation, Des Plaines, IL
Bink Glisson Historical Preservation Trust Inc., West Palm Beach, FL
Birmingham Public Schools Adopt-A-School Board of Directors, Birmingham, AL
Black Affairs Center Inc., Silver Spring, MD
Black Economic Cluster Fund Inc., Landover, MD
Blackjack Community Center Inc., Starkville, MS
Blue Valley Northwest Booster Club Inc., Overland Park, KS
Bnai Brith Elmwood House Inc., Medford, NJ
Boiling Springs Parent Teacher Student Association, Spartanburg, SC
Boost Our Southwick Schools, Southwick, MA
Boosters for IGA Inc., Menlo Park, CA
Boston Boys Choir Inc., Cambridge, MA
Boston City Opera Company Inc., Melrose, MA
Boston School for Young Children, Watertown, MA
Boy Scouts of America Troop 106 & Pack 106 of Ironton Ohio, Ironton, OH
Boys & Girls Club of Bloomfield Inc., Bloomfield, NM
Boys & Girls Club of Cherokee County Inc., Canton, GA
Bridges of North Carolina Inc., Fayetteville, NC
Brigham City Main Street Program, Brigham City, UT
Bronx Health & Human Services Development Corporation Inc., Bronx, NY
Bronx Hispanic Foundation Inc., Bronx, NY
Brookfield Rotary Club Foundation Inc., Brookfield, CT
Brown County Veterans Assistance Inc. Program, Oneida, WI
Bucks County Civil War Round Table, Doylestown, PA
Buf Health and Human Services Corporation Inc., Plainfield, NJ
Burke County Firefighters Association Inc., Morganton, NC
Butler Sports Boosters, Oak Brook, IL
Butts County Humane Society Inc., Flovilla, GA
Byzantine Orthodox Ecclesiastical Community, Trenton, NJ
C. Waldo Scott Center for HOPE Inc., Newport News, VA
California 49ers Educational Association Inc., Fountain Valley, CA
Calvary Community Development Corporation, Philadelphia, PA
Cambridge-Isanti Arena Corporation, Cambridge, MN
Camptown Youth Group, Franklin, VA
Carmel Health Network, Mobile, AL
Carroll County Civic League, Huntingdon, TN
Casa de New Mexico, Albuquerque, NM
Casa Grande 2000 Inc., Casa Grande, AZ
Casas del Sol Resident Management Corporation, Calexico, CA
Catawba Community Mental Health Foundation Inc., Rock Hill, SC
Cavani String Quartet, Woodmere, OH
Celestine Project Inc., East Islip, NY
Cemco Industrial Scholarship Fund, Albuquerque, NM
Center for Community Recovery Innovations Inc., Boston, MA
Center for Employment Dispute Resolution Inc., Chicago, IL
Center for Independent Living of Middle Tennessee, Nashville, TN

Center for Latin American Arts of New York Inc., New York, NY
Central Arkansas Peace Corps Association, Little Rock, AR
Central Bronx Community Services & Relations for the Blind, Bronx, NY
Central City Information Drug and Alcohol Office Inc., Des Moines, IA
Central Elementary School Parents Teacher Organization of Winchester, Winchester, KY
Central Iowa Juvenile Detention Center, Eldora, IA
Central Midlands Development Corporation, Columbia, SC
Central Ozarks Human Development Foundation, Rolla, MO
Central Valley Group Homes Inc., Fresno, CA
Central Virginia Regional Library, Farmville, VA
Chamberlain School District Foundation, Chamberlain, SD
Charlotte-Mecklenburg Crime Stoppers Inc., Charlotte, NC
Chaucer Street Apartments Inc., Hot Springs, AR
Cherry Tree Association, Bronx, NY
Chester Community Prevention Coalition, Chester, PA
Child Assault Prevention Project of Erie County Inc., Sandusky, OH
Childrens Programs Inc., Springfield, IL
Childrens Services Network, Charlotte, NC
First Ward Development Fund Inc., Elizabeth, NJ
Gateway C B Club, Jeffersonville, KY
Gujarat Samanvay Parivar, Richmond, VA
Hamilton-Wenham Little League Inc., S. Hamilton, MA
Help Agency of the Forest Inc., Silver Springs, FL
Institute for Cooperation of Art and Research Inc., Philadelphia, PA
Laguna Fire Relief Coalition, Laguna Beach, CA
Local 144 Hospital & Health Facilities Education Fund, New York, NY
M A A Foundation Inc., Redondo Beach, CA
Macedonia High School JROTC Booster Club Association, Moncks Corner, SC
Needed Organization-Transformation of Youth, Detroit, MI
New Northside Multi-Family Development Inc., St. Louis, MO
Nine Twenty-One Sixty-Six Inc., Tulsa, OK
North American Sasquatch Foundation, Phoenix, AZ
Tampa Area Playground Project, Tampa, FL
The Downtown Sailing Center Inc., Baltimore, MD
Triune Foundation Inc., New York, NY
Tropical Forestry Initiative Inc., Lansing, NY
Turning Point Youth Services Institute Inc., New York, NY
University Association of Central Oregon, Inc., Bend, OR
West Haven Interfaith Housing Corporation, W. Haven, CT

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

26 CFR 1.42–16: Eligible basis reduced by federal grants.

Low-income housing tax credit. This revenue ruling advises taxpayers that certain rental assistance payments made to a building owner on behalf of, or in respect to, a tenant under the Housing Opportunities for Persons With AIDS (HOPWA) program are not grants made with respect to a building or its operation under section 42(d)(5) of the Code.

Rev. Rul. 99–39

Pursuant to § 1.42–16(b)(3) of the Income Tax Regulations, the Internal Revenue Service has determined that certain rental assistance payments made to a building owner on behalf or in respect of a tenant under the Housing Opportunities for Persons With AIDS (HOPWA) program (42 U.S.C. 12901–12912) are not grants made with respect to a building or its operation under § 42(d)(5) of the Internal Revenue Code. These rental assistance payments are provided under 24 C.F.R. 574.300(b)(5).

DRAFTING INFORMATION

The principal author of this revenue ruling is Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Wilson on (202) 622-3040 (not a toll-free call).

Section 1275.—Other Definitions and Special Rules

26 CFR 1.1275–7: Inflation-indexed debt instruments.

T.D. 8838

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Inflation-Indexed Debt Instruments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the federal income tax treatment of inflation-indexed debt instruments, including Treasury Inflation-Indexed Securities. The regulations in this document provide needed guidance to holders and issuers of inflation-indexed debt instruments.

EFFECTIVE DATE: The regulations are effective September 7, 1999.

FOR FURTHER INFORMATION CONTACT: Helen Vanek-Bigelow or William E. Blanchard, (202) 622-3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 6, 1997, temporary regulations (T.D. 8709, 1997–1 C.B. 167) relating to the federal income tax treatment of inflation-indexed debt instruments under sections 1275 and 1286 of the Internal Revenue Code (Code) were published in the **Federal Register** (62 F.R. 615). A notice of proposed rulemaking (REG–242996–96, 1997–1 C.B. 784) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (62 F.R. 694). A public hearing was held on April 30, 1997. However, no one requested to speak at the hearing.

No written comments responding to the notice were received. Therefore, the proposed regulations under sections 1275 and 1286 are adopted by this Treasury decision with no changes, and the corresponding temporary regulations are redesignated as final regulations.

Explanation of provisions

The following is a general explanation of the provisions in the final regulations, which are the same as the provisions in the temporary regulations.

A. *In General.*

The final regulations provide rules for the treatment of certain debt instruments that are indexed for inflation and deflation, including Treasury Inflation-Indexed Securities. The final regulations generally require holders and issuers of inflation-indexed debt instruments to account for interest and original issue discount (OID) using constant yield principles. In addition, the final regulations generally require holders and issuers of inflation-indexed debt instruments to account for inflation and deflation by making current adjustments to their OID accruals.

B. *Applicability.*

The final regulations apply to inflation-indexed debt instruments. In general, an inflation-indexed debt instrument is a debt instrument that (1) is issued for cash, (2) is indexed for inflation and deflation (as described below), and (3) is not otherwise a contingent payment debt instrument. The final regulations do not apply, however, to certain debt instruments, such as debt instruments issued by qualified state tuition programs.

C. *Indexing Methodology.*

A debt instrument is considered indexed for inflation and deflation if the payments on the instrument are indexed by reference to the changes in the values of a general price or wage index over the term of the instrument. Specifically, the amount of each payment on an inflation-indexed debt instrument must equal the product of (1) the amount of the payment that would be payable on the instrument (determined as if there were no inflation or deflation over the term of the instrument) and (2) the ratio of the value of the reference index for the payment date to the value of the reference index for the issue date.

The reference index for a debt instrument is the mechanism for measuring inflation and deflation over the term of the instrument. This mechanism associates the value of a single qualified inflation index for a particular month with a specified day of a succeeding month. For example, under the terms of the Treasury Inflation-Indexed Securities, the reference index for the first day of a month is the value of a qualified inflation index for the third preceding month. The reference index must be reset once a month to the current value of a qualified inflation index. Between reset dates, the value of

the reference index is determined through straight-line interpolation.

A qualified inflation index is a general price or wage index that is updated and published at least monthly by an agency of the United States Government. A general price or wage index is an index that measures price or wage changes in the economy as a whole. An index is not general if it only measures price or wage changes in a particular segment of the economy. For example, the non-seasonally adjusted U.S. City Average All Items Consumer Price Index for All Urban Consumers (CPI-U), which is published by the Bureau of Labor Statistics of the Department of Labor, is a qualified inflation index because it measures general price changes in the economy. By contrast, the gasoline price component of the CPI-U is not a qualified inflation index because it only measures price changes in a particular segment of the economy.

D. *Coupon Bond Method.*

The final regulations provide a simplified method of accounting for qualified stated interest and inflation adjustments on certain inflation-indexed debt instruments (the coupon bond method). To qualify for the coupon bond method, an inflation-indexed debt instrument must satisfy two conditions. First, there must be no more than a de minimis difference between the debt instrument's issue price and its principal amount for the issue date. Second, all stated interest on the debt instrument must be qualified stated interest. Because Treasury Inflation-Indexed Securities that are not stripped into principal and interest components satisfy both of these conditions, the coupon bond method applies to these securities.

If an inflation-indexed debt instrument qualifies for the coupon bond method, the stated interest payable on the debt instrument is taken into account under the taxpayer's regular method of accounting. Any increase in the inflation-adjusted principal amount is treated as OID for the period in which the increase occurs. Any decrease in the inflation-adjusted principal amount is taken into account under the rules for deflation adjustments described below.

For example, if a taxpayer holds a Treasury Inflation-Indexed Security for an entire calendar year and the taxpayer uses the cash receipts and disbursements method of accounting (cash method), the taxpayer generally includes in income the interest payments received on the security during the year. In addition, the taxpayer includes in income an amount of OID measured by subtracting the inflation-adjusted principal amount of the security at the beginning of the year from the inflation-adjusted principal amount of the security at the end of the year. If the taxpayer uses an accrual method of accounting rather than the cash method, the taxpayer includes in income the qualified stated interest that accrued on the debt instrument during the year and an amount of OID measured by subtracting the inflation-adjusted principal amount of the security at the beginning of the year from the inflation-adjusted principal amount of the security at the end of the year.

E. *Discount Bond Method.*

If an inflation-indexed debt instrument does not qualify for the coupon bond method (for example, because it is issued at a discount), the instrument is subject to the discount bond method. In general, the discount bond method requires holders and issuers to make current adjustments to their OID accruals to account for inflation and deflation.

Under the discount bond method, a taxpayer determines the amount of OID allocable to an accrual period by using steps similar to those provided in §1.1272–1(b)(1). First, the taxpayer determines the yield to maturity of the debt instrument as if there were no inflation or deflation over the term of the instrument. Second, the taxpayer determines the length of the accrual periods to be used to allocate OID over the term of the debt instrument, provided no accrual period is longer than one month. Third, the taxpayer determines the percentage change in the value of the reference index during the accrual period by comparing the value at the beginning of the period to the value at the end of the period. Fourth, the taxpayer determines the OID allocable to the accrual period by using a formula that takes into account both the yield of the debt instrument and the percentage change in the value of the reference index during the period. Fifth, the taxpayer allocates to each day in the accrual period a ratable portion of the OID for the accrual period (the daily portions). If the daily portions for an accrual period are positive amounts, these amounts are taken into account under section 163(e) by an issuer and under section 1272 by a holder. If the daily portions for an accrual period are negative amounts, these amounts are taken into account under the rules for deflation adjustments described below.

F. *Deflation Adjustments.*

The final regulations treat deflation adjustments in a manner consistent with the treatment of net negative adjustments on contingent payment debt instruments under §1.1275–4(b)(6)(iii). If a holder has a deflation adjustment for a taxable year, the deflation adjustment first reduces the amount of interest otherwise includible in income with respect to the debt instrument for the taxable year. If the amount of the deflation adjustment exceeds the interest otherwise includible in income for the taxable year, the holder treats the excess as an ordinary loss in the taxable year. However, the amount treated as an ordinary loss is limited to the amount by which the holder's total interest inclusions on the debt instrument in prior taxable years exceed the total amount treated by the holder as an ordinary loss on the debt instrument in prior taxable years. If the deflation adjustment exceeds the interest otherwise includible in income by the holder with respect to the debt instrument for the taxable year and the amount treated as an ordinary loss for the taxable year, the excess is carried forward to offset interest income on the debt instrument in subsequent taxable years. Similar rules apply to determine an issuer's interest deductions and income for the debt instrument.

G. *Miscellaneous Rules.*

The final regulations provide special rules for reopenings, strips, subsequent holders, and minimum guarantees.

H. *Effective Date.*

The final regulations apply to an inflation-indexed debt instrument issued on or after January 6, 1997.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of the regulations is Helen Vanek-Bigelow, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for §§1.1275–7T and 1.1286–2T and adding two entries in numerical order to read in part as follows:

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

Section 1.1275–7 also issued under 26 U.S.C. 1275(d). * * *

Section 1.1286–2 also issued under 26 U.S.C. 1286(f). * * *

§1.148–4 [Amended]

Par. 2. Section 1.148–4 is amended by:

1. Removing the "T" from the reference "§1.1275–7T" in paragraph (h)(2)-(v)(A).

2. Removing the "T" from the reference "§1.1275–7T" in paragraph (h)(2)-(v)(B).

§1.163–13 [Amended]

Par. 3. Section 1.163–13 is amended by:

1. Removing the "T" from the reference "§1.1275–7T(f)(1)(ii)" in the next to the last sentence in paragraph (e)(2).

2. Removing the "T" from the reference "§1.1275–7T" in the last sentence in paragraph (e)(2).

§1.171–3 [Amended]

Par. 4. Section 1.171–3 is amended by:

1. Removing the "T" from the reference "§1.1275–7T(f)(1)(i)" in the next to last sentence in paragraph (b).

2. Removing the "T" from the reference "§1.1275–7T" in the last sentence in paragraph (b).

Par. 5. In §1.1271–0, paragraph (b) is amended by revising the entry for §1.1275–7T to read as follows:

§1.1271–0 Original issue discount; effective date; table of contents.

* * * * *

(b) * * *

* * * * *

§1.1275–7 Inflation-indexed debt instruments.

* * * * *

§1.1275–4 [Amended]

Par. 6. Section 1.1275–4 is amended by removing the "T" from the reference "§1.1275–7T" in paragraph (a)(2)(vii).

§1.1275–7T [Redesignated as §1.1275–7]

Par. 7. Section 1.1275–7T is redesignated as §1.1275–7 and the language "(temporary)" is removed from the section heading.

§1.1286–2T [Redesignated as §1.1286–2]

Par. 8. Section 1.1286–2T is redesignated as §1.1286–2 and the language "(temporary)" is removed from the section heading.

Par. 9. Newly designated §1.1286–2 is amended by removing the "T" from the reference "§1.1275–7T(e)".

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 25, 1999.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 3, 1999, 8:45 a.m., and published in the issue of the Federal Register for September 7, 1999, 64 F.R. 48545)

Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402–5: Offset of past-due support against overpayments.

T.D. 8837

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Revision of the Tax Refund Offset Program

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the administration of the Tax Refund Offset Program (TROP). This action is necessary because effective January 1, 1999, TROP, which had been administered by the IRS, was fully merged into the centralized administrative offset program known as the Treasury Offset Program (TOP), which is administered by the Financial Management Service (FMS). These regulations will affect State and Federal agencies that participate in TROP.

DATES: *Effective Dates:* These regulations are effective September 7, 1999.

Dates of Applicability: For dates of applicability of these regulations, see §§301.6402–5(h) and 301.6402–6(n).

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations on Procedure and Administration (26 CFR part 301) that revise the effective dates for regulations under section 6402(c) and (d). Those subsections provide rules relating to the offset of past-due support payments and debts owed to Federal agencies against Federal tax refunds, respectively.

On August 31, 1998, a notice of proposed rulemaking (REG–104565–97, 1998–39, I.R.B. 21) under section 6402(c) and (d) was published in the **Federal Register** (63 F.R. 46205). Although written or electronic comments and requests for a public hearing were solicited, no comments were received and no public hearing was requested or held. The proposed regulations under section 6402(c) and (d) are adopted by this Treasury decision without revision.

Explanation of Provisions

Section 6402(c) provides, in general, that the amount of any overpayment to be refunded to the person making the overpayment must be reduced by the amount of any past-due support (as defined in section 464(c) of the Social Security Act) owed by that person of which the Secretary has been notified by a State in accordance with section 464 of the Social Security Act.

Section 6402(d) provides, in general, that upon receiving notice from any Federal agency that a named person owes a past-due, legally enforceable debt to that agency, the Secretary must reduce the amount of any overpayment payable to that person by the amount of the debt, pay the amount by which the overpayment is reduced to the agency, and notify the person making the overpayment that the overpayment has been reduced.

Prior to January 1, 1998, the IRS made offsets pursuant to section 6402(d) according to regulations prescribed under §301.6402–6. Prior to January 1, 1999, the IRS made offsets pursuant to section 6402(c) according to regulations prescribed under §301.6402–5.

Section 31001(v)(2) and (w) of the Debt Collection Improvement Act of 1996 (110 Stat. 1321–375), amended 42 U.S.C. 664(a)(2)(A) and 31 U.S.C. 3720A(h), respectively, to clarify that the disbursing agency of the Treasury Department may conduct tax refund offsets. The disbursing agency of the Treasury Department is the Financial Management Service (FMS).

The IRS and FMS agreed to merge the Tax Refund Offset Program (TROP), which had been administered by the IRS, into the centralized administrative offset program known as the Treasury Offset Program (TOP), which is administered by the FMS. The merger of the two programs is intended to maximize and improve the Treasury Department's government-wide collection of nontax debts, including those subject to offset against the debtor's federal tax refund. The full merger of TROP with TOP occurred on January 1, 1999.

Final rules concerning the manner in which the FMS will administer the collection of nontax Federal debts after the merger of TROP with TOP were published by the FMS in the **Federal Register** on August 28, 1998 (63 F.R. 46140) (codified at 31 CFR Part 285.2) effective for refunds payable after January 1, 1998. The regulations in this document provide an ending effective date for §301.6402–6 to accommodate the beginning effective date of the FMS regulations. Accordingly, §301.6402–6 does not apply to refunds payable after January 1, 1998.

Final rules concerning the manner in which the FMS will administer the collection of past-due support payments were published by the FMS in the **Federal Register** on December 30, 1998 (63 F.R. 72092) (codified at 31 CFR Part 285.3), effective for refunds payable after January 1, 1999. The regulations in this document provide an ending effective date for §301.6402–5 to accommodate the beginning date for the full merger of TROP with TOP. Accordingly, §301.6402–5 does not apply to refunds payable after January 1, 1999.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Beverly A. Baughman of the Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6402–5 is amended by adding paragraph (h) to read as follows:

§301.6402–5 Offset of past-due support against overpayments.

* * * * *

(h) *Effective dates.* This section applies to refunds payable on or before January 1, 1999. For the rules applicable after January 1, 1999, see 31 CFR part 285.

Par. 3. Section 301.6402–6 is amended by revising paragraph (n) to read as follows:

§301.6402–6 Offset of past-due, legally enforceable debt against overpayment.

* * * * *

(n) *Effective dates.* This section applies to refunds payable under section 6402 after April 15, 1992, and on or be-

fore January 1, 1998. For the rules applicable after January 1, 1998, see 31 CFR part 285.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 25, 1999.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 3, 1999, 8:45 a.m., and published in the issue of the Federal Register for September 7, 1999, 64 F.R. 48547)

Section 7121.—Closing Agreements

This notice specifies rates the Service will use for the purpose of computing the amount due pursuant to a closing agreement concerning failed life insurance contracts under §7702 of the Internal Revenue Code. See Notice 99–48, page 429.

Section 7702.—Life Insurance Contract Defined

This notice specifies rates the Service will use for the purpose of computing the amount due pursuant to a closing agreement concerning failed life insurance contracts under §7702 of the Internal Revenue Code. See Notice 99–48, page 429.

Center for Latin American Arts of New York Inc., New York, NY
Central Arkansas Peace Corps Association, Little Rock, AR
Central Bronx Community Services & Relations for the Blind, Bronx, NY
Central City Information Drug and Alcohol Office Inc., Des Moines, IA
Central Elementary School Parents Teacher Organization of Winchester, Winchester, KY
Central Iowa Juvenile Detention Center, Eldora, IA
Central Midlands Development Corporation, Columbia, SC
Central Ozarks Human Development Foundation, Rolla, MO
Central Valley Group Homes Inc., Fresno, CA
Central Virginia Regional Library, Farmville, VA
Chamberlain School District Foundation, Chamberlain, SD
Charlotte-Mecklenburg Crime Stoppers Inc., Charlotte, NC
Chaucer Street Apartments Inc., Hot Springs, AR
Cherry Tree Association, Bronx, NY
Chester Community Prevention Coalition, Chester, PA
Child Assault Prevention Project of Erie County Inc., Sandusky, OH
Childrens Programs Inc., Springfield, IL
Childrens Services Network, Charlotte, NC
First Ward Development Fund Inc., Elizabeth, NJ
Gateway C B Club, Jeffersonville, KY
Gujarat Samanvay Parivar, Richmond, VA
Hamilton-Wenham Little League Inc., S. Hamilton, MA
Help Agency of the Forest Inc., Silver Springs, FL
Institute for Cooperation of Art and Research Inc., Philadelphia, PA
Laguna Fire Relief Coalition, Laguna Beach, CA
Local 144 Hospital & Health Facilities Education Fund, New York, NY
M A A Foundation Inc., Redondo Beach, CA
Macedonia High School JROTC Booster Club Association, Moncks Corner, SC
Needed Organization-Transformation of Youth, Detroit, MI
New Northside Multi-Family Development Inc., St. Louis, MO
Nine Twenty-One Sixty-Six Inc., Tulsa, OK
North American Sasquatch Foundation, Phoenix, AZ
Tampa Area Playground Project, Tampa, FL
The Downtown Sailing Center Inc., Baltimore, MD
Triune Foundation Inc., New York, NY
Tropical Forestry Initiative Inc., Lansing, NY
Turning Point Youth Services Institute Inc., New York, NY
University Association of Central Oregon, Inc., Bend, OR
West Haven Interfaith Housing Corporation, W. Haven, CT

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part IV. Items of General Interest

T.D. 8830

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 801

Establishment of a Balanced Measurement System

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the adoption by the IRS of a balanced system to measure organizational performance within the IRS. These regulations further prescribe rules relating to the measurement of employee performance and implement requirements that all employees be evaluated on whether they provided fair and equitable treatment to taxpayers and bar use of records of tax enforcement results to evaluate or to impose or suggest goals for any employee of the IRS. These regulations implement sections 1201 and 1204 of the Internal Revenue Restructuring and Reform Act of 1998. These regulations affect internal operations of the IRS and the systems that agency employs to evaluate the performance of organizations within IRS and individuals employed by IRS.

DATES: These regulations are effective September 7, 1999.

FOR FURTHER INFORMATION CONTACT: Michael G. Gallagher, 202-283-7900 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

On January 5, 1999, the IRS published in the **Federal Register** (64 F.R. 457) a notice of proposed rulemaking (REG–119192–98, 1999–11 I.R.B. 45) regarding the establishment of a balanced system of measures for the IRS. Comments were received and a public hearing on the proposed regulations was held on May 13, 1999.

This document adopts, with modifications, the proposed regulations as final regulations.

Explanation of Revisions and Summary of Comments

A commentator suggested that certain organizational changes might add clarity to the regulation. We have adopted this suggestion and have reorganized the regulation to contain separate sections that describe the system for measuring organizational performance and the system for measuring employee performance. Consistent with the suggestion of the commentator, we have revised the heading on the latter performance measurement system to make it clear that it relates to measuring "employee" performance. The organizational changes required incidental reordering within the regulation, as well as the renumbering of additional sections.

A commentator suggested that the discussion of the performance criteria applicable to Senior Executive Service (SES) employees make explicit reference to 5 U.S.C. 4313, which contains certain performance criteria. We have adopted this suggestion and included references to 5 U.S.C. 4313 in section 801.3. The same commentator also suggested that the regulation be modified to provide that SES and managerial employees of the IRS will be evaluated on the basis of organizational performance, as measured under the balanced measurement system for organizational performance. While the IRS will modify the performance criteria for all employees to ensure that they support the organizational measures adopted in this regulation, it will evaluate employees on the basis of the performance criteria made applicable to the positions those employees occupy. Accordingly, this suggestion was not adopted.

A commentator suggested that, while it would be appropriate to gather data regarding customer and employee satisfaction via "questionnaires, surveys and other types of information gathering mechanisms" and a "questionnaire," respectively, as the proposed regulation provides, the IRS might in the future find other appropriate means to gather such data and should not be confined by the regulation from adopting such other information gathering techniques. Although the IRS intends in the near term to gather such customer and employee satisfaction data via questionnaires and surveys, it may in the future determine that other methods of information gathering can provide accurate data. Accordingly, we have adopted the commentator's suggestion and made it clear that questionnaires and surveys are only examples of the information gathering techniques the IRS may employ to measure customer and employee satisfaction. Sections 801.4 and 801.5 of the regulations reflect the changes. A commentator suggested that since certain organizations within the IRS provide service to customers other than taxpayers, the final regulation should make clear that information gathered from persons other than taxpayers could be used in measuring customer satisfaction. We have adopted this suggestion and modified §801.5.

A commentator suggested that the quantity element of the business results measure be eliminated because, in an attempt to improve organizational performance with respect to that quantity element, managers might exert pressure upon employees to dispose of taxpayer cases too quickly or without regard to merits of the issues presented. The fundamental premise of the balanced system of organizational measures is that the presence of measures that evaluate the quality of the work done by the unit, the satisfaction of customers served by the unit (including taxpayers), and the satisfaction of employees working in the unit will obviate the risk that managers place undue emphasis upon the quantity of work completed. The absolute prohibitions (1) on the use of tax enforcement results and (2) on the use of quantity data to evaluate non-supervisory employees who exercise judgment with respect to tax enforcement results operate as effective checks against the overzealous use of enforcement authority. Accordingly, we have not adopted this suggestion. We have slightly modified the description of the quantity measure to include customer education, assistance and outreach efforts.

A commentator suggested that taxpayers against whom collection actions have

been taken would be unable to provide objective information regarding their interactions with IRS personnel and therefore should not be included among the taxpayers requested to provide information regarding customer satisfaction. IRS experience with customer satisfaction surveys, including those taken at Problem Solving Day events, indicates that this commentator's comments are not well founded. Accordingly, the suggestion was not adopted.

Finally, a commentator suggested that IRS should limit the authority delegated to lower-level employees. This suggestion was beyond the scope of the current regulation and was not adopted.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Michael G. Gallagher, Office of the Assistant Chief Counsel (General Legal Services). However, other personnel from the Internal Revenue Service and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR Chapter I is amended by adding part 801 to Subchapter H to read as follows:

PART 801—BALANCED SYSTEM FOR MEASURING ORGANIZATIONAL AND EMPLOYEE PERFORMANCE WITHIN THE INTERNAL REVENUE SERVICE

Sec.

801.1 Balanced performance measurement system; in general.
801.2 Measuring organizational performance.
801.3 Measuring employee performance.
801.4 Customer satisfaction measures.
801.5 Employee satisfaction measures.
801.6 Business results measures.

Authority: 5 U.S.C 9501 *et seq.*; secs. 1201, 1204, Pub. L. 105–206, 112 Stat. 685, 715–716, 722 (26 U.S. C. 7804 note).

§801.1 Balanced performance measurement system; In general.

(a) *In general*—(1) The regulations in this part 801 implement the provisions of sections 1201 and 1204 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–106, 112 Stat. 685, 715–716, 722) and provide rules relating to the establishment by the Internal Revenue Service of a balanced performance measurement system.

(2) Modern management practice and various statutory and regulatory provisions require the IRS to set performance goals for organizational units and to measure the results achieved by those organizations with respect to those goals. To fulfill these requirements, the IRS has established a balanced performance measurement system, composed of three elements: Customer Satisfaction Measures; Employee Satisfaction Measures; and Business Results Measures. The IRS is likewise required to establish a performance evaluation system for individual employees.

(b) *Effective date.* This part 801 is effective September 7, 1999.

§801.2 Measuring organizational performance.

(a) *In general.* The performance measures that comprise the balanced measurement system will, to the maximum extent possible, be stated in objective, quantifiable and measurable terms and, subject to the limitation set forth in paragraph (b) of this section, will be used to measure the overall performance of various operational units within the IRS. In addition to implementing the requirements of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206, 112 Stat. 685), the measures described here will, where appropriate, be used in performance goals and performance evaluations established, inter alia, under Division E, National Defense Authorization Act for Fiscal Year 1996 (the Clinger-Cohen Act of 1996) (Public Law 104–106, 110 Stat. 186, 679); the Government Performance and Results Act of 1993 (Public Law 103–62, 107 Stat. 285); and the Chief Financial Officers Act of 1990 (Public Law 101–576, 108 Stat. 2838).

(b) *Limitation*—quantity measures (as described in §801.6) will not be used to evaluate the performance of or to impose or suggest production goals for any organizational unit with employees who are responsible for exercising judgment with respect to tax enforcement results (as defined in §801.6) except in conjunction with an evaluation or goals based also upon Customer Satisfaction Measures, Employee Satisfaction Measures, and Quality Measures.

§801.3 Measuring employee performance.

(a) *In general.* All employees of the IRS will be evaluated according to the critical elements and standards or such other performance criteria as may be established for their positions. In accordance with the requirements of 5 U.S.C. 4312, 4313 and 9508 and section 1201 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206, 112 Stat. 685) (as is appropriate to the employee's position), the performance criteria for each position will be composed of elements that support the organizational measures of Customer Satisfaction, Employee Satisfaction and Business Results; however, such organizational measures will not directly determine the evaluation of individual employees.

(b) *Fair and equitable treatment of taxpayers.* In addition to all other criteria required to be used in the evaluation of em-

ployee performance, all employees of the IRS will be evaluated on whether they provided fair and equitable treatment to taxpayers.

(c) *Senior Executive Service and special positions.* Employees in the Senior Executive Service will be rated in accordance with the requirements of 5 U.S.C. 4312 and 4313 and employees selected to fill positions under 5 U.S.C. 9503 will be evaluated pursuant to workplans, employment agreements, performance agreements or similar documents entered into between the Internal Revenue Service and the employee.

(d) *General workforce.* The performance evaluation system for all other employees will:

(1) Establish one or more retention standards for each employee related to the work of the employee and expressed in terms of individual performance —

(i) Require periodic determinations of whether each employee meets or does not meet the employee's established retention standards; and

(ii) Require that action be taken, in accordance with applicable laws and regulations, with respect to employees whose performance does not meet the established retention standards.

(2) Establish goals or objectives for individual performance consistent with the IRS's performance planning procedures —

(i) Use such goals and objectives to make performance distinctions among employees or groups of employees; and

(ii) Use performance assessments as a basis for granting employee awards, adjusting an employee's rate of basic pay, and other appropriate personnel actions, in accordance with applicable laws and regulations.

(e) *Limitations*—(1) No employee of the Internal Revenue Service may use records of tax enforcement results (as defined in §801.6) to evaluate any other employee or to impose or suggest production quotas or goals for any employee.

(i) For purposes of the limitation contained in this paragraph (e), employee has the meaning as defined in 5 U.S.C. 2105(a).

(ii) For purposes of the limitation contained in this paragraph (e), evaluate includes any process used to appraise or measure an employee's performance for purposes of providing the following:

(A) Any required or requested performance rating.

(B) A recommendation for an award covered by Chapter 45 of Title 5; 5 U.S.C. 5384; or section 1201(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, (Public Law 105–206, 112 Stat. 685, 713–716).

(C) An assessment of an employee's qualifications for promotion, reassignment or other change in duties.

(D) An assessment of an employee's eligibility for incentives, allowances or bonuses.

(E) Ranking of employees for release/recall and reductions in force.

(2) Employees who are responsible for exercising judgment with respect to tax enforcement results (as defined in §801.6) in cases concerning one or more taxpayers may be evaluated with respect to work done on such cases only on the basis of information derived from a review of the work done on the taxpayer cases handled by such employee.

(3) Performance measures based in whole or in part on Quantity Measures (as described in §801.6) will not be used to evaluate the performance of or to impose or suggest goals for any non-supervisory employee who is responsible for exercising judgment with respect to tax enforcement results (as defined in §801.6).

§801.4 Customer satisfaction measures.

The customer satisfaction goals and accomplishments of operating units within the Internal Revenue Service will be determined on the basis of information gathered via various methods. For example, questionnaires, surveys and other types of information gathering mechanisms may be employed to gather data regarding customer satisfaction. Information to measure customer satisfaction for a particular work unit will be gathered from a statistically valid sample of the customers served by that operating unit and will be used to measure, among other things, whether those customers believe that they received courteous, timely and professional treatment by the Internal Revenue Service personnel with whom they dealt. Customers will be permitted to provide information requested for these purposes under conditions that guarantee them anonymity. For purposes of this section, customers may include individual taxpayers, organizational units or employees within Internal Revenue Service and external groups affected by the services performed by the Internal Revenue Service operating unit.

§801.5 Employee satisfaction measures.

The employee satisfaction numerical ratings to be given operating units within the Internal Revenue Service will be determined on the basis of information gathered via various methods. For example, questionnaires, surveys and other information gathering mechanisms may be employed to gather data regarding employee satisfaction. The information gathered will be used to measure, among other factors bearing upon employee satisfaction, the quality of supervision and the adequacy of training and support services. All employees of an operating unit will have an opportunity to provide information regarding employee satisfaction within the operating unit under conditions that guarantee them anonymity.

§801.6 Business results measures.

(a) *In general.* The business results measures will consist of numerical scores determined under the Quality Measures and the Quantity Measures described elsewhere in this section.

(b) *Quality measures.* The quality measure will be determined on the basis of a review by a specially dedicated staff within the Internal Revenue Service of a statistically valid sample of work items handled by certain functions or organizational units determined by the Commissioner or his delegate such as the following:

(1) *Examination and Collection units and Automated Collection System units (ACS).* The quality review of the handling of cases involving particular taxpayers will focus on such factors as whether Internal Revenue Service personnel devoted an appropriate amount of time to a matter, properly analyzed the issues presented, developed the facts regarding those issues, correctly applied the law to the facts, and complied with statutory, regulatory and Internal Revenue Service procedures, including timeliness, adequacy of notifications and required contacts with taxpayers.

(2) *Toll-free telephone sites.* The quality review of telephone services will focus

on such factors as whether Internal Revenue Service personnel provided accurate tax law and account information.

(3) *Other workunits.* The quality review of other workunits will be determined according to criteria prescribed by the Commissioner or his delegate.

(c) *Quantity measures.* The quantity measures will consist of outcome-neutral production and resource data, such as the number of cases closed, work items completed, customer education, assistance and outreach efforts undertaken, hours expended and similar inventory, workload and staffing information, that does not contain information regarding the tax enforcement result reached in any case involving particular taxpayers.

(d) *Definitions*—(1) *Tax enforcement result.* A *tax enforcement result* is the outcome produced by an Internal Revenue Service employee's exercise of judgment recommending or determining whether or how the Internal Revenue Service should pursue enforcement of the tax laws.

(i) *Examples of tax enforcement results.* The following are examples of a tax enforcement result: a lien filed; a levy served; a seizure executed; the amount assessed; the amount collected; and a fraud referral.

(ii) *Examples of data that are not tax enforcement results.* The following are examples of data that are not tax enforcement results: case closures; time per case; direct examination time/out of office time; cycle time; number or percentage of overage cases; inventory information; toll-free level of access; talk time; number and type of customer education, assistance and outreach efforts completed; and data derived from a quality review or from a review of an employee's or a workunit's work on a case, such as the number or percentage of cases in which correct examination adjustments were proposed or appropriate lien determinations were made.

(2) *Records of tax enforcement results.* Records of tax enforcement results are data, statistics, compilations of information or other numerical or quantitative recordations of the tax enforcement results reached in one or more cases, but do not include tax enforcement results of individual cases when used to determine whether an employee exercised appropriate judgment in pursuing enforcement of the tax laws based upon a review of the employee's work on that individual case.

(e) *Permitted uses of records of tax enforcement results.* Records of tax enforcement results may be used for purposes such as forecasting, financial planning, resource management, and the formulation of case selection criteria.

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

Example 1. In conducting a performance evaluation, a supervisor may take into consideration information showing that the employee had failed to propose an appropriate adjustment to tax liability in one of the cases the employee examined, provided that information is derived from a review of the work done on the case. All information derived from such a review of individual cases handled by an employee, including time expended, issues raised, and enforcement outcomes reached may be considered in evaluating the employee.

Example 2. When assigning a case, a supervisor may discuss with the employee the merits, issues and development of techniques of the case based upon a review of the case file.

Example 3. A supervisor may not establish a goal for proposed adjustments in a future examination, based upon the tax enforcement results achieved in other cases.

Example 4. A headquarters unit may use records of tax enforcement results to develop methodologies and algorithms for use in selecting tax returns to audit.

Charles O. Rossotti,
Commissioner of Internal Revenue.

Approved July 22, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 5, 1999, 8:45 a.m., and published in the issue of the Federal Register for August 6, 1999, 64 F.R. 42834)

Foundations Status of Certain Organizations

Announcement 99-92

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

According to Prophecy Ministries, Lemon Grove, CA
African American Unity Congress, Columbia, SC
African Americans for Humanitarian Relief, Houston, TX
American Friends of the Maine Inc., New York, NY
American Friends of the University of Buckingham Inc., Chicago, IL
American Friends of Torah Umesorah of Latinoamerica Inc., Monsey, NY
American Indian Language Center, Inc., Eufaula, OK
The American Military Education Foundation Inc., Manassas Park, VA
American Nursing Informatics Association, Anaheim, CA
American-Russian Education Assc. Inc., Brooklyn, NY
Archangelus Ministries, Stanhope, NJ
Associated Youth Partnership Programs Inc., Farmingdale, NY
Association of JoJo White Growth Leagues Inc., Rochester, NY
Aura a Cole PTO Inc., Constantia, NY
Bainbridge Womens Club, Richmond, VA
Barracuda Boosters Inc., Cincinnati, OH
Bartlesville Area Crime Stoppers Inc., Bartlesville, OK
Bluebonnet Health & Human Services Inc., Belton, TX
Brazos Valley Quality Work Force Planning Incorporation, Bryan, TX
Bullock County Public Schools Foundation Inc. Partners In, Union Springs, AL
Capital Area Library Network, Mason, MI
Castle Foundation, Columbus, OH
Center for Childrens Television Inc., Amherst, MA
Center for Conflict Management, Fort Collins, CO
Central Florida Puppet Guild, Orlando, FL

Charitable Trust for the Womens Institute for African Rural Development, Boston, MA
Charlotte Swim Association Inc., Charlotte, NC
Chelten Christian Crusade Center for Advancement Inc., Philadelphia, PA
Child Development Center Parent Advisory Council, Ferguson, MO
Childrens Railway Society Inc., Boothwyn, PA
Christian School Foundation of Cape Girardeau, Cape Girardeau, MO
Columbia Lightning Athletic Organization, Columbia, MD
Congress of African-American Unity Inc., Rochester, NY
Connecticut Blackhawks Inc., Guilford, CT
Crime Victims United Inc., New York, NY
Cullen Christian Development Center Inc., Houston, TX
Dance Masters of America-New England Chapter 5 Inc., Randolph, MA
Dixie Childrens Fund, San Rafael, CA
Downingtown Young Whippets, Downingtown, PA
Dragons Gate An Arts Community Development System, Houston, TX
Duxbury Blue Line Club Inc., Duxbury, MA
Elmhurst House Inc., E. Greenwich, RI
Environmental Diversity Forum, Boston, MA
Everett Bullpen Club, Holt, MI
Fannin Learning Center Inc., Brandon, MS
Friends of Children United Supporting Educational Dev. Inc., Gladewater, TX
Friends of Penn Farm Inc., Duncanville, TX
Friends of the Obion County Public Library, Union City, TN
Fundacion Amigos de Corazon, Springfield, VA
Georgia Mining Foundation Inc., Atlanta, GA
Gods Favorite People Inc., Atlanta, GA
Grand Strand Swim Team Inc., Myrtle Beach, SC
Greater Detroit Free-Net, Grosse Pointe Farms, MI
Greater Kansas City Street Preservation Corporation, Kansas City, MO
Gujarati Samaj of Northeast Florida, Jacksonville, FL
Gymnastics Boosters Club Inc., Grandville, MI
Harmony Unlimited, Federal Way, WA
Help the Homeless Outreach Ministry Inc., Mesa, AZ
Homes for Brighter Futures, New Castle, PA
Horton Memorial Chapel Inc., Teague, TX
Institute for Mass Communications Inc., Brooklyn, NY
Islamic Family Services Inc., Brooklyn, NY
Jerusalem Education Fund Inc., Bala Cynwyd, PA
JoJo White Growth League of Rochester New York Inc., Rochester, NY
Just Between Friends Inc., Stone Mountain, GA
Kentucky Coal Mining Museum and Exhibition Mine Inc., Benham, KY
Keys to Empowering Youth Inc., Dorchester, MA
Kids With Cancer Foundation, Sacramento, CA
Ladies Civic League, Springfield, MO
Little Caesars Soccer Club Inc., Cedar Rapids, IA
Long Island Surf Youth Outreach Program Inc., Syosset, NY
Lubavitch Yeshiva of Minnesota Inc., St. Paul, MN
Lyndhurst Education Association Philanthropic Fund, Hewitt, NJ
Mable M. Chandler Scholarship Foundation, Dallas, TX
Mazel Tov Foundation Inc., Brooklyn, NY
Mednotes 1998, Columbus, OH
Midrange Professional Association, Buffalo, IL
Mississippi Wildlife Conservation Inc., Crystal Springs, MS
Missouri Statewide Parent Advisory Network, St. Louis, MO
Moorish Manufacturing Corp., Chicago, IL
Mound City Vo-Ag Booster Association Inc., Mound City, MO
National Urban Youth Fund Inc., Providence, RI
Native Nations, Austin, TX
New American Opera Company, Milford, PA
New Orleans Youth Action Corps., New Orleans, LA
North Suburban Jewish Community Center Inc., Peabody, MA
Pac Boosters Inc., Clemmons, NC
Parents of Gymnasts, Bartonsville, PA
Partners in Public Education Fund, Seattle, WA
Permian Basin Educational Project Inc., Midland, TX
Pittsfield Elementary Parent Teacher Organization, Pittsfield, NH
Reading Fine and Performing Arts Association Inc., Reading, MA
Shady Oak Community Development Corporation, Collins, MS
Silsbee High School Crime Stoppers Inc., Silsbee, TX
Simba Wachanga Society, Brooklyn, NY
Skatin Place Artistic Skating Club Ltd., Janesville, WI
Small Farm Research Incorporated, Carver, MA
Sports Opportunity and Information Center, Richmond, CA
Sprint Across America Inc., Hoboken, NJ
Stanford Parent-Teacher Organization, Bloomington, IL
Stonehenge Foundation Incorporated, Gladwyne, PA
Sunrise Child Development Center Inc., Newark, NJ
The Arlington Philharmonic Inc., Arlington, TX
The Danville Community Orchestra Inc., Danville, VA
Theatre in the Valley, Henderson, NV
Thoreau Nm-A Production Company, Pittsburgh, PA
Tiggeriffic Productions Inc., Boston, MA
Tri-County Transitional Treatment Centers Inc., San Marcos, TX
U Should Know Inc., Amsterdam, NY
United Charities Inc., Brea, CA
US-China Arts Exchange Center Inc., Brooklyn, NY
Very Good Musical Theatre Company, Mequon, WI
Vision Productions Unlimited, Hoffman Estates, IL
Warren Metropolitan Society of Arts, Warren, MI
Washingtonville Sea Hawks Swim Club Inc., Salisbury Mills, NY
Waterloo Community Concert Band, Waterloo, IA
West Point Parents Club of Long Island, Huntington Station, NY
Westville Care, Monroeville, PA
Wildkit Swimming Organization, Evanston, IL
Windfire Flute & Percussion Spectacular, Chesterfield, MO
Winning Swing of America, Austin, TX

Wintersville Baseball Association, Steubenville, OH
WJC Home Organization, Hope, AR
Word to the Wise Foundation, Richmond, VA
World Aid Relief Corporation, New York, NY
World Peace Project, Denver, CO
Young Athletes Against AIDS Inc., New York, NY
Youth Achievement Recognition Council of Long Island Inc., Farmingdale, NY
Youth Philharmonic Northwest, Redmond, WA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 99–49

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for August 1999 is 6.07 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
September	1999	6.00	5.40 to 6.30	5.40 to 6.60

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number).

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 99–94

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Quincy Junior College Student Government Association Inc., Quincy, MA
R H C D S Educational Scholarship Fund Inc., Torrance, CA
Ram-Sacc Inc., Ramsey, NJ
Ramapo Central Foundation Inc., Suffern, NY
Randolph County Council for the Prevention of Child Abuse Inc., Cuthbert, GA
Reading Residential Programs Inc., Wakefield, MA
Region A Partnership for Children, Sylva, NC
Religious Alliance for Decency, Lakewood, CO
Research Center of Communications Psychology Inc., New York, NY
Research Education & Development Fund Inc. of the Suffolk for Women, Hauppauge, NY
Residents Promoting A Better Community, Lafayette, TN
Resource Center Foundation Inc., Grand Junction, CO
Respitecare Incorporated, Evanston, IL
Retro Theatre Inc., Chicago, IL
Richard Leigh Walker Foundation for Journalists, Atlanta, GA
Richmond Triangle Players, Richmond, VA
Rieck Center for Habitat Studies, Findlay, OH
Ritz Community Theater Project Inc., Sanford, FL
River Town of Jacksonville Inc., Jacksonville, FL
Rivers of Living Waters Ministries Inc., Nashville, GA
Riverside County Latino Commission on Alcohol & Drug Abuse, Indio, CA
Riverside the Farnsley-Moremen Landing Inc., Louisville, KY
Robert E. Ellis Middle School PTO, Hendersonville, TN
Roosevelt School Parents Association, Hubbard, OH
Rotary Charities Foundation of Effingham, Effingham, IL
Rotary Club of Arlington Heights-Breakfast Charitable Foundation, Arlington Heights, IL
Rotary Club of Bay Hill Charitable Foundation Inc., Orlando, FL
Royal Educational Foundation of Port Jefferson Incorporated, Port Jefferson, NY
Rural Colorado Arts Access Project, Denver, CO
Russian American Exchanges Inc., Pittsford, NY
Sacred Heart Village Inc., Cincinnati, OH
Sail Program Inc., Ft. Lauderdale, FL
Salt Fork Valley Transportation Company, Pond Creek, OK
San Benito Housing Association, Hollister, CA
San Diego Music Theatre Inc., San Diego, CA
SBAM Small Business Loan Fund Inc., Lansing, MI
Schomburg Collection of Black History Life & Art Inc., New York, NY
Science and Technology Research Initiative to Develop Excellence, New York, NY
Second Chance Social Services, Riverside, CA
Second Source Servcorps, Chicago, IL
Selma Public Education Foundation, Selma, CA
Senseny Road Elementary School PTD, Winchester, VA
Sentry Services Inc., Dillsboro, IN
Sexual Assault Prevention and Awareness Inc., Schenectady, NY
Shady Side Hockey Dba Shady Side Academy Hockey Club, Pittsburgh, PA
Shasta Lake Gateway Library, Shasta Lake, CA
Shenango Area Youth Chorus, Hermitage, PA
Short Story Theatre, Wheaton, IL
Stone County Council on Aging Inc., Kimberling City, MO
Stoughton Educational Alliance Inc., Stoughton, MA
Straight From the Corner Promotions, St. Paul, MN
Success Network, Placitas, NM
Summa Foundation TR, New York, NY
Summit House of Brooklyn Inc., Brooklyn, NY
Sunny Rehabilitation House, Chicago, IL
Symphonic Friends of District Two, Spartanburg, SC
Synergy Housing Development Corp Inc., Whitehouse Station, NJ
Tacoma Master Chorale, Tacoma, WA
Tactile Museum for the Blind, Tempe, AZ
Take Time Out Inc., Farmington Hills, MI
Tele-Services Center Inc., St. Albans, NY
Temple Israel Endowment Funds, Minneapolis, MN
Tewksbury Historical Society Inc., Tewksbury, MA
Texas Highland Celtic Brigade Inc., Lubbock, TX
The Bedford Township Volunteer Fire Department, Shade, OH
The Corporation of the National Unborn Childrens Memorial, St. Louis, MO
The Federalist Center Inc., Highland Park, NJ
The Greater Harford Soccer Club Inc., Jarrettsville, MD
The Greater Washington Park Community Development Corporation, Chicago, IL
The Helping Hand Organization Inc., Glassboro, NJ
The Industrial Evolution Inc., Utica, NY
The Martin Karl Feldman Foundation, Wilmington, DE
The Mary N. Smith Alumni Association Incorporated, Rahway, NJ
The Metropolitan Singers, Marietta, GA
The Rainbows End, Park Forest, IL
The Richmond P C Rehab Lab Inc., Richmond, VA

The Robert A. Shuker Scholarship Fund Inc., Washington, DC
The Samaritan Center, Minot, ND
The Sephardic Youth Inc., Brooklyn, NY
The Visitation Scholarship Program Inc., Chicago, IL
The Volunteer Center of San Joaquin, Stockton, CA
The Womens Project Fund, Austin, TX
THI-10, Chicago, IL
THI-11, Chicago, IL
THI-9, Chicago, IL
Tiffin Home Development Inc., Oak Ridge, TN
Total Theatre Inc., Columbus, OH
Triangle Assessment & Treatment Services Inc., Raleigh, NC
Triangle Performance Ensemble Inc., Durham, NC
United Harmony for Peace Inc., Somerville, MA
United States Relief Fund Inc., White Plains, NY
University Obstetrical and Gynecological Associates Inc., Las Vegas, NV
Urban Childrens Mental Health Coalition, Denver, CO
Urban Revitalization Community Development Corporation, Norfolk, VA
Urban Youth Network, New York, NY
Ventura County Homeless and Housing Coalition, Ventura, CA
Veterans Community Leadership Corps Inc., Jackson, FL
Visayan Association of Ventura County Inc., Oxnard, CA
Vista Alegre Incorporated, Trinidad, CO
Vocational Development Center Foundation Inc., Council Bluffs, IA
Voluntary Organization for Learning, Gray, ME
Volunteers for Literacy of Crawford County, Alma, AR
Vote USA-The Voter Outreach and Training Enterprise of the USA Inc., Washington, DC
Voyages Inc., Plymouth, MA
W A Wright Elem PTO, Mt. Juliet, TN
Wantagh Foundation for Educational Excellence, Wantagh, NY
Washakie Memorial Hospital Foundation Inc., Worland, WY
Washington Beauty Network Education Trust Inc., Seat Pleasant, MD
Washingtonville Police Athletic League, Washingtonville, NY
Waukesha Area Arts Alliance, Waukesha, WI
Waynesville Middle School Parent Teacher Organization, Waynesville, NC
Welfare Action Program Inc., Bronx, NY
Wellington Avenue Local Development Organization, Chicago, IL
Wells Middle School Choir Booster Club, Houston, TX
Wellspring Inc., Springfield, MO
Western Maryland Symphony Association Inc., Cumberland, MD
Westside Sexual Assault Services Network, Chicago, IL
Weymouth Field of Dreams Committee Inc., Weymouth, MA
White Plains Youth Fund Inc., White Plains, NY
Whitely Neighborhood Council Inc., Muncie, IN
Williamson County Casa Inc., Franklin, TN
Willie Dejarnette Athletic Club, Chester, PA
Wisconsin Style Inc., Milwaukee, WI
Wise Ones Inc., Putney, VT
Women Empowerment Institute Inc., New York, NY
Women of the Celebrity Golf Association Inc., Ocean City, MD
Womens Consumer Foundation Inc., New York, NY
Womens Network, Denver, CO
Workplace Literacy Foundation of America, New York, NY
World Peace Championship, Phoenix, AZ
Worlds of Wisdom Child Development Services Corp., East Stroudsburg, PA
Wyoming Perinatal Substance Abuse Coalition, Casper, WY
Yes I Can, Bronx, NY
Youth Action Homes III H D F C , New York, NY
Youth Benefits Inc., Northglenn, CO
Youth Berkeley, Moncks Corner, SC
Youth Enhancement Services, Harrisburg, PA
Youth Outreach International, Vero Beach, FL
Youthventures Inc., Tallahassee, FL
Zocalo Theatre & Performance Company, Houston, TX

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Rev. Rul. 99–41

This revenue ruling provides various prescribed rates for federal income tax purposes for October 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 99–41 TABLE 1

Applicable Federal Rates (AFR) for October 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	5.54%	5.47%	5.43%	5.41%
110% AFR	6.11%	6.02%	5.98%	5.95%
120% AFR	6.67%	6.56%	6.51%	6.47%
130% AFR	7.24%	7.11%	7.05%	7.01%

REV. RUL. 99–41 TABLE 1—Continued

Applicable Federal Rates (AFR) for October 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Mid-Term				
AFR	6.02%	5.93%	5.89%	5.86%
110% AFR	6.63%	6.52%	6.47%	6.43%
120% AFR	7.25%	7.12%	7.06%	7.02%
130% AFR	7.86%	7.71%	7.64%	7.59%
150% AFR	9.10%	8.90%	8.80%	8.74%
175% AFR	10.65%	10.38%	10.25%	10.16%
Long-Term				
AFR	6.31%	6.21%	6.16%	6.13%
110% AFR	6.95%	6.83%	6.77%	6.73%
120% AFR	7.59%	7.45%	7.38%	7.34%
130% AFR	8.23%	8.07%	7.99%	7.94%

REV. RUL. 99–41 TABLE 2

Adjusted AFR for October 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.79%	3.75%	3.73%	3.72%
Mid-term adjusted AFR	4.55%	4.50%	4.47%	4.46%
Long-term adjusted AFR	5.45%	5.38%	5.34%	5.32%

REV. RUL. 99–41 TABLE 3

Rates Under Section 382 for October 1999

Adjusted federal long-term rate for the current month	5.45%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.45%

REV. RUL. 99–41 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for October 1999

Appropriate percentage for the 70% present value low-income housing credit	8.45%
Appropriate percentage for the 30% present value low-income housing credit	3.62%

REV. RUL. 99–41 TABLE 5

Rate Under Section 7520 for October 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.2%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, page 439.

Section 6402.—Authority To Make Credits or Refunds

26 CFR 301.6402–3: Special rules applicable to income tax.

If an overpayment claimed on a return is credited to the succeeding year's estimated tax or refunded without interest, from what date will interest be assessed on a subsequently determined deficiency for the overpayment return year. See Rev. Rul. 99–40, on this page.

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment, of Tax

26 CFR 301.6601-1: Interest on underpayments. (Also sections 6402, 7805(b); 301.6402–3, 301.7805–1.)

Rev. Rul. 99–40

ISSUE

If an overpayment claimed on a return is credited to the succeeding year's estimated tax or refunded without interest, from what date will interest be assessed on a subsequently determined deficiency for the overpayment return year?

FACTS

Situation 1. *X* Corporation files its federal income tax returns on a calendar year basis. For 1995, *X* made timely estimated tax payments of $100x. On March 15, 1996, *X* filed Form 7004, Application for Automatic Extension of Time to File Corporation Income Tax Return, and received a 6-month extension of time to file its income tax return. *X* paid $120x with the request for extension. On September 15, 1996, *X* filed Form 1120, U.S. Corporation Income Tax Return, for 1995 showing a tax liability of $210x and elected to have the overpayment of $10x credited against its 1996 estimated tax. The $10x overpayment is deemed to arise on March 15, 1996. *X*'s required estimated tax for 1996 was $100x. In order to avoid the addition to tax for underpayment of estimated tax for 1996, *X* was required to make payments of $25x each on April 15, 1996, June 15, 1996, September 15, 1996, and December 15, 1996. *X* timely made the required $25x payments in April and June. On September 15, *X* made a payment of $15x. In 1998, the Internal Revenue Service examined *X*'s 1995 return and determined that *X*'s correct 1995 tax was $215x, resulting in a deficiency of $5x.

Situation 2. The facts are the same as in *Situation 1* except that *X* paid $23x on April 15, 1996, and $14x on June 15, 1996, instead of the required payments of $25x on each of these dates.

Situation 3. *A*, an individual, files federal income tax returns on a calendar year basis. In 1995, *A* made timely estimated tax payments of $100x. On April 15, 1996, *A* filed Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, and received a 4-month extension of time to file *A*'s income tax return. On August 15, 1996, *A* filed Form 1040, U.S. Individual Income Tax Return, for 1995 showing tax due of $80x, and requested a refund of the $20x overpayment. The overpayment is deemed to arise on April 15, 1996. The refund was made within 45 days of the date the timely return was filed, by a check dated September 14, 1996. In 1998, the Service examined *A*'s 1995 return and determined that the correct tax was $85x, resulting in a deficiency of $5x.

Situation 4. The facts are the same as in *Situation 3,* except that *A*'s correct tax liability was $105x, resulting in a deficiency of $25x.

LAW AND ANALYSIS

Section 6601(a) of the Internal Revenue Code provides that if any amount of tax is not paid on or before the last date prescribed for payment, interest will be paid on the amount from such last date to the date paid. Section 6151(a) provides, in general, that the date prescribed for payment is the time fixed for filing the return, determined without regard to any extension of time for filing. Section 6601(b)(1) provides that for determining interest on underpayments, the "last date prescribed for payment" is determined without regard to any extension of time for payment or filing.

Section 6402(b) states that the Secretary is authorized to prescribe regulations providing for the crediting against the estimated tax for any taxable year of the amount determined by the taxpayer or the Secretary to be an overpayment of the income tax for the preceding taxable year.

Section 301.6402–3(a)(5) of the Regulations on Procedure and Administration provides that a taxpayer may elect to apply all or part of the overpayment shown by its return to its estimated tax for the succeeding tax year by so indicating on its return. No interest is allowed on the portion of the overpayment credited and the amount of the credit is applied as a payment on account of the estimated income tax for the year or the installments thereof. *See also* § 301.6611–1(h)(2)(vii).

In Rev. Rul. 77–475, 1977–2 C.B. 476, revoked by Rev. Rul. 83–111, 1983–2 C.B. 245, reinstated and modified by Rev. Rul. 84–58, the Service held that if an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election. If the overpayment occurs after the due date of the first installment of estimated tax for the succeeding taxable year, it may be credited only against an installment of estimated tax due on or after the date the overpayment was made. Under these circumstances, § 6655(b)(3) provides that a payment of estimated tax by a corporation is credited against unpaid required installments in the order in which the installments are required to be paid. Section 6654(b)(3) provides the same rule for individuals.

The Tax Reform Act of 1984, § 413, 1984–3 (Vol. 1) C.B. 301, provides that the application of the Code with respect to the crediting of an overpayment against estimated tax shall be determined without regard to Rev. Rul. 83–111 and with full regard to the rules in effect prior to Rev. Rul. 83–111. The legislative history provides that "[w]here the credit is made to an estimated tax payment arising prior to the election [to credit the overpayment], interest on the overpayment will not be

payable, and interest on the underpayment which arises because of a deficiency in tax for the prior year will run from the date the credit is effective." H. R. Rep. No. 98–432, Pt. 2, 98th Cong., 2d Sess. 1489–90 (1984).

Rev. Rul. 84–58, 1984–1 C.B. 254, holds that for returns filed after December 31, 1983, when a taxpayer elects to have an income tax overpayment credited against the succeeding year's estimated tax, the Service will apply overpayments arising on or before the due date of the return against the first installment payment of the succeeding year's estimated tax, unless the taxpayer requests that it be applied to a later installment.

Rev. Rul. 88–98, 1988–2 C.B. 356, holds that when a taxpayer claims an overpayment on a return filed either on the original due date or on extension, and the claimed overpayment is applied in full against an installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on the part of the deficiency that is equal to or less than the claimed overpayment and from the original due date of the return on the remainder. Rev. Rul. 88–98 follows *Avon Products, Inc. v. United States,* 588 F.2d 342 (2d Cir. 1978), in which the court interpreted § 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid. The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of § 6601(a). Prior to that date the government has the use of the funds with respect to the prior year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. *See* § 301.6402–3(a)(5) and § 301.6611–1(h)(2)(vii). In the case of a refund made without interest under § 6611(e), the date on which the tax is both due and unpaid is the date when the amount in question is refunded, even when that date is subsequent to the date of the claim for refund.

In Situation 2 of Rev. Rul. 88–98, the Service applied the taxpayer's 1983 overpayment to the first installment of its 1984 taxes because the taxpayer did not indicate the installment to which the overpayment was to be applied. Rev. Rul. 88–98 held in Situation 2 that, because the overpayment was applied to the first installment, interest ran from April 15, 1984, on a subsequently determined deficiency for 1983 that was equal to or less than the claimed overpayment. However, Situation 2 does not indicate whether the taxpayer had actually made all or part of the April 15th estimated tax payment. Thus, it is not clear whether the taxpayer received any benefit of the overpayment as a payment of the April 15th installment.

In *May Department Stores Co. v. United States,* 36 Fed. Cl. 680 (1996), *acq.* AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should credit the overpayment. Pursuant to Rev. Rul. 84–58, the Service applied the overpayment to the first installment. A deficiency was determined for the taxpayer's 1983 tax year and interest was assessed by the Service on the deficiency from the due date of the first installment in accordance with Situation 2 of Rev. Rul. 88–98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by § 6655 for 1984 for the first and second installments of estimated tax due for 1984. The court concluded that the Service's application of the taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of the taxpayer's overpayment from the due date of the first installment (May 15) to the date the overpayment was applied to the third installment (October 15) since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In light of the *May Department Stores* decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated income tax under §§ 6654 or 6655 with respect to such year. The Service will assess interest on a subsequently determined deficiency for the overpayment year from the date(s) that the overpayment is applied to the succeeding year's estimated taxes.

Since the overpayment will be applied in the order necessary to avoid the addition to tax for underpayment of estimated tax, designation of all or part of the overpayment to a specific estimated tax installment is not necessary. Accordingly, the Service will not accept such designations after October 4, 1999.

In *Situation 1,* interest on the $5x deficiency for 1995 runs from September 15, 1996, the date on which the $10x overpayment is applied to *X*'s third installment of 1996 estimated taxes. The overpayment was not needed to satisfy an installment of estimated tax prior to September 15, 1996.

In *Situation 2,* interest on the $5x deficiency for 1995 runs from June 15, 1996, the date on which the overpayment is applied to *X*'s 1996 estimated taxes. A portion ($2x) of the overpayment is applied to the April 15th installment of 1996 estimated tax. The remaining $8x of the overpayment is applied to *X*'s June 15th installment of 1996 estimated tax. Because the $8x portion of the return overpayment exceeded the subsequently determined deficiency of $5x, interest does not begin to run for 1995 before the date that portion was applied to *X*'s 1996 estimated taxes.

In *Situation 3,* interest on the $5x deficiency runs from September 14, 1996. Although *A*'s 1995 taxes were due on April 15, 1996, *A*'s 1995 taxes were not underpaid until the $20x was refunded without interest to *A* on September 14, 1996.

In *Situation 4,* interest runs from September 14, 1996, on $20x of the deficiency, and from April 15, 1996, on the remaining $5x of the deficiency. Because *A*'s 1995 taxes of $105x were due on April 15, 1996, and *A* had only paid $100x as of that date, *A*'s 1995 taxes were underpaid by $5x on April 15, 1996. Nevertheless, *A* was not underpaid with respect to the $20x until that amount was refunded to A on September 14, 1996.

In all situations, the estimated tax rules in effect for the tax year for which the

election to credit a return overpayment is effective are used to determine when the overpayment is applied to that tax year's estimated taxes, and, thus, for determining when interest begins to run on the subsequently determined deficiency.

HOLDING

When a taxpayer reports an overpayment on its income tax return, interest will be assessed on that portion of a subsequently determined deficiency for the overpayment return year that is less than or equal to the overpayment as of: (1) the date on which the Service refunds the overpayment without interest; or (2) the date on which the overpayment is applied to the succeeding year's estimated taxes. Interest will be assessed on any remaining portion of the deficiency from the original due date of the tax for the overpayment return year.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 88–98, Rev. Rul. 84–58, and Rev. Rul. 77–475 are modified and, as modified, are superseded.

PROSPECTIVE APPLICATION

Pursuant to § 7805(b), this ruling will not be applied adversely to a taxpayer that designated an overpayment to apply to an installment of estimated tax in accordance with Rev. Rul. 84–58 prior to October 4, 1999.

DRAFTING INFORMATION

The principal author of this revenue ruling is John J. McGreevy of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling contact Mr. McGreevy at (202) 622-4910 (not a toll-free call).

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, page 439.

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.

If an overpayment claimed on a return is credited to the succeeding year's estimated tax or refunded without interest, from what date will interest be assessed on a subsequently determined deficiency for the overpayment return year. See Rev. Rul. 99–40, page 441.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 1999. See Rev. Rul. 99–41, page 439.

Part III. Administrative, Procedural, and Miscellaneous

Prohibition of *Ex Parte* Communications Between Appeals Officers and Other Internal Revenue Service Employees

Notice 99-50

This notice provides a proposed revenue procedure that, when finalized, will provide guidance to address, in part, the directive in the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, 112 Stat. 685 (RRA 98), to develop a plan to prohibit *ex parte* communications between officers of the Internal Revenue Service Office of Appeals (Appeals) and other Internal Revenue Service employees that appear to compromise the independence of Appeals Officers.

Section 1001(a)(4) of RRA 98 states that the Commissioner's plan to reorganize the Internal Revenue Service shall ensure an independent Appeals function within the Internal Revenue Service. The Treasury Department and the Internal Revenue Service are developing the reorganization plan. As part of that plan, guidance for Internal Revenue Service personnel and taxpayers is being developed to address the prohibition of ex parte communications between Appeals Officers and other Internal Revenue Service employees that appear to compromise the independence of Appeals Officers.

The proposed revenue procedure includes guidance, in the form of a series of questions and answers, that address situations frequently encountered by Appeals Officers during the course of an administrative appeal.

Before issuing final guidance, the Treasury Department and the Service invite comments from the public to aid in the development of this revenue procedure. The prohibition on ex parte communications will not take effect until the revenue procedure is issued in final form. In the interim, existing procedures relating to communications in the course of Appeals consideration of disputes remain in effect. Comments should be submitted by December 3, 1999 either to:

Internal Revenue Service
National Director of Appeals
Attn.: C:AP:CIIT
1111 Constitution Ave.
Washington, DC 20224

or electronically via: http:/www.irs. gov/prod/tax_regs/comments.html (the Service Internet site).

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.

PROPOSED REV. PROC. 99-XX

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SECTION 1. PURPOSE AND SCOPE

Section 1001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, 112 Stat. 685 (RRA 98), states that "The Commissioner of Internal Revenue shall develop and implement a plan to reorganize the Internal Revenue Service. The plan shall . . .

> (4) ensure an independent appeals function within the Internal Revenue Service, including the prohibition in the plan of ex parte communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of the appeals officers."

This revenue procedure contains guidance for Service personnel and taxpayers to address the prohibition of ex parte communications between Appeals Officers and other Internal Revenue Service employees that appear to compromise the independence of Appeals Officers. The guidance is in the form of a series of questions and answers that address situations frequently encountered by Appeals Officers during the course of an administrative appeal.

SECTION 2. BACKGROUND

In 1927, the Internal Revenue Service established an administrative appeal process to resolve tax disputes without litigation. Local appeals offices have traditionally been separate from the IRS office that proposed the adjustment. However, section 1001(a)(4) of RRA 98 requires the IRS, as part of its reorganization plan, to establish an independent Office of Appeals — one that may not be influenced by tax collection or examination employees through ex parte communications with Appeals Officers that appear to compromise the independence of Appeals Officers.

SECTION 3. GUIDANCE CONCERNING THE EX PARTE COMMUNICATIONS PROHIBITION DESCRIBED IN SECTION 1001(a)(4) OF THE INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998

Q-1 What is "ex parte communication" and when is it prohibited?

A-1 For the purposes of this revenue procedure, ex parte communications are communications that take place in the absence of one of the parties to the controversy — specifically the taxpayer or his or her representative (taxpayer/representative). Ex parte communications between Appeals Officers and other Internal Revenue Service employees are prohibited to the extent that such communications appear to compromise the independence of the Appeals Officers.

Q-2 Does the prohibition on ex parte communications extend to discussions between the Appeals Officer and the originating office during the course of preliminary review of a newly assigned case?

A-2 The Appeals Officer may ask general or clarifying questions which do not address the strengths and weaknesses of the issues and positions taken in the case. For example, the Appeals Officer may ask for clarification of a factual description or legal assertion in the file without involving the taxpayer/representative. The Appeals Officer may also ask whether cer-

tain information was requested and whether it was received. The Appeals Officer, however, may not engage in discussions of the strengths and weaknesses of the issues and positions in the case, which would appear to compromise the Appeals Officer's independence.

Q-3 Does the prohibition on ex parte communications change the criteria for premature referrals?

A-3 As a general rule, there is no change to current procedures. In essence, RRA 98 reinforces the instructions in Internal Revenue Manual 8.2.1.2 and reaffirms Appeals' role as the settlement arm of the Service. If a case is not ready for Appeals consideration, the Appeals Officer may return it for further development or for other reasons described in IRM 8.2.1.2. The Appeals Officer may communicate with Examination regarding the anticipated return of the case to the originating function, but may not engage in a discussion of the strengths and weaknesses of specific issues or positions, or the case as a whole, as part of a discussion of whether the premature referral guidelines require further Examination activity.

Q-4 Is there any change to the Appeals new issue policy?

A-4 No. New issues must continue to satisfy the "material" and "substantial" tests of IRM 8.6.1.4 and succeeding sections. The prohibition against ex parte communications does not affect Appeals' existing policy about raising new issues in Appeals. However, any new issue must first satisfy Appeals' new issue policy. If discussions with the originating function are needed in order to evaluate the strengths and weaknesses of the possible new issue, the taxpayer/representative must be given an opportunity to participate in such discussions. Appeals will continue to follow the principles of Policy Statement P-8-49 and the "General Guidelines" outlined in IRM 8.6.1.4.2 in deciding whether or not to raise a new issue.

Q-5 May Appeals Officers continue to have ongoing communication with the originating function during the course of an appeal?

A-5 The prohibition on ex parte communications will affect the manner in which Appeals has traditionally operated during the course of the appeal. The Appeals Officer must give the taxpayer/representative the opportunity to participate in any discussions with the originating function regarding the strengths and weaknesses of an issue or position in the case.

Q-6 What should the Appeals Officer do if new information or evidence is submitted? Can Appeals still return the new material to the originating function for review and comment?

A-6 There is no change to existing procedures. The principles in IRM 8.2.1.2.2 remain in effect. The originating function should be given the opportunity to timely review and comment on significant new information presented by the taxpayer. "Significant new information" is information of a non-routine nature which, in the judgment of the Appeals Officer, may have had an impact on the originating function's findings or which may impact on the Appeals Officer's independent evaluation of the litigating hazards. Generally, the review can be accomplished by sending the material to the originating function while Appeals retains jurisdiction of the case and proceeds with resolution of other issues. However, if it appears that important new information or evidence was purposely withheld from the originating function, the entire case should be returned to the originating function and jurisdiction relinquished pursuant to IRM 8.2.1.2.2(3). The taxpayer/representative must be notified when a case is returned to the originating function or new material not available during initial consideration has been sent to the originating function. The results of the originating function's review of the new information will be communicated to the taxpayer/representative.

Q-7 Does the prohibition on ex parte communications have any impact on the relationship between Appeals and Counsel?

A-7 Chief Counsel is the legal adviser to the Commissioner of Internal Revenue and his or her officers and employees on all matters pertaining to the administration and enforcement of the internal revenue laws and related statutes. Chief Counsel's authority encompasses the provision of comprehensive legal advice to IRS employees, including employees in the Appeals organization, relating to the enforcement and administration of such laws. The prohibition on ex parte communication does not preclude Chief Counsel attorneys from advising Appeals Officers of the legal position of Chief Counsel on specific questions of law, assisting Appeals Officers in comprehending or interpreting specific legal authorities or otherwise providing legal assistance to Appeals Officers in the course of their duties. Appeals Officers are cautioned, however, that while they may obtain legal advice from the Office of Chief Counsel, they remain responsible for independent evaluation of the strengths and weaknesses of specific issues or positions in the case, or of the case as a whole, and for making independent judgments concerning the hazards of litigation. The prohibition on ex parte communications will have no impact on the procedures in Rev. Proc. 87–24, 1987–1 C.B. 720, or subsequent procedures relating to the administration of the Appeals process for cases docketed in the United States Tax Court.

Q-8 Appeals is required to submit certain cases to the Joint Committee on Taxation for review. On occasion, the Joint Committee will question a settlement or raise a new issue. Are communications with the Joint Committee covered by the ex parte communications prohibition?

A-8 No. The prohibition applies only to communications between the Appeals Officer and other Internal Revenue Service employees.

Q-9 Does the prohibition on ex parte communications have any impact on the requirement that ISP issues in cases in Appeals jurisdiction be reviewed and approved by the Appeals ISP Coordinator?

A-9 No. Existing procedures for review and approval remain in place. The Appeals ISP Coordinator serves as a resource person for all Appeals Officers. The purpose of the review is to ensure consistency of settlements and adherence to approved settlement guidelines. Communications between the Appeals Officer and the Appeals ISP Coordinator are entirely internal within Appeals, and consequently, the ex parte communications prohibition does not apply.

Q-10 Delegation Order 247 gives Examination case managers limited settlement authority to resolve ISP coordinated issues which have Appeals Settlement Guidelines, provided that they secure the review and approval of both the Examination and Appeals ISP Coordinators.

Would such communications constitute a violation of the ex-parte communications prohibition?

A-10 No. The purpose of the review is to ensure that the resolution by Examination fits within the guidelines developed by Appeals and that the application of the guidelines is consistent. The role of the Appeals ISP coordinator is directive in nature and has no impact on the independence of Appeals Officers.

Q-11 Does the prohibition on ex parte communications come into play in the context of meetings which include representatives from Appeals, Counsel, Collection and Examination (ACCE meetings), industry wide ISP coordination meetings, or meetings of Compliance Councils or the Large Case Policy Board?

A-11 Meetings of this type may include general discussions of how to handle technical issues or procedural matters, but these discussions are generally not case specific. Therefore, the prohibition on ex parte communications would not apply. Similarly, the prohibition would not apply to discussions relating to cases which are not under Appeals jurisdiction. However, if a case-specific discussion arises on a case which is open in Appeals jurisdiction, the discussion should be postponed. Appeals must provide the taxpayer/representative with an opportunity to participate when an Appeals Officer engages in any case-specific discussion with the originating office which addresses the strengths and weaknesses of an issue or position in a specific case that is open in Appeals jurisdiction.

Q-12 Does the ex parte communications prohibition apply to Appeals consideration of cases which originated in the Collection function, e.g., collection due process (CDP) appeals, collection appeals program (CAP) cases, offers in compromise, trust fund recovery penalty cases, etc.?

A-12 Yes. The principles discussed in A-2, A-5 and A-6 above apply to discussions between Appeals Officers and Collection Division employees. The Appeals Officer may inquire about how the originating function reached its decision and the manner in which the law was applied if such information is not clear in the administrative file. The Appeals Officer may also ask whether certain information was requested and whether it was received. The Appeals Officer, however, may not engage in discussions of the strengths and weaknesses of the issues and positions in the case, which would appear to compromise the Appeals Officer's independence. Any discussion of the strengths and weaknesses relating to the proposed action requires that the taxpayer/representative be given an opportunity to participate in the discussion. Section 3401 of RRA 98, regarding due process in IRS collection actions, states that at a hearing, the Appeals Officer must obtain verification "that the requirements of any applicable law or administrative procedure have been met." Communications seeking to verify compliance with legal and administrative requirements are similar to the general or clarifying inquiries discussed in A-2 above. Therefore, such communications are not subject to the prohibition on ex parte communications.

Q-13 Does the prohibition on ex parte communications have any impact on Appeals Officer communications with the Office of the National Taxpayer Advocate (ONTA) on an open case?

A-13 Communications by an Appeals Officer with the ONTA that are initiated by the ONTA are not subject to the prohibition because the Appeals Officer may assume that the ONTA is acting at the request, and with the consent, of the taxpayer.

Q-14 Is the prohibition on ex parte communications limited to oral communications?

A-14 No. The prohibition is not limited to oral communications. It applies to any form of communication, oral or written (manually or computer generated).

Q-15 Several responses in this document refer to the taxpayer/representative being given an "opportunity to participate." What does this phrase mean?

A-15 It means that the taxpayer/representative will be given a reasonable opportunity to attend a meeting or be a participant in a conference call with the Appeals Officer and the originating function when the strengths and weaknesses of issues or positions in the taxpayer's case are discussed. The taxpayer/representative will be notified of a scheduled meeting or conference call and invited to participate. If the taxpayer/representative is unable to participate at the scheduled time, reasonable accommodations will be made to reschedule. This does not mean that the Service will delay scheduling a meeting for a protracted period of time to accommodate the taxpayer/representative. Facts and circumstances will govern what constitutes a reasonable delay.

Q-16 What if the taxpayer/representative declines to participate or seeks to delay the meeting/conference call beyond a reasonable time?

A-16 The Appeals Officer should document the taxpayer/representative's declination or the reason for proceeding in the absence of the taxpayer/representative. This could be accomplished by an entry in the Case Activity Record and a letter to the taxpayer/representative.

Q-17 The IRM provides for computational review within 120 days of a team case being assigned. If this review reveals computational errors affecting the proposed tax liability, can the Appeals Officer discuss these errors with Examination without violating the prohibition on ex parte communications?

A-17 If the error involves the interpretation of a legal principle or application of the law to a particular set of facts, the taxpayer/representative should be afforded the opportunity to participate in any scheduled meetings with Examination to discuss the discrepancy. In such cases, there may be instances where the best approach is for Appeals to return the case to Examination for further development and correction. However, if the discrepancy is purely mathematical, any discussion would likely be informational only, and no violation of the prohibition is likely. Both the taxpayer/representative and Examination would be advised before a mathematical correction is made.

Q-18 What impact does the prohibition on ex parte communications have on pre- conference meetings with Examination on team cases?

A-18 This is clearly a situation where the intended communications could appear to compromise the independence of Appeals Officers. Pre-conference meetings should not be held unless the taxpayer/representative is given the opportunity to participate.

Q-19 Does the prohibition on ex parte communications apply to post-settlement conferences with Examination?

A-19 No. The post-settlement conference with Examination is intended to inform Examination about the settlement of issues and to supply information that may

be helpful in the examination of subsequent cycles. Appeals' objective is to ensure that Examination fully understands the settlement and the rationale for the resolution. In addition, the conference provides an opportunity for Appeals to discuss with Examination the application of Delegation Orders 236 and 247 (i.e., settlement by Examination consistent with prior Appeals settlement or ISP settlement guidelines) to issues settled by Appeals. Because the tax periods before Appeals have been finalized, discussion of the resolution of issues present in those periods does not jeopardize the independence of Appeals. As long as there is no discussion of new issues not previously considered by Appeals, the post-settlement communication is not subject to the prohibition on ex parte communications.

Q-20 Does the prohibition on ex parte communications alter existing procedures for handling claims filed late in the Appeals process?

A-20 There is no change to existing procedure. The claim should be referred to the originating function with a request for expedited examination. Because such a referral is in the nature of a ministerial act and involves no discussion by Appeals with Examination about the strengths and weaknesses of the issue, the referral is not subject to the prohibition.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for communications between Appeals Officers and other Internal Revenue Service employees which take place after the date this revenue procedure is published in the Internal Revenue Bulletin in final form.

DRAFTING INFORMATION

The principal author of this revenue procedure is David M. Geber of the Office of Corporate and Individual Income Tax, National Office Appeals. For further information regarding this revenue procedure, contact Mr. Geber at (202) 694-1827 (not a toll free number).

Work Opportunity and Welfare-to-Work Tax Credits

Notice 99–51

The Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105-277 (the Act) was enacted on October 21, 1998. Among the Act's provisions were (1) the retroactive reenactment and extension of the Work Opportunity Tax Credit (WOTC) under section 51 of the Internal Revenue Code, and (2) the extension of the Welfare-to-Work (WtW) Tax Credit under section 51A of the Code. This notice briefly describes the two credits and clarifies their operation where an individual is employed by more than one employer in the process of moving from welfare to work.

Treasury and the IRS understand that similar questions may arise when individuals who are members of other targeted groups (such as qualified veterans and qualified ex-felons) move from one employer to another. Although this notice focuses primarily on certain former welfare recipients, the analysis set forth herein applies to members of any targeted group.

Background

Substantive Requirements for the WOTC

In general

Section 51 of the Code provides a tax credit to employers who hire individuals belonging to one of the eight targeted groups set forth in section 51(d). The credit generally equals 40 percent of qualified first-year wages up to $6,000 for certified workers who work at least 400 hours in the first year (for a maximum credit of $2,400 per certified worker). Sections 51(a) and (b). The credit percentage is reduced to 25 percent for certified workers who work at least 120 hours but less than 400 hours. Section 51(i)(3).

"Qualified first-year wages" are wages attributable to services rendered during the one-year period beginning on the date the individual begins to work for the employer. Section 51(b) of the Code.

Qualified IV-A Recipients constitute one of the eight targeted WOTC groups. A Qualified IV-A Recipient is a member of a family that receives assistance under a State plan approved under part A of Title IV of the Social Security Act (relating to assistance for needy families with minor children) for any nine months during the 18-month period ending on the hiring date.

For purposes of the credit, an individual is not a member of a targeted group unless the individual is certified as such by a designated local agency, usually a state employment security agency. Section 51(d) of the Code; Notice 96–52, 1996–2 C.B. 218; and Notice 97–54, 1997–2 C.B. 306.

Section 52(c) of the Code provides that the WOTC generally is not available to any organization that is exempt from tax.

The Act retroactively reenacted and extended the WOTC to June 30, 1999.

Substantive Requirements for the WtW Tax Credit

In general

Section 51A of the Code provides a tax credit to employers that hire individuals who are Long-Term Family Assistance Recipients, as defined in section 51A(c). The amount of the WtW tax credit differs from the WOTC. The WtW tax credit is 35 percent of qualifying first-year wages and 50 percent of qualifying second-year wages of up to $10,000. Sections 51A(a) and (b)(4).

"Qualified-first year wages" are wages attributable to service rendered during the one-year period beginning on the day the individual begins work for the employer. "Qualified second-year wages" are wages attributable to service rendered during the one-year period beginning on the day after the last day of the one-year period for measuring "qualified first-year wages." Section 51A(b) of the Code. For purposes of the WtW tax credit (although not for the WOTC), wages include certain tax-exempt amounts relating to accident and health coverage, educational assistance programs, and dependent care assistance programs. Section 51A(b)(5). The maximum WtW tax credit for first-year wages is $3,500 and for second-year wages is $5,000. Section 51A(a).

A Long-Term Family Assistance Recipient is an individual whom the designated local agency certifies as belonging in one of the following groups:

(a) members of a family that have received family assistance under a State plan approved under part A of title IV of the Social Security Act for at least 18 consecutive months ending on the hiring date;

(b) members of a family that have received family assistance for a total of at least 18 months (whether or not con-

secutive) beginning after August 5, 1997, who are hired by the employer after February 5, 1999, and who have a hiring date which is not more than two years after the end of the earliest such 18-month period; or

(c) members of a family that cease after August 5, 1997, to be eligible for family assistance by reason of a limitation imposed by Federal or State law on the maximum period such assistance can be paid and who have a hiring date which is not more than two years after the date of such cessation.

Like the WOTC, the WtW tax credit generally is not available to any organization that is exempt from tax. Section 51A(d) of the Code.

The Act extended the WtW tax credit to June 30, 1999.

Coordination of the WOTC and WtW Tax Credit

In some instances, an individual meets the requirements both as a Qualified IV-A Recipient for purposes of the WOTC and as a Long-Term Family Assistance Recipient for purposes of the WtW tax credit. In any taxable year, an employer who hires such an individual may choose to claim either the WOTC or the WtW tax credit, but not both, with respect to that employee. Section 51A(e) of the Code. For a further discussion of the coordination of the WOTC and WtW tax credit, see Notice 97–54, supra.

Availability of Credits Where an Individual Moves from Employer to Employer while Moving from Welfare to Work

If an individual qualifies as a Qualified IV-A Recipient and/or a Long-Term Family Assistance Recipient on the hiring date, the WOTC and/or WtW tax credit, as applicable, generally is available to employers other than those described in section 52(c) of the Code, regardless of any other circumstances applicable to the individual on that date.

For example, if the individual meets the applicable statutory requirements (e.g., the nine out of 18-month requirement for WOTC purposes or one of the requirements for purposes of the WtW tax credit) on the hiring date, the employer may claim the applicable credit even if the individual was working for another employer immediately before the hiring date and even if that other employer claimed the same credit for all or part of the wages paid to the individual. However, a successor employer or a second employer that is part of the same controlled group of businesses generally is treated as a continuation of the first employer. Sections 51(k), 51A(d) and 52(a) and (b) of the Code.

For WOTC purposes, as noted above, the same analysis applies in the case of individuals other than Qualified IV-A Recipients. In each case, employment by an unrelated employer immediately prior to the hiring date does not preclude an individual from being a member of a targeted group if the individual can still meet the applicable statutory requirements on the hiring date.

Examples

The following examples illustrate the application of these requirements where an employee is employed by more than one employer while moving from welfare to work.

For purposes of these examples, it is assumed that all of the applicable requirements for credit eligibility are met.

Example 1: On October 1, 1998, X, a charitable organization that is exempt from tax under section 501(a) of the Internal Revenue Code, hires A to participate in a transition-to-work program. A's family has been receiving assistance under a qualified IV-A program for the nine consecutive months ending on September 30, 1998. A works for X for three months in the job training program. On January 1, 1999, Y, a taxable business, hires A for a permanent job. On the day Y hires A, A is a qualified IV-A recipient for purposes of the WOTC, because A's family has received assistance under a qualified IV-A program during nine of the preceding 18 months. (In fact, A's family has received such assistance for nine of the preceding 12 months.) Y's only relationship to X is that it hires workers from X's transition-to-work program and occasionally makes charitable contributions to X. Therefore, Y is not a successor employer to X and is not part of the same controlled group of businesses as X. Y may claim the WOTC for up to $6,000 of the wages Y pays to A for services rendered during the one-year period commencing on January 1, 1999, the day A begins to work for Y.

Example 2: The facts are the same as in Example 1, except that A works for X for 12 months, and Y hires A on October 1, 1999. On the day Y hires A, A is not a qualified IV-A recipient for purposes of the WOTC, because A's family only received assistance under a qualified IV-A program for six of the 18 months preceding the October 1, 1999 hiring date. Thus, Y may not claim the WOTC for any wages that it pays to A.

Example 3: On October 1, 1998, Z, a taxable business, hires B. B's family has been receiving assistance under a qualified IV-A program for the nine consecutive months ending on September 30, 1998. B works for Z for three months, and Z claims the WOTC with respect to wages paid to B. On January 1, 1999, Y, a taxable business, hires B. On the day Y hires B, B is a qualified IV-A recipient for purposes of the WOTC, because B's family has received assistance under a qualified IV-A program during nine of the preceding 18 months. (In fact, B's family has received such assistance for nine of the preceding 12 months.) Y has no relationship to Z. Therefore, Y is not a successor employer to Z and is not part of the same controlled group of businesses as Z. Y may claim the WOTC for up to $6,000 of the wages Y pays to B for services rendered during the one-year period commencing on January 1, 1999, the day B begins to work for Y.

Example 4: The facts are the same as in Example 3, except that on January 1, 1999, Y acquired from Z substantially all of the property used in the trade or business in which Z employed B. As part of the same transaction, Y became B's employer. In the three months during which B worked for Z, Z claimed the WOTC with respect to $4,000 of wages paid to B. Because Y is a successor employer to Z, Y is treated as a continuation of Z for purposes of the WOTC. Thus, Y may claim the WOTC only with respect to $2,000 of wages that Y pays to B for services rendered during the nine-month period beginning on January 1, 1999, the day B starts to work for Y.

Example 5: On March 1, 1999, X, a charitable organization that is exempt from tax under section 501(a) of the

Code, hires C to participate in its transition-to-work program. C's family received assistance under a qualified IV-A program for the 18 consecutive months beginning August 6, 1997, and ending February 5, 1999. C participates in X's program for four months. On June 30, 1999, Z, a taxable business, hires C. On the day Z hires C, C is a long-term family assistance recipient for purposes of the WtW tax credit, because C's family has received assistance under a qualified IV-A program for a total of 18 months beginning after August 5, 1997, C is hired by Z after February 5, 1999, and C has a hiring date which is not more than two years after the end of the 18-month period. Z's only relationship to X is that Z hires workers from X's transition-to-work program and occasionally provides technical assistance to X. Therefore, Z is not a successor employer to X and is not part of the same controlled group of businesses as X. Z may claim the WtW tax credit both for up to $10,000 of the wages Z pays to C for services rendered during the one-year period commencing on June 30, 1999, the day C begins to work for Z, and for up to $10,000 of the wages Z pays to C for services rendered during the next one-year period commencing on June 30, 2000.

(Under the facts of this example 5, C also is a qualified IV-A recipient for purposes of the WOTC. Thus, for any particular taxable year of Z in which Z pays C for services rendered during C's first one-year period of employment with Z, Z may elect to claim the WOTC rather than the WTW tax credit for wages paid to C. Notice 97-54, supra.)

Drafting Information

The principal author of this Notice is Robert Wheeler, Office of Assistant Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this Notice, contact Robert Wheeler at (202) 622-6060 (not a toll-free call).

26 CFR 601.602: Forms and instructions.
(Also Part 1, sections 220, 408, 408A, 6041, 6041A, 6042, 6043, 6044, 6045, 6047, 6049, 6050A, 6050B, 6050D, 6050E, 6050H, 6050J, 6050N, 6050P, 6050Q, 6050R, 6050S, 1.408–5, 1.408–7, 1.408A–7, 1.6041–1, 7.6041–1, 1.6042–2, 1.6042–4, 1.6044–2, 1.6044–5, 1.6045–1, 5f.6045–1, 1.6045–2, 1.6045–4, 1.6047–1, 1.6049–4, 1.6049–6, 1.6049–7, 1.6050A–1, 1.6050B–1, 1.6050D–1, 1.6050E–1, 1.6050H–1, 1.6050H–2, 1.6050J–1T, 1.6050N–1, 1.6050P–1).

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Part 1

General Information

Section 1.1 – Overview of Revenue Procedure 99–34

1.1.1 Purpose

The purpose of this revenue procedure is to set forth the 1999 requirements for:

- Using official Internal Revenue Service (IRS) forms to file information returns with the IRS,
- Preparing acceptable substitutes of the official IRS forms to file information returns with the IRS, and
- Using official or acceptable substitute forms to furnish information to a recipient.

1.1.2 Which Forms Are Covered?

This revenue procedure contains specifications for the following information returns:

Form	Title
1096	Annual Summary and Transmittal of U.S. Information Returns
1098	Mortgage Interest Statement
1098-E	Student Loan Interest Statement
1098-T	Tuition Payments Statement
1099-A	Acquisition or Abandonment of Secured Property
1099-B	Proceeds From Broker and Barter Exchange Transactions
1099-C	Cancellation of Debt
1099-DIV	Dividends and Distributions
1099-G	Certain Government and Qualified State Tuition Program Payments
1099-INT	Interest Income
1099-LTC	Long-Term Care and Accelerated Death Benefits
1099-MISC	Miscellaneous Income
1099-MSA	Distributions From an MSA or Medicare+Choice MSA
1099-OID	Original Issue Discount
1099-PATR	Taxable Distributions Received From Cooperatives
1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
1099-S	Proceeds From Real Estate Transactions
5498	IRA Contribution Information
5498-MSA	MSA or Medicare+Choice MSA Information
W-2G	Certain Gambling Winnings

1.1.3 Scope

For purposes of this revenue procedure, a substitute form or statement is one that is not printed by the IRS. For a substitute form or statement to be acceptable to the IRS, it must conform to the official form or the specifications outlined in this revenue procedure. **Do not submit any substitute forms or statements to the IRS for approval.** Privately printed forms may not state "This is an IRS approved form."

Filers making payments to certain recipients during a calendar year are required by the Internal Revenue Code (IRC) to file information returns with the IRS for these payments. These filers must also provide this information to their recipients. In some cases, this also applies to payments received. See **Section 1.5** for the specifications that apply to form recipient statements (generally Copy B).

In general, section 6011 of the IRC contains requirements for filers of information returns. A filer must file information returns on magnetic media (including electronic filing) or on paper. A filer who is required to file 250 or more information returns of any one type during a calendar year must file those returns on magnetic media.
Exception. Filers are not required to use magnetic media when filing 250 or more Forms 1098-E or 1098 T.

Although not required, small volume filers (fewer than 250 returns during a calendar year) and Form 1098-E and 1098-T filers may file the forms on magnetic media. See the legal requirements for filing information returns (and providing a copy to a payee) in the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G. In addition, see **Pub. 1220,** Specifications for Filing Forms 1098, 1099, 5498, and W- 2G Magnetically or Electronically.

1.1.4 For More Information

The IRS prints and provides the forms on which various payments must be reported. Alternatively, filers may prepare substitute copies of these IRS forms and use such forms to report payments to the IRS.

- For copies of the official forms and the instruction booklet for the reporting year, call our toll-free number **1-800-TAX-FORM (1-800-829-3676).**
- The IRS operates a central call site in Martinsburg, WV, to answer questions related to information returns, penalties, and backup withholding. Call **304-263-8700** Monday through Friday 8:30 a.m. to 4:30 p.m. eastern time. The TTY/TDD number is **304-267-3367.**

1.1.5 Changes to the Revenue Procedure

The following changes have been made to the Revenue Procedure and exhibits:

- **Form 1099-G**
  1. The title was changed to "Certain Government and Qualified State Tuition Program Payments."
  2. Box 5, "Qualified state tuition program earnings," was added.
- **Form 1099-INT**
  1. Box 5, "Investment expenses," was added.
  2. Boxes 5 and 6 were renumbered 6 and 7.
- **Form 1099-MSA**
  1. The title was changed to "Distributions From an MSA or Medicare+Choice MSA."
  2. Box 4 was added to report the account's fair market value on the date of the account holder's death.
  3. A checkbox for a Medicare+Choice MSA was added in new box 5.
  4. New code 6 was added to the distribution codes in box 3 for a death distribution to a nonspouse beneficiary from an MSA after the year of death.
- **Form 1099-OID**
  1. Box 6, "Original issue discount on U.S. Treasury obligations," was added.
  2. Box 7, "Investment expenses," was added.
- **Form 1099-R** – The following changes were made to box 7:
  1. Code J was changed to "Distribution from a Roth IRA."
  2. Code R, "Recharacterized IRA Contribution," was added.
  3. Codes B, C, and K were eliminated.
- **Form 5498** – The "Roth conv." checkbox in box 6 was deleted and a new checkbox titled "Rechar." was added to identify recharacterized IRA contributions in a trustee-to-trustee transfer.
- **Form 5498-MSA**
  1. The title was changed to "MSA or Medicare+Choice MSA Information."
  2. A "Medicare+Choice MSA" checkbox was added to box 6.
- The IRS mailing address in Section 1.2 has changed as follows:

  Internal Revenue Service
  Attn: Substitute Forms Program
  OP:FS:FP:F:CD
  1111 Constitution Ave., NW
  Room 5244 IR
  Washington, DC 20224

- The Information Reporting Program Bulletin Board System (IRP-BBS) is no longer available and has been deleted from **Sections 1.1** and **4.3.**

Section 1.2 – Requirements for Acceptable Substitute Forms 1096, 1098, 1099, 5498, and W-2G

1.2.1 Introduction

Paper substitutes for Form 1096 and Copy A of Forms 1098, 1099, 5498, and W-2G that totally conform to the specifications listed in this revenue procedure may be privately printed and filed as returns with the IRS. The reference to the Department of the Treasury - Internal Revenue Service should be included on all such forms. If you are uncertain of any specification and want it clarified, you may submit a letter citing the specification, stating your understanding and interpretation of the specification, and enclosing an example of the form (if appropriate) to:

Internal Revenue Service
Attn: Substitute Forms Program
OP:FS:FP:F:CD
1111 Constitution Ave., NW
Room 5244 IR
Washington, DC 20224

Note: *Allow at least 45 days for the IRS to respond.*

Forms 1096, 1098, 1099, 5498, and W-2G are subject to annual review and possible change. Therefore, filers are cautioned against overstocking supplies of privately printed substitutes. **The specifications contained in this revenue procedure apply to 1999 forms only.**

1.2.2 Copy A

Proposed substitutes for Copy A that do not conform to the specifications in this revenue procedure are not acceptable. Further, if you file such forms with the IRS, you may be subject to a penalty for failure to file an information return under section 6721 of the IRC. Generally, the penalty is $50 for each failure to file a form (up to $250,000) that the IRS cannot accept as a return because it does not meet the provisions in this revenue procedure. No IRS office is authorized to allow deviations from this revenue procedure.

1.2.3 Copy B and Copy C

Copies B and Copies C of the following forms must contain the information in **Section 1.5** to be considered a "statement" or "official form" under the applicable provisions of the IRC. The format of this information is at the discretion of the filer with the exception of the location of the tax year, form number, form name, and the information for composite Form 1099 statements as outlined under **Sections 1.5.3 and 1.5.8.**

Copy B of the following forms are:

Form	Recipient
1098	For Payer
1098-E; 1099-A	For Borrower
1098-T	For Student
1099-C	For Debtor
1099-LTC	For Policyholder
1099-S	For Transferor
All other Forms 1099	For Recipient
Forms 5498; 5498-MSA	For Participant
Forms W-2G; 1099-R	(These forms may require Copy B to be attached to the Federal income tax return.)

Copy C of the following forms are:

Form	Recipient
1099-LTC	For Insured
1099-R	For Recipient's Records
W-2G	For Winner's Records

Note: *On Copy C, Form 1099-LTC, you may reverse the locations of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.*

Section 1.3 – Definitions

1.3.1 Form Recipient

Form recipient means the person to whom you are required by law to furnish a copy of the official form or information statement. The form recipient may be referred to by different names on various Forms 1099 and related forms ("payer/borrower," "borrower," "student," "debtor," "policyholder," "insured," "transferor," "payment recipient," "participant," or, in the case of Form W-2G, the "winner"). See **Section 1.2.3** earlier.

1.3.2 Filer

Filer means the person or organization required by law to file a form listed in **Section 1.1.2** with the IRS. As outlined earlier, a filer may be a payer, creditor, recipient of mortgage or student loan interest payments, educational institution, broker, barter exchange, person reporting real estate transactions, trustee or issuer of any individual retirement arrangement or medical savings account, or lender who acquires an interest in secured property or who has reason to know that the property has been abandoned.

1.3.3 Substitute Form

Substitute form means a paper substitute of Copy A of an official form listed in **Section 1.1.2** that totally conforms to the provisions in this revenue procedure.

1.3.4 Substitute Form Recipient Statement

Substitute form recipient statement means a paper statement of the information reported on a form listed in **Section 1.1.2** that must be furnished to a person (form recipient), as defined under the applicable provisions of the IRC and the applicable regulations.

1.3.5 Composite Substitute Statement

Composite substitute statement means one in which two or more required statements (e.g., Forms 1099-INT and 1099-DIV) are furnished to the recipient on one document. However, each statement must be designated separately and must contain all the requisite Form 1099 information except as provided under **Section 1.5.** A composite statement **may not** be filed with the IRS.

Section 1.4 – Instructions for Preparing Paper Forms That Will Be Filed With the IRS (Copy A)

1.4.1 Recipient Information

The form recipient's name, street address, city, state, and ZIP code information should be **typed or machine printed in black ink** in the same format as shown on the official IRS form. Although handwritten forms will be accepted, the IRS prefers that filers **type or machine print** data entries. Also, filers should insert data in the **middle of blocks** well separated from other printing and guidelines, and take measures to guarantee clear, dark black, sharp images. Carbon copies and photocopies are not acceptable. The city, state, and ZIP code must be on the same line.

The following rules apply to the form recipient's name(s):

- The name of the appropriate form recipient must be shown on the first or second name line in the area provided for the form recipient's name.
- No descriptive information or other name may precede the form recipient's name.
- Only **one** form recipient's name may appear on the first name line of the form.
- If the multiple recipients' names are required on the form, enter on the first name line the recipient name that corresponds to the recipient taxpayer identification number (TIN) shown on the form. Place the other form recipients' names on the second name line (only 2 name lines are allowable).

Because certain states require that trust accounts be provided in a different format, generally filers should provide information returns reflecting payments to trust accounts with the:

- Trust's employer identification number (EIN) in the recipient's TIN area,
- Trust's name on the recipient's first name line, and
- Name of the trustee on the recipient's second name line.

1.4.2 Account Number Box

You should use the account number box for an account number designation. This number must not appear anywhere else on the form, and this box may not be used for any other item.

Showing the account number is optional. However, it may be to your benefit to include the recipient's account number or designation on paper documents if your recordkeeping system uses for identification purposes the account number or designation in conjunction with, or instead of, the name, social security number, or employer identification number.

If you furnish the account number, the IRS will include it in future notices to you about backup withholding. If you use window envelopes and a reduced rate to mail statements to recipients, be sure the account number does not appear in the window. Otherwise, the Postal Service may not accept them for mailing.

1.4.3 Specifications and Restrictions

Machine-printed forms should be printed using a 6 lines/inch option, and should be printed in 10 pitch pica (10 print positions per inch) or 12 pitch elite (12 print positions per inch). Proportional spaced fonts are unacceptable. Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single sheet before they are filed with the IRS. The size specified **does not include pinfeed holes.** Pinfeed holes **must not** be present on forms filed with the IRS.

DO NOT:

- Use a felt tip marker. The machine used to "read" paper forms generally cannot read this ink type.
- Use dollar signs ($), ampersands (&), asterisks (*), commas (,), or other special characters in the numbered money boxes.
  Exception. Use decimal points to indicate dollars and cents (e.g., 2000.00 is acceptable).
- Fold Forms 1096, 1098, 1099, or 5498 mailed to the IRS. Mail these forms flat in an appropriately sized envelope or box. Folded documents cannot be readily moved through the machine used in IRS processing.
- Staple Forms 1096 to the transmitted returns. Any staple holes near the return code number may impair the IRS's ability to machine scan the type of documents.
- Type other information on Copy A.
- Cut or separate the individual forms on the sheet of forms of Copy A (except Forms W-2G).

1.4.4 Where To File

Mail completed paper forms to the IRS service center shown on the back of Form 1096 and in the 1999 **Instructions for Forms 1099, 1098, 5498, and W-2G.** Specific information needed to complete the forms in this revenue procedure is given in those instructions. A chart is included in those instructions giving a quick guide to which form must be filed to report a particular payment.

Section 1.5 – Substitute Statements to Form Recipients and Form Recipient Copies

1.5.1 Introduction

If you do not use the official IRS form to furnish statements to recipients, you must furnish an acceptable substitute statement. To be acceptable, your substitute statement must comply with the rules in this section. In general, see Regulations sections 1.6042–4, 1.6044–5, 1.6049–6, and 1.6050N-1 to determine how certain statements must be provided to recipients (statement mailing requirements for most Forms 1099-DIV and 1099-INT, all Forms 1099-OID and 1099-PATR, and Form 1099-MISC or 1099-S for royalties).

Note: *A trustee of a grantor-type trust may choose to file Forms 1099 and furnish a statement to the grantor under Regulations sections 1.671–4(b)(2)(iii) and (b)(3)(ii). The statement required by those regulations is not subject to the requirements outlined in this section.*

1.5.2 Substitute Statements to Recipients for Certain Forms 1099-INT and 1099-DIV, and for Forms 1099-OID and 1099-PATR

The rules in this section apply to Form 1099-INT (except for interest reportable under section 6041), 1099-DIV (except for section 404(k) dividends), 1099-OID, and 1099-PATR. You may furnish form recipients with Copy B of the official Form 1099 or a substitute Form 1099 (form recipient statement) if it contains the same language as the official IRS form (such as aggregate amounts paid to the form recipient, any backup withholding, the name, address, and TIN of the person making the return, and any other information required by the official form). Information not required by the official form should not be included on the substitute form except state income tax withholding information.

You may enter a total of the individual accounts listed on the form only if they have been paid by the same payer. For example, if you are listing interest paid on several accounts by one financial institution on Form 1099-INT, you may also enter the total interest amount. You may also enter a date next to the corrected box if that box is checked.

A substitute form recipient statement for Forms 1099-INT, 1099-DIV, 1099-OID, or 1099-PATR must comply with the following requirements:

1. Box captions and numbers that are applicable must be clearly identified, using the same wording and numbering as on the official form.
   Note: *For Form 1099-INT, if box 3 is not on your substitute form, you may drop "not included in box 3" from the box 1 caption.*
2. The form recipient statement must contain all applicable form recipient instructions provided on the front and back of the official IRS form. Those instructions may be provided on a separate sheet of paper.
3. The form recipient statement must contain the following in bold and conspicuous type:
   This important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
4. The box caption **"Federal income tax withheld"** must be in boldface type on the form recipient statement.
5. The form recipient statement must contain the Office of Management and Budget (OMB) number as shown on the official IRS form. See Part 4.
6. The form recipient statement must contain the tax year (e.g., 1999), form number (e.g., Form 1099-INT), and form name (e.g., Interest Income) of the official IRS Form 1099. This information must be displayed prominently together in one area of the statement. For example, the tax year, form number, and form name could be shown in the upper right part of the statement. Each copy must be appropriately labeled (such as Copy B, For Recipient). See Part 4 for applicable labels and arrangement of assembly of forms.
   Note: ***Do not*** *include the words "Substitute for" or "In lieu of" on the form recipient statement.*
7. Layout and format of the form is at the discretion of the filer. However, the IRS encourages the use of boxes so that the statement has the appearance of a form and can be easily distinguished from other nontax statements.
8. Each recipient statement must include the direct access telephone number of an individual who can answer questions about the statement. **You must include the telephone number conspicuously anywhere on the recipient statement.**
9. Until new regulations are issued, the IRS will not assess penalties for use of a logo (e.g., the name of the payer in any typeface, font, or style, and/or a symbolic icon) or slogan on a recipient statement if the logo or slogan is used by the payer in the ordinary course of its trade or business. In addition, use

of the logo or slogan must not make it less likely for a reasonable payee to recognize the importance of the statement for tax reporting purposes.

10. A mutual fund family may state separately on one document (e.g., one piece of paper) the dividend income earned by a recipient from each fund within the family of funds as required by Form 1099-DIV. However, each fund and its earnings must be stated separately. The form must contain an instruction to the recipient that each fund's dividends and name, not the name of the mutual fund family, must be reported on the recipient's tax return. **The form cannot contain an aggregate total of all funds.** In addition, a mutual fund family may furnish a single statement (as a single filer) for Forms 1099-INT, 1099-DIV, and 1099-OID information. Each fund and its earnings must be stated separately. The form must contain an instruction to the recipient that each fund's earnings and name, not the name of the mutual fund family, must be reported on the recipient's tax return. **The form cannot contain an aggregate total of all funds.**

1.5.3 Composite Substitute Statements for Certain Forms 1099-INT, 1099-DIV, 1099-MISC, and 1099-S, and for Forms 1099-OID and 1099-PATR

A composite form recipient statement is permitted for reportable payments of interest, dividends, original issue discount, patronage dividends, and royalties (Forms 1099-INT (except for interest reportable under section 6041), 1099-DIV (except for section 404(k) dividends), 1099-MISC or 1099-S (for royalties only), 1099-OID, or 1099-PATR) when one payer is reporting more than one of these payments during a calendar year to the same form recipient. Generally, do not include any other Form 1099 information (e.g., 1098 or 1099-A) on a composite statement with the information required on the forms listed in the preceding sentence.

Exception. A filer may include Form 1099-B information on a composite form with the forms listed above.

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the following requirements in addition to the requirements listed earlier in **Section 1.5.2.**

1. All information pertaining to a particular type of payment must be located and blocked together on the form and separate from any information covering other types of payments included on the form. For example, if you are reporting interest and dividends, the **Form 1099-INT** information must be presented separately from the **Form 1099-DIV** information.
2. The composite form recipient statement must prominently display the tax year, form number, and form name of the official IRS form together in one area at the beginning of each appropriate block of information.
3. Any information required by the official IRS forms that would otherwise be repeated in each information block is required to be listed only once in the first information block on the composite form. For example, there is no requirement to report the name of the filer in each information block. This rule does not apply to any money amounts (e.g., Federal income tax withheld) or to any other information that applies to money amounts.
4. A composite statement is an acceptable substitute only if the type of payment and the recipient's tax obligation with respect to the payment are as clear as if each required statement were furnished separately on an official form.

1.5.4 Substitute Statements to Recipients for Certain Forms 1098, 1099, 5498, and W-2G

Statements to form recipients for Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-G, 1099-LTC, 1099-MISC, 1099-MSA, 1099-R, 1099-S, 5498, 5498-MSA, W-2G, 1099-DIV (only for section 404(k) dividends reportable under section 6047), and 1099-INT (only for interest of $600 or more made in the course of a trade or business reportable under section 6041) can be copies of the official forms or an acceptable substitute. To be acceptable, a substitute form recipient statement must meet the following requirements.

1. The tax year, form number, and form name must be the same as the official form and must be displayed prominently together in one area on the statement. For example, they may be shown in the upper right part of the statement.
2. The filer's and the form recipient's identifying information required on the official IRS form must be included.
3. Each substitute recipient statement for Forms W-2G, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-DIV, 1099-G (excluding state and local income tax refunds), 1099-INT, 1099-LTC, 1099-MISC (excluding fishing boat proceeds), 1099-OID, 1099-PATR, and 1099-S must include the direct access telephone number of an individual who can answer questions about the statement. **You may include**

the telephone number conspicuously anywhere on the recipient statement. Although not required, payers reporting on Forms 1099-C, 1099-MSA, 1099-R, 5498, and 5498-MSA are encouraged to furnish telephone numbers.

4. All applicable money amounts and information, including box numbers, required to be reported to the form recipient must be titled on the form recipient statement in substantially the same manner as those on the official IRS form. The box caption **"Federal income tax withheld"** must be in boldface type on the form recipient statement.

   Exception. If you are reporting a payment as "Other income" in box 3 of Form 1099-MISC, you may substitute appropriate language for the box title. For example, for payments of accrued wages and leave to a beneficiary of a deceased employee, you might change the title of box 3 to "Beneficiary payments" or something similar.

   Note: *You cannot make this change on Copy A.*

5. You must provide appropriate instructions to the form recipient, similar to those on the official IRS form, to aid in the proper reporting on the form recipient's income tax return. For payments reported on Form 1099-B, the requirement to include instructions substantially similar to those on the official IRS form may be satisfied by providing form recipients with a single set of instructions for all Forms 1099-B statements required to be furnished in a calendar year.

   Note: *If Federal income tax is withheld and shown on Form 1099-R or W-2G, Copy B and Copy C must be furnished to the recipient. If Federal income tax is not withheld, only Copy C of Form 1099-R or W-2G must be furnished. However, for Form 1099-R, instructions similar to those on the back of the official Copy B and Copy C of Form 1099-R must be furnished to the recipient. For convenience, you may choose to provide both Copies B and C of Form 1099-R to the recipient.*

6. If you use carbon to produce recipient statements, the quality of the carbon must meet the following standards:
   - All copies must be **clearly legible,**
   - All copies must be able to be photocopied, and
   - Fading must not diminish legibility and the ability to photocopy.

   In general, black chemical transfer inks are preferred, but other colors are permitted if the above standards are met. Hot wax and cold carbon spots are not permitted on any of the internal form plies. The back of a mailer top envelope ply may contain these spots.

7. A mutual fund family may state separately on one document (e.g., one piece of paper) the Form 1099-B information for a recipient from each fund as required by Form 1099-B. However, the gross proceeds, etc., from each transaction within a fund must be stated separately. The form must contain an instruction to the recipient that each fund's (not the mutual fund family's) name and amount must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds.

8. You may use a Uniform Settlement Statement (under the Real Estate Settlement Procedures Act of 1974 (RESPA)) for Form 1099-S. The Uniform Settlement Statement is acceptable as the written statement to the transferor if you include the legend for Form 1099-S below and indicate which information on the Uniform Settlement Statement is being reported to the IRS on Form 1099-S.

9. For reporting state income tax withholding and state payments, you may add an additional box(es) to recipient copies as appropriate.

   Note: *You cannot make this change on Copy A.*

10. On Copy C of Form 1099-LTC, you may reverse the location of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.

11. Logos are permitted on substitute recipient statements for the forms listed in this section **(Section 1.5.4).**

1.5.5 Required Legends for Forms 1098

Form 1098 recipient statements must contain the following legends:

- **Form 1098**
  1. "The information in boxes 1, 2, and 3 is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for this mortgage interest or for these points or because you did not report this refund of interest on your return."
  2. **"Caution:** *The amount shown may not be fully deductible by you. Limits based on the loan amount and the cost and value of the secured property may apply. Also, you may only deduct interest to the extent it was incurred by you, actually paid by you, and not reimbursed by another person."*
- **Form 1098-E** – "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for student loan interest."
- **Form 1098-T** – "This is important tax information and is being furnished to the Internal Revenue Service."

1.5.6 Required Legends for Forms 1099 and W-2G

Forms 1099 and W-2G recipient statements must contain the following legends:

- **Forms 1099-A and 1099-C** – "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported."
- **Forms 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, and W-2G (Copy C)** – "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported."
- **Form W-2G (Copy B)** – "This information is being furnished to the Internal Revenue Service. Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 2, attach this copy to your return."
- **Form 1099-LTC**

  Copy B – "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported."

  Copy C – "Copy C is provided to you for information only. Only the policyholder is required to report this information on a tax return."
- **Form 1099-MSA** – "This information is being furnished to the Internal Revenue Service."
- **Form 1099-R**

  Copy B – "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return. This information is being furnished to the Internal Revenue Service."

  Copy C – "This information is being furnished to the Internal Revenue Service."
- **Form 1099-S** – "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported."

1.5.7 Required Legends for Forms 5498

Form 5498 recipient statements must contain the following legends:

- **Form 5498** – "This information is being furnished to the Internal Revenue Service."
  Note: *If you do not furnish another statement to the participant because no contributions were made for the year, the statement of the fair market value of the account must contain this legend and a designation of which information is being furnished to the Internal Revenue Service.*
- **Form 5498-MSA** – "The information in boxes 1 through 6 is being furnished to the Internal Revenue Service."

1.5.8 Composite Substitute Statements to Recipients for Forms Specified in Section 1.5.4

A composite form recipient statement for the forms specified in **Section 1.5.4** is permitted when one filer is reporting more than one type of payment during a calendar year to the same form recipient. A composite statement is not allowed for a combination of forms listed in **Section 1.5.4** and forms listed in **Section 1.5.2.**

Exceptions. Form 1099-B information may be reported on a composite form with the forms specified in **Section 1.5.2** as described in **Section 1.5.3.** In addition, royalties reported on Form 1099-MISC or 1099-S may be reported on a composite form only with the forms specified in **Section 1.5.2.**

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the requirements listed in
Section 1.5.3 as well as the requirements in **Section 1.5.4.** A composite statement of Forms 1098 and 1099-INT (for interest reportable under section 6049) is **not** allowed.

Part 2

Specifications for Substitute Forms To Be Filed With the IRS (Except Form W-2G)

Section 2.1 - Specifications

2.1.1 Introduction

The following specifications prescribe the format requirements for Forms 1096 and Copy A of Forms 1098, 1099, and 5498. (See Part 3 for Form W-2G specifications.)

2.1.2 Form Identifying Numbers

The form identifying number (e.g., 9191 for Form 1099-DIV) must be printed in nonreflective black carbon-based ink in print positions 15 through 19 using an OCR A font. The checkboxes to the right of the form identifying number must be 10-point boxes; the void checkbox is in print position 25 and the corrected checkbox is in position 33. These measurements are from the left edge of the paper, not including the perforated strip.

2.1.3 Specifications for Form 1096 and Copy A of Forms 1098, 1099, and 5498

The substitute form must be an exact replica of the official IRS form with respect to layout and content.

Note: *To determine the correct form measurements, see Exhibits A through T at the end of this publication.*

- Hot wax and cold carbon spots are not permitted on any of the internal form plies. These spots are permitted on the back of a mailer top envelope ply.
- Use of chemical transfer paper for Copy A is acceptable.
- The Government Printing Office (GPO) symbol must be deleted.

2.1.4 Color and Paper Quality

Color and paper quality for Copy A (cut sheets and continuous pinfeed forms) as specified by JCP Code 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.*

- Acidity: Ph value, average, not less than 4.5
- Basis Weight 17 × 22 500 cut sheets 18-20
  Metric equivalent—g/m^2 75
  A tolerance of ± 5 pct. is allowed.
- Stiffness: Average, each direction, not less than—milligrams 50
- Tearing strength: Average, each direction, not less than—grams 40
- Opacity: Average, not less than—percent 82
- Thickness: Average—inch 0.0038
  Metric equivalent—mm 0.097
  A tolerance of +0.0005 inch (0.0127 mm) is allowed. Paper cannot vary more than 0.0004 inch (0.0102 mm) from one edge to the other.
- Porosity: Average, not less than—seconds 10
- Finish (smoothness): Average, each side—seconds 20-55
  For information only, the Sheffield equivalent—units 170-100
- Dirt: Average, each side, not to exceed—parts per million 8

2.1.5 Chemical Transfer Paper

Chemical transfer paper is permitted for Copy A only if the following standards are met:

- Only chemically backed paper is acceptable for Copy A.
- Carbon-coated forms are not permitted. Front and back chemically treated paper cannot be processed properly by machine.
- Chemically transferred images must be black.

All copies must be **clearly legible.** Hot wax and cold carbon spots **are not** permitted for Copy A. **Interleaved carbon** should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

2.1.6 Printing

All printing on Copy A of Forms 1098, 1099, 5498, and the Form 1096 printing above the statement "Please return this entire page to the Internal Revenue Service. Photocopies are NOT acceptable." must be in Flint J-6983 red OCR dropout ink or an exact match. However, the four-digit form identifying number must be in nonreflective carbon-based black ink in OCR A font.

The shaded areas of any substitute form should generally correspond to the format of the official form.

The printing for the Form 1096 statement and the following text may be in any shade or tone of black ink. Black ink should only appear on the lower part of the reverse side of Form 1096 where it will not bleed through and interfere with scanning.

Note: *The instructions on the back of Form 1096, which include filing addresses, must be printed.*

Separation between fields must be 0.1 inch.

Except for Form 1099-R, the numbered captions are printed as solid with no shaded background.

Other printing requirements are discussed below.

2.1.7 OCR Specifications

The contractor must initiate or have a quality control program to assure OCR ink density. In addition, the contractor must have access to either a MacBeth PCM-II, Kidder 082A, or similar tester to regularly evaluate the ink throughout a shift.

2.1.8 Paper and Ink

Readings will be made when printed on approved 20 lb. white OCR bond with a reflectance of not less than 80%. Black ink must not have a reflectance greater than 15%. These readings are based on requirements of the "Scan-Optics Series 9000" Optical Scanner using Flint J-6983 red OCR dropout ink or an exact match.

2.1.9 Testers

The following testers and ranges are acceptable:

- MacBeth PCM-II. The tested Print Contrast Signal (PCS) values when using the MacBeth PCM-II tester on the "C" scale must range from .01 minimum to .06 maximum.
- Kidder 082A. The tested PCS values when using the Kidder 082A tester on the Infra Red (IR) scale must range from .12 minimum to .21 maximum. White calibration disc must be 100%; sensitivity must be set at one (1).
- Alternative testers. Alternative testers must be approved by the Government so that tested PCS values can be established. You may obtain approval by writing to the following address:

  Commissioner of Internal Revenue
  Attn: OP:FS:M:T:M Room 1225
  Tax Products
  1111 Constitution Avenue, NW
  Washington, DC 20224

2.1.10 Typography

Type must be substantially identical in size and shape to the official form. All rules are either ½-point or ¾-point. Rules must be identical to that on the official IRS form.

Note: *The form identifying number must be nonreflective carbon-based black ink in OCR A font.*

2.1.11 Dimensions

Three Forms 1098, 1099, or 5498 (Copy A) are contained on a single page, 8 inches wide (without any snap-stubs and/or pinfeed holes) by 11 inches deep.

Exception. Form 1099-R contains two documents per page.

There is a .33 inch top margin from the top of the corrected box, and a .25 inch right margin. There is a 1/32" (0.0313") tolerance for the right margin. If the right and top margins are properly aligned, the left margin for all forms will be correct. All margins must be free of print. See Exhibits A through T in this publication for the correct form measurements.

These measurements are constant for all Forms 1098, 1099, and 5498. These measurements are shown only once in this publication, on Form 1098 (Exhibit B). Exceptions to these measurements are shown on the rest of the exhibits.

The depth of the individual trim size of each form on a page must be 3⅔ inches, the same depth as the official form.

Exception. The depth of Form 1099-R is 5½ inches.

2.1.12 Other Specifications

The words "For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G"** *must* be printed on Copy A; **"For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G"** *must* be printed on Form 1096.

2.1.13 Perforation

Copy A (three per page; two per page for Form 1099-R) of privately printed continuous substitute forms must be perforated at each 11" page depth. No perforations are allowed between the 3⅔" forms (5½" for Form 1099-R) on a single copy page of Copy A.

The words "Do NOT Cut or Separate Forms on This Page" must be printed in red dropout ink (as required by form specifications) between the three forms (two for Form 1099-R).

Note: *Perforations are required between all the other individual copies (Copies B and C, and Copies 1 and 2 for Form 1099-R and Form 1099-MISC, and Copy D for Form 1099-R) included in the set.*

2.1.14 What To Include

You must include the OMB Number on Copies A and Form 1096 in the same location as on the official form.

Printer's symbol — The GPO symbol must not be printed on substitute Copy A. Instead, the employer identification number (EIN) of the forms printer must be entered in the bottom margin on the face of each individual form of Copy A, or the bottom margin on the reverse side of each Form 1096.

A postal indicia may be used if it meets the following criteria:
- It is printed in the OCR ink color prescribed for the form, and
- No part of the indicia is within one print position of the scannable area.

The Catalog Number (Cat. No.) shown on the 1999 forms is used for IRS distribution purposes and need not be printed on any substitute forms.

The form **must not** contain the statement "IRS approved" or any similar statement.

Part 3

Specifications for Substitute Form W-2G To Be Filed With the IRS

Section 3.1 – General

3.1.1 Purpose

The following specifications give the format requirements for Form W-2G **(Copy A only).**

A filer may use a substitute Form W-2G to file with the IRS (referred to as "substitute Copy A"). The substitute form must be an exact replica of the official form with respect to layout and content.

Section 3.2 – Specifications for Copy A of Form W-2G

3.2.1 Substitute Form W-2G (Copy A)

You must follow these specifications when printing substitute Copy A of Form W-2G.

Item	Substitute Form W-2G (Copy A)
Paper Color and Quality	Paper for Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 × 22-500), plus or minus 5 percent. The paper must consist substantially of bleached chemical wood pulp. It must be free from unbleached or ground wood pulp or post-consumer recycled paper. It also must be suitably sized to accept ink without feathering.
Ink Color and Quality	All printing must be in a high quality nongloss black ink.
Typography	The type must be substantially identical in size and shape to the official form. All rules on the document are either ½ point (.007 inch), 1 point (0.015 inch), or 3 point (0.045). Vertical rules must be parallel to the left edge of the document, horizontal rules to the top edge.
Dimensions	The official form is 8 inches wide × 3 ⅔ inches deep, exclusive of a ⅔ inch snap stub on the left side of the form. Any substitute Copy A must be the same dimensions. The snap feature is not required on substitutes. All margins must be free of print. The top and right margins must be ¼ inch plus or minus .0313. If the top and right margins are properly aligned, the left margin for all forms will be correct. If the substitute forms are in continuous or strip form, they must be burst and stripped to conform to the size specified for a single form.
Hot Wax and Cold Carbon Spots	Hot wax and cold carbon spots are not permitted on any of the internal form plies. These spots are permitted on the back of a mailer top envelope ply. Interleaved carbons, if used, should be black and of good quality to avoid smudging.
Printer's Symbol	The Government Printing Office (GPO) symbol must not be printed on substitute Forms W-2G. Instead, the employer identification number (EIN) of the forms printer must be printed in the bottom margin on the face of each individual Copy A on a sheet. The form must not contain the statement "IRS approved" or any similar statement.
Catalog Number	The Catalog Number (Cat. No.) shown on Form W-2G is used for IRS distribution purposes and need not be printed on any substitute forms.

Part 4

Additional Instructions for Substitute Forms 1098, 1099, 5498, and W-2G

Section 4.1 - Copies B, C, D, 1, and 2

4.1.1 Miscellaneous Instructions

The following table gives additional instructions concerning copies B, C, D, 1, and 2 of the forms.

Item	Instructions
Copies	Copies B, C, and in some cases, D, 1, and 2 are included in the official assembly for the convenience of the filer. You are not required to include all these copies with the privately printed substitute forms. Copies B and, in some cases, C will satisfy the requirement of the law and regulations to provide the statement of information to the form recipient. **Note:** *If an amount of Federal income tax withheld is shown on Form 1099-R or W-2G, Copy B (to be attached to the tax return) and Copy C must be furnished to the recipient. Copy D (Forms 1099-R and W-2G) may be used for filer records. Only Copy A should be filed with the IRS.*
Arrangement of Assembly	The parts of the assembly must be arranged, from top to bottom, as follows: • All forms—Copy A "For Internal Revenue Service Center." • Form 1098—Copy B "For Payer"; Copy C "For Recipient." • Form 1098-E—Copy B "For Borrower"; Copy C "For Recipient." • Form 1098-T—Copy B "For Student"; Copy C "For Filer." • Form 1099-A—Copy B "For Borrower"; Copy C "For Lender." • Forms 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MSA, 1099-OID, and 1099-PATR—Copy B "For Recipient"; Copy C "For Payer." • From Form 1099-C—Copy B "For Debtor"; Copy C "For Creditor." • Form 1099-LTC—Copy B "For Policyholder"; Copy C "For Insured"; and Copy D "For Payer." • Form 1099-MISC—Copy 1 "For State Tax Department"; Copy B "For Recipient"; Copy 2 "To be filed with recipient's state income tax return, when required"; and Copy C "For Payer." • Form 1099-R—Copy 1 "For State, City, or Local Tax Department"; Copy B "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return"; Copy C "For Recipient's Records"; Copy 2 "File this copy with your state, city, or local income tax return, when required"; Copy D "For Payer." • Form 1099-S—Copy B "For Transferor"; Copy C "For Filer." • Form 5498—Copy B "For Participant"; Copy C "For Trustee or Issuer." • Form 5498-MSA—Copy B "For Participant"; Copy C "For Trustee." • Form W-2G—Copy 1 "For State Tax Department"; Copy B "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 2, attach this copy to your return"; Copy C "For Winner's Records"; Copy 2 "Attach this copy to your state income tax return, if required."; Copy D "For Payer."
Perforations	Perforations are required between forms on all copies except Copy A to make separating the forms easier. Copy A of Form W-2G may be perforated.

Section 4.2 - OMB Requirements

4.2.1 OMB Requirements

Official Office of Management and Budget (OMB) numbers are shown on official IRS printed forms, and are also shown on the forms in the exhibits.

Public Law 96-511 requires that:

- The OMB approve IRS tax forms.
- Each form show the OMB approval number in the upper right corner. (The official OMB numbers may be found on the official IRS printed forms and are also shown on the forms in the exhibits in Part 5.)
- The form (or its instructions) state:
  1. Why the IRS is collecting the information,
  2. How it will be used, and
  3. Whether it must be given to the IRS.

  (Any substitute IRS forms or instructions must also contain this information.)

4.2.2 Substitute Form Requirements

The OMB requirements for substitute IRS forms are:

- Any substitute form or substitute statement to recipient must show the OMB number as it appears on the official IRS form.
- For Copy A, the OMB number must appear exactly as shown on the official IRS form.
- For any copy other than Copy A, the OMB number must use one of the following formats.
  1. OMB No. XXXX-XXXX (preferred) or
  2. OMB # XXXX-XXXX
- All substitute forms (**Copy A only**) must state "For Privacy Act and Paperwork Reduction Act Notice, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G."

Section 4.3 – Reproducible Copies

4.3.1 Introduction

The IRS does not take orders for reproducible and information copies of Federal tax materials. However, other ways to get Federal tax material include:

- The Internet.
- CD-ROM.
- GPO Superintendent of Documents Bookstores.

Forms 1096, 1098, 1099 series, and 5498 series are provided electronically on the IRS home page and on the Federal Tax Forms CD-ROM, but cannot be used for filing with the IRS when printed from a conventional printer. These forms contain drop-out ink requirements as described in Part 2 of this publication.

4.3.2 Internet

You can download tax materials from the Internet.

You Can Access the Internet by...	Using...
File Transfer Protocol (FTP)	ftp.irs.gov
World Wide Web	www.irs.gov

4.3.3 IRS Federal Tax Forms CD-ROM

The IRS also offers an alternative to downloading electronic files and provides current and prior-year access to tax forms and instructions through its Federal Tax Forms CD-ROM. The CD will be available for the upcoming filing season. Order **Pub. 1796,** Federal Tax Products on CD-ROM, by either:

- Calling the National Technical Information Service (NTIS) at **1-877-233-6767** toll free,
- Using the IRS's Internet Web Site at **www.irs.gov/cdorders,** or
- Faxing at **703-605-6900.**

4.3.4 GPO Supt. of Documents Bookstores

The Government Printing Office (GPO) Superintendent of Documents Bookstores also sell individual copies of tax forms, instructions, and publications. Call **202-512-1800** to find the bookstore nearest you.

Section 4.4 – Effect on Other Revenue Procedures

4.4.1 Other Revenue Procedures

Revenue Procedure 98–37, 1998–26 I.R.B. 6, which provides rules and specifications for private printing of 1998 substitute forms and statements to recipients, is superseded.

Part 5

Exhibits

Section 5.1 – Exhibits of Forms in the Revenue Procedure

5.1.1 Purpose

Exhibits A through T illustrate some of the specifications that were discussed earlier in this revenue procedure. The dimensions apply to the actual size forms, but the exhibits have been reduced in size.

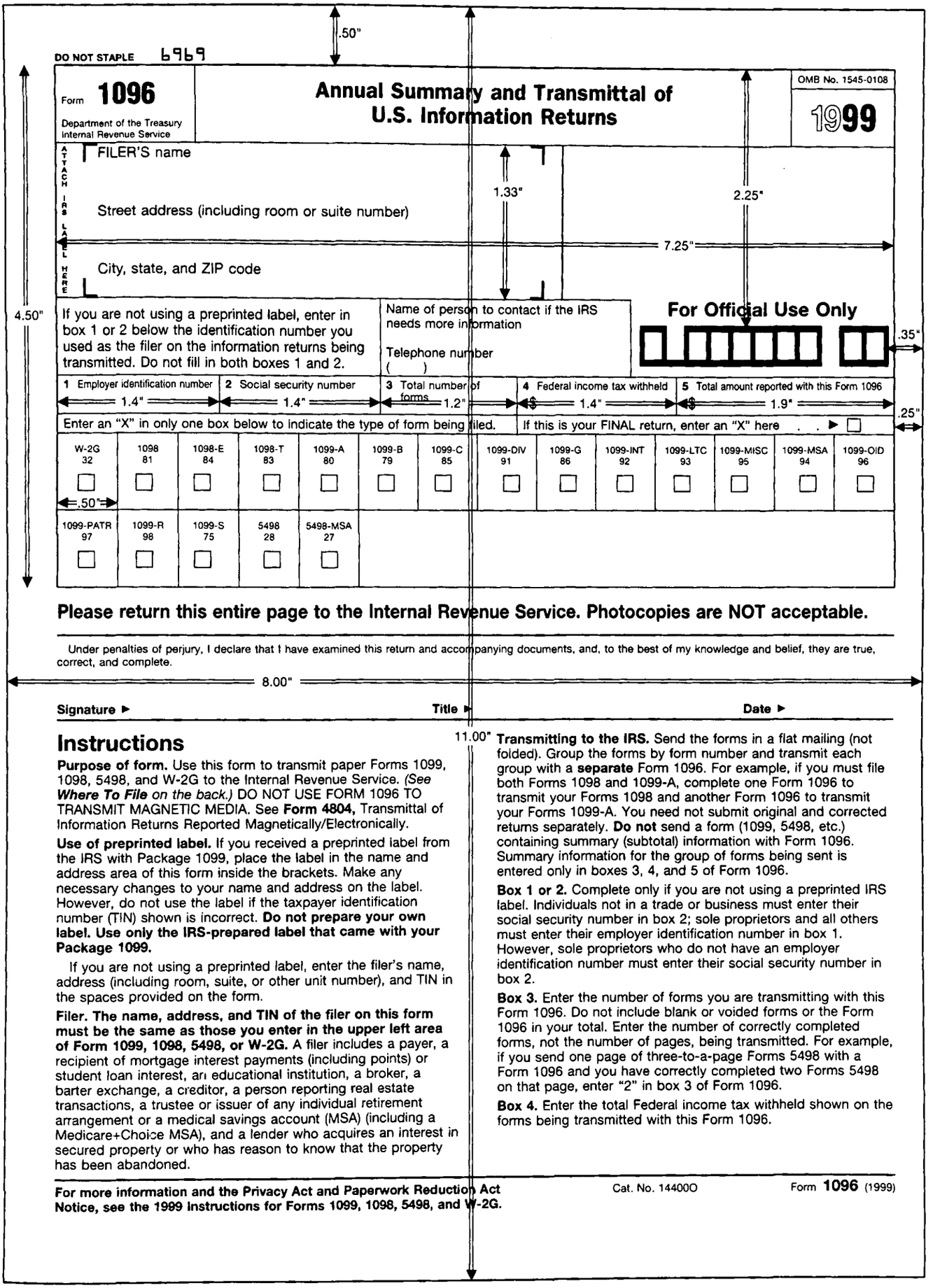
Generally, the illustrated dimensions apply to all like forms. For example, Exhibit B shows 11.00" from the top edge to the bottom edge of Form 1098 and .85" between the bottom rule of the top form and the top rule of the second form on the page. These dimensions apply to all forms that are printed three to a page.

5.1.2 Guidelines

Keep in mind the following guidelines when printing substitute forms.

- Closely follow the specifications to avoid delays in processing the forms.
- Always use the specifications as outlined in this revenue procedure and illustrated in the exhibits.
- Do not add the text line "Do NOT Cut or Separate Forms on This Page" to the bottom form. This will cause inconsistency with the specifications.

Exhibit A



DO NOT STAPLE 6969

Form **1096**
Department of the Treasury
Internal Revenue Service

Annual Summary and Transmittal of U.S. Information Returns

OMB No. 1545-0108

1999

ATTACH IRS LABEL HERE

FILER'S name

Street address (including room or suite number)

City, state, and ZIP code

If you are not using a preprinted label, enter in box 1 or 2 below the identification number you used as the filer on the information returns being transmitted. Do not fill in both boxes 1 and 2.

Name of person to contact if the IRS needs more information

Telephone number ( )

For Official Use Only

1 Employer identification number	2 Social security number	3 Total number of forms	4 Federal income tax withheld	5 Total amount reported with this Form 1096
			$	$

Enter an "X" in only one box below to indicate the type of form being filed. If this is your FINAL return, enter an "X" here . . ▶ ☐

W-2G 32	1098 81	1098-E 84	1098-T 83	1099-A 80	1099-B 79	1099-C 85	1099-DIV 91	1099-G 86	1099-INT 92	1099-LTC 93	1099-MISC 95	1099-MSA 94	1099-OID 96
☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

1099-PATR 97	1099-R 98	1099-S 75	5498 28	5498-MSA 27
☐	☐	☐	☐	☐

Please return this entire page to the Internal Revenue Service. Photocopies are NOT acceptable.

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.

Signature ▶ **Title ▶** **Date ▶**

Instructions

Purpose of form. Use this form to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. *(See **Where To File** on the back.)* DO NOT USE FORM 1096 TO TRANSMIT MAGNETIC MEDIA. See **Form 4804,** Transmittal of Information Returns Reported Magnetically/Electronically.

Use of preprinted label. If you received a preprinted label from the IRS with Package 1099, place the label in the name and address area of this form inside the brackets. Make any necessary changes to your name and address on the label. However, do not use the label if the taxpayer identification number (TIN) shown is incorrect. **Do not prepare your own label. Use only the IRS-prepared label that came with your Package 1099.**

If you are not using a preprinted label, enter the filer's name, address (including room, suite, or other unit number), and TIN in the spaces provided on the form.

Filer. The name, address, and TIN of the filer on this form must be the same as those you enter in the upper left area of Form 1099, 1098, 5498, or W-2G. A filer includes a payer, a recipient of mortgage interest payments (including points) or student loan interest, an educational institution, a broker, a barter exchange, a creditor, a person reporting real estate transactions, a trustee or issuer of any individual retirement arrangement or a medical savings account (MSA) (including a Medicare+Choice MSA), and a lender who acquires an interest in secured property or who has reason to know that the property has been abandoned.

Transmitting to the IRS. Send the forms in a flat mailing (not folded). Group the forms by form number and transmit each group with a **separate** Form 1096. For example, if you must file both Forms 1098 and 1099-A, complete one Form 1096 to transmit your Forms 1098 and another Form 1096 to transmit your Forms 1099-A. You need not submit original and corrected returns separately. **Do not** send a form (1099, 5498, etc.) containing summary (subtotal) information with Form 1096. Summary information for the group of forms being sent is entered only in boxes 3, 4, and 5 of Form 1096.

Box 1 or 2. Complete only if you are not using a preprinted IRS label. Individuals not in a trade or business must enter their social security number in box 2; sole proprietors and all others must enter their employer identification number in box 1. However, sole proprietors who do not have an employer identification number must enter their social security number in box 2.

Box 3. Enter the number of forms you are transmitting with this Form 1096. Do not include blank or voided forms or the Form 1096 in your total. Enter the number of correctly completed forms, not the number of pages, being transmitted. For example, if you send one page of three-to-a-page Forms 5498 with a Form 1096 and you have correctly completed two Forms 5498 on that page, enter "2" in box 3 of Form 1096.

Box 4. Enter the total Federal income tax withheld shown on the forms being transmitted with this Form 1096.

For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.

Cat. No. 14400O

Form **1096** (1999)

Exhibit B

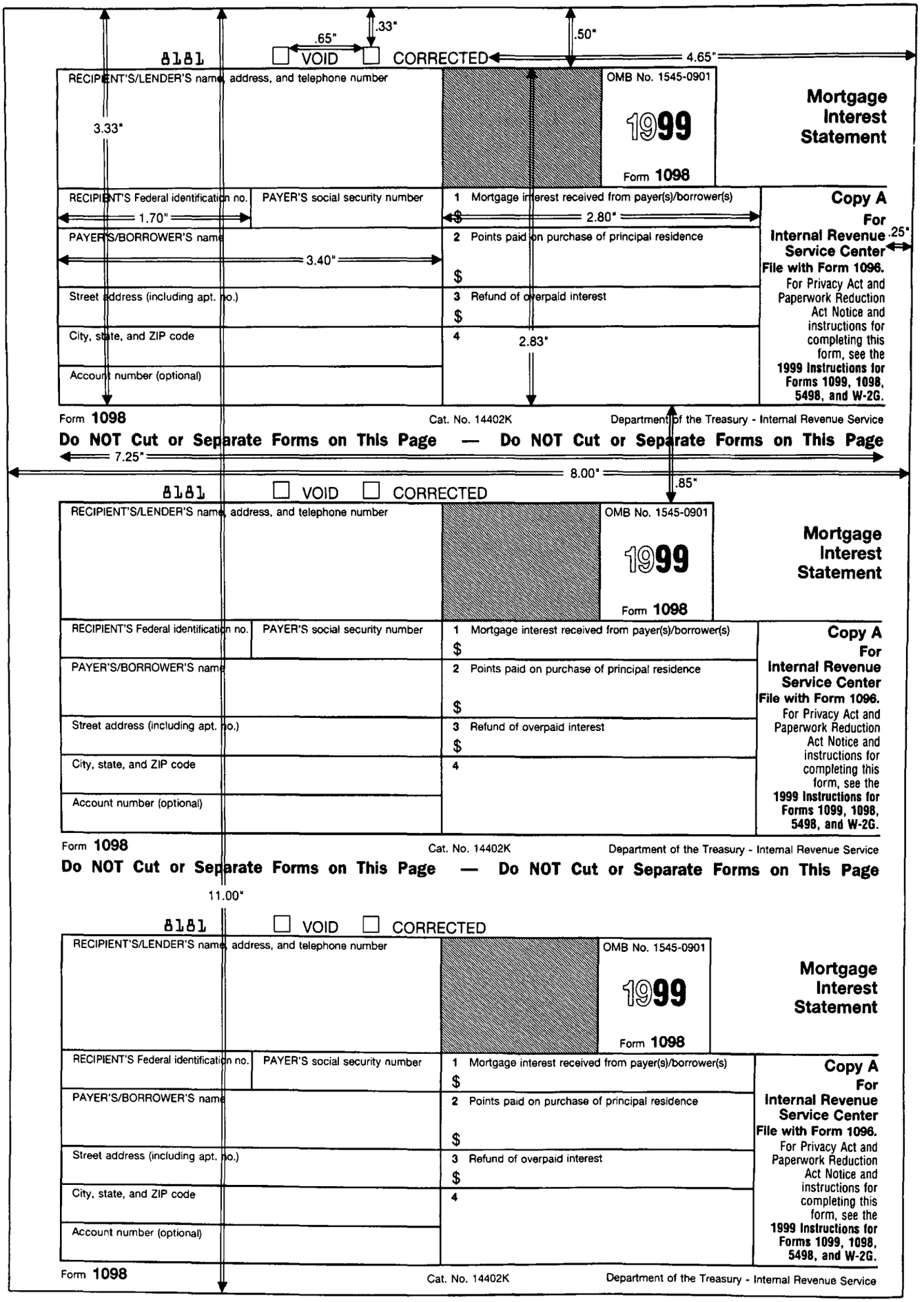

8181
VOID
CORRECTED
.65"
.33"
.50"
4.65"
3.33"
RECIPIENT'S/LENDER'S name, address, and telephone number
OMB No. 1545-0901
1999
Form 1098
Mortgage Interest Statement
RECIPIENT'S Federal identification no.
PAYER'S social security number
1.70"
1 Mortgage interest received from payer(s)/borrower(s)
$
2.80"
PAYER'S/BORROWER'S name
3.40"
2 Points paid on purchase of principal residence
$
Street address (including apt. no.)
3 Refund of overpaid interest
$
City, state, and ZIP code
4
2.83"
Account number (optional)
Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
.25"
Form 1098
Cat. No. 14402K
Department of the Treasury - Internal Revenue Service
Do NOT Cut or Separate Forms on This Page — Do NOT Cut or Separate Forms on This Page
7.25"
8.00"
.85"
11.00"

Exhibit C

8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 **1999** Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S Federal identification no.	BORROWER'S social security number	1 Student loan interest received $ 2.80"	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name 3.40"		2.83"	
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (optional)			

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

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8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 **1999** Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S Federal identification no.	BORROWER'S social security number	1 Student loan interest received $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name			
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (optional)			

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

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8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 **1999** Form **1098-E**	**Student Loan Interest Statement**
RECIPIENT'S Federal identification no.	BORROWER'S social security number	1 Student loan interest received $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
BORROWER'S name			
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (optional)			

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

Exhibit D

8383 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number	1	OMB No. 1545-1574	**Tuition Payments Statement**
	2	**1999**	
	1.4"	Form **1098-T**	
FILER'S Federal identification no. / STUDENT'S social security number			**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
STUDENT'S name (3.40")			
Street address (including apt. no.)			
City, state, and ZIP code (2.80")			
Account number (optional)	3 Check if at least half-time student . ☐	4 Check if a graduate student . . . ☐	

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

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8383 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number	1	OMB No. 1545-1574	**Tuition Payments Statement**
	2	**1999**	
		Form **1098-T**	
FILER'S Federal identification no. / STUDENT'S social security number			**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
STUDENT'S name			
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (optional)	3 Check if at least half-time student . ☐	4 Check if a graduate student . . . ☐	

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

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8383 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone number	1	OMB No. 1545-1574	**Tuition Payments Statement**
	2	**1999**	
		Form **1098-T**	
FILER'S Federal identification no. / STUDENT'S social security number			**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
STUDENT'S name			
Street address (including apt. no.)			
City, state, and ZIP code			
Account number (optional)	3 Check if at least half-time student . ☐	4 Check if a graduate student . . . ☐	

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

Exhibit E

8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city, state, ZIP code, and telephone no.		OMB No. 1545-0877 1999 Form 1099-A **Acquisition or Abandonment of Secured Property**
LENDER'S Federal identification number / BORROWER'S identification number	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $
BORROWER'S name	3	4 Fair market value of property $
Street address (including apt. no.)	5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No	
City, state, and ZIP code	6 Description of property	
Account number (optional)		

Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

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8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city, state, ZIP code, and telephone no.		OMB No. 1545-0877 1999 Form 1099-A **Acquisition or Abandonment of Secured Property**
LENDER'S Federal identification number / BORROWER'S identification number	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $
BORROWER'S name	3	4 Fair market value of property $
Street address (including apt. no.)	5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No	
City, state, and ZIP code	6 Description of property	
Account number (optional)		

Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

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8080 ☐ VOID ☐ CORRECTED

LENDER'S name, street address, city, state, ZIP code, and telephone no.		OMB No. 1545-0877 1999 Form 1099-A **Acquisition or Abandonment of Secured Property**
LENDER'S Federal identification number / BORROWER'S identification number	1 Date of lender's acquisition or knowledge of abandonment	2 Balance of principal outstanding $
BORROWER'S name	3	4 Fair market value of property $
Street address (including apt. no.)	5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No	
City, state, and ZIP code	6 Description of property	
Account number (optional)		

Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

Exhibit F

7979 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1a Date of sale	OMB No. 1545-0715 **1999** Form **1099-B**	**Proceeds From Broker and Barter Exchange Transactions**
	1b CUSIP No.		
	2 Stocks, bonds, etc. $	Reported to IRS ☐ Gross proceeds ☐ Gross proceeds less commissions and option premiums	1.9"
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Bartering	4 Federal income tax withheld $	3.9"
RECIPIENT'S name	5 Description		**Copy A For Internal Revenue Service Center**
	Regulated Futures Contracts		**File with Form 1096.**
Street address (including apt. no.)	6 Profit or (loss) realized in 1999 $	7 Unrealized profit or (loss) on open contracts—12/31/98 $	1.4" / 1.4"
City, state, and ZIP code	8 Unrealized profit or (loss) on open contracts—12/31/99 $	9 Aggregate profit or (loss) $	4.1"
Account number (optional) 2.8" / 2nd TIN Not. ☐			For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**

Form **1099-B** .60" Cat. No. 14411V Department of the Treasury - Internal Revenue Service

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7979 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1a Date of sale	OMB No. 1545-0715 **1999** Form **1099-B**	**Proceeds From Broker and Barter Exchange Transactions**
	1b CUSIP No.		
	2 Stocks, bonds, etc. $	Reported to IRS ☐ Gross proceeds ☐ Gross proceeds less commissions and option premiums	
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Bartering $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Description		**File with Form 1096.**
	Regulated Futures Contracts		For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	6 Profit or (loss) realized in 1999 $	7 Unrealized profit or (loss) on open contracts—12/31/98 $	
City, state, and ZIP code	8 Unrealized profit or (loss) on open contracts—12/31/99 $	9 Aggregate profit or (loss) $	
Account number (optional) / 2nd TIN Not. ☐			

Form **1099-B** Cat. No. 14411V Department of the Treasury - Internal Revenue Service

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7979 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1a Date of sale	OMB No. 1545-0715 **1999** Form **1099-B**	**Proceeds From Broker and Barter Exchange Transactions**
	1b CUSIP No.		
	2 Stocks, bonds, etc. $	Reported to IRS ☐ Gross proceeds ☐ Gross proceeds less commissions and option premiums	
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Bartering $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	5 Description		**File with Form 1096.**
	Regulated Futures Contracts		For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	6 Profit or (loss) realized in 1999 $	7 Unrealized profit or (loss) on open contracts—12/31/98 $	
City, state, and ZIP code	8 Unrealized profit or (loss) on open contracts—12/31/99 $	9 Aggregate profit or (loss) $	
Account number (optional) / 2nd TIN Not. ☐			

Form **1099-B** Cat. No. 14411V Department of the Treasury - Internal Revenue Service

Exhibit G

8585 ☐ VOID ☐ CORRECTED

CREDITOR'S name, street address, city, state, and ZIP code		OMB No. 1545-1424 1999 Form 1099-C	Cancellation of Debt
CREDITOR'S Federal identification number / DEBTOR'S identification number	1 Date canceled	2 Amount of debt canceled	Copy A For Internal Revenue Service Center File with Form 1096.
DEBTOR'S name	3 Interest if included in box 2 $	4	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)	5 Debt description		
City, state, and ZIP code			
Account number (optional)	6 Check for bankruptcy ☐	7 Fair market value of property $	

Form 1099-C Cat. No. 26280W Department of the Treasury - Internal Revenue Service

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8585 ☐ VOID ☐ CORRECTED

CREDITOR'S name, street address, city, state, and ZIP code		OMB No. 1545-1424 1999 Form 1099-C	Cancellation of Debt
CREDITOR'S Federal identification number / DEBTOR'S identification number	1 Date canceled	2 Amount of debt canceled	Copy A For Internal Revenue Service Center File with Form 1096.
DEBTOR'S name	3 Interest if included in box 2 $	4	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)	5 Debt description		
City, state, and ZIP code			
Account number (optional)	6 Check for bankruptcy ☐	7 Fair market value of property $	

Form 1099-C Cat. No. 26280W Department of the Treasury - Internal Revenue Service

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8585 ☐ VOID ☐ CORRECTED

CREDITOR'S name, street address, city, state, and ZIP code		OMB No. 1545-1424 1999 Form 1099-C	Cancellation of Debt
CREDITOR'S Federal identification number / DEBTOR'S identification number	1 Date canceled	2 Amount of debt canceled	Copy A For Internal Revenue Service Center File with Form 1096.
DEBTOR'S name	3 Interest if included in box 2 $	4	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)	5 Debt description		
City, state, and ZIP code			
Account number (optional)	6 Check for bankruptcy ☐	7 Fair market value of property $	

Form 1099-C Cat. No. 26280W Department of the Treasury - Internal Revenue Service

Exhibit H

9191 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Ordinary dividends $	OMB No. 1545-0110 **1999** Form **1099-DIV**	**Dividends and Distributions**
	2a Total capital gain distr. $ (1.4")		
PAYER'S Federal identification number / RECIPIENT'S identification number	2b 28% rate gain $	2c Unrecap. sec. 1250 gain $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	2d Section 1202 gain $	3 Nontaxable distributions $	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	4 Federal income tax withheld $	5 Investment expenses $	
City, state, and ZIP code	6 Foreign tax paid $	7 Foreign country or U.S. possession	
Account number (optional) (2.8") / 2nd TIN Not. ☐ (.60")	8 Cash liquidation distr. $	9 Noncash liquidation distr. $ (4.5")	

Form **1099-DIV** Cat. No. 14415N Department of the Treasury - Internal Revenue Service

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9191 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Ordinary dividends $	OMB No. 1545-0110 **1999** Form **1099-DIV**	**Dividends and Distributions**
	2a Total capital gain distr. $		
PAYER'S Federal identification number / RECIPIENT'S identification number	2b 28% rate gain $	2c Unrecap. sec. 1250 gain $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	2d Section 1202 gain $	3 Nontaxable distributions $	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	4 Federal income tax withheld $	5 Investment expenses $	
City, state, and ZIP code	6 Foreign tax paid $	7 Foreign country or U.S. possession	
Account number (optional) / 2nd TIN Not. ☐	8 Cash liquidation distr. $	9 Noncash liquidation distr. $	

Form **1099-DIV** Cat. No. 14415N Department of the Treasury - Internal Revenue Service

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9191 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Ordinary dividends $	OMB No. 1545-0110 **1999** Form **1099-DIV**	**Dividends and Distributions**
	2a Total capital gain distr. $		
PAYER'S Federal identification number / RECIPIENT'S identification number	2b 28% rate gain $	2c Unrecap. sec. 1250 gain $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	2d Section 1202 gain $	3 Nontaxable distributions $	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	4 Federal income tax withheld $	5 Investment expenses $	
City, state, and ZIP code	6 Foreign tax paid $	7 Foreign country or U.S. possession	
Account number (optional) / 2nd TIN Not. ☐	8 Cash liquidation distr. $	9 Noncash liquidation distr. $	

Form **1099-DIV** Cat. No. 14415N Department of the Treasury - Internal Revenue Service

Exhibit I

8686 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Unemployment compensation 1.4" $	OMB No. 1545-0120 1999 Form 1099-G	Certain Government and Qualified State Tuition Program Payments
	2 State or local income tax refunds, credits, or offsets $		
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction 1.15" ~~Act Notice and~~ instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	5 Qualified state tuition program earnings $	6 Taxable grants $	
Street address (including apt. no.)	7 Agriculture payments $	8 The amount in box 2 applies to income from a trade or business ▶ ☐	
City, state, and ZIP code			
Account number (optional)			

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

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8686 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Unemployment compensation $	OMB No. 1545-0120 1999 Form 1099-G	Certain Government and Qualified State Tuition Program Payments
	2 State or local income tax refunds, credits, or offsets $		
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	5 Qualified state tuition program earnings $	6 Taxable grants $	
Street address (including apt. no.)	7 Agriculture payments $	8 The amount in box 2 applies to income from a trade or business ▶ ☐	
City, state, and ZIP code			
Account number (optional)			

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

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8686 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Unemployment compensation $	OMB No. 1545-0120 1999 Form 1099-G	Certain Government and Qualified State Tuition Program Payments
	2 State or local income tax refunds, credits, or offsets $		
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	5 Qualified state tuition program earnings $	6 Taxable grants $	
Street address (including apt. no.)	7 Agriculture payments $	8 The amount in box 2 applies to income from a trade or business ▶ ☐	
City, state, and ZIP code			
Account number (optional)			

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

Exhibit J

9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional)	OMB No. 1545-0112 **1999** Form **1099-INT**	**Interest Income**

PAYER'S Federal identification number	RECIPIENT'S identification number	1 Interest income not included in box 3 $		**Copy A For Internal Revenue Service Center File with Form 1096.**
RECIPIENT'S name		2 Early withdrawal penalty $	3 Interest on U.S. Savings Bonds and Treas. obligations $	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)		4 Federal income tax withheld $	5 Investment expenses $	
City, state, and ZIP code		6 Foreign tax paid	7 Foreign country or U.S. possession	
Account number (optional)	2nd TIN Not. ☐	$		

2 8" 1.4" 4.1" .60"

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

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9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional)	OMB No. 1545-0112 **1999** Form **1099-INT**	**Interest Income**

PAYER'S Federal identification number	RECIPIENT'S identification number	1 Interest income not included in box 3 $		**Copy A For Internal Revenue Service Center File with Form 1096.**
RECIPIENT'S name		2 Early withdrawal penalty $	3 Interest on U.S. Savings Bonds and Treas. obligations $	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)		4 Federal income tax withheld $	5 Investment expenses $	
City, state, and ZIP code		6 Foreign tax paid	7 Foreign country or U.S. possession	
Account number (optional)	2nd TIN Not. ☐	$		

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

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9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional)	OMB No. 1545-0112 **1999** Form **1099-INT**	**Interest Income**

PAYER'S Federal identification number	RECIPIENT'S identification number	1 Interest income not included in box 3 $		**Copy A For Internal Revenue Service Center File with Form 1096.**
RECIPIENT'S name		2 Early withdrawal penalty $	3 Interest on U.S. Savings Bonds and Treas. obligations $	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)		4 Federal income tax withheld $	5 Investment expenses $	
City, state, and ZIP code		6 Foreign tax paid	7 Foreign country or U.S. possession	
Account number (optional)	2nd TIN Not. ☐	$		

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

Exhibit K

9393 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $	OMB No. 1545-1519	Long-Term Care and Accelerated Death Benefits
	2 Accelerated death benefits paid $	1999 Form 1099-LTC	

PAYER'S Federal identification number	POLICYHOLDER'S identification number	3 Check one: ☐ Per diem ☐ Reimbursed amount	INSURED'S social security no. 1.40"	Copy A For Internal Revenue Service Center
POLICYHOLDER'S name 3.40"		INSURED'S name		File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)		Street address (including apt. no.) 2.80"		
City, state, and ZIP code		City, state, and ZIP code		
Account number (optional)		4 (optional) ☐ Chronically ill ☐ Terminally ill	Date certified 1.0"	

Form 1099-LTC Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

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9393 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $	OMB No. 1545-1519	Long-Term Care and Accelerated Death Benefits
	2 Accelerated death benefits paid $	1999 Form 1099-LTC	

PAYER'S Federal identification number	POLICYHOLDER'S identification number	3 Check one: ☐ Per diem ☐ Reimbursed amount	INSURED'S social security no.	Copy A For Internal Revenue Service Center
POLICYHOLDER'S name		INSURED'S name		File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)		Street address (including apt. no.)		
City, state, and ZIP code		City, state, and ZIP code		
Account number (optional)		4 (optional) ☐ Chronically ill ☐ Terminally ill	Date certified	

Form 1099-LTC Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

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9393 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $	OMB No. 1545-1519	Long-Term Care and Accelerated Death Benefits
	2 Accelerated death benefits paid $	1999 Form 1099-LTC	

PAYER'S Federal identification number	POLICYHOLDER'S identification number	3 Check one: ☐ Per diem ☐ Reimbursed amount	INSURED'S social security no.	Copy A For Internal Revenue Service Center
POLICYHOLDER'S name		INSURED'S name		File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)		Street address (including apt. no.)		
City, state, and ZIP code		City, state, and ZIP code		
Account number (optional)		4 (optional) ☐ Chronically ill ☐ Terminally ill	Date certified	

Form 1099-LTC Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

Exhibit L

9595 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Rents $ (1.4")	OMB No. 1545-0115 **1999** Form **1099-MISC**	**Miscellaneous Income**
	2 Royalties $		
	3 Other income $		
PAYER'S Federal identification number / RECIPIENT'S identification number	4 Federal income tax withheld $	5 Fishing boat proceeds $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	6 Medical and health care payments $	7 Nonemployee compensation $	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	8 Substitute payments in lieu of dividends or interest $	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ► ☐	
City, state, and ZIP code	10 Crop insurance proceeds $	11 State income tax withheld $	
Account number (optional) (2.8") / 2nd TIN Not. ☐	12 State/Payer's state number	13 $ (4.1")	

Form **1099-MISC** (.60") Cat. No. 14425J Department of the Treasury - Internal Revenue Service

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9595 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Rents $	OMB No. 1545-0115 **1999** Form **1099-MISC**	**Miscellaneous Income**
	2 Royalties $		
	3 Other income $		
PAYER'S Federal identification number / RECIPIENT'S identification number	4 Federal income tax withheld $	5 Fishing boat proceeds $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	6 Medical and health care payments $	7 Nonemployee compensation $	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	8 Substitute payments in lieu of dividends or interest $	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ► ☐	
City, state, and ZIP code	10 Crop insurance proceeds $	11 State income tax withheld $	
Account number (optional) / 2nd TIN Not. ☐	12 State/Payer's state number	13 $	

Form **1099-MISC** Cat. No. 14425J Department of the Treasury - Internal Revenue Service

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9595 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Rents $	OMB No. 1545-0115 **1999** Form **1099-MISC**	**Miscellaneous Income**
	2 Royalties $		
	3 Other income $		
PAYER'S Federal identification number / RECIPIENT'S identification number	4 Federal income tax withheld $	5 Fishing boat proceeds $	**Copy A For Internal Revenue Service Center**
RECIPIENT'S name	6 Medical and health care payments $	7 Nonemployee compensation $	**File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
Street address (including apt. no.)	8 Substitute payments in lieu of dividends or interest $	9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ► ☐	
City, state, and ZIP code	10 Crop insurance proceeds $	11 State income tax withheld $	
Account number (optional) / 2nd TIN Not. ☐	12 State/Payer's state number	13 $	

Form **1099-MISC** Cat. No. 14425J Department of the Treasury - Internal Revenue Service

Exhibit M

9494 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		OMB No. 1545-1517 **1999** Form **1099-MSA**		**Distributions From an MSA or Medicare+Choice MSA**
PAYER'S Federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess contributions $	**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.)		5 Medicare+Choice MSA . . . . ☐		
City, state, and ZIP code				
Account number (optional)				

Form **1099-MSA** Cat. No. 23114L Department of the Treasury - Internal Revenue Service

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9494 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		OMB No. 1545-1517 **1999** Form **1099-MSA**		**Distributions From an MSA or Medicare+Choice MSA**
PAYER'S Federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess contributions $	**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.)		5 Medicare+Choice MSA . . . . ☐		
City, state, and ZIP code				
Account number (optional)				

Form **1099-MSA** Cat. No. 23114L Department of the Treasury - Internal Revenue Service

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9494 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		OMB No. 1545-1517 **1999** Form **1099-MSA**		**Distributions From an MSA or Medicare+Choice MSA**
PAYER'S Federal identification number	RECIPIENT'S identification number	1 Gross distribution $	2 Earnings on excess contributions $	**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		3 Distribution code	4 FMV on date of death $	
Street address (including apt. no.)		5 Medicare+Choice MSA . . . . ☐		
City, state, and ZIP code				
Account number (optional)				

Form **1099-MSA** Cat. No. 23114L Department of the Treasury - Internal Revenue Service

Exhibit N

9696 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Original issue discount for 1999 (1.4") $	OMB No. 1545-0117 **1999** Form **1099-OID**	**Original Issue Discount**
	2 Other periodic interest $		
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Early withdrawal penalty $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	5 Description		
Street address (including apt. no.)	6 Original issue discount on U.S. Treasury obligations $		
City, state, and ZIP code	7 Investment expenses $		
Account number (optional) (2.8")	2nd TIN Not. ☐	(4.1")	

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

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9696 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Original issue discount for 1999 $	OMB No. 1545-0117 **1999** Form **1099-OID**	**Original Issue Discount**
	2 Other periodic interest $		
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Early withdrawal penalty $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	5 Description		
Street address (including apt. no.)	6 Original issue discount on U.S. Treasury obligations $		
City, state, and ZIP code	7 Investment expenses $		
Account number (optional)	2nd TIN Not. ☐		

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

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9696 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Original issue discount for 1999 $	OMB No. 1545-0117 **1999** Form **1099-OID**	**Original Issue Discount**
	2 Other periodic interest $		
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Early withdrawal penalty $	4 Federal income tax withheld $	**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name	5 Description		
Street address (including apt. no.)	6 Original issue discount on U.S. Treasury obligations $		
City, state, and ZIP code	7 Investment expenses $		
Account number (optional)	2nd TIN Not. ☐		

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

Exhibit O

9797 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Patronage dividends $ (1.4")	OMB No. 1545-0118	Taxable Distributions Received From Cooperatives
	2 Nonpatronage distributions $	1999	
	3 Per-unit retain allocations $	Form 1099-PATR	
PAYER'S Federal identification number / RECIPIENT'S identification number	4 Federal income tax withheld $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	5 Redemption of nonqualified notices and retain allocations $		
Street address (including apt. no.)	6 $	7 Investment credit $	
City, state, and ZIP code	8 Work opportunity credit $	9 Patron's AMT adjustment $	
Account number (optional) (2.8") / 2nd TIN Not. ☐	(4.1")		

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

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9797 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Patronage dividends $	OMB No. 1545-0118	Taxable Distributions Received From Cooperatives
	2 Nonpatronage distributions $	1999	
	3 Per-unit retain allocations $	Form 1099-PATR	
PAYER'S Federal identification number / RECIPIENT'S identification number	4 Federal income tax withheld $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	5 Redemption of nonqualified notices and retain allocations $		
Street address (including apt. no.)	6 $	7 Investment credit $	
City, state, and ZIP code	8 Work opportunity credit $	9 Patron's AMT adjustment $	
Account number (optional) / 2nd TIN Not. ☐			

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

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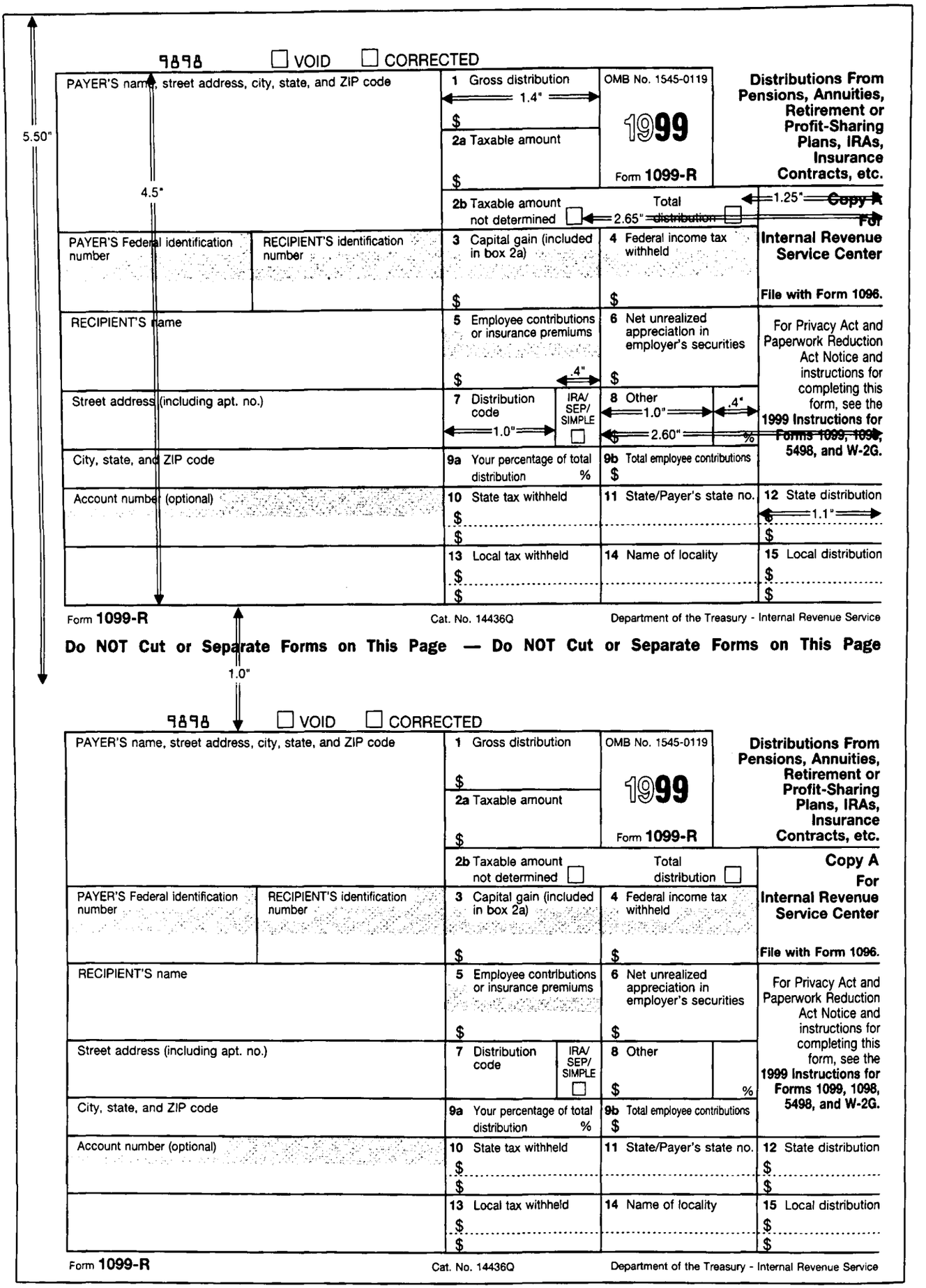
9797 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Patronage dividends $	OMB No. 1545-0118	Taxable Distributions Received From Cooperatives
	2 Nonpatronage distributions $	1999	
	3 Per-unit retain allocations $	Form 1099-PATR	
PAYER'S Federal identification number / RECIPIENT'S identification number	4 Federal income tax withheld $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	5 Redemption of nonqualified notices and retain allocations $		
Street address (including apt. no.)	6 $	7 Investment credit $	
City, state, and ZIP code	8 Work opportunity credit $	9 Patron's AMT adjustment $	
Account number (optional) / 2nd TIN Not. ☐			

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

Exhibit P



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9898 ☐ VOID ☐ CORRECTED
PAYER'S name, street address, city, state, and ZIP code
1 Gross distribution
OMB No. 1545-0119
1999
Form 1099-R
Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
2a Taxable amount
2b Taxable amount not determined
Total distribution
Copy A For Internal Revenue Service Center
File with Form 1096.
PAYER'S Federal identification number
RECIPIENT'S identification number
3 Capital gain (included in box 2a)
4 Federal income tax withheld
RECIPIENT'S name
5 Employee contributions or insurance premiums
6 Net unrealized appreciation in employer's securities
For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)
7 Distribution code
IRA/ SEP/ SIMPLE
8 Other
City, state, and ZIP code
9a Your percentage of total distribution %
9b Total employee contributions
Account number (optional)
10 State tax withheld
11 State/Payer's state no.
12 State distribution
13 Local tax withheld
14 Name of locality
15 Local distribution
Form 1099-R
Cat. No. 14436Q
Department of the Treasury - Internal Revenue Service

Exhibit Q

7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone no.	1 Date of closing 1.4"	OMB No. 1545-0997 1999	**Proceeds From Real Estate Transactions**
	2 Gross proceeds $	Form 1099-S	
FILER'S Federal identification number (1.7") | TRANSFEROR'S identification number (1.7")	3 Address or legal description (including city, state, and ZIP code) (2.8")		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
TRANSFEROR'S name			
Street address (including apt. no.)			
City, state, and ZIP code	4 Check here if the transferor received or will receive property or services as part of the consideration. ▶ ☐ (1.15")		
Account number (optional)	5 Buyer's part of real estate tax $		

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

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7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone no.	1 Date of closing	OMB No. 1545-0997 1999	**Proceeds From Real Estate Transactions**
	2 Gross proceeds $	Form 1099-S	
FILER'S Federal identification number | TRANSFEROR'S identification number	3 Address or legal description (including city, state, and ZIP code)		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
TRANSFEROR'S name			
Street address (including apt. no.)			
City, state, and ZIP code	4 Check here if the transferor received or will receive property or services as part of the consideration. ▶ ☐		
Account number (optional)	5 Buyer's part of real estate tax $		

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

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7575 ☐ VOID ☐ CORRECTED

FILER'S name, street address, city, state, ZIP code, and telephone no.	1 Date of closing	OMB No. 1545-0997 1999	**Proceeds From Real Estate Transactions**
	2 Gross proceeds $	Form 1099-S	
FILER'S Federal identification number | TRANSFEROR'S identification number	3 Address or legal description (including city, state, and ZIP code)		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
TRANSFEROR'S name			
Street address (including apt. no.)			
City, state, and ZIP code	4 Check here if the transferor received or will receive property or services as part of the consideration. ▶ ☐		
Account number (optional)	5 Buyer's part of real estate tax $		

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

Exhibit R

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 IRA contributions (other than amounts in boxes 2, 3, and 7–10) $	OMB No. 1545-0747 **1999** Form **5498**	**IRA Contribution Information**
	2 Rollover contributions $		
TRUSTEE'S or ISSUER'S Federal identification no. / PARTICIPANT'S social security number	3 Roth conversion amount $		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name	4 Fair market value of account $	5 Life insurance cost included in box 1 $	
Street address (including apt. no.)	6 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐ Rechar. ☐ Ed IRA ☐		
City, state, and ZIP code	7 SEP contributions $	8 SIMPLE contributions $	
Account number (optional)	9 Roth IRA contributions $	10 Ed IRA contributions $	

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 IRA contributions (other than amounts in boxes 2, 3, and 7–10) $	OMB No. 1545-0747 **1999** Form **5498**	**IRA Contribution Information**
	2 Rollover contributions $		
TRUSTEE'S or ISSUER'S Federal identification no. / PARTICIPANT'S social security number	3 Roth conversion amount $		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name	4 Fair market value of account $	5 Life insurance cost included in box 1 $	
Street address (including apt. no.)	6 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐ Rechar. ☐ Ed IRA ☐		
City, state, and ZIP code	7 SEP contributions $	8 SIMPLE contributions $	
Account number (optional)	9 Roth IRA contributions $	10 Ed IRA contributions $	

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 IRA contributions (other than amounts in boxes 2, 3, and 7–10) $	OMB No. 1545-0747 **1999** Form **5498**	**IRA Contribution Information**
	2 Rollover contributions $		
TRUSTEE'S or ISSUER'S Federal identification no. / PARTICIPANT'S social security number	3 Roth conversion amount $		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name	4 Fair market value of account $	5 Life insurance cost included in box 1 $	
Street address (including apt. no.)	6 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐ Rechar. ☐ Ed IRA ☐		
City, state, and ZIP code	7 SEP contributions $	8 SIMPLE contributions $	
Account number (optional)	9 Roth IRA contributions $	10 Ed IRA contributions $	

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

Exhibit S

2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code	1 Employee or self-employed person's MSA contributions made in 1999 and 2000 for 1999 $	OMB No. 1545-1518 1999 Form 5498-MSA	MSA or Medicare+Choice MSA Information
	2 Total contributions made in 1999 $ (1.4")		
TRUSTEE'S Federal identification number / PARTICIPANT'S social security number	3 Total MSA contributions made in 2000 for 1999 $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name (3.40")	4 Rollover contributions $	5 Fair market value of MSA or M+C MSA $	
Street address (including apt. no.)	6 Medicare+Choice MSA . . . . ☐		
City, state, and ZIP code			
Account number (optional)			

Form **5498-MSA** Cat. No. 23097L Department of the Treasury - Internal Revenue Service

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2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code	1 Employee or self-employed person's MSA contributions made in 1999 and 2000 for 1999 $	OMB No. 1545-1518 1999 Form 5498-MSA	MSA or Medicare+Choice MSA Information
	2 Total contributions made in 1999 $		
TRUSTEE'S Federal identification number / PARTICIPANT'S social security number	3 Total MSA contributions made in 2000 for 1999 $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name	4 Rollover contributions $	5 Fair market value of MSA or M+C MSA $	
Street address (including apt. no.)	6 Medicare+Choice MSA . . . . ☐		
City, state, and ZIP code			
Account number (optional)			

Form **5498-MSA** Cat. No. 23097L Department of the Treasury - Internal Revenue Service

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2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code	1 Employee or self-employed person's MSA contributions made in 1999 and 2000 for 1999 $	OMB No. 1545-1518 1999 Form 5498-MSA	MSA or Medicare+Choice MSA Information
	2 Total contributions made in 1999 $		
TRUSTEE'S Federal identification number / PARTICIPANT'S social security number	3 Total MSA contributions made in 2000 for 1999 $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name	4 Rollover contributions $	5 Fair market value of MSA or M+C MSA $	
Street address (including apt. no.)	6 Medicare+Choice MSA . . . . ☐		
City, state, and ZIP code			
Account number (optional)			

Form **5498-MSA** Cat. No. 23097L Department of the Treasury - Internal Revenue Service

Exhibit T

3232 ☐ CORRECTED

PAYER'S name	1 Gross winnings (1.45")	2 Federal income tax withheld (1.45")	OMB No. 1545-0238
Street address (3.0")	3 Type of wager	4 Date won	**1999** **Form W-2G** **Certain Gambling Winnings**
City, state, and ZIP code	5 Transaction	6 Race	
Federal identification number / Telephone number	7 Winnings from identical wagers	8 Cashier	(1.4") For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.** **File with Form 1096.**
WINNER'S name (2.8")	9 Winner's taxpayer identification no.	10 Window	
Street address (including apt. no.)	11 First I.D.	12 Second I.D.	
City, state, and ZIP code	13 State/Payer's state identification no.	14 State income tax withheld	
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments. **Signature ►** **Date ►**			**Copy A For Internal Revenue Service Center**

Form **W-2G** Cat. No. 10138V Department of the Treasury - Internal Revenue Service

3232 ☐ CORRECTED

PAYER'S name	1 Gross winnings	2 Federal income tax withheld	OMB No. 1545-0238
Street address	3 Type of wager	4 Date won	**1999** **Form W-2G** **Certain Gambling Winnings**
City, state, and ZIP code	5 Transaction	6 Race	
Federal identification number / Telephone number	7 Winnings from identical wagers	8 Cashier	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.** **File with Form 1096.**
WINNER'S name	9 Winner's taxpayer identification no.	10 Window	
Street address (including apt. no.)	11 First I.D.	12 Second I.D.	
City, state, and ZIP code	13 State/Payer's state identification no.	14 State income tax withheld	
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments. **Signature ►** **Date ►**			**Copy A For Internal Revenue Service Center**

Form **W-2G** Cat. No. 10138V Department of the Treasury - Internal Revenue Service

3232 ☐ CORRECTED

PAYER'S name	1 Gross winnings	2 Federal income tax withheld	OMB No. 1545-0238
Street address	3 Type of wager	4 Date won	**1999** **Form W-2G** **Certain Gambling Winnings**
City, state, and ZIP code	5 Transaction	6 Race	
Federal identification number / Telephone number	7 Winnings from identical wagers	8 Cashier	For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.** **File with Form 1096.**
WINNER'S name	9 Winner's taxpayer identification no.	10 Window	
Street address (including apt. no.)	11 First I.D.	12 Second I.D.	
City, state, and ZIP code	13 State/Payer's state identification no.	14 State income tax withheld	
Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments. **Signature ►** **Date ►**			**Copy A For Internal Revenue Service Center**

Form **W-2G** Cat. No. 10138V Department of the Treasury - Internal Revenue Service

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Lessee Construction Allowances for Short-Term Leases

REG–106010–98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations concerning an exclusion from gross income for qualified lessee construction allowances provided by a lessor to a lessee for the purpose of constructing long-lived property to be used by the lessee pursuant to a short-term lease. The proposed regulations affect a lessor and a lessee paying and receiving, respectively, qualified lessee construction allowances that are depreciated by a lessor as nonresidential real property and excluded from the lessee's gross income. The proposed regulations provide guidance on the exclusion, the information required to be furnished by the lessor and the lessee, and the time and manner for providing that information to the IRS. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by December 20, 1999. Outlines of topics to be discussed at the public hearing scheduled for January 19, 2000, must be received by December 29, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–106010–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–106010–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/ tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Paul Handleman, (202) 622-3040; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Michael Slaughter, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224.

Comments on the collection of information should be received by November 19, 1999.

Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The requirement for the collection of information in this notice of proposed rulemaking is in §1.110–1(c). The information is required so that a taxpayer receiving a construction allowance as lessee from the lessor may establish the amount qualifying for the safe harbor under section 110(a). The collection of information is mandatory. The likely respondents are businesses and other for-profit organizations.

Estimated total annual reporting burden: 10,000 hours.

The estimated annual burden per respondent varies from .5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents : 10,000.

Estimated annual frequency of responses: once.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) to provide regulations under section 110 of the Internal Revenue Code of 1986. Section 110 was added to the Code by section 1213(a) of the Taxpayer Relief Act of 1997, Public Law 105-34 (Act). Under section 1213(e) of the Act, the amendment made by section 1213(a) applies to leases entered into after August 5, 1997.

Explanation of Provisions

Tax Treatment of Lessee Construction Allowances

Section 61(a) provides that gross income means "all income from whatever

source derived" except as otherwise provided in subtitle A of the Internal Revenue Code. Generally, the receipt of a construction allowance by a lessee from a lessor for property to be constructed and used by the lessee pursuant to a lease represents an accession to wealth includible in gross income in the year of receipt. However, amounts received by a lessee that are expended by the lessee on assets owned by the lessor are not includible in the lessee's gross income because there is no accession to wealth. Thus, the proper tax treatment of construction allowances turns on whether the lessee or the lessor owns the property constructed with the allowance.

Ownership for tax purposes generally is determined by applying a "benefits and burdens of ownership" test to the facts and circumstances surrounding the transaction. The benefits and burdens of ownership test was developed by the Tax Court to determine whether a purported lease should be treated as a sale for Federal income tax purposes. The court set forth the following factors to determine whether the taxpayer had the benefits and burdens of ownership of the leased property: (1) whether legal title passes; (2) how the parties treat the transaction; (3) whether an equity interest was acquired in the property; (4) whether the contract creates a present obligation on the seller to execute and deliver a deed and a present obligation on the purchaser to make payments; (5) whether the right of possession is vested in the purchaser; (6) which party pays the property taxes; (7) which party bears the risk of loss or damage to the property; and (8) which party receives the profits from the operation and sale of the property. *See Grodt & McKay Realty, Inc. v. Commissioner,* 77 T.C. 1221 (1981), and *Coleman v. Commissioner,* T.C. Memo. 1987-195, *aff'd,* 16 F.3d 821 (7th Cir. 1994).

In a coordinated issue paper dated October 7, 1996, the IRS enumerated certain specific factors that help establish whether the benefits and burdens of ownership of the leasehold improvements are with the lessee or the lessor; *i.e.,* who carries personal property and liability insurance on the leasehold improvements; who is the beneficiary under those policies; who is responsible for replacing the leasehold improvements if they wear out prior to the end of the lease term; and, if the usefulness of the leasehold improvements extends beyond the lease term, who has the remainder interest in the improvements.

To the extent the lessee holds the benefits and burdens of ownership of the leasehold improvements constructed with the construction allowance, the lessee has an accession to wealth and income under section 61(a). However, to the extent the lessor holds the benefits and burdens of ownership, the lessee is acting merely as an agent of the lessor and the construction allowance is not includible in the gross income of the lessee.

Congress was concerned that the traditional factors used by the IRS in making the determination of who is the tax owner of property may be applied differently by the lessor and the lessee and may lead to controversies between the IRS and taxpayers. H.R. Rep. No. 148, 105th Cong., 1st Sess. 423 (1997) (House Report); S. Rep. No. 33, 105th Cong., 1st Sess. 232-33 (1997) (Senate Report). Consequently, the Act provides a safe harbor whereby it is assumed that a construction allowance is used to construct or improve lessor property (and is properly excludable by the lessee) when long-lived property is constructed or improved and used pursuant to a short-term lease. The Act also provides a reporting requirement to ensure that both the lessee and the lessor consistently treat the property subject to the construction allowance as nonresidential real property owned by the lessor. House Report at page 424; Senate Report at page 233.

Safe Harbor under Section 110

Section 110(a) provides, in general, that gross income of a lessee does not include any amount received in cash (or treated as a rent reduction) by a lessee from a lessor under a short-term lease of retail space, for the purpose of such lessee's constructing or improving qualified long-term real property for use in such lessee's trade or business at such retail space, but only to the extent that such amount does not exceed the amount expended by the lessee for such construction or improvement.

Section 110(c)(1) defines the term "qualified long-term real property" as nonresidential real property which is part of, or otherwise present at, the retail space referred to in section 110(a) and which reverts to the lessor at the termination of the lease. Section 110(c)(2) defines the term "short-term lease" as a lease (or other agreement for occupancy or use) of retail space for 15 years or less (as determined under the rules of section 168(i)(3)). Section 110(c)(3) defines the term "retail space" as real property leased, occupied, or otherwise used by a lessee in its trade or business of selling tangible personal property or services to the general public.

Consistent with section 110(c)(1), the proposed regulations define the term "qualified long-term real property" as nonresidential real property under section 168(e)(2)(B), which is section 1250 property other than residential rental property and property with a class life of less than 27.5 years. The proposed regulations do not require a direct tracing of the construction allowance, but assume that the construction allowance is used to construct or improve the lessor's property if qualified long-term real property is constructed by the lessee at the leased retail space. The IRS and the Department of Treasury specifically request comments on whether the definition of "retail space" needs to be clarified.

The proposed regulations recognize that a lessee may not be able to construct the qualified long-term real property in the same taxable year as it receives the construction allowance from the lessor. Thus, the proposed regulations give the lessee additional time to satisfy the safe harbor by allowing the construction allowance to be expended for qualified long-term real property until 8½ months after the close of the taxable year in which the construction allowance was received by the lessee.

The legislative history of the Act states that no inference is intended as to the treatment of amounts that are not subject to the safe harbor provision. In such cases, the provisions of IRS coordinated issue paper and present law (including case law) will continue to apply where applicable. H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 658–59 (1997). Thus, a construction allowance failing to qualify under the safe harbor provision is not includible in the lessee's gross income if the

lessor has the benefits and burdens of ownership of the property constructed with the construction allowance. Ownership of the property is determined under general principles of Federal tax law based on all the facts and circumstances.

Consistency between Lessee and Lessor and Reporting Requirements

Section 110(b) provides that qualified long-term real property constructed or improved in connection with any amount excluded from a lessee's income by reason of section 110(a) shall be treated as nonresidential real property of the lessor (including for purposes of section 168(i)(8)(B)).

Section 110(d) provides that, under regulations, the lessee and lessor described in section 110(a) must, at such times and in such manner as may be provided in such regulations, furnish to the Secretary information concerning the amounts received (or treated as a rent reduction) and expended as described in section 110(a), and any other information which the Secretary deems necessary to carry out the provisions of section 110.

The Act provides that the lessor will treat any qualified long-term real property constructed or improved with a construction allowance excluded from the lessee's gross income under section 110(a) as nonresidential real property owned by the lessor. However, the lessee's exclusion is not dependent upon the lessor's treatment of the property as nonresidential real property. House Report at page 424; Senate Report at page 233.

The proposed regulations prescribe the information required to be furnished by the lessor and the lessee and the time and manner for providing that information to the IRS. A lessor or a lessee that fails to furnish the required information may be subject to a penalty under section 6721.

Proposed Effective Date

The regulations are proposed to be applicable to leases entered into on or after the date final regulations are published in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that any burden on taxpayers is minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, January 19, 2000, at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 29, 1999.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Paul F. Handleman, Office of the Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.110–1 also issued under 26 U.S.C. 110(d); * * *

Par. 2. Section 1.110–1 is added to read as follows:

§1.110–1 Qualified lessee construction allowances.

(a) *Overview.* Amounts provided to a lessee by a lessor for property to be constructed and used by the lessee pursuant to a lease are not includible in the lessee's gross income if the amount is a qualified lessee construction allowance under paragraph (b) of this section.

(b) *Qualified lessee construction allowance*—(1) *In general.* A qualified lessee construction allowance means any amount received in cash (or treated as a rent reduction) by a lessee from a lessor–

(i) Under a short-term lease of retail space;

(ii) For the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at that retail space; and

(iii) To the extent the amount is expended by the lessee in the taxable year received on the construction or improvement of qualified long-term real property for use in the lessee's trade or business at that retail space.

(2) *Definitions*—(i) *Qualified long-term real property* is nonresidential real property under section 168(e)(2)(B) that is part of, or otherwise present at, the retail space referred to in paragraph (b)(1)(i) of this section and which reverts to the lessor at the termination of the lease. Thus, qualified long-term real property does not include property qualifying as section 1245 property under section 1245(a)(3).

(ii) *Short-term lease* is a lease (or other agreement for occupancy or use) of retail space for 15 years or less (as determined pursuant to section 168(i)(3)).

(iii) *Retail space* is nonresidential real property under section 168(e)(2)(B) that is leased, occupied, or otherwise used by the lessee in its trade or business of selling tangible personal property or services to the general public.

(3) *Purpose requirement.* An amount will meet the requirement in paragraph (b)(1)(ii) of this section only to the extent that the lease agreement for the retail space expressly provides that the construction allowance is for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at that retail space.

(4) *Expenditure requirement*—(i) *In general.* Expenditures referred to in paragraph (b)(1)(iii) of this section will be treated as being made first from the lessee's construction allowance. Tracing of the construction allowance to the actual lessee expenditures for the construction or improvement of qualified long-term real property is not required. However, the lessee should maintain accurate records of the amount of the qualified lessee construction allowance received and the expenditures made for qualified long-term real property.

(ii) *Time when expenditures deemed made.* For purposes of paragraph (b)(1)(iii) of this section, an amount is deemed to have been expended by a lessee in the taxable year in which the construction allowance was received by the lessee if the amount is expended within 8½ months after the close of that taxable year.

(5) *Consistent treatment by lessor.* Qualified long-term real property constructed or improved with any amount excluded from a lessee's gross income by reason of paragraph (a) of this section must be treated as nonresidential real property owned by the lessor (for purposes of depreciation under 168(e)(2)(B) and determining gain or loss under section 168(i)(8)(B)). For purposes of the preceding sentence, the lessor must treat the construction allowance as fully expended in the manner required by paragraph (b)(1)(iii) of this section unless the lessor is notified by the lessee in writing to the contrary. General tax principles apply for purposes of determining when the lessor may begin depreciation of its nonresidential real property. The lessee's exclusion from gross income under paragraph (a) of this section, however, is not dependent upon the lessor's treatment of the property as nonresidential real property.

(c) *Information required to be furnished*—(1) *In general.* The lessor and the lessee described in paragraph (b) of this section who are paying and receiving a qualified lessee construction allowance, respectively, must furnish the information described in paragraph (c)(3) of this section in the time and manner prescribed in paragraph (c)(2) of this section.

(2) *Time and manner for furnishing information.* The requirement to furnish information under paragraph (c)(1) of this section is met by attaching a statement with the information described in paragraph (c)(3) of this section to the lessor's or the lessee's, as applicable, timely filed (including extensions) Federal income tax return for the taxable year in which the construction allowance was paid by the lessor or received by the lessee (either in cash or treated as a rent reduction), as applicable. A lessor or a lessee may report the required information for several qualified lessee construction allowances on a combined statement. However, a lessor's or a lessee's failure to provide information with respect to each lease will be treated as a separate failure to provide information for purposes of paragraph (c)(4) of this section.

(3) *Information required*—(i) *Lessor.* The statement provided by the lessor must contain the lessor's name (and, in the case of a consolidated group, the parent's name), employer identification number, taxable year and the following information for each lease:

(A) The lessee's name (in the case of a consolidated group, the parent's name).

(B) The address of the lessee.

(C) The employer identification number of the lessee.

(D) The location of the retail space (including mall or strip center name, if applicable, and store name).

(E) The amount of the construction allowance.

(F) The amount of the construction allowance treated by the lessor as nonresidential real property owned by the lessor.

(ii) *Lessee.* The statement provided by the lessee must contain the lessee's name (and, in the case of a consolidated group, the parent's name), employer identification number, taxable year and the following information for each lease:

(A) The lessor's name (in the case of a consolidated group, the parent's name).

(B) The address of the lessor.

(C) The employer identification number of the lessor.

(D) The location of the retail space (including mall or strip center name, if applicable, and store name).

(E) The amount of the construction allowance.

(F) The amount of the construction allowance that is a qualified lessee construction allowance under paragraph (b) of this section.

(4) *Failure to furnish information.* A lessor or a lessee that fails to furnish the information required in this paragraph (c) may be subject to a penalty under section 6721.

(d) *Effective date.* This section is applicable to leases entered into on or after the date final regulations are published in the **Federal Register.**

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on September 17, 1999, 8:45 a.m., and published in the issue of the Federal Register for September 20, 1999, 64 F.R. 50783)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The August 1999 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, August 31, 1999.

Rev. Rul. 99–42

The following Department Store Inventory Price Indexes for August 1999 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, 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, August 31, 1999.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups – soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	Aug. 1998	Aug. 1999	Percent Change from Aug. 1998 to Aug. 1999[1]
1. Piece Goods	555.1	546.1	–1.6
2. Domestics and Draperies	630.9	630.1	–0.1
3. Women's and Children's Shoes	656.2	635.3	–3.2
4. Men's Shoes	910.5	882.3	–3.1
5. Infants' Wear	616.2	623.9	1.2
6. Women's Underwear	579.1	550.7	–4.9
7. Women's Hosiery	306.5	322.1	5.1
8. Women's and Girls' Accessories	548.8	528.1	–3.8
9. Women's Outerwear and Girls' Wear	399.0	377.6	–5.4
10. Men's Clothing	621.0	609.9	–1.8
11. Men's Furnishings	594.0	610.6	2.8
12. Boys' Clothing and Furnishings	498.8	473.3	–5.1
13. Jewelry	981.9	962.0	–2.0
14. Notions	767.8	793.9	3.4
15. Toilet Articles and Drugs	940.7	971.6	3.3
16. Furniture and Bedding	679.6	679.3	0.0
17. Floor Coverings	601.8	602.1	0.0
18. Housewares-	809.9	788.2	–2.7
19. Major Appliances	238.0	234.8	–1.3
20. Radio and Television	71.4	65.7	–8.0
21. Recreation and Education[2]	103.5	97.0	–6.3
22. Home Improvements[2]	131.1	127.6	–2.7
23. Auto Accessories[2]	107.3	106.8	–0.5
Groups 1 – 15: Soft Goods	598.7	589.9	–1.5
Groups 16 – 20: Durable Goods	460.2	447.4	–2.8
Groups 21 – 23: Misc. Goods[2]	107.8	102.9	–4.5
Store Total[3]	548.4	536.9	–2.1

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Richard C. Farley, Jr. of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Farley on (202) 622-4970 (not a toll-free call).

Section 6109.—Identifying Numbers

26 CFR 301.6109–1: Identifying numbers.

T.D. 8839

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 301 and 602

IRS Adoption Taxpayer Identification Numbers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 6109 relating to taxpayer identifying numbers. The final regulations provide rules for obtaining IRS adoption taxpayer identification numbers (ATINs), which are used to identify children placed for adoption. The regulations assist prospective adoptive parents in claiming tax benefits with respect to these children.

DATES: *Effective Date:* These regulations are effective September 22, 1999.

Dates of Applicability: For dates of applicability of these regulations, see §§301.6109–1(h)(2)(iii) and 301.6109–3(d).

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–1564. Responses to this collection of information are required to obtain ATINs, which are used by prospective adoptive parents to claim tax benefits with respect to children placed for adoption.

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

The collection of information in this final regulation is contained in §301.6109–3(c)(2). The information collection requirements of that section are satisfied by including the required information on Form W-7A or such other form as may be prescribed by the IRS to apply for an adoption taxpayer identification number (ATIN). The burden for this requirement is reflected in the burden estimated for the form. The current burden estimated for Form W-7A is 40 minutes per form.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains final Regulations on Procedure and Administration (26 CFR Part 301) relating to identifying numbers under section 6109.

On November 24, 1997, final and temporary regulations (T.D. 8739, 1997–2 C.B. 251) were published in the **Federal Register** (62 F.R. 62518). A notice of proposed rulemaking (REG–103330–97, 1997–2 C.B. 645) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (62 F.R. 62538).

Written comments responding to these notices were received and a public hearing was held on March 4, 1998. After consideration of all the comments, the proposed regulations under section 6109 are adopted with minor changes by this Treasury decision, and the corresponding temporary regulations are removed. The comments and revisions are discussed below.

Explanation of Revisions and Summary of Comments

Comments were received concerning the requirement that, in order for an ATIN to be assigned, the child must be placed for adoption by an *authorized placement agency* as defined in §1.152–2(c)(2) of the regulations. The commentators expressed concern that because of this requirement ATINs are not available in the case of independent adoptions as defined by state law. In general, independent adoptions take two forms. In one type the biological parent(s) places the child with the adoptive parents with the assistance of an attorney or other intermediary. In other independent adoptions, no such intermediary is necessary because the adoptive parents and the biological parent(s) know one another.

The IRS and Treasury Department believe that, under section 1.152–2(c), *authorized placement agency* is not limited to governmental and private organizations authorized by state law to place children for legal adoption, but also includes biological parents and other persons authorized by state law to place children for legal adoption. To address commentators' concerns regarding independent adoptions, the IRS and Treasury Department intend to amend section 1.152–2(c) to clarify that this is the meaning of *authorized placement agency.* Accordingly, the final ATIN regulations continue to provide that *authorized placement agency* has the same meaning as in section 1.152-2(c) of the regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because

the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Only individuals may receive ATINs under this Treasury decision.

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Beverly A. Baughman of the Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 301 and 602 are amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by:

1. Removing the entries for sections 301.6109–1T and 301.6109–3T; and

2. Adding an entry in numerical order to read in part as follows:

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

Section 301.6109–3 also issued under 26 U.S.C. 6109; * * *

Par. 2 Section 301.6109–1 is amended by:

1. Revising paragraph (a)(1)(i).

2. Revising the introductory text of paragraph (a)(1)(ii).

3. Revising paragraph (a)(1)(ii)(A).

4. Revising paragraph (a)(1)(ii)(B).

5. Revising paragraph (h)(2)(iii).

The revisions read as follows:

§301.6109–1 Identifying numbers.

(a) *In general*—(1) *Taxpayer identifying numbers*—(i) *Principal types.* There are several types of taxpayer identifying numbers that include the following: social security numbers, Internal Revenue Service (IRS) individual taxpayer identification numbers, IRS adoption taxpayer identification numbers, and employer identification numbers. Social security numbers take the form 000-00-0000. IRS individual taxpayer identification numbers and IRS adoption taxpayer identification numbers also take the form 000-00-0000 but include a specific number or numbers designated by the IRS. Employer identification numbers take the form 00-0000000.

(ii) *Uses.* Social security numbers, IRS individual taxpayer identification numbers, and IRS adoption taxpayer identification numbers are used to identify individual persons. Employer identification numbers are used to identify employers. For the definition of social security number and employer identification number, see §§301.7701–11 and 301.7701–12, respectively. For the definition of IRS individual taxpayer identification number, see paragraph (d)(3) of this section. For the definition of IRS adoption taxpayer identification number, see §301.6109–3(a). Except as otherwise provided in applicable regulations under this chapter or on a return, statement, or other document, and related instructions, taxpayer identifying numbers must be used as follows:

(A) Except as otherwise provided in paragraph (a)(1)(ii)(B) and (D) of this section, and §301.6109–3, an individual required to furnish a taxpayer identifying number must use a social security number.

(B) Except as otherwise provided in paragraph (a)(1)(ii)(D) of this section and §301.6109–3, an individual required to furnish a taxpayer identifying number but who is not eligible to obtain a social security number must use an IRS individual taxpayer identification number.

* * * * *

(h) * * *

(2) * * *

(iii) Paragraphs (a)(1)(i), (a)(1)(ii) introductory text, (a)(1)(ii)(A), and (a)(1)(ii)(B) of this section apply to income tax returns due (without regard to extensions) on or after April 15, 1998.

§301.6109–1T [Removed]

Par. 3. Section 301.6109–1T is removed.

Par. 4. Section 301.6109–3 is added to read as follows:

§301.6109–3 IRS adoption taxpayer identification numbers.

(a) *In general*—(1) *Definition.* An *IRS adoption taxpayer identification number* (ATIN) is a temporary taxpayer identifying number assigned by the Internal Revenue Service (IRS) to a child (other than an alien individual as defined in §301.6109–1(d)(3)(i)) who has been placed, by an authorized placement agency, in the household of a prospective adoptive parent for legal adoption. An ATIN is assigned to the child upon application for use in connection with filing requirements under the Internal Revenue Code and the regulations thereunder. When an adoption becomes final, the adoptive parent must apply for a social security number for the child. After the social security number is assigned, that number, rather than the ATIN, must be used as the child's taxpayer identification number on all returns, statements, or other documents required under the Internal Revenue Code and the regulations thereunder.

(2) *Expiration and extension.* An ATIN automatically expires two years after the number is assigned. However, upon request, the IRS may grant an extension if the IRS determines the extension is warranted.

(b) *Definitions.* For purposes of this section—

(1) *Authorized placement agency* has the same meaning as in §1.152–2(c) of this chapter;

(2) *Prospective adoptive child* or *child* means a child who has not been adopted, but who has been placed in the household of a prospective adoptive parent for legal adoption by an authorized placement agency; and

(3) *Prospective adoptive parent* or *parent* means an individual in whose household a prospective adoptive child is placed by an authorized placement agency for legal adoption.

(c) *General rule for obtaining a number*—(1) *Who may apply.* A prospective adoptive parent may apply for an ATIN for a child if—

(i) The prospective adoptive parent is eligible to claim a personal exemption under section 151 with respect to the child;

(ii) An authorized placement agency places the child with the prospective adoptive parent for legal adoption;

(iii) The Social Security Administration will not process an application for an SSN by the prospective adoptive parent on behalf of the child (for example, because the adoption is not final); and

(iv) The prospective adoptive parent has used all reasonable means to obtain the child's assigned social security number, if any, but has been unsuccessful in obtaining this number (for example, because the biological parent who obtained the number is not legally required to disclose the number to the prospective adoptive parent).

(2) *Procedure for obtaining an ATIN.* If the requirements of paragraph (c)(1) of this section are satisfied, the prospective adoptive parent may apply for an ATIN for a child on Form W-7A, *Application for Taxpayer Identification Number for Pending Adoptions* (or such other form as may be prescribed by the IRS). An application for an ATIN should be made far enough in advance of the first intended use of the ATIN to permit issuance of the ATIN in time for such use. An application for an ATIN must include the information required by the form and accompanying instructions, including the name and address of each prospective adoptive parent and the child's name and date of birth. In addition, the application must include such documentary evidence as the IRS may prescribe to establish that a child was placed in the prospective adoptive parent's household by an authorized placement agency for legal adoption. Examples of acceptable documentary evidence establishing placement for legal adoption by an authorized placement agency may include—

(i) A copy of a placement agreement entered into between the prospective adoptive parent and an authorized placement agency;

(ii) An affidavit or letter signed by the adoption attorney or government official who placed the child for legal adoption pursuant to state law;

(iii) A document authorizing the release of a newborn child from a hospital to a prospective adoptive parent for adoption; and

(iv) A court document ordering or approving the placement of a child for adoption.

(d) *Effective date.* The provisions of this section apply to income tax returns due (without regard to extension) on or after April 15, 1998.

§301.6109–3T [Removed]

Par. 5. Section 301.6109–3T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, paragraph (b) is amended by removing the entry for 301.6109–3T from the table and adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b)* * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
301.6109–3	1545–1564
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 17, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 21, 1999, 8:45 a.m., and published in the issue of the Federal Register for September 22, 1999, 64 F.R. 51241)

Part III. Administrative, Procedural, and Miscellaneous

Administrative Appeal of Proposed Adverse Determination of Tax-Exempt Status of Bond Issue

Revenue Procedure 99–35

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SECTION 1. PURPOSE

As required by § 3105 of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, 112 Stat. 685 (RRA 98), this revenue procedure provides procedures for Issuers (as defined in Rev. Proc. 96–16, 1996–1 C.B. 630) to request an administrative appeal to the Office of Appeals (Appeals) of a proposed adverse determination by an Employee Plans/Exempt Organizations Key District (the District) that the interest on their debt obligations (the Bond Issue) is not excludable from gross income under § 103 of the Internal Revenue Code.

SECTION 2. BACKGROUND

Prior to RRA 98, procedures did not exist for Issuers to appeal a proposed adverse determination by the District that the interest on a Bond Issue is not excludable from gross income of the bondholders. Section 3105 of RRA 98 directs the Service to modify its administrative procedures to allow Issuers to appeal a proposed adverse determination by the District to Appeals with respect to a Bond Issue. As a result, an Issuer may appeal a proposed adverse determination to Appeals before the District proceeds to tax bondholders. This revenue procedure sets forth procedures for Issuers to appeal proposed adverse determinations by the District, and makes other modifications to the examination process made appropriate by RRA 98.

As a result of the changes made by section 3105 of RRA 98, examination procedures have been modified to eliminate the requirement that the District receive a technical advice memorandum from Assistant Chief Counsel (Financial Institutions & Products) that is unfavorable to the Issuer before the District proceeds to tax bondholders.

SECTION 3. SCOPE

.01 In general. An appeal of a proposed adverse determination by the District is optional and is initiated by the Issuer as described below. Any issue raised by the District during an examination of a Bond Issue that would cause the interest on the Bond Issue not to be excludable from gross income under § 103 or claims for refund or rebates raised by the Issuers are appropriate for consideration by Appeals.

.02 Issuers as taxpayers. For purposes of examining Bond Issues, Issuers are treated as taxpayers. See Section 8.02 of this revenue procedure regarding other persons that may participate in an Appeals proceeding.

.03 Conduit borrowers. In appropriate circumstances, Appeals may consider issues that relate to the tax liability of the beneficiary of bond proceeds in a conduit financing (Conduit Borrower) at the same time as the Issuer's appeal. Appeals will only consider an issue relating to the tax liability of a Conduit Borrower if the Conduit Borrower is under examination with respect to the issue, the resolution of the issue is affected by the determination of whether the interest on the Bond Issue is excludable from gross income under § 103, and the Conduit Borrower agrees to resolving the issue at the same time as the Issuer's appeal under this revenue procedure. See section 8.01 of this revenue procedure for Appeals procedures governing the Conduit Borrower.

.04 Early referral. Section 3465 of RRA 98 provides that the Service shall prescribe procedures by which a taxpayer may request early referral of one or more unresolved issues to Appeals. Under Revenue Procedure 99–28, 1999–29 I.R.B. 109, an Issuer may make a separate request to the District for the early referral to Appeals of one or more issues regarding a Bond Issue. See section 2.02 of Rev. Proc. 99–28 for issues that are appropriate for early referral. Early referral may also be appropriate for issues that are not determinative of whether the interest on the Bond Issue is excludable from gross income under § 103, including such issues for which the National Office has issued a technical advice memorandum to the District.

SECTION 4. ADMINISTRATIVE APPEAL PROCESS

.01 In general. Sections 4.03, 4.04, and 4.05 of this revenue procedure describe the circumstances in which an Issuer may appeal a proposed adverse determination by the District that the interest on a Bond Issue is not excludable from gross income under § 103. To the extent provided in sections 4.03(2), 4.04(2), or 4.05(2), the Issuer may request an appeal in accordance with section 5.

.02 Consultations with District Counsel. Prior to issuing a proposed adverse determination to the Issuer regarding a Bond Issue, the District will consult with District Counsel regarding whether the District should request technical advice. Technical advice should be requested, for example, when there is a lack of uniformity regarding the disposition of an issue or when an issue is unusual or complex enough to warrant consideration by the National Office.

.03 The District requests technical advice. (1) If, after consultation with District Counsel, the District determines that technical advice is warranted, the District will follow the procedures for requesting technical advice set forth in Rev. Proc. 99–2, 1999–1 I.R.B. 73, or subsequent revenue procedure. If the National Office issues a technical advice memorandum to the District, the District will notify the Issuer, in writing, of the National Office's determination.

(2) The written notice will identify the Bond Issue under examination and will include a copy of the technical advice memorandum. If the District has made a proposed adverse determination that the interest on the Bond Issue under examination is not excludable from gross income under § 103, the written notice will state the District's reasons for the proposed adverse determination, and will inform the Issuer of the availability of an administrative appeal of such proposed adverse determination.

.04 The Issuer requests technical advice. (1) If, after consultation with District Counsel, the District determines that technical advice is not necessary, the District will notify the Issuer, in writing, of its preliminary adverse determination that the interest on the Bond Issue is not excludable from gross income under § 103, and provide the Issuer with an opportunity to have closing agreement discussions. The notice will also inform the Issuer that it may request that an issue be referred to the National Office for technical advice in accordance with Rev. Proc. 99–2, 1999–1 I.R.B. 73, or subsequent revenue procedure. If the Issuer requests that an issue be referred to the National Office for technical advice, such referral will be made, and considered, in accordance with the procedures set forth in Rev. Proc. 99–2, or subsequent revenue procedure. If the National Office issues a technical advice memorandum to the District, the District will notify the Issuer, in writing, of the National Office's determination.

(2) The written notice will identify the Bond Issue under examination and will include a copy of the technical advice memorandum. If the District has made a proposed adverse determination that the interest on the Bond Issue under examination is not excludable from gross income under § 103, the written notice will state the District's reasons for the proposed adverse determination, and will inform the Issuer of the availability of an administrative appeal of such proposed adverse determination.

.05 Technical advice not requested. (1) If, after receiving notice of the District's preliminary adverse determination described in section 4.04(1) of this revenue procedure, the Issuer does not request technical advice or if the Issuer's request is denied, the District will provide the Issuer with an opportunity to have closing agreement discussions. If closing agreement discussions between the Issuer and the District are unsuccessful, the District will send the Issuer a written notice to the effect that the District has made a proposed adverse determination that the interest on the Bond Issue under examination is not excludable from gross income under § 103.

(2) The written notice will identify the Bond Issue under examination, state the District's reasons for its proposed adverse determination and inform the Issuer of the availability of an administrative appeal of the District's proposed adverse determination.

.06 Closing agreement with the District. The District will retain jurisdiction over the Bond Issue until the Issuer has made a request to appeal the District's proposed adverse determination that interest on the Bond Issue is not excludable from gross income under § 103 and the agent's file has been sent to Appeals in accordance with section 6 of this revenue procedure. Prior to requesting an appeal, the Issuer may enter into closing agreement discussions with the District and execute a closing agreement with respect to the Bond Issue. The District will generally prepare a closing agreement using the model closing agreement provided in Internal Revenue Manual exhibit 7.6.2.5–3.

SECTION 5. HOW TO REQUEST AN APPEAL

.01 In general. Established Appeals procedures, including those governing submissions and taxpayer conferences, apply to requesting an appeal of a proposed adverse determination that interest on a Bond Issue is not excludable from gross income under ' 103. *See* § 601.106 *et seq.* of the Statement of Procedural Rules.

.02 The Issuer's appeal request and response to the District's notice. The Issuer's appeal request must be in writing. The appeal request must include a detailed written response to the District's notice of the District's proposed adverse determination, and include any further explanation of the Issuer's position regarding the issue(s) in dispute. The Issuer's written appeal request must be submitted to the District within 30 days of the date of the notice from the District regarding its proposed adverse determination. The District may extend this 30-day requirement following a written request by the Issuer justifying such extension. The Issuer or the Issuer's authorized representative must sign an appeal request. It is preferred that Form 2848, Power of Attorney and Declaration of Representative, be used to designate an authorized representative when making an appeal request under this revenue procedure.

.03 Failure to make appeal request. If the Issuer does not submit a written appeal request within the time period set forth in section 5.02 of this revenue procedure, the District's proposed adverse determination shall become final and the District may begin the process of taxing bondholders without further notice to the Issuer.

SECTION 6. THE DISTRICT FORWARDS CASE FILE TO APPEALS

The District will forward the case file to Appeals. The file should include copies of the following:

1. the technical advice memorandum, if any;
2. all information received by the District from the Issuer regarding the Bond Issue;
3. all work papers of the District examining the Bond Issue;
4. the District's notice;

5. the Issuer's written appeal request, and

6. the District's response to the Issuer's position, if any.

After the case file is sent to Appeals, Appeals will have jurisdiction over the Bond Issue.

SECTION 7. PROCESSING AN APPEAL REQUEST

An appeal by an Issuer of a proposed adverse determination will be assigned to a senior Appeals officer, who will make every effort to resolve the case as expeditiously as possible.

SECTION 8. RESOLVING AN APPEAL ISSUE(S)

.01 In general. Established Appeals procedures, including those governing submissions and taxpayer conferences, apply to appeals regarding Bond Issues. *See* § 601.106 *et seq.* of the Statement of Procedural Rules. See also Treasury Department Circular 230, 31 C.F.R., Part 10. The procedures in sections 8.04 and 8.05 of this revenue procedure, specifically apply to Bond Issues.

.02 Other participants in the Appeals process. The Issuer may authorize any person (e.g., Conduit Borrower) to inspect or receive confidential information during the Appeals process by submitting a duly executed Taxpayer Information Authorization (Form 8821) to the Appeals officer. In addition, the Issuer may authorize certain persons to represent the Issuer before Appeals by submitting a duly executed Power of Attorney and Declaration of Representative (Form 2848) to the Appeals Officer.

.03 New information provided. If the Issuer provides additional information not previously given to the District, Appeals will forward the information to the District for its comments.

.04 If agreement is reached. If Appeals and the Issuer agree that no action is necessary with respect to the Bond Issue, Appeals will notify the District and close the case. If Appeals and the Issuer reach an agreement with respect to the Bond Issue, Appeals will generally prepare a closing agreement using the model closing agreement provided in Internal Revenue Manual exhibit 7.6.2.5–3.

.05 If agreement is not reached. (1) If Appeals and the Issuer fail to reach an agreement with respect to an appeal, Appeals will close the appeal file, return jurisdiction over the Bond Issue to the District, and send a copy of the Appeals Case Memorandum with respect to the Bond Issue to the District. In such case, the District's proposed adverse determination shall become final and the District may begin the process of taxing the bondholders without further notice to the Issuer.

(2) Appeals will not reconsider an unagreed appeal unless there has been a substantial change in the circumstances regarding the appeal issue.

SECTION 9. NO USER FEE

There is no user fee for an appeal request.

SECTION 10. EFFECTIVE DATE

These procedures are generally effective on September 22, 1999, the date this revenue procedure is released to the public, with respect to proposed adverse determinations made by the District for Bond Issues for which a closing agreement has not been executed.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Theodore J. Cichaski, Senior Program Analyst and Thomas Carter Louthan, Director, Office of Alternative Dispute Resolution & Customer Service Programs, National Office Appeals; Bruce M. Serchuk, Senior Technician Reviewer, Office of Associate Chief Counsel (Financial Institutions and Products); and Joseph Grabowski, Senior Analyst, Exempt Organizations Division. For further information regarding this revenue procedure, please contact Mr. Louthan at (202) 694-1842, Mr. Serchuk at (202) 622-3980, or Mr. Grabowski at (202) 622-7761 (not toll-free numbers).

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 99–96

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

American Community for Research and Education Development, Inc., New York, NY
American Friends of the Vincentian Mission, Massapequa Park, NY
American Fund for Human Potential, Inc., Tamarac, FL
American Luxor Foundation, Hertford, NC
Annie's Orphans, Durango, CO
Baseball Americana Foundation, Inc., Deerfield, IL
Bibleway Community Development Corporation, Gary, IN
Bio-Behavioral Institute, Inc., Jacksonville, FL
Biomedical Park Development Corporation, New Haven, CT
Blue Ice Corporation, Ellicott City, MD
Bonsall Community Center, Fallbrook, CA
Bread for the Soul, Washington, DC
Carolyn Darch Ministries, Inc., Troy, MI
Citizens for Lecompte United for a Better Community, Inc., Lecompte, LA
Community Economic Development Corporation, Los Angeles, CA
Conference of Funeral Service Examining Boards Foundation, Inc., Muncie, IN
Deborah G. Dunston Seniors Retreat, Mt. Ida, AR
Diana Roberts Memorial Scholarship Fund, New York, NY
Duzyj Charitable Foundation, Warren, MI
Earth Now, Eugene, OR
Economic and Human Development Foundation, Willow Creek, CA
El Shaddai Elohim Ministry, Inc., Ava, MO
Ernst Krenek Society, Inc., Palm Springs, CA
Ezras Mamesh Tr, Brooklyn, NY
Families First, Missoula, MT
First Amendment Productions, Inc., Huntington, NY
Florida School of Safe Performance, Inc., Okahumpka, FL
Foundation for Cultural & Literary Studies, Henderson, NV
Foundation for the Deaf-Blind, Inc., Somerset, NJ
Friends of the Israeli Women's Network, Inc., Springfield, NJ
Friends of Prairie Spirit Farm, Inc., Verona, WI
Garden of Dreams Youth and Family Services, Richton Park, IL
Garricks Animal Shelter, Readfield, WI
Gospel Skates, Inc., Oakland, CA
Grace Development Corporation, Moline Acres, MO
Grace International Foundation for Total Health, Ltd., Boca Raton, FL
Guiding Light Outreach Ministries Church, Inc., St. Louis, MO
Halifax Organization for Economic Development, Durham, NC
Hearts of Heroes, Inc., Titusville, FL
Henry and Company Boarding Home, Inc., Orange, NJ
Heritage Preservation Society, Houston, TX
Heroes Unite, Inc., Miami, FL
High Land Place, Inc., Blaine, MN
Hoganson Foundation, Ltd., Burlington, WI
Institute for Advanced Scientific Studies, Ltd., Wilmington, DE
Institute of Interdisciplinary Research and Technology, Inc., New York, NY
Interlinks Community Development Corporation, Memphis, TN
International Center of Design Art to God to the World and to Man, Inc., New York, NY
Jimmy Ray Ministries, Inc., Tulsa, OK
John and Mary Alice Beck Scholarships, Inc., Cohassett, MA
Killingsworth-Utsman Foundation, San Angelo, TX
Kings Kids Outreach Ministries, Abilene, TX
The Lighthouse Foundation, McAllen, TX
Lighthouse Ministries, Honolulu, HI
Linking Industry with Nonprofit Charities, Inc., Tulsa, OK
Louisiana Horseman Substance Abuse Foundation, Inc., New Orleans, LA
Marine Academy Scholarship Fund, Inc., Dallas, TX
Montessori Catholic Council, Inc., Centerville, VA
Mother of the Holy Incarnation, Colorado Springs, CO
Music Missions International, Inc., Charlotte, NC
National Ego Project, Inc., Berea, OH
National Men's Health Foundation, Emmaus, PA
Neighborhood of Winners NOW, Inc., Birmingham, AL
New Covenant Research, Chicago, IL
New Life Systems a Nonprofit Corporation, Santa Monica, CA
Old City of Jerusalem Fund, Brooklyn, NY
Operation Children's Hope, Marengo, IL
Parents and Students Succeed Association, Dallas, TX
Parke Vermillion Vocational Building Trades, Inc., Clinton, IN
Partnership for Connecticut Cities, Inc., New Haven, CT
Philippine National Day Association, Sacramento, CA
Phoenix Rising, Inc., Missoula, MT
Pino Foundation, Inc., Orlando, FL
Pleasant Hills Historical Society, Pittsburgh, PA
Potomac Community Development Corporation, Alexandria, VA
Project Heart, East Hanover, NJ
Public Golf Foundation of America, Chicago, IL
Reliefnet, New York, NY
Rescue Foundation, South Pasadena, CA
Ron Santo-Freedom Jet Foundation, Inc., Bradley, IL
Rural Health Foundation of Iowa, Des Moines, IA

Sam Butcher Fund, Inc., Morgantown, WV
Seguin-Guadalupe County Heritage Museum, Inc., Seguin, TX
Senior Citizens Center, Inc., Beatrice, NE
Shepherd of the Streets, Inc., New York, NY
Sistership, Inc., Dayton, OH
S M Temple Foundation, Inc., Hudson, OH
Society for the Humanitarian Assistance of Nortern Iraq, Annandale, VA
Spiritual Library, Inc., Gaithersburg, MD
Team L.A., Inc., Santa Monica, CA
Tedsco, Inc., Norman, OK
Thee Art Tree Service, Seattle, WA
Tregoe Education Forum, Inc., Princeton, NJ
Trinity & Associates, Inc., Mexico, NY
United Communities to Advance Our Neighborhoods, Inc., Russell, KY
Upper Skagit Historical and Recreational Association, Concrete, WA
US Metro American Metropolitan Institute Corporation, Springfield, VA
Warren James Memorial Home for Children, Lakeview Terrace, CA
Winter Park Association, Kennebunk, ME
Wolf Lake Research Laboratories, Inc., Grass Lake, MI
World Hope Organization, Inc., Brooklyn, NY
Youthful Elderly and Retirement Seniors, Inc., Beaumont, TX
YWCA Housing Corporation, Lincoln, NE

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Deletions From Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 99–97

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on October 12, 1999, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1).

For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Mississippi Wildlife Conservation, Inc.
Brookhaven, MS

Sta-Home Home Health Agency of Forest, Inc., Jackson, MS

Sta-Home Home Health Agency of Grenada, Inc., Jackson, MS

Sta-Home Home Health Agency of Jackson, Inc., Jackson, MS

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organizations listed below have recently filed timely declaratory judgment suits under section 7428 of the Code, challenging revocation of their status as eligible donees under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

American Heart Foundation
Des Moines, IA

IHC Health Plans, Inc.
Salt Lake City, UT

Sta-Home Home Health Agency of Grenada, Inc., Jackson, MS

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 108.—Income From Discharge of Indebtedness

26 CFR 1.108–1(a)(1): Income from discharge of indebtedness.

Do allocations of cancellation of indebtedness income to an insolvent partner lack substantiality under § 1.704–1(b)(2)(iii) of the Income Tax Regulations when the partners amend the partnership agreement to create offsetting special allocations of particular items after the events giving rise to the items have occurred? See Rev. Rul. 99–43, on this page.

Section 704.—Partner's Distributive Share

26 CFR 1.704–1: Determination of partner's distributive share.

26 CFR 1.704–2: Allocations attributable to nonrecourse liabilities.
(Also Part 1, section 108; 1.108–1(a)(1).)

Partnership allocations; cancellation of nonrecourse indebtedness. This ruling provides guidance on the substantiality of special allocations made by amendments to a partnership agreement after the events giving rise to the specially allocated items have occurred.

Rev. Rul. 99–43

ISSUE

Do partnership allocations lack substantiality under § 1.704–1(b)(2)(iii) of the Income Tax Regulations when the partners amend the partnership agreement to create offsetting special allocations of particular items after the events giving rise to the items have occurred?

FACTS

A and *B*, both individuals, formed a general partnership, *PRS*. *A* and *B* each contributed $1,000 and also agreed that each would be allocated a 50-percent share of all partnership items. The partnership agreement provides that, upon the contribution of additional capital by either partner, *PRS* must revalue the partnership's property and adjust the partners' capital accounts under § 1.704–1(b)(2)(iv)(*f*).

PRS borrowed $8,000 from a bank and used the borrowed and contributed funds to purchase nondepreciable property for $10,000. The loan was nonrecourse to *A* and *B* and was secured only by the property. No principal payments were due for 6 years, and interest was payable semi-annually at a market rate.

After one year, the fair market value of the property fell from $10,000 to $6,000, but the principal amount of the loan remained $8,000. As part of a workout arrangement among the bank, *PRS*, *A*, and *B*, the bank reduced the principal amount of the loan by $2,000, and *A* contributed an additional $500 to *PRS*. *A*'s capital account was credited with the $500, which *PRS* used to pay currently deductible expenses incurred in connection with the workout. All $500 of the currently deductible workout expenses were allocated to *A*. *B* made no additional contribution of capital. At the time of the workout, *B* was insolvent within the meaning of § 108(a) of the Internal Revenue Code. *A* and *B* agreed that, after the workout, *A* would have a 60-percent interest and *B* would have a 40-percent interest in the profits and losses of *PRS*.

As a result of the property's decline in value and the workout, *PRS* had two items to allocate between *A* and *B*. First, the agreement to cancel $2,000 of the loan resulted in $2,000 of cancellation of indebtedness income (COD income). Second, *A*'s contribution of $500 to *PRS* was an event that required *PRS*, under the partnership agreement, to revalue partnership property and adjust *A*'s and *B*'s capital accounts. Because of the decline in value of the property, the revaluation resulted in a $4,000 economic loss that must be allocated between *A*'s and *B*'s capital accounts.

Under the terms of the original partnership agreement, *PRS* would have allocated these items equally between *A* and *B*. *A* and *B*, however, amend the partnership agreement (in a timely manner) to make two special allocations. First, *PRS* specially allocates the entire $2,000 of COD income to *B*, an insolvent partner. Second, *PRS* specially allocates the book loss from the revaluation $1,000 to *A* and $3,000 to *B*.

While *A* receives a $1,000 allocation of book loss and *B* receives a $3,000 allocation of book loss, neither of these allocations results in a tax loss to either partner. Rather, the allocations result only in adjustments to *A*'s and *B*'s capital accounts. Thus, the cumulative effect of the special allocations is to reduce each partner's capital account to zero immediately following the allocations despite the fact that *B* is allocated $2,000 of income for tax purposes.

LAW

Section 61(a)(12) provides that gross income includes income from the discharge of indebtedness.

Rev. Rul. 91–31, 1991–1 C.B. 19, holds that a taxpayer realizes COD income when a creditor (who was not the seller of the underlying property) reduces the principal amount of an under-secured nonrecourse debt.

Under § 704(b) and the regulations thereunder, allocations of a partnership's items of income, gain, loss, deduction, or credit provided for in the partnership agreement will be respected if the allocations have substantial economic effect. Allocations that fail to have substantial economic effect will be reallocated according to the partners' interests in the partnership (as defined in § 1.704–1(b)(3)).

Section 1.704–1(b)(2)(iv)(*f*) provides that a partnership may, upon the occurrence of certain events (including the contribution of money to the partnership by a new or existing partner), increase or decrease the partners' capital accounts to reflect a revaluation of the partnership property.

Section 1.704–1(b)(2)(iv)(*g*) provides that, to the extent a partnership's property is reflected on the books of the partnership at a book value that differs from the adjusted tax basis, the substantial economic effect requirements apply to the allocations of book items. Section 704(c) and § 1.704–1(b)(4)(i) govern the partners' distributive shares of tax items.

Section 1.704–1(b)(2)(i) provides that the determination of whether an allocation of income, gain, loss, or deduction (or item thereof) to a partner has substantial economic effect involves a two-part analysis that is made at the end of the partnership year to which the allocation relates. In order for an allocation to have substantial economic effect, the allocation

must have both economic effect (within the meaning of § 1.704–1(b)(2)(ii)) and be substantial (within the meaning of § 1.704–1(b)(2)(iii)).

Section 1.704-1(b)(2)(iii)(*a*) provides that the economic effect of an allocation (or allocations) is substantial if there is a reasonable possibility that the allocation (or allocations) will substantially affect the dollar amounts to be received by the partners from the partnership independent of the tax consequences. However, the economic effect of an allocation is not substantial if, at the time the allocation becomes part of the partnership agreement, (1) the after-tax economic consequences of at least one partner may, in present value terms, be enhanced compared to the consequences if the allocation (or allocations) were not contained in the partnership agreement, and (2) there is a strong likelihood that the after-tax economic consequences of no partner will, in present value terms, be substantially diminished compared to the consequences if the allocation (or allocations) were not contained in the partnership agreement. In determining the after-tax economic benefit or detriment to a partner, tax consequences that result from the interaction of the allocation with the partner's tax attributes that are unrelated to the partnership will be taken into account.

Section 1.704–1(b)(2)(iii)(*b*) provides that the economic effect of an allocation (or allocations) in a partnership taxable year is not substantial if the allocations result in shifting tax consequences. Shifting tax consequences result when, at the time the allocation (or allocations) becomes part of the partnership agreement, there is a strong likelihood that (1) the net increases and decreases that will be recorded in the partners' respective capital accounts for the taxable year will not differ substantially from the net increases and decreases that would be recorded in the partners' respective capital accounts for the year if the allocations were not contained in the partnership agreement, and (2) the total tax liability of the partners (for their respective tax years in which the allocations will be taken into account) will be less than if the allocations were not contained in the partnership agreement.

Section 1.704–1(b)(2)(iii)(*c*) provides that the economic effect of an allocation (or allocations) in a partnership taxable year is not substantial if the allocations are transitory. Allocations are considered transitory if a partnership agreement provides for the possibility that one or more allocations (the "original allocation(s)") will be largely offset by other allocations (the "offsetting allocation(s)"), and, at the time the allocations become part of the partnership agreement, there is a strong likelihood that (1) the net increases and decreases that will be recorded in the partners' capital accounts for the taxable years to which the allocations relate will not differ substantially from the net increases and decreases that would be recorded in such partners' respective capital accounts for such years if the original and offsetting allocation(s) were not contained in the partnership agreement, and (2) the total tax liability of the partners (for their respective tax years in which the allocations will be taken into account) will be less than if the allocations were not contained in the partnership agreement.

Section 761(c) provides that a partnership agreement includes any modifications made prior to, or at, the time prescribed for filing a partnership return (not including extensions) which are agreed to by all partners, or which are adopted in such other manner as may be provided by the partnership agreement.

ANALYSIS

PRS is free to allocate partnership items between *A* and *B* in accordance with the provisions of the partnership agreement if the allocations have substantial economic effect under § 1.704–1(b)(2). To the extent that the minimum gain chargeback rules do not apply,[1] COD income may be allocated in accordance with the rules under § 1.704–1(b)(2). This is true notwithstanding that the COD income arises in connection with the cancellation of a nonrecourse debt.

The economic effect of an allocation is not substantial if, at the time that the allocation becomes part of the partnership agreement, the allocation fails each of two tests. The allocation fails the first test if the after-tax consequences of at least one partner may, in present value terms, be enhanced compared to the consequences if the allocation (or allocations) were not contained in the partnership agreement. The allocation fails the second test if there is a strong likelihood that the after-tax economic consequences of no partner will, in present value terms, be substantially diminished compared to such consequences if the allocation (or allocations) were not contained in the partnership agreement.

A and *B* amended the *PRS* partnership agreement to provide for an allocation of the entire $2,000 of the COD income to *B*. *B*, an insolvent taxpayer, is eligible to exclude the income under § 108, so it is unlikely that the $2,000 of COD income would increase *B*'s immediate tax liability. Without the special allocation, *A*, who is not insolvent or otherwise entitled to exclude the COD income under § 108, would pay tax immediately on the $1,000 of COD income allocated under the general ratio for sharing income. *A* and *B* also amended the *PRS* partnership agreement to provide for the special allocation of the book loss resulting from the revaluation. Because the two special allocations offset each other, *B* will not realize any economic benefit from the $2,000 income allocation, even if the property subsequently appreciates in value.

The economics of *PRS* are unaffected by the paired special allocations. After the capital accounts of *A* and *B* are adjusted to reflect the special allocations, *A* and *B* each have a capital account of zero. Economically, the situation of both partners is identical to what it would have been had the special allocations not occurred. In addition, a strong likelihood exists that the total tax liability of *A* and *B* will be less than if *PRS* had allocated 50 percent of the $2,000 of COD income and 50 percent of the $4,000 book loss to each partner. Therefore, the special allocations of COD income and book loss are shifting allocations under § 1.704–1(b)(2)(iii)(*b*) and lack substantiality. (Alternatively, the

[1] Under certain circumstances, the COD income would be allocated between the partners in accordance with their shares of partnership minimum gain because the cancellation of the nonrecourse debt would result in a decrease in partnership minimum gain. *See* § 1.704–2(d). However, in this situation, there is no minimum gain because the principal amount of the debt never exceeded the property's book value. Therefore, the minimum gain chargeback requirement does not govern the manner in which the COD income is allocated between A and B, and PRS's special allocation of COD income must satisfy the substantial economic effect standard. *See* Rev. Rul. 92–97, 1992–2 C.B. 124.

allocations could be transitory allocations under § 1.704–1(b)(2)(iii)(*c*) if the allocations occur during different partnership taxable years).

This conclusion is not altered by the "value equals basis" rule that applies in determining the substantiality of an allocation. See § 1.704–1(b)(2)(iii)(*c*)(2). Under that rule, the adjusted tax basis (or, if different, the book value) of partnership property will be presumed to be the fair market value of the property. This presumption is appropriate in most cases because, under § 1.704–1(b)(2)(iv), property generally will be reflected on the books of the partnership at its fair market value when acquired. Thus, an allocation of gain or loss from the disposition of the property will reflect subsequent changes in the value of the property that generally cannot be predicted.

The substantiality of an allocation, however, is analyzed "at the time the allocation becomes part of the partnership agreement," not the time at which the allocation is first effective. See § 1.704–1(b)(2)(iii)(*a*). In the situation described above, the provisions of the *PRS* partnership agreement governing the allocation of gain or loss from the disposition of property are changed at a time that is after the property has been revalued on the books of the partnership, but are effective for a period that begins prior to the revaluation. See § 1.704–1(b)(2)(iv)(*f*).

Under these facts, the presumption that value equals basis does not apply to validate the allocations. Instead, *PRS*'s allocations of gain or loss must be closely scrutinized in determining the appropriate tax consequences. *Cf.* § 1.704–1(b)(4)(vi). In this situation, the special allocations of the $2,000 of COD income and $4,000 of book loss will not be respected and, instead, must be allocated in accordance with the *A*'s and *B*'s interests in the partnership under § 1.704–1(b)(3).

Close scrutiny also would be required if the changes were made at a time when the events giving rise to the allocations had not yet occurred but were likely to occur or if, under the original allocation provisions of a partnership agreement, there was a strong likelihood that a disproportionate amount of COD income earned in the future would be allocated to any partner who is insolvent at the time of the allocation and would be offset by an increased allocation of loss or a reduced allocation of income to such partner or partners.

HOLDING

Partnership special allocations lack substantiality when the partners amend the partnership agreement to specially allocate COD income and book items from a related revaluation after the events creating such items have occurred if the overall economic effect of the special allocations on the partners' capital accounts does not differ substantially from the economic effect of the original allocations in the partnership agreement.

DRAFTING INFORMATION

The principal author of this revenue ruling is David J. Sotos of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Sotos at (202) 622-3050 (not a toll-free call).

Section 832.—Insurance Company Taxable Income

26 CFR 1.832–4: Gross income.

The salvage discount factors are set forth for the 1999 accident year. These factors will be used for computing estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 99–37, page 517.

Section 846.—Discounted Unpaid Losses Defined

26 CFR 1.846–1: Application of discount factors.

The loss payment patterns and discount factors are set forth for the 1999 accident year. These factors will be used for computing discounted unpaid losses under section 846 of the Code. See Rev. Proc. 99–36, page 509.

The salvage discount factors are set forth for the 1999 accident year. These factors will be used for computing estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 99–37, page 517.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters. (Also Part I, section 846; 1.846–1.)

Rev. Proc. 99–36

SECTION 1. PURPOSE

This revenue procedure prescribes the loss payment patterns and discount factors for the 1999 accident year. These factors will be used for computing discounted unpaid losses under § 846 of the Internal Revenue Code. *See* Rev. Proc. 98–11, 1998–4 I.R.B. 9, for background concerning the loss payment patterns and application of the discount factors.

SEC. 2. SCOPE

This revenue procedure applies to any taxpayer that is required to discount its unpaid losses under § 846 for a line of business using discount factors published by the Secretary.

SEC. 3. TABLES OF DISCOUNT FACTORS

.01 The following tables present separately for each line of business the discount factors under § 846 for accident year 1999. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 1999, which is 6.30 percent, and by assuming all loss payments occur in the middle of the calendar year.

.02 If the groupings of individual lines of business on the annual statement changes, taxpayers must discount the unpaid losses on the resulting lines of business in accordance with the discounting patterns that would have applied to those unpaid losses based on their classification on the 1995 annual statement. In addition, section V of Notice 88–100, 1988–2 C.B. 439, provides rules concerning the determination of losses for accident years not separately reported on the annual statement.

.03 Tables

Accident and Health
(Other Than Disability Income or Credit Disability Insurance)

Discount factor for all years equals 96.9914 percent.

Auto Physical Damage

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+0	89.9430	89.9430	10.0570	9.7022	96.4715
AY+1	99.3814	9.4384	0.6186	0.5822	94.1173
AY+2	N/A	0.3093	0.3093	0.3000	96.9914
AY+3	N/A	0.3093	0.0000	0.0000	***

Commercial Auto/Truck Liability/Medical

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+0	25.8075	25.8075	74.1925	64.9334	87.5201
AY+1	49.8793	24.0718	50.1207	44.2057	88.1984
AY+2	67.6592	17.7799	32.3408	28.6592	88.6163
AY+3	79.7711	12.1119	20.2289	17.9771	88.8686
AY+4	88.2132	8.4421	11.7868	10.4057	88.2830
AY+5	93.1778	4.9646	6.8222	5.9427	87.1083
AY+6	95.9623	2.7845	4.0377	3.4462	85.3511
AY+7	97.0091	1.0468	2.9909	2.5840	86.3975
AY+8	97.5719	0.5628	2.4281	2.1666	89.2302
AY+9	98.2191	0.6471	1.7809	1.6359	91.8539
AY+10	N/A	0.6471	1.1338	1.0717	94.5239
AY+11	N/A	0.6471	0.4867	0.4721	96.9914
AY+12	N/A	0.4867	0.0000	0.0000	***

Composite Discount Factors

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	35.4611	35.4611	64.5389	55.2028	85.5342
AY+ 1	59.1449	23.6838	40.8551	34.2621	83.8626
AY+ 2	70.8220	11.6771	29.1780	24.3814	83.5608
AY+ 3	81.9019	11.0799	18.0981	14.4938	80.0847
AY+ 4	86.3688	4.4669	13.6312	10.8015	79.2407
AY+ 5	90.0497	3.6809	9.9503	7.6869	77.2526
AY+ 6	92.7488	2.6991	7.2512	5.3883	74.3092
AY+ 7	93.8259	1.0771	6.1741	4.6173	74.7845
AY+ 8	94.2415	0.4156	5.7585	4.4797	77.7924
AY+ 9	94.8568	0.6153	5.1432	4.1275	80.2516
AY+10	N/A	0.6153	4.5279	3.7531	82.8892
AY+11	N/A	0.6153	3.9125	3.3551	85.7535
AY+12	N/A	0.6153	3.2972	2.9321	88.9266
AY+13	N/A	0.6153	2.6819	2.4824	92.5620
AY+14	N/A	0.6153	2.0665	2.0043	96.9914
AY+15	N/A	2.0665	0.0000	0.0000	***

Fidelity/Surety

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	24.1540	24.1540	75.8460	70.1069	92.4332
AY+ 1	59.0961	34.9421	40.9039	38.4977	94.1173
AY+ 2	N/A	20.4520	20.4520	19.8367	96.9914
AY+ 3	N/A	20.4520	0.0000	0.0000	***

Financial Guaranty/Mortgage Guaranty

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	9.2513	9.2513	90.7487	83.8402	92.3872
AY+ 1	50.5659	41.3146	49.4341	46.5260	94.1173
AY+ 2	N/A	24.7171	24.7171	23.9734	96.9914
AY+ 3	N/A	24.7171	0.0000	0.0000	***

International
(Composite)

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	35.4611	35.4611	64.5389	55.2028	85.5342
AY+ 1	59.1449	23.6838	40.8551	34.2621	83.8626
AY+ 2	70.8220	11.6771	29.1780	24.3814	83.5608
AY+ 3	81.9019	11.0799	18.0981	14.4938	80.0847
AY+ 4	86.3688	4.4669	13.6312	10.8015	79.2407
AY+ 5	90.0497	3.6809	9.9503	7.6869	77.2526
AY+ 6	92.7488	2.6991	7.2512	5.3883	74.3092
AY+ 7	93.8259	1.0771	6.1741	4.6173	74.7845
AY+ 8	94.2415	0.4156	5.7585	4.4797	77.7924
AY+ 9	94.8568	0.6153	5.1432	4.1275	80.2516
AY+10	N/A	0.6153	4.5279	3.7531	82.8892
AY+11	N/A	0.6153	3.9125	3.3551	85.7535
AY+12	N/A	0.6153	3.2972	2.9321	88.9266
AY+13	N/A	0.6153	2.6819	2.4824	92.5620
AY+14	N/A	0.6153	2.0665	2.0043	96.9914
AY+15	N/A	2.0665	0.0000	0.0000	***

Medical Malpractice — Claims-Made

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	6.3899	6.3899	93.6101	76.7674	82.0076
AY+ 1	24.0011	17.6112	75.9989	63.4463	83.4831
AY+ 2	42.6970	18.6959	57.3030	48.1675	84.0576
AY+ 3	58.0610	15.3640	41.9390	35.3615	84.3166
AY+ 4	69.6653	11.6043	30.3347	25.6251	84.4744
AY+ 5	75.6033	5.9380	24.3967	21.1172	86.5577
AY+ 6	81.8786	6.2753	18.1214	15.9776	88.1701
AY+ 7	87.8539	5.9753	12.1461	10.8236	89.1118
AY+ 8	89.5207	1.6668	10.4793	9.7870	93.3936
AY+ 9	94.3025	4.7818	5.6975	5.4734	96.0675
AY+10	N/A	4.7818	0.9157	0.8882	96.9914
AY+11	N/A	0.9157	0.0000	0.0000	***

Medical Malpractice — Occurrence

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	2.1239	2.1239	97.8761	71.4452	72.9955
AY+ 1	6.4831	4.3592	93.5169	71.4519	76.4053
AY+ 2	15.5987	9.1156	84.4013	66.5550	78.8553
AY+ 3	31.9062	16.3075	68.0938	53.9345	79.2062
AY+ 4	45.0931	13.1868	54.9069	43.7365	79.6557
AY+ 5	50.0751	4.9821	49.9249	41.3553	82.8351
AY+ 6	60.9728	10.8976	39.0272	32.7250	83.8518
AY+ 7	69.2138	8.2411	30.7862	26.2900	85.3955
AY+ 8	72.8658	3.6519	27.1342	24.1811	89.1165
AY+ 9	80.0005	7.1347	19.9995	18.3484	91.7445
AY+10	N/A	7.1347	12.8648	12.1483	94.4311
AY+11	N/A	7.1347	5.7300	5.5576	96.9914
AY+12	N/A	5.7300	0.0000	0.0000	***

Miscellaneous Casualty

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	77.6669	77.6669	22.3331	21.1598	94.7461
AY+ 1	94.0673	16.4004	5.9327	5.5837	94.1173
AY+ 2	N/A	2.9664	2.9664	2.8771	96.9914
AY+ 3	N/A	2.9664	0.0000	0.0000	***

Multiple Peril Lines
(Homeowners/Farmowners Multiple Peril, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler and Machinery))

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	55.9587	55.9587	44.0413	39.0516	88.6704
AY+ 1	77.8939	21.9352	22.1061	18.8962	85.4798
AY+ 2	84.0083	6.1144	15.9917	13.7827	86.1863
AY+ 3	91.3188	7.3105	8.6812	7.1137	81.9437
AY+ 4	92.1670	0.8482	7.8330	6.6873	85.3739
AY+ 5	94.3838	2.2168	5.6162	4.8231	85.8781
AY+ 6	96.4959	2.1121	3.5041	2.9494	84.1680
AY+ 7	97.3670	0.8712	2.6330	2.2370	84.9605
AY+ 8	98.0034	0.6364	1.9966	1.7218	86.2368
AY+ 9	98.4059	0.4025	1.5941	1.4153	88.7833
AY+10	N/A	0.4025	1.1916	1.0895	91.4298
AY+11	N/A	0.4025	0.7892	0.7432	94.1747
AY+12	N/A	0.4025	0.3867	0.3751	96.9914
AY+13	N/A	0.3867	0.0000	0.0000	***

Other
(Including Credit)

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	66.7418	66.7418	33.2582	31.3512	94.2659
AY+ 1	89.2755	22.5337	10.7245	10.0936	94.1173
AY+ 2	N/A	5.3622	5.3622	5.2009	96.9914
AY+ 3	N/A	5.3622	0.0000	0.0000	***

Other Liability — Claims-Made

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	10.2440	10.2440	89.7560	73.7794	82.2000
AY+ 1	29.3763	19.1323	70.6237	58.7018	83.1191
AY+ 2	44.4111	15.0349	55.5889	46.8988	84.3672
AY+ 3	67.8197	23.4086	32.1803	25.7187	79.9207
AY+ 4	73.4753	5.6555	26.5247	21.5080	81.0867
AY+ 5	78.8604	5.3852	21.1396	17.3108	81.8882
AY+ 6	83.5027	4.6422	16.4973	13.6152	82.5295
AY+ 7	84.0676	0.5649	15.9324	13.8905	87.1838
AY+ 8	85.2129	1.1453	14.7871	13.5847	91.8688
AY+ 9	90.5992	5.3863	9.4008	8.8872	94.5367
AY+10	N/A	5.3863	4.0145	3.8938	96.9914
AY+11	N/A	4.0145	0.0000	0.0000	***

Other Liability — Occurrence

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	13.5751	13.5751	86.4249	67.7370	78.3767
AY+ 1	26.3964	12.8213	73.6036	58.7855	79.8676
AY+ 2	40.2725	13.8761	59.7275	48.1824	80.6703
AY+ 3	55.4566	15.1841	44.5434	35.5628	79.8385
AY+ 4	65.3309	9.8742	34.6691	27.6227	79.6751
AY+ 5	74.0647	8.7339	25.9353	20.3581	78.4959
AY+ 6	80.9090	6.8442	19.0910	14.5842	76.3927
AY+ 7	84.3622	3.4532	15.6378	11.9426	76.3702
AY+ 8	84.6163	0.2542	15.3837	12.4330	80.8193
AY+ 9	86.7311	2.1147	13.2689	11.0359	83.1712
AY+10	N/A	2.1147	11.1542	9.5509	85.6257
AY+11	N/A	2.1147	9.0395	7.9722	88.1936
AY+12	N/A	2.1147	6.9247	6.2941	90.8938
AY+13	N/A	2.1147	4.8100	4.5103	93.7704
AY+14	N/A	2.1147	2.6953	2.6142	96.9914
AY+15	N/A	2.6953	0.0000	0.0000	***

Private Passenger Auto Liability/Medical

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	37.9339	37.9339	62.0661	56.2648	90.6530
AY+ 1	67.7044	29.7705	32.2956	29.1156	90.1533
AY+ 2	81.5316	13.8272	18.4684	16.6937	90.3908
AY+ 3	89.8898	8.3583	10.1102	9.1279	90.2847
AY+ 4	94.6531	4.7633	5.3469	4.7920	89.6216
AY+ 5	97.1265	2.4734	2.8735	2.5437	88.5243
AY+ 6	98.4587	1.3322	1.5413	1.3305	86.3222
AY+ 7	98.9811	0.5224	1.0189	0.8757	85.9452
AY+ 8	99.2330	0.2519	0.7670	0.6712	87.5035
AY+ 9	99.4067	0.1737	0.5933	0.5344	90.0640
AY+10	N/A	0.1737	0.4196	0.3890	92.6904
AY+11	N/A	0.1737	0.2460	0.2344	95.3018
AY+12	N/A	0.1737	0.0723	0.0701	96.9914
AY+13	N/A	0.0723	0.0000	0.0000	***

Products Liability — Claims-Made

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	4.9750	4.9750	95.0250	75.3753	79.3215
AY+ 1	15.1072	10.1322	84.8928	69.6774	82.0769
AY+ 2	30.9560	15.8488	69.0440	57.7267	83.6085
AY+ 3	38.2420	7.2860	61.7580	53.8514	87.1975
AY+ 4	68.6101	30.3681	31.3899	25.9340	82.6188
AY+ 5	78.5966	9.9865	21.4034	17.2716	80.6954
AY+ 6	88.3971	9.8005	11.6029	8.2552	71.1475
AY+ 7	93.2957	4.8986	6.7043	3.7247	55.5568
AY+ 8	88.3815	-4.9142	11.6185	9.0260	77.6862
AY+ 9	89.6105	1.2290	10.3895	8.3274	80.1528
AY+10	N/A	1.2290	9.1604	7.5849	82.8009
AY+11	N/A	1.2290	7.9314	6.7956	85.6799
AY+12	N/A	1.2290	6.7024	5.9566	88.8728
AY+13	N/A	1.2290	5.4733	5.0647	92.5339
AY+14	N/A	1.2290	4.2443	4.1166	96.9914
AY+15	N/A	4.2443	0.0000	0.0000	***

Products Liability — Occurrence

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	9.0653	9.0653	90.9347	68.5721	75.4081
AY+ 1	14.9035	5.8382	85.0965	66.8729	78.5848
AY+ 2	29.2591	14.3555	70.7409	56.2851	79.5651
AY+ 3	45.6462	16.3871	54.3538	42.9356	78.9928
AY+ 4	57.5945	11.9483	42.4055	33.3216	78.5785
AY+ 5	63.8634	6.2689	36.1366	28.9575	80.1335
AY+ 6	75.2266	11.3632	24.7734	19.0662	76.9622
AY+ 7	78.2679	3.0413	21.7321	17.1317	78.8313
AY+ 8	78.1898	-0.0781	21.8102	18.2915	83.8668
AY+ 9	81.8722	3.6825	18.1278	15.6472	86.3162
AY+10	N/A	3.6825	14.4453	12.8363	88.8613
AY+11	N/A	3.6825	10.7628	9.8483	91.5027
AY+12	N/A	3.6825	7.0803	6.6720	94.2328
AY+13	N/A	3.6825	3.3979	3.2956	96.9914
AY+14	N/A	3.3979	0.0000	0.0000	***

Reinsurance A
(Nonproportional Property)

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	27.1668	27.1668	72.8332	64.6152	88.7167
AY+ 1	68.7008	41.5340	31.2992	25.8636	82.6335
AY+ 2	70.0362	1.3354	29.9638	26.1162	87.1592
AY+ 3	87.5338	17.4976	12.4662	9.7212	77.9803
AY+ 4	90.2132	2.6794	9.7868	7.5712	77.3605
AY+ 5	91.3751	1.1619	8.6249	6.8502	79.4230
AY+ 6	94.3845	3.0095	5.6155	4.1789	74.4181
AY+ 7	93.3293	-1.0552	6.6707	5.5301	82.9022
AY+ 8	N/A	1.0387	5.6320	4.8076	85.3629
AY+ 9	N/A	1.0387	4.5932	4.0395	87.9453
AY+10	N/A	1.0387	3.5545	3.2231	90.6758
AY+11	N/A	1.0387	2.5158	2.3552	93.6165
AY+12	N/A	1.0387	1.4771	1.4326	96.9914
AY+13	N/A	1.4771	0.0000	0.0000	***

Reinsurance B
(Nonproportional Liability)

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	6.6962	6.6962	93.3038	68.5209	73.4385
AY+ 1	22.3944	15.6982	77.6056	56.6526	73.0006
AY+ 2	32.6486	10.2542	67.3514	49.6494	73.7169
AY+ 3	50.2234	17.5748	49.7766	34.6574	69.6258
AY+ 4	53.5839	3.3605	46.4161	33.3760	71.9062
AY+ 5	55.6838	2.0999	44.3162	33.3137	75.1727
AY+ 6	63.6144	7.9306	36.3856	27.2358	74.8534
AY+ 7	66.4211	2.8066	33.5789	26.0580	77.6022
AY+ 8	N/A	2.8066	30.7723	24.8059	80.6113
AY+ 9	N/A	2.8066	27.9656	23.4750	83.9423
AY+10	N/A	2.8066	25.1590	22.0602	87.6832
AY+11	N/A	2.8066	22.3524	20.5563	91.9649
AY+12	N/A	2.8066	19.5457	18.9577	96.9914
AY+13	N/A	19.5457	0.0000	0.0000	***

Reinsurance C
(Financial Lines)

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	11.4622	11.4622	88.5378	76.8870	86.8408
AY+ 1	44.5791	33.1169	55.4209	47.5866	85.8641
AY+ 2	63.9134	19.3343	36.0866	30.6506	84.9362
AY+ 3	65.6185	1.7051	34.3815	30.8235	89.6516
AY+ 4	79.9778	14.3593	20.0222	17.9607	89.7042
AY+ 5	88.9152	8.9374	11.0848	9.8777	89.1099
AY+ 6	91.2490	2.3338	8.7510	8.0938	92.4895
AY+ 7	94.7645	3.5155	5.2355	4.9791	95.1030
AY+ 8	N/A	3.5155	1.7200	1.6682	96.9914
AY+ 9	N/A	1.7200	0.0000	0.0000	***

Special Property
(Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	57.4895	57.4895	42.5105	40.4302	95.1064
AY+ 1	90.5193	33.0297	9.4807	8.9230	94.1173
AY+ 2	N/A	4.7404	4.7404	4.5978	96.9914
AY+ 3	N/A	4.7404	0.0000	0.0000	***

Workers' Compensation

Tax Year	Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
AY+ 0	23.6461	23.6461	76.3539	62.2052	81.4696
AY+ 1	44.8166	21.1705	55.1834	44.2969	80.2722
AY+ 2	57.9652	13.1486	42.0348	33.5311	79.7700
AY+ 3	72.0542	14.0889	27.9458	21.1177	75.5664
AY+ 4	80.5542	8.5000	19.4458	13.6844	70.3719
AY+ 5	84.8876	4.3334	15.1124	10.0786	66.6913
AY+ 6	87.1173	2.2297	12.8827	8.4147	65.3182
AY+ 7	88.2647	1.1473	11.7353	7.7619	66.1415
AY+ 8	88.5404	0.2757	11.4596	7.9666	69.5194
AY+ 9	88.8062	0.2658	11.1938	8.1945	73.2056
AY+10	N/A	0.2658	10.9279	8.4366	77.2025
AY+11	N/A	0.2658	10.6621	8.6941	81.5418
AY+12	N/A	0.2658	10.3963	8.9677	86.2590
AY+13	N/A	0.2658	10.1304	9.2586	91.3940
AY+14	N/A	0.2658	9.8646	9.5678	96.9914
AY+15	N/A	9.8646	0.0000	0.0000	***

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky on (202) 622-3477 (not a toll-free number).

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26 CFR 601.201: Rulings and determination letters. (Also Part I, sections 832, 846; 1.832–4, 1.846–1.)

Rev. Proc. 99–37

SECTION 1. PURPOSE

This revenue procedure prescribes the salvage discount factors for the 1999 accident year. These factors will be used for computing discounted estimated salvage recoverable under § 832 of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 832(b)(5)(A) requires that all estimated salvage recoverable (including that which cannot be treated as an asset for state accounting purposes) be taken into account in computing the deduction for losses incurred. Under § 832(b)-(5)(A), paid losses are to be reduced by salvage and reinsurance recovered during the taxable year. This amount is adjusted to reflect changes in discounted unpaid losses on nonlife insurance contracts and in unpaid losses on life insurance contracts. An adjustment is then made to reflect any changes in discounted estimated salvage recoverable and in reinsurance recoverable.

Pursuant to § 832(b), the amount of estimated salvage is determined on a discounted basis in accordance with procedures established by the Secretary.

SEC. 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount estimated salvage recoverable under § 832.

SEC. 4. APPLICATION

.01 The following tables present separately for each line of business the discount factors under § 832 for the 1999 accident year. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 1999, which is 6.30 percent, and by assuming all estimated salvage is recovered in the middle of each calendar year. *See* Rev. Proc. 98–12, 1998–4 I.R.B. 18, for background regarding the tables.

.02 These tables must be used by taxpayers irrespective of whether they elected to discount unpaid losses using their own historical experience under § 846.

.03 Section V of Notice 88–100, 1988–2 C. B. 439, provides guidance concerning the determination of discount factors for unpaid losses for accident years not separately reported on the annual statement.

.04 Tables.

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Discount factor for all years equals 96.9914 percent.

Auto Physical Damage

Tax Year	Discount Factors (%)
AY+ 0	95.5695
AY+ 1	94.1173
AY+ 2	96.9914

Commercial Auto/Truck Liability/Medical

Tax Year	Discount Factors (%)
AY+ 0	88.1039
AY+ 1	87.2517
AY+ 2	88.9900
AY+ 3	88.2622
AY+ 4	88.0871
AY+ 5	90.4901
AY+ 6	85.7328
AY+ 7	91.4181
AY+ 8	89.8355
AY+ 9	9?.4551
AY+10	95.0697
AY+11	96.9914

Composite Discount Factors

Tax Year	Discount Factors (%)
AY+ 0	85.6093
AY+ 1	83.9887
AY+ 2	83.5630
AY+ 3	83.4530
AY+ 4	84.2000
AY+ 5	84.7825
AY+ 6	84.8358
AY+ 7	84.9271
AY+ 8	87.7984
AY+ 9	90.3741
AY+10	93.0175
AY+11	95.6437
AY+12	96.9914

Fidelity/Surety

Tax Year	Discount Factors (%)
AY+ 0	92.7828
AY+ 1	94.1173
AY+ 2	96.9914

Financial Guaranty/Mortgage Guaranty

Tax Year	Discount Factors (%)
AY+ 0	94.6355
AY+ 1	94.1173
AY+ 2	96.9914

International (Composite)

Tax Year	Discount Factors (%)
AY+ 0	85.6093
AY+ 1	83.9887
AY+ 2	83.5630
AY+ 3	83.4530
AY+ 4	84.2000
AY+ 5	84.7825
AY+ 6	84.8358
AY+ 7	84.9271
AY+ 8	87.7984
AY+ 9	90.3741
AY+10	93.0175
AY+11	95.6437
AY+12	96.9914

Medical Malpractice — Claims-Made

Tax Year	Discount Factors (%)
AY+ 0	69.8521
AY+ 1	72.5407
AY+ 2	71.0672
AY+ 3	70.4106
AY+ 4	73.9891
AY+ 5	72.3274
AY+ 6	82.1285
AY+ 7	91.3849
AY+ 8	96.2899
AY+ 9	96.9914

Medical Malpractice — Occurrence

Tax Year	Discount Factors (%)
AY+ 0	63.6130
AY+ 1	66.9948
AY+ 2	71.5686
AY+ 3	75.3861
AY+ 4	72.1518
AY+ 5	78.2468
AY+ 6	83.2448
AY+ 7	86.3963
AY+ 8	90.9167
AY+ 9	93.6125
AY+10	96.3310
AY+11	96.9914

Miscellaneous Casualty

Tax Year	Discount Factors (%)
AY+ 0	94.9728
AY+ 1	94.1173
AY+ 2	96.9914

Multiple Peril Lines (Homeowners/Farmowners Multiple Peril, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler And Machinery))

Tax Year	Discount Factors (%)
AY+ 0	88.1923
AY+ 1	87.1353
AY+ 2	87.9117
AY+ 3	87.5629
AY+ 4	88.7011
AY+ 5	90.1672
AY+ 6	90.1613
AY+ 7	89.1007
AY+ 8	91.5372
AY+ 9	94.2606
AY+10	96.9914

Other (Including Credit)

Tax Year	Discount Factors (%)
AY+ 0	96.0338
AY+ 1	94.1173
AY+ 2	96.9914

Other Liability — Claims-Made

Tax Year	Discount Factors (%)
AY+ 0	77.2784
AY+ 1	82.8178
AY+ 2	81.8164
AY+ 3	79.4571
AY+ 4	82.4769
AY+ 5	87.1976
AY+ 6	85.6914
AY+ 7	91.4229
AY+ 8	93.5743
AY+ 9	96.2841
AY+10	96.9914

Other Liability — Occurrence

Tax Year	Discount Factors (%)
AY+ 0	78.2635
AY+ 1	78.9961
AY+ 2	81.4078
AY+ 3	83.4032
AY+ 4	84.6724
AY+ 5	82.2100
AY+ 6	86.3544
AY+ 7	88.3424
AY+ 8	92.5115
AY+ 9	95.1243
AY+10	96.9914

Private Passenger Auto Liability/Medical

Tax Year	Discount Factors (%)
AY+ 0	91.4618
AY+ 1	90.9068
AY+ 2	89.9635
AY+ 3	89.5735
AY+ 4	89.1026
AY+ 5	89.5637
AY+ 6	88.3400
AY+ 7	89.0749
AY+ 8	89.7735
AY+ 9	92.3920
AY+10	95.0094
AY+11	96.9914

Products Liability — Claims-Made

Tax Year	Discount Factors (%)
AY+ 0	78.7056
AY+ 1	80.7697
AY+ 2	85.3179
AY+ 3	85.2263
AY+ 4	80.7596
AY+ 5	87.8587
AY+ 6	80.4380
AY+ 7	88.0132
AY+ 8	96.7141
AY+ 9	96.9914

Products Liability — Occurrence

Tax Year	Discount Factors (%)
AY+ 0	75.2045
AY+ 1	77.8428
AY+ 2	76.1949
AY+ 3	77.5126
AY+ 4	79.2935
AY+ 5	78.6299
AY+ 6	80.0215
AY+ 7	72.0300
AY+ 8	77.5666
AY+ 9	80.0419
AY+10	82.7021
AY+11	85.5978
AY+12	88.8131
AY+13	92.5030
AY+14	96.9914

Reinsurance A (Nonproportional Property)

Tax Year	Discount Factors (%)
AY+ 0	86.3193
AY+ 1	89.5547
AY+ 2	92.3252
AY+ 3	91.6732
AY+ 4	78.5915
AY+ 5	94.7028
AY+ 6	93.2934
AY+ 7	95.9512
AY+ 8	96.9914

Reinsurance B (Nonproportional Liability)

Tax Year	Discount Factors (%)
AY+ 0	74.2797
AY+ 1	76.5792
AY+ 2	77.3123
AY+ 3	76.7003
AY+ 4	79.2343
AY+ 5	74.2190
AY+ 6	75.9976
AY+ 7	83.6134
AY+ 8	86.0629
AY+ 9	88.6137
AY+10	91.2729
AY+11	94.0524
AY+12	96.9914

Reinsurance C (Financial Lines)

Tax Year	Discount Factors (%)
AY+ 0	80.7539
AY+ 1	83.1736
AY+ 2	86.4993
AY+ 3	92.4836
AY+ 4	91.0300
AY+ 5	92.9471
AY+ 6	89.3955
AY+ 7	96.8756
AY+ 8	96.9914

Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

Tax Year	Discount Factors (%)
AY+ 0	92.0956
AY+ 1	94.1173
AY+ 2	96.9914

Workers' Compensation

Tax Year	Discount Factors (%)
AY+ 0	78.1046
AY+ 1	80.5669
AY+ 2	82.5003
AY+ 3	84.0905
AY+ 4	84.2036
AY+ 5	84.3691
AY+ 6	85.5654
AY+ 7	86.3250
AY+ 8	88.7748
AY+ 9	91.4218
AY+10	94.1684
AY+11	96.9914

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky on (202) 622-3477 (not a toll-free number).

Part IV. Items of General Interest

Medical Savings Accounts

Announcement 99–95

PURPOSE

Sections 220(i) and (j) of the Internal Revenue Code provide that if the number of Medical Savings Account (MSA) returns filed for 1998 or a statutorily specified projection of the number of MSA returns that will be filed for 1999 exceeds 750,000, then October 1, 1999, is a "cut-off" date for the MSA pilot project. The Internal Revenue Service (IRS) has determined that the applicable number of MSA returns filed for 1998 is 32,371 and that the applicable number of MSA returns projected to be filed for 1999 is 44,784 (after reduction in each case for statutorily specified exclusions, such as the exclusion for previously uninsured taxpayers). Consequently, October 1, 1999, is not a "cut-off' date and 1999 is not a "cut-off' year for the MSA pilot project.

BACKGROUND

The Health Insurance Portability and Accountability Act of 1996 added section 220 to the Code to permit eligible individuals to establish MSAs under a pilot project effective January 1, 1997. The pilot project has a scheduled "cut-off" year of 2000, but may have an earlier "cut-off" year if the number of individuals who have established MSAs exceeds certain numerical limitations. See sections 220(i) and (j).

If a year is a "cut-off" year, section 220(i)(1) generally provides that no individual will be eligible for a deduction or exclusion for MSA contributions for any taxable year beginning after the "cut-off' year unless the individual (A) was an active MSA participant for any taxable year ending on or before the close of the "cut-off' year, or (B) first became an active MSA participant for a taxable year ending after the "cut-off" year by reason of coverage under a high deductible health plan of an MSA-participating employer.

Section 220(j)(2)(A) provides that the numerical limitation for 1999 is exceeded if the number of MSA returns filed on or before April 15, 1999, for taxable years ending with or within the 1998 calendar year, plus the Secretary's estimate of the number of MSA returns for those taxable years which will be filed after April 15, 1999, exceeds 750,000. For this purpose, section 220(j)(2)(A) provides that a tax return is an MSA return for a taxable year if any exclusion is claimed under section 106(b) or any deduction is claimed under section 220 for that taxable year. Section 220(j)(2)(B) provides, as an alternative test, that the numerical limitation for 1999 is also exceeded if the sum of 90 percent of the MSA returns for 1998 plus the product of 2.5 and the number of MSAs for taxable years beginning in 1999 that are established during the portion of 1999 preceding July 1 (based on reports by MSA trustees and custodians), exceeds 750,000.

Under section 220(j)(3), in determining whether any calendar year is a "cut-off" year, the MSA of any previously uninsured individual is not taken into account. In addition, section 220(j)(4)(D) specifies that, to the extent practical, all MSAs established by an individual are aggregated and two married individuals opening separate MSAs are to be treated as having a single MSA for purposes of determining the number of MSAs.

A total of 36,638 tax returns reporting an excludable or deductible contribution to an MSA for the 1998 taxable year were filed by April 15, 1999. Of this total, 8,749 taxpayers were reported as being previously uninsured. It has been estimated that an additional 5,839 tax returns reporting MSA contributions for the 1998 taxable year have been or will be filed after April 15, 1999, including 1,357 taxpayers who were previously uninsured. Accordingly, it has been determined that there were 42,477 (36,638 plus 5,839) MSA returns for 1998. Of this total, 10,106 (8,749 plus 1,357) were for taxpayers reported as being previously uninsured. As a result, 32,371 (42,477 minus 10,106) MSA returns count toward the applicable statutory limitation for 1998 MSA returns of 750,000.

Based on the Forms 8851 filed on or before August 1, 1999 by MSA trustees and custodians, it has been determined that 11,727 taxpayers who did not have MSA contributions for 1998 established MSAs for 1999 during the portion of 1999 preceding July 1. Of this total, 4,468 taxpayers were reported by trustees and custodians as previously uninsured, and therefore are not taken into account in determining whether 1999 is a "cut-off" year. In addition, 963 taxpayers were reported by trustees and custodians as excludable from the count because their spouse also established an MSA, and 36 taxpayers had more than one account. Accordingly, the applicable number of MSAs established from January 1, 1999 through June 30, 1999, is 6,260 (11,727 minus (4,468 plus 963 plus 36)). The alternative limitation for 1999 (90 percent of the applicable number of MSA returns for 1998 plus the product of 2.5 and the number of applicable MSAs established from January 1, 1999 through June 30, 1999) is 44,784 (90 percent of 32,371 plus 2.5 times 6,260), which is less than the statutory limit of 750,000. Thus, 1999 is not a "cut- off" year for the MSA pilot project by reason of either the 1998 MSA returns test of section 220(j)(2)(A) or the alternative test of section 220(j)(2)(B) of the Code.

Questions regarding this announcement may be directed to Felix Zech in the Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622-4606 (not a toll free number).

Appeals Customer Service Program

Announcement 99–98

To emphasize Appeal's commitment to advancing its customer service program under the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 685, Appeals Policy Statement P-8-1, and Treasury Directive 63–01, this announcement informs taxpayers about Appeals Customer Service Representatives. Appeals presently has a Customer Service Representative in each of the thirty-three Appeals Offices nationwide.

The duties of the Appeals Customer Service Representatives include:

1) Serving as proponents of the Appeals process;

2) Providing assistance to taxpayers during their administrative appeal;

3) Handling taxpayers complaints regarding Appeals;

4) Participating in National Problem Solving Days;

5) Coordinating with Taxpayer Advocate representative on Appeals matters;

6) Performing Appeals education and outreach with the public, as well as other IRS functions;

7) Ensuring that taxpayer rights are not abridged; and

8) Identifying problems and trends, including analyzing customer survey and balanced measures results.

A list of the office locations and telephone numbers of the Appeals Customer Service Representatives, and the National and Regional Coordinators, as of October 1999, appears at the end of this announcement.

The announcement of these Appeals Customer Service Representatives reaffirms the Commissioner's concept for modernizing the Internal Revenue Service to focus on:

1) Service to Each Taxpayer,
2) Service to All Taxpayers, and
3) Productivity Through a Quality Work Environment.

Please call your local Appeals Customer Service Representative whenever you need assistance with an Appeals tax matter. For further information, visit Appeals Internet Web Site at http://www.irs.gov/prod/ind_info/appeals/index.html

DRAFTING INFORMATION

The principal author of this announcement is Thomas C. Louthan, Director, Office of Alternative Dispute Resolution and Customer Service Programs. For further information regarding this announcement, contact Mr. Louthan at (202) 694-1842, Frederick L. Gavin at (616) 235-1280, or Darlene M. Marshall at (202) 694-1875 (not a toll-free call).

TELEPHONE DIRECTORY

Appeals Customer Service Representatives

Office *(Location)*	Customer Service Representatives (Not A Toll-Free Number)
NORTHEAST REGION	
Brooklyn *(Hempstead)*	(516) 539-6259
Connecticut-Rhode Island *(East Hartford)*	(860) 290-4055
Manhattan *(New York City)*	(212) 298-2430
Michigan *(Detroit)*	(313) 226-2314 ext. 62344
New England *(Boston)*	(617) 565-7962
New Jersey *(Newark)*	(973) 645-6288
Ohio *(Cleveland)*	(216) 623-2047
Pennsylvania *(Philadelphia)*	(215) 597-2177 ext. 160
Upstate New York *(Buffalo)*	(716) 551-5330 ext. 21
SOUTHEAST REGION	
Delaware-Maryland *(Baltimore)*	(410) 962-9354
Georgia *(Atlanta)*	(404) 338-7197
Gulf Coast *(New Orleans)*	(504) 558-3177
Indiana *(Indianapolis)*	(317) 226-6778
Kentucky-Tennessee *(Nashville)*	(615) 250-5613
North Florida *(Jacksonville)*	(904) 665-0962
North-South Carolina *(Greensboro)*	(336) 378-2309
South Florida *(Ft. Lauderdale)*	(305) 982-5377
Virginia-West Virginia *(Richmond)*	(804) 771-2772
MIDSTATES REGION	
Oklahoma-Arkansas *(Oklahoma)*	(405) 297-4956
Houston *(Houston)*	(281) 721-7215
Illinois *(Chicago)*	(312) 886-5736 ext. 652
Kansas-Missouri *(St. Louis)*	(314) 612-4672
Midwest *(Milwaukee)*	(414) 297-4120
North Central *(St. Paul)*	(651) 290-3868
North Texas *(Dallas)*	(972) 308-7271
South Texas *(Austin)*	(512) 499-5650

TELEPHONE DIRECTORY—Continued

Appeals Customer Service Representatives

Office *(Location)*	Customer Service Representatives (Not A Toll-Free Number)
WESTERN REGION	
Central California *(San Jose)*	(408) 817-4622
Los Angeles *(Los Angeles)*	(213) 894-4700 ext. 129
Northern California *(San Francisco)*	(415) 744-9255
Pacific Northwest *(Seattle)*	(206) 220-6054
Southern California *(Laguna Niguel)*	(949) 360-6380
Southwest *(Phoenix)*	(602) 207-8167
Rocky Mountain *(Denver)*	(303) 844-1951

For additional information, contact:

National Office ***(Washington, DC)***

Office of Alternative Dispute Resolution and Customer Service Programs: Tom Louthan (202) 694-1842, Frederick L. Gavin (616) 235-1280, or Darlene Marshall (202) 694-1875

Regional Coordinators

Northeast Region (New York City): Ellen Wassong (212) 298-2361
Southeast Region (Atlanta): Janell Gadd (404) 338-7706
Midstates Region (Dallas): Leonard Horton (972) 308-7495
Western Region (San Francisco): Dennis Malone (415) 575-7313

Twelfth Annual Institute on Current Issues in International Taxation

Announcement 99-99

Assistant Commissioner (International) John Lyons has announced the Twelfth Annual Institute on Current Issues in International Taxation, co-sponsored with The George Washington University, to be held December 9 and 10, 1999, at the J.W. Marriott Hotel in Washington, D.C.

Designed for professionals in international tax law, the Institute will open with an overview of issues facing world tax administrations for the new millennium. The first day will also include sessions on taxation of multinational enterprises, global asymmetries, alleviating double taxation, and ethics. A panel of the Competent Authorities from Canada, Germany, the United Kingdom, and the United States will discuss availability of treaty benefits, confidentiality, and cooperation. Larry Langdon, Commissioner of the IRS Large and Mid-Size Business Division, will be the featured luncheon speaker. The second day will include sessions on international mergers and acquisitions, inbound taxation, electronic commerce and communication, information reporting and exchange for the 21st century, and an "Ask the IRS" panel. Jonathan Talisman, Acting Assistant Secretary for Tax Policy for the U.S. Treasury Department, will be the featured luncheon speaker.

Those interested in attending may obtain more information from The George Washington University, Conference Management Services, by calling (202) 973-1110 or visiting their Internet site at *http://www.gwu.edu/~cms/iti12.*

Application of Section 382 in Short Taxable Years and With Respect to Controlled Groups; Correction

Announcement 99-100

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to T.D. 8825, 1999-28 I.R.B. 19, which was published in the **Federal Register** on Friday, July 2, 1999 (64 F.R. 36175). These regulations relate to limitations on net operating loss carryovers and certain built-in losses following an ownership change of a corporation.

FOR FURTHER INFORMATION CONTACT: Lee A. Kelley at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections are under section 382 of the Internal Revenue Code.

Need for Correction

As published, T.D .8825 contains errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 8825), which are the subject of F.R. Doc. 99–16163, is corrected as follows:

1. On page 36177, column 2, instructional paragraph 2, the language "**Par 2.** Section 382–1 is amended by" is corrected to read "**Par. 2.** Section 1.382–1 is amended by:".

2. On page 36177, column 3, the section heading "**§1.1382–2 [Amended]**" is corrected to read "**§1.382–2 [Amended]**".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on September 29, 1999, 8:45 a.m., and published in the issue of the Federal Register for September 30, 1999, 64 F.R. 52650)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

26 CFR 1.62–2T: Reimbursements and other expense allowance arrangements (temporary).

Rules under which a reimbursement or other expense allowance arrangement for the cost of operating an automobile for business purposes will satisfy the requirements of section 62(c) of the Code as to business connection, substantiation, and returning amounts in excess of expenses. See Rev. Proc. 99–38, page 525.

Section 162.—Trade or Business Expenses

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

Rules are set forth for substantiating the amount of a deduction or an expense for business use of an automobile that most nearly represents current costs. See Rev. Proc. 99–38, page 525.

Section 170.—Charitable, etc., Contributions and Gifts

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

Rules are set forth for substantiating the amount of a deduction or an expense for charitable use of an automobile. See Rev. Proc. 99–38, page 525.

Section 213.—Medical, Dental, etc., Expenses

26 CFR 1.213–1: Medical, dental, etc., expenses.

Rules are set forth for substantiating the amount of a deduction or an expense for use of an automobile to obtain medical services. See Rev. Proc. 99–38, page 525.

Section 217.—Moving Expenses

26 CFR 1.217–2: Moving expenses.

Rules are set forth for substantiating the amount of a deduction or an expense for use of an automobile as part of a move. See Rev. Proc. 99–38, page 525.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274–5T: Substantiation requirements (temporary).

Simplified optional method for substantiating the amount of the ordinary and necessary business expenses of an employee for business use of an automobile when a payor provides a mileage allowance for such expenses. See Rev. Proc. 99–38, page 525.

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26 CFR 1.274(d)–1T: Substantiation requirements (temporary).

Simplified optional method for substantiating the amount of the ordinary and necessary business expenses of an employee for business use of an automobile when a payor provides a mileage allowance for such expenses. See Rev. Proc. 99–38, page 525.

Section 3504.—Acts To Be Performed by Agents

26 CFR 31.3504–1: Acts to be performed by agents.

What are the requirements of the Form 941 *e-file* Program, which combines the Form 941 Electronic Filing Program with an on-line filing program that allows a taxpayer to electronically file a Form 941, Employer's Quarterly Federal Tax Return, using a personal computer, modem, and commercial tax preparation software? See Rev. Proc. 99–39, page 532.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 31.6011(a)–7: Execution of returns.

What are the requirements of the Form 941 *e-file* Program, which combines the Form 941 Electronic Filing Program with an on-line filing program that allows a taxpayer to electronically file a Form 941, Employer's Quarterly Federal Tax Return, using a personal computer, modem, and commercial tax preparation software? See Rev. Proc. 99–39, page 532.

Section 6061.—Signing of Returns and Other Documents

26 CFR 301.6061–1: Signing of returns and other documents.

What are the requirements of the Form 941 *e-file* Program, which combines the Form 941 Electronic Filing Program with an on-line filing program that allows a taxpayer to electronically file a Form 941, Employer's Quarterly Federal Tax Return, using a personal computer, modem, and commercial tax preparation software? See Rev. Proc. 99–39, page 532.

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 31.6071(a)–1: Time for filing returns and other documents.

What are the requirements of the Form 941 *e-file* Program, which combines the Form 941 Electronic Filing Program with an on-line filing program that allows a taxpayer to electronically file a Form 941, Employer's Quarterly Federal Tax Return, using a personal computer, modem, and commercial tax preparation software? See Rev. Proc. 99–39, page 532.

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 99–52

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for September 1999 is 6.07 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
October	1999	5.99	5.39 to 6.29	5.39 to 6.59

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number).

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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, sections 62, 162, 274, 1016; 1.62–2, 1.162–17, 1.274–5T, 1.274(d)–1T, 1.1016–3.)

Rev. Proc. 99–38

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 98–63, 1998–52 I.R.B. 25, as modified by Announcement 99–7, 1999–2 I.R.B. 45, by providing optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under § 1.274–5T of the temporary Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation.

SECTION 2. SUMMARY OF STANDARD MILEAGE RATES

.01 *Standard mileage rates.*

(1) Business (section 5 below)	32.5 cents per mile
(2) Charitable (section 7 below)	14 cents per mile
(3) Medical and Moving (section 7 below)	10 cents per mile

.02 *Determination of standard mileage rates.* The business, medical, and moving standard mileage rates reflected in this revenue procedure are based on an annual study of the fixed and variable costs of operating an automobile conducted on behalf of the Service by an independent contractor, and the charitable standard mileage rate is provided in § 170(i) of the Internal Revenue Code. In connection with its study, the contractor has suggested that a change be made to the study methodology regarding the business standard mileage rate. This suggested change would include the cost of personal rather than business automobile insurance because taxpayers who use the business standard mileage rate generally carry personal rather than business insurance on their automobiles. The Service has reviewed this suggested change and has adopted it in this revenue procedure.

SECTION 3. BACKGROUND AND CHANGES

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating an automobile to the extent that it is used in a trade or business. However, under § 262, no portion of the cost of operating an automobile that is attributable to personal use is deductible.

.02 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 with respect to any listed property (as defined in § 280F(d)(4) to include passenger automobiles and any other property used as a means of transportation) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.03 Section 1.274(d)–1T, in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of local travel and transportation away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such allowances, if in accordance with reasonable business practice, will be regarded as (1) equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel and transportation

expenses for purposes of § 1.274–5T(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of such expenses for purposes of § 1.274–5T(f).

.04 Section 62(a)(2)(A) allows an employee, in determining adjusted gross income, a deduction for the expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.05 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)-(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement. Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.06 Under § 1.62–2(c)(1), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2T(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274(d)–1T will be treated as substantiation of the amount of such expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing mileage allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to miles of travel not substantiated.

.07 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a mileage allowance under an arrangement that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to miles of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under § 274(d) and § 1.274(d)–1, and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this excess portion.

.08 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on mileage allowances.

SECTION 4. DEFINITIONS

.01 *Standard mileage rate.* The term "standard mileage rate" means the applicable amount provided by the Service for optional use by employees or self-employed individuals in computing the deductible costs of operating automobiles (including vans, pickups, or panel trucks) owned or leased for business purposes, or by taxpayers in computing the deductible costs of operating automobiles for charitable, medical, or moving expense purposes.

.02 *Transportation expenses.* The term "transportation expenses" means the expenses of operating an automobile for local travel or transportation away from home.

.03 *Mileage allowance.* The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62–2(c)(1) and that is

(1) paid with respect to the ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for transportation expenses in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule.* A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 4.03 of this revenue procedure. Such allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for such purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

SECTION 5. BUSINESS STANDARD MILEAGE RATE

.01 *In general.* The standard mileage rate for transportation expenses is 32.5 cents per mile for all miles of use for business purposes. This business standard mileage rate will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.02 *Use of the business standard mileage rate.* A taxpayer may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. A taxpayer generally may deduct an amount equal to either the business standard mileage rate times the number of business miles traveled or the actual costs (both operating and fixed) paid or incurred by the taxpayer that are allocable to traveling those business miles.

.03 *Business standard mileage rate in lieu of operating and fixed costs.* A deduction using the standard mileage rate for business miles is computed on a yearly basis and is in lieu of all operating and fixed costs of the automobile allocable to business purposes (except as provided in section 9.06 of this revenue procedure). Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and license and registration fees are included in operating and fixed costs for this purpose.

.04 *Parking fees, tolls, interest, and taxes.* Parking fees and tolls attributable to use of the automobile for business purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local taxes (other than those included in the cost of gasoline) may be deducted as separate items, but only to the extent that the interest or taxes are allowable deductions under § 163 or 164 respectively. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable. However, § 163(h)-(2)(A) expressly provides that interest is nondeductible personal interest when it is paid or accrued on indebtedness properly allocable to the trade or business of performing services as an employee. Section 164 also expressly provides that state and local taxes that are paid or accrued by a taxpayer in connection with an acquisition or disposition of property will be treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition of such property.

.05 *Depreciation.* For owned automobiles placed in service for business purposes, and for which the business standard mileage rate has been used for any year, depreciation will be considered to have been allowed at the rate of 12 cents per mile for 1996, 1997, 1998, and 1999; and 14 cents per mile for 2000, for those years in which the business standard mileage rate was used. If actual costs were used for one or more of those years, the rates above will not apply to any year in which such costs were used. The depreciation described above will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016.

.06 *Limitations.*

(1) The business standard mileage rate may not be used to compute the deductible expenses of (a) automobiles used for hire, such as taxicabs, or (b) two or more automobiles used simultaneously (such as in fleet operations).

(2) The business standard mileage rate may not be used to compute the deductible business expenses of an automobile leased by a taxpayer unless the taxpayer uses either the business standard mileage rate or a FAVR allowance (as provided in section 8 of this revenue procedure) to compute the deductible business expenses of the automobile for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(3) The business standard mileage rate may not be used to compute the deductible expenses of an automobile for which the taxpayer has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. By using the business standard mileage rate, the taxpayer has elected to exclude the automobile (if owned) from MACRS pursuant to § 168(f)(1). If, after using the business standard mileage rate, the taxpayer uses actual costs, the taxpayer must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(4) The business standard mileage rate and this revenue procedure may not be used to compute the amount of the deductible automobile expenses of an employee of the United States Postal Service incurred in performing services involving the collection and delivery of mail on a rural route if the employee receives qualified reimbursements (as defined in § 162(o)) for such expenses. See § 162(o) for the rules that apply to these qualified reimbursements.

SECTION 6. RESERVED

SECTION 7. CHARITABLE, MEDICAL, AND MOVING STANDARD MILEAGE RATE

.01 *Charitable.* Section 170(i) provides a standard mileage rate of 14 cents per mile for purposes of computing the charitable deduction for use of an automobile in connection with rendering gratuitous services to a charitable organization under § 170.

.02 *Medical and moving.* The standard mileage rate is 10 cents per mile for use of an automobile (a) to obtain medical care described in § 213, or (b) as part of a move for which the expenses are deductible under § 217. The standard mileage rates for medical and moving transportation expenses will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.03 *Charitable, medical, or moving expense standard mileage rate in lieu of operating expenses.* A deduction computed using the applicable standard mileage rate for charitable, medical, or moving expense miles is in lieu of all operating expenses (including gasoline and oil) of the automobile allocable to such purposes. Costs for such items as depreciation (or lease payments), maintenance and repairs, tires, insurance, and license and registration fees are not deductible, and are not included in such standard mileage rates.

.04 *Parking fees, tolls, interest, and taxes.* Parking fees and tolls attributable to the use of the automobile for charitable, medical, or moving expense purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local taxes (other than those included in the cost of gasoline) may be deducted as separate items, but only to the extent that the interest and taxes are allowable deductions under § 163 or 164, respectively.

SECTION 8. FIXED AND VARIABLE RATE ALLOWANCE

.01 *In general.*

(1) The ordinary and necessary expenses paid or incurred by an employee in driving an automobile owned or leased by the employee in connection with the performance of services as an employee of the employer will be deemed substantiated (in an amount determined under section 9 of this revenue procedure) when a payor reimburses such expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements of section 8 of this revenue procedure (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses employees receiving the allowance would incur as owners of the standard automobile.

.02 *Definitions.*

(1) *FAVR allowance.* A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, such optional high mileage payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes when paid. See section 9.05 of this revenue procedure. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and substantiated by the employee for a calendar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment.* A periodic fixed payment covers the projected fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving the standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs of the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment.* A periodic variable payment covers the projected operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected operating costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality.* A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of operating costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile.* A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost.* The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of such an automobile. Further, the standard automobile cost may not exceed $27,300.

(7) *Annual mileage.* Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage.* Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage.* A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

Annual business mileage	*Business use percentage*
6,250 or more but less than 10,000	45 percent
10,000 or more but less than 15,000	55 percent
15,000 or more but less than 20,000	65 percent
20,000 or more	75 percent

(10) *Retention period.* A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. Such period may not be less than two calendar years.

(11) *Retention mileage.* Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value.* The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

Retention period	*Residual value*
2-year	70 percent
3-year	60 percent
4-year	50 percent

.03 *FAVR allowance in lieu of operating and fixed costs.*

(1) A reimbursement computed using a FAVR allowance is in lieu of the employee's deduction of all the operating and fixed costs paid or incurred by an employee in driving the automobile in connection with the performance of services as an employee of the employer, except as provided in section 9.06 of this revenue procedure. Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, license and registration fees, and personal property taxes are included in operating and fixed costs for this purpose.

(2) Parking fees and tolls attributable to an employee driving the standard automobile in connection with the performance of services as an employee of the employer are not included in fixed and operating costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item, but only to the extent that the interest is an allowable deduction under § 163.

.04 *Depreciation.*

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. If an employee uses actual costs for an owned automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(2) Except as provided in section 8.04(3) of this revenue procedure, the total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of such depreciation component may not exceed the sum of the annual § 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) If the depreciation component of periodic fixed payments exceeds the limitations in section 8.04(2) of this revenue procedure, that section will be treated as satisfied in any year during which the total annual amount of the periodic fixed payments and the periodic variable payments made to an employee driving 80 percent of the annual business mileage of the standard automobile does not exceed the amount obtained by multiplying 80 percent of the annual business mileage of the standard automobile by the applicable business standard mileage rate for that year (see, e.g., section 5.01 of this revenue procedure).

(4) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. See section 8.07(2) of this revenue procedure for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations.*

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in § 1.61–21(f)(5) and (6), excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) At no time during a calendar year may a majority of the employees covered by a FAVR allowance be management employees.

(4) At all times during a calendar year at least five employees of an employer must be covered by one or more FAVR allowances.

(5) A FAVR allowance may be paid only with respect to an automobile (a) owned or leased by the employee receiving the payment, (b) the cost of which, when new, is at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) A FAVR allowance may not be paid with respect to an automobile leased by an employee for which the employee has used actual expenses to compute the deductible business expenses of the automobile for any year during the entire lease period. For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(7) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account such rate-increasing factors as poor driving records or young drivers.

(8) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting.* Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if such coverage has lapsed, the employee by written declaration must provide the payor with the following information: (a) the make, model, and year of the employee's automobile, (b) written proof of the insurance coverage limits on the automobile, (c) the odometer reading of the automobile, (d) if owned, the purchase price of the automobile or, if leased, the price at which the automobile is ordinarily sold by retailers (the gross capitalized cost of the automobile), and (e) if owned, whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 8.04(1) of this revenue procedure or, if leased, whether the employee has computed deductible business expenses with respect to the automobile using actual expenses. The information described in (a), (b), and (c) of the preceding sentence also must be supplied by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting.*

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 8.06 of this revenue procedure.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement that, for automobile owners, lists the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explains that by receiving a FAVR allowance the employee has elected to exclude the automobile from MACRS pursuant to § 168(f)(1). For automobile lessees, the statement must explain that by receiving the FAVR allowance the employee may not compute the deductible business expenses of the automobile using actual expenses for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

.08 *Failure to meet section 8 requirements.* If an employee receives a mileage allowance that fails to meet one or more of the requirements of section 8 of this revenue procedure, the employee may not be treated as covered by any FAVR allowance of the payor during the period of such failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in sections 5, 9.01(1), and 9.02 of this revenue procedure to the extent the requirements of those sections are met.

SECTION 9. APPLICATION

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either:

(1) for any mileage allowance other than a FAVR allowance, the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance, the amount paid under the FAVR allowance less the sum of (a) any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of transportation expenses is deemed substantiated under the rules provided in section 9.01 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expenses in accordance with paragraphs (b)(2) (travel away from home), (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation), and (c) of § 1.274–5T, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5T(f), as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5T(c). See § 1.62–2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance other than a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of such an allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of such an allowance that relates to the miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an ad-

vance mileage allowance of $70 based on an anticipated 200 business miles at 35 cents per mile (at a time when the applicable business standard mileage rate is 32.5 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts will be treated as satisfied if the employee is required to return the portion of the allowance that relates to the 80 unsubstantiated business miles ($28) even though the employee is not required to return the portion of the allowance ($3) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($39) for the 120 substantiated business miles. However, the $3 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 9.05.

(2) For a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)), (a) the portion (if any) of the periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) the portion (if any) of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02. See § 1.274–5T(f)-(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. See §§ 1.62–2(c)(2) and (c)(4).

.05 An employee is required to include in gross income only the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02 of this revenue procedure. See § 1.274-5T(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. See §§ 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.06

(1) Except as otherwise provided in section 9.06(2) of this revenue procedure with respect to leased automobiles, if the amount of the expenses deemed substantiated under the rules provided in section 9.01 of this revenue procedure is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance received from the payor that exceeds the amount deemed substantiated. See § 1.274–5T(f)(2)(iii). However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 9.01 of this revenue procedure. The itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

(2) An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(1) of this revenue procedure (relating to an allowance other than a FAVR allowance) may not claim a deduction based on actual expenses unless the employee does so consistently beginning with the first business use of the automobile after December 31, 1997. However, an employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(2) of this revenue procedure (relating to a FAVR allowance) may not claim a deduction based on actual expenses.

.07 An employee may deduct an amount computed pursuant to section 5.01 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.08 A self-employed individual may deduct an amount computed pursuant to section 5.01 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.09 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. See §§ 1.62–2(c)(3), (c)(5), and (h)(2).

SECTION 10. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a mileage allowance (other than a FAVR allowance), if any, that relates to the miles of business travel substantiated and that exceeds the amount deemed substantiated for those miles under section 9.01(1) of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62–2(h)(2)(i)(B).

(1) In the case of a mileage allowance paid as a reimbursement, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the business miles substantiated. See § 1.62–2(h)(2)-(i)(B)(2).

(2) In the case of a mileage allowance paid as an advance, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the business miles with respect to which the advance was paid are substantiated. See § 1.62–2(h)-(2)(i)(B)(*3*). If some or all of the business

miles with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those miles within a reasonable period of time, the portion of the allowance that relates to those miles is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62–2(h)(2)(i)(A).

(3) In the case of a mileage allowance that is not computed on the basis of a fixed amount per mile of travel (e.g., a mileage allowance that combines periodic fixed and variable rate payments, but that does not satisfy the requirements of section 8 of this revenue procedure), the payor must compute periodically (no less frequently than quarterly) the amount, if any, that exceeds the amount deemed substantiated under section 9.01(1) of this revenue procedure by comparing the total mileage allowance paid for the period to the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee for the period. Any excess is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. See § 1.62–2(h)-(2)(i)(B)(*4*).

(4) For example, assume an employer pays its employees a mileage allowance at a rate of 35 cents per mile (when the business standard mileage rate is 32.5 cents per mile). The employer does not require the return of the portion of the allowance (2.5 cents) that exceeds the business standard mileage rate for the business miles substantiated. In June, the employer advances an employee $175 for 500 miles to be traveled during the month. In July, the employee substantiates to the employer 400 business miles traveled in June and returns $35 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $130 and the employee is not required to return the remaining $10. No later than the first payroll period following the payroll period in which the 400 business miles traveled are substantiated, the employer must withhold and pay employment taxes on $10.

.02 The portion of a FAVR allowance, if any, that exceeds the amount deemed substantiated for those miles under section 9.01(2) of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62–2(h)-(2)(i)(B).

(1) Any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return within a reasonable period, or any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return within a reasonable period, is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62–2(h)-(2)(i)(A).

(2) Any optional high mileage payment is subject to withholding and payment of employment taxes when paid.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 98–63, 1998–52 I.R.B. 25, as modified by Announcement 99–7, 1999–2 I.R.B. 45, is hereby superseded for mileage allowances that are paid both (1) to an employee on or after January 1, 2000, and (2) with respect to transportation expenses paid or incurred by the employee on or after January 1, 2000. Rev. Proc. 98–63, as modified by Announcement 99–7, is also hereby superseded for purposes of computing the amount allowable as a deduction for transportation expenses paid or incurred on or after January 1, 2000.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Cleverdon at (202) 622-4920 (not a toll-free call).

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26 CFR 601.602: Tax forms and instructions.
(Also Part I, sections 3504, 6011, 6061, 6071; 31.3504–1, 31.6011(a)–7, 31.6061–1, 301.6061–1, 31.6071(a)–1.)

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SECTION 1. PURPOSE

This revenue procedure provides the requirements of the Form 941 *e-file* Program, which combines the Form 941 Electronic Filing (ELF) Program with an on-line filing program that allows a taxpayer to electronically file a Form 941, Employer's Quarterly Federal Tax Return, using a personal computer, modem, and commercial tax preparation software. The technical specifications for filing Form 941 electronically are published separately in Publication 1855, Technical Specifications Guide for the Electronic Filing System of Form 941, Employer's Quarterly Federal Tax Return. This revenue procedure amplifies, clarifies, modifies, and supersedes Rev. Proc. 97–47, 1997–2 C.B. 510.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 6011(a) of the Internal Revenue Code provides that any person liable for any tax imposed by this title, or for the collection thereof, must make a return or statement according to the forms and regulations prescribed by the Secretary. Every person required to make a return or statement must include therein the information required by such forms or regulations.

.02 Section 31.6011(a)–4 of the Employment Tax Regulations provides in general that every person required to make a return of income tax withheld from wages pursuant to § 3402 must make a return for the first calendar quarter in which the person is required to deduct and withhold such tax and for each subsequent calendar quarter until the person has filed a final return. Except as otherwise provided, Form 941 is the form prescribed for making the return.

.03 Section 31.6011(a)–7 provides that each return, together with any prescribed copies or supporting data, must be filled in and disposed of in accordance with the forms, instructions, and regulations applicable thereto. The return may be made by an agent in the name of the person required to make the return if an acceptable power of attorney is filed with the Internal Revenue Service office with which such person is required to file returns and if such a return includes all taxes required to be reported by such person on such return. Form 8655, Reporting Agent Authorization for Magnetic Tape/Electronic Filers, is an acceptable power of attorney, if prepared in accordance with the requirements set forth in Rev. Proc. 96–17, 1996–1 C.B. 633, as modified by section 21.02 of this revenue procedure.

.04 Section 31.6061–1 provides that the return may be signed for the taxpayer by an agent that is fully authorized in accordance with § 31.6011(a)–7 to make such return. An Agent may sign the Form 941 on behalf of a taxpayer that has a valid Form 8655 on file with the Service.

.05 Section 301.6061–1 of the Regulations on Procedure and Administration provides that the Secretary may prescribe in forms, instructions, or other appropriate guidance the method for signing any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations. The Service has prescribed in the electronic filing instructions to Form 941 that an electronically filed Form 941 is signed by the entry of the Authorized Signatory's Personal Identification Number ("PIN").

.06 Section 31.6071(a)–1 generally provides that each return required to be made under § 31.6011(a)–1 for taxes imposed by the Federal Insurance Contributions Act, or required to be made under § 31.6011(a)–4 for withheld income taxes, must be filed on or before the last day of the first calendar month following the period for which it is made. However, under § 31.6071(a)–1, a return may be filed on or before the 10th day of the second calendar month following such period if timely deposits under § 6302(c) and the regulations thereunder have been made in full payment of such taxes due for the period.

.07 Procedures for the magnetic filing of Form 941 are in Rev. Proc. 96–18, 1996–1 C.B. 637, and the specifications are in Publication 1264. For further information, see Publication 1264, File Specifications, Process Criteria, and Record Layouts for Magnetic Tape Filing of Form 941, Employer's Quarterly Federal Tax Return.

.08 This revenue procedure updates Rev. Proc. 97–47. The updates include changes in the Form 941 *e-file* Program and additional guidance derived from other Service documents that relate to the Form 941 *e-file* Program. Some of the updates are:

(1) returns for any quarter in the previous year can be filed electronically (section 3);

(2) On-Line Filers, who prepare and file Forms 941 on-line using their personal computer, modem, and commercial tax preparation software, have been added to the Form 941 *e-file* Program (section 4.05);

(3) the signature provisions for an electronically filed Form 941 have been modified to allow On-Line Filers to use a PIN as an electronic signature alternative to sign electronic Forms 941 for the Form 941 *e-file* Program (sections 4.01 and 6.05);

(4) the definition of an Electronic Filer has been expanded to include a Transmitter (Section 4.02);

(5) the limitations on balance due returns in section 3.03 of Rev. Proc. 97–47 have been eliminated; and

(6) the restriction in sections 5.03 and 23.02 of Rev. Proc. 97–47 on Reporting Agents filing fewer than ten returns has been eliminated.

SECTION 3. SCOPE

The Form 941 *e-file* Program accepts electronically filed Forms 941 that are current returns, late returns for the current year, and returns for any quarter in the previous year. The Form 941 *e-file* Program will not accept the electronic filing of amended returns, corrected returns, or returns containing attachments other than Schedule B. A violation of these restrictions will cause a Processing Interruption (as defined in section 4.07 of this revenue procedure).

SECTION 4. DEFINITIONS

.01 *Authorized Signatory.* The Authorized Signatory is the person who is authorized to use the PIN to sign returns filed by or through an Electronic Filer under the Form 941 *e-file* Program or during software development testing.

.02 *Electronic Filer.* An Electronic Filer may be a:

(1) *Reporting Agent.* A Reporting Agent ("Agent") is an accounting service, franchiser, bank, or other person that complies with Rev. Proc. 96–17, as modified by section 21.02 of this revenue procedure, and is authorized to prepare and electronically file a Form 941 for a taxpayer;

(2) *Software Developer.* A Software Developer develops software for the purposes of (a) formatting returns according to the Service's electronic return specifications in Publication 1855; and/or (b) transmitting electronic returns directly to the Service. A Software Developer may also sell its software; or

(3) *Transmitter.* A Transmitter is a firm, organization, or individual that receives returns and Letters of Application electronically from its clients, reformats the data (if necessary), batches them with returns or electronic Letters of Application from other clients, and then transmits the data to the Service. A Transmitter does not have signature authority for the taxpayers that it services.

.03 *Electronic Filing Help Desk.* The Electronic Filing Help Desk ("*e-file* Help Desk") is responsible for the administration of the Form 941 *e-file* Program. See section 20 of this revenue procedure for the address, telephone number, and web site of the *e-file* Help Desk.

.04 *Letter of Application.* A Letter of Application ("LOA") is a paper or electronic request to participate in the Form 941 *e-file* Program that is submitted to the Service by a prospective Electronic Filer or On-Line Filer.

.05 *On-Line Filer.* An On-Line Filer is a taxpayer that electronically files a Form 941 through a Transmitter using a personal computer, modem, and commercial tax preparation software.

.06 *Personal Identification Number.* A Personal Identification Number ("PIN") is a number assigned by the Service to the Authorized Signatory for purposes of signing an electronically filed Form 941.

.07 *Processing Interruption.* A "Processing Interruption" is an abnormal termination of a program run caused by the electronic data submitted by an Electronic Filer.

.08 *Reporting Agent Authorization.* A Reporting Agent Authorization ("Authorization") allows a taxpayer to designate an Agent. The Authorization may be submitted on Form 8655, or any other instrument that complies with Rev. Proc. 96–17, as modified by section 21.02 of this revenue procedure. An Authorization must be submitted for each taxpayer on the Reporting Agent's List.

.09 *Reporting Agent's List.* For purposes of the Form 941 *e-file* Program, a Reporting Agent's List ("Agent's List") identifies all taxpayers for whom an Agent will file Forms 941 electronically. A separate Authorization must be submitted for each taxpayer on the Agent's List. The Agent's List must contain each taxpayer's employer identification number ("EIN").

.10 *User identification/password.* The user identification/password ("userid/password") consists of an identification number (userid) issued by the Service and a confidential set of characters (password) that, when used in conjunction with each other, permit an Electronic Filer access to the Form 941 *e-file* Program.

.11 *Validated Reporting Agent's List.* A Validated Reporting Agent's List ("Validated Agent's List") is the source of the EIN and name control to be used as an identification of each taxpayer by an Electronic Filer that is an Agent. A Validated Agent's List is a list of taxpayers and their EINs prepared by an Agent that is confirmed and assigned name controls by the Service. Once the Service returns a Validated Agent's List, the Agent must use it to fill in certain required fields (for example, the name control field) of the electronic transmission. See Publication 1855.

SECTION 5. APPLICATION FOR THE FORM 941 *e-file* PROGRAM

.01 A prospective Electronic Filer must first submit an LOA to the Service to participate in the Form 941 *e-file* Program. See Publication 1855 for a sample LOA and the application procedures.

.02 A prospective On-Line Filer must submit an electronic LOA through a Transmitter to participate in the Form 941 *e-file* Program. The Transmitter is required to batch and bundle the electronic LOA files, and then transmit those files to the Service. The Transmitter is required to send an acknowledgment to the On-Line Filer to verify that the electronic LOA was transmitted successfully to the Service. The LOA is provided in the commercial tax preparation software used by the On-Line Filer in order to participate in the Form 941 *e-file* Program.

.03 In addition to the LOA, an Agent must also include an Agent's List, providing the names of all taxpayers for which it will file returns. Each name on the Agent's List must be accompanied by an Authorization made on Form 8655, except as provided in section 5.04 of this revenue procedure. See Rev. Proc. 96–17, as modified by section 21.02 of this revenue procedure, for general instructions on preparing Form 8655. See Publication 1855 for instructions on adding names to, or deleting names from, the Agent's List.

.04 A revised Authorization is not required to replace an Authorization made on Form 8655 with a revision date before October 1995 (or its equivalent) that was previously submitted to the Service by an Agent, provided that the Authorization places no restriction on the medium for filing Form 941, and the Agent:

(1) advises its client that its Forms 941 may be filed electronically, and provides the client with the option of rejecting electronic filing as the medium for filing its Forms 941. An Agent may use the

most efficient and timely method of clearly providing this notification to a client. A client's rejection of electronic filing for its Forms 941 must be submitted in writing to the Agent; and

(2) immediately removes any client from its electronic filing client base that rejects having its Forms 941 filed electronically.

SECTION 6. ACCEPTANCE IN THE FORM 941 *e-file* PROGRAM

.01 A prospective Electronic Filer or On-Line Filer will receive an acceptance or rejection regarding their LOA for the Form 941 *e-file* Program within 45 days of the Service's receipt of their completed LOA.

.02 An Electronic Filer that is accepted in the Form 941 *e-file* Program will be required to submit a successful test transmission before being granted approval to file tax returns. Details regarding test requirements may be found in Publication 1855.

.03 After evaluating the test file, the Service will notify an Electronic Filer in writing of approval or denial of electronic filing privileges. An approval remains in effect unless the Electronic Filer:

(1) that is an Agent fails to comply with the Authorization requirements of sections 5.03 and 5.04 of this revenue procedure;

(2) that is a Software Developer fails to comply with the requirements of section 9.04 of this revenue procedure;

(3) that is a Transmitter fails to comply with the requirements of section 9.03 of this revenue procedure; or

(4) is suspended from the Form 941 *e-file* Program. See section 15 of this revenue procedure for the effect of a suspension.

.04 The acceptance by the Service of a Software Developer as an Electronic Filer:

(1) establishes only that the test electronic transmission(s) are formatted properly and may be processed by the Service;

(2) is not an endorsement by the Service of the software or the quality of services provided by the Software Developer; and

(3) does not entitle the Software Developer to electronically file Forms 941 unless the Software Developer is also accepted in the Form 941 e-file Program as an Agent or Transmitter.

.05 If an LOA is approved, the Service will send the following:

(1) for an Electronic Filer, a notification of approval that will contain the userid/password, and information and procedures regarding signing onto the system for filing electronic Forms 941; and

(2) for an Authorized Signatory, a PIN that may be used only by the Authorized Signatory named in the LOA.

.06 Upon receipt of the document(s) referenced in section 6.05 of this revenue procedure, the Electronic Filer must return the following documents to the Service:

(1) an acknowledgment signed by each employee recipient of the userid/password indicating possession of, and responsibility for, the userid/password; and

(2) where applicable, an acknowledgment signed by the Authorized Signatory indicating possession of, and responsibility for, the proper use of the PIN for signing tax returns (pursuant to § 301.6061–1) filed in the Form 941 *e-file* Program.

See Publication 1855 for a sample userid/password and PIN receipt.

.07 Upon receipt of the PIN referenced in section 6.05(2) of this revenue procedure, the On-Line Filer must return an acknowledgment signed by the Authorized Signatory indicating possession of, and responsibility for, the proper use of the PIN for signing tax returns (pursuant to § 301.6061–1) filed in the Form 941 *e-file* Program.

.08 The Service will activate the userid/password and the PIN upon receiving the Electronic Filer's or On-Line Filer's acknowledgments referenced in sections 6.06 and 6.07 of this revenue procedure.

.09 If a prospective Electronic Filer that is an Agent is denied, or does not receive, approval to participate in the Form 941 *e-file* Program before the end of the tax quarter for which the Forms 941 will be filed, the Agent should file the returns on paper Forms 941 (or on magnetic tape if the Agent meets the requirements of Rev. Proc. 96–18).

SECTION 7. ELECTRONIC FILING OF FORM 941

.01 An Electronic Filer that is an Agent must ensure that a current electronic Form 941 is filed on or before the due date of the return. The due dates prescribed for filing paper Forms 941 with the Service also apply to returns filed under the Form 941 *e-file* Program. Forms 941 are due on or before the last day of the first calendar month following the period for which the return is made. However, a return for which all tax deposits were made when due for the quarter may be filed by the 10th day of the month following the due date.

.02 An Electronic Filer that is a Transmitter must ensure that an electronic Form 941 is transmitted to the Service by the later of: (1) three days after receipt of the return; or (2) the due date of the return without regard to extensions.

.03 An electronically filed Form 941 is not considered filed until it has been acknowledged as accepted for processing by the Service. If an electronically filed Form 941 is transmitted to the Service on or before the return due date, the return will be deemed timely filed. If an electronically filed Form 941 is initially transmitted to the Service on or before the return due date and is ultimately rejected, but the Electronic Filer complies with section 7.04 or 7.05 of this revenue procedure, as appropriate, and the On-Line Filer complies with section 7.06 of this revenue procedure, the return will be deemed timely filed.

.04 An electronic transmission that causes a Processing Interruption may not be accepted. An Electronic Filer that is an Agent will be asked to resubmit the return(s). If the electronic transmission is acknowledged as rejected by the Service, the Agent should correct the error(s) and retransmit the return(s) on the same calendar day. If the Agent chooses not to have the previously rejected return retransmitted, or if the return still cannot be accepted for processing, a paper Form 941 (or a Form 941 on magnetic tape if the Electronic Filer meets the requirements of Rev. Proc. 96–18) must be filed by the later of: (1) the due date of the return; or (2) within five calendar days of the rejection or notice that the return cannot be retransmitted, with an explanation of why the return is being filed after the due date. For the penalty for failure to file a timely return, see section 17 of this revenue procedure.

.05 If a Processing Interruption occurs with an Electronic Filer that is a Transmit-

ter, and the Transmitter cannot promptly correct any transmission error that causes an electronic transmission to be rejected, then the Transmitter, within 24 hours of receiving the rejection, must take reasonable steps to inform the On-Line Filer that the return has not been filed. When the Transmitter advises the On-Line Filer that the return has not been filed, the Transmitter must provide the On-Line Filer with the reject code(s), an explanation of the reject code(s), and the sequence number of each reject code(s). See Publication 1855 for an explanation of the reject codes.

.06 If the On-Line Filer chooses not to have the electronic portion of the return corrected and transmitted to the Service, or if the electronic portion of the return cannot be accepted for processing by the Service, the On-Line Filer must file a paper Form 941 by the later of: (1) the due date of the return; or (2) within five calendar days of the rejection or notice that the return cannot be retransmitted, with an explanation of why the return is being filed after the due date. For the penalty for failure to file a timely return, see section 17 of this revenue procedure.

SECTION 8. ADJUSTMENTS TO FORM 941

Forms 941 filed under the Form 941 *e-file* Program must not contain adjustments other than adjustments resulting from rounding fractions of cents or from third-party sick pay for which an employer is not responsible. Returns with other adjustments must be filed on magnetic tape or on paper.

SECTION 9. RESPONSIBILITIES OF PARTICIPANTS IN FORM 941 *e-file* PROGRAM

.01 To ensure that complete returns are accurately and efficiently filed, Electronic Filers must comply with the technical specifications detailed in Publication 1855.

.02 An Electronic Filer or On-Line Filer must comply with the following applicable userid/password and PIN requirements:

(1) if an Electronic Filer suspects that the confidentiality of the userid/password has been compromised, the Electronic Filer must contact the *e-file* Help Desk within 24 hours for instructions on how to proceed. See section 20 of this revenue procedure for Service contact information;

(2) the Electronic Filer or On-Line Filer is responsible for ensuring that the PIN remains the confidential information of the Authorized Signatory. If the Electronic Filer or On-Line Filer suspects that the confidentiality of the PIN has been compromised, the Electronic Filer or On-Line Filer must contact the *e-file* Help Desk within 24 hours for instructions on how to proceed. See section 20 of this revenue procedure for Service contact information;

(3) if the Authorized Signatory changes, the Electronic Filer or On-Line Filer must notify the Service of the name and title of the new Authorized Signatory for the electronically filed Form 941 and apply for a new PIN no later than 15 days before the filing of another return. After this notification, the Service will deactivate the current PIN and issue a new PIN to the new Authorized Signatory. The new Authorized Signatory must submit a PIN receipt as specified in section 6.06 or 6.07 of this revenue procedure in order to activate the new PIN; and

(4) the Authorized Signatory must manually enter the PIN signature for each transmission of electronically filed Forms 941.

.03 An Electronic Filer that is a Transmitter must:

(1) retrieve the acknowledgment file (in which the Service states whether it accepts or rejects the electronic portion of a taxpayer's return for processing) within two work days of transmission;

(2) match the acknowledgment file to the original transmission file and send to the On-Line Filer either

(a) an acceptance notice within two days of retrieving the acknowledgment file; or

(b) a rejection notice within 24 hours of retrieving the acknowledgment file;

(3) immediately contact the appropriate service center for further instructions if an acknowledgment of acceptance for processing has not been received by the Transmitter within two work days of transmission or if a Transmitter receives an acknowledgment for a return that was not transmitted on the designated transmission;

(4) promptly correct any transmission error that causes an electronic transmission to be rejected; and

(5) ensure the security of all transmitted data.

.04 An Electronic Filer that is a Software Developer must:

(1) promptly correct any software error that may cause, or causes, an electronic return to be rejected;

(2) promptly distribute any such software correction;

(3) ensure that any software package that will be used to transmit returns from multiple Electronic Filers that are Agents has the capability of combining these returns into one Service transmission file; and

(4) not incorporate into its software a Service assigned PIN.

SECTION 10. ALTERNATIVE FILING PROCEDURES

.01 Procedures for the filing of Form 941 on magnetic tape are in Rev. Proc. 96-18 and the specifications are in Publication 1264.

.02 An Electronic Filer that is an Agent may use a Form 941 *e-file* Program Authorization to file a paper Form 941 under the following circumstances:

(1) the late receipt of payroll information from a taxpayer that would jeopardize the timely submission of the taxpayer's return;

(2) the amendment of returns filed under the Form 941 *e-file* Program;

(3) the rejection of an electronic transmission that would jeopardize the timely submission of the taxpayer's return;

(4) an authorization by the Service for an Agent to file paper Forms 941 instead of electronically filed Forms 941; or

(5) the suspension of an Agent from the Form 941 *e-file* Program as provided in section 15.02(3) of this revenue procedure.

.03 An Agent may prepare a paper Form 941 for the taxpayer's signature. A taxpayer's authorized representative that is not an Agent participating in the Form 941 *e-file* Program (including a suspended Agent) must have a valid power of attorney (usually a Form 2848, Power of Attorney and Declaration of Representative) that authorizes the representative to sign and file a paper Form 941 on behalf of a taxpayer.

.04 Each paper Form 941 must be signed by the taxpayer, the taxpayer's authorized representative, or a participating Agent to the extent permitted under section 10.02 of this revenue procedure.

SECTION 11. REVISION OF COMPUTER SPECIFICATIONS BY THE SERVICE

.01 If Publication 1855 is revised, the Service, if necessary, will advise all current Electronic Filers to submit test files prior to filing under the new specifications. Failure to submit a test file may later result in a Processing Interruption, which may result in a notice of suspension. See section 13 of this revenue procedure concerning the reasons for suspension of electronic filing privileges.

.02 If an Electronic Filer is unable to comply with the changes in specifications, the Electronic Filer must contact the *e-file* Help Desk for further instructions.

SECTION 12. ADVERTISING STANDARDS

.01 An Electronic Filer must:

(1) comply with the advertising and solicitation provisions of 31 C.F.R. Part 10 (Treasury Department Circular No. 230). This circular prohibits the use or participation in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive, or unfair statement or claim. In addition, advertising must not imply a special relationship with the Service, Financial Management Service ("FMS"), or the Treasury Department;

(2) adhere to all relevant federal, state, and local consumer protection laws;

(3) not use the Service's name, "Internal Revenue Service" or "IRS", within a firm's name;

(4) not use improper or misleading advertising in relation to the Form 941 *e-file* Program;

(5) not carry the Service, FMS, or other Treasury Seals on its advertising material;

(6) clearly state the names of all cooperating parties if advertising for a cooperative electronic return filing project (public/private sector);

(7) pre-record any radio or television advertisement and keep a copy of this advertisement for a period of at least 36 months from the date of the last transmission or use; and

(8) retain a copy of any actual direct mailing or fax communications, along with a list or other description of persons to whom the communication was mailed, faxed, or otherwise distributed for a period of at least 36 months from the date of the last mailing, fax, or distribution.

.02 Acceptance to participate in the Form 941 *e-file* Program does not imply endorsement by the Service, FMS, or the Treasury Department of the software or quality of services provided.

SECTION 13. REASONS FOR SUSPENSION

.01 The Service reserves the right to suspend an Electronic Filer from the Form 941 *e-file* Program for the following reasons (this list is not all-inclusive):

(1) submitting tax returns for which the Service did not receive Authorizations;

(2) repeatedly submitting tax returns that cause a Processing Interruption;

(3) submitting tax returns that cause a Processing Interruption after failing to submit the test file required by section 6.02 of this revenue procedure;

(4) failing to comply with the responsibilities of an Electronic Filer set forth in section 9 of this revenue procedure;

(5) failing to abide by the advertising standards in section 12 of this revenue procedure; or

(6) significant complaints about an Electronic Filer's performance in the Form 941 *e-file* Program.

.02 If the Electronic Filing Coordinator informs an Electronic Filer that a certain action is a reason for suspension and the action continues, the service center director may send the Electronic Filer a notice proposing suspension of the Electronic Filer. However, a notice proposing suspension may be sent without a warning if the Electronic Filer's action indicates an intentional disregard of rules. A notice proposing suspension will describe the reason(s) for the proposed suspension, and indicate the length of the suspension and the conditions that need to be met before the suspension will terminate.

.03 An Electronic Filer that is an Agent or Transmitter has an obligation to notify its Form 941 *e-file* Program clients when that Agent or Transmitter is suspended from filing under the Form 941 *e-file* Program as provided in sections 15.02(4) and 15.03 of this revenue procedure. The Service reserves the right to extend the period of suspension of any Agent or Transmitter that fails to comply with this requirement.

SECTION 14. ADMINISTRATIVE REVIEW PROCESS FOR PROPOSED SUSPENSION

.01 An Electronic Filer that receives a notice proposing suspension may request an administrative review prior to the proposed suspension taking effect.

.02 The request for an administrative review must be in writing and contain detailed reasons, with supporting documentation, for withdrawal of the proposed suspension.

.03 The written request for an administrative review and a copy of the notice proposing suspension must be delivered to the Electronic Filing Coordinator within 30 calendar days of the date on the notice proposing suspension. The Electronic Filing Coordinator will forward the written request to the National Program Analyst for Electronic Filing of Business Returns ("National Coordinator") if the service center director continues to believe that suspension is warranted.

.04 After consideration of the written request for an administrative review, the National Coordinator will either issue a suspension letter or notify the Electronic Filer in writing that the proposed suspension is withdrawn.

.05 If an Electronic Filer receives a suspension letter, the Electronic Filing Coordinator's subsequent determination of whether a reason for suspension has been corrected is not subject to review or appeal.

.06 If an Electronic Filer does not timely submit a written request for an administrative review, the service center director will issue a suspension letter.

.07 Failure to submit a written request for an administrative review within the 30-day period described in section 14.03 of this revenue procedure irrevocably terminates the Electronic Filer's right to an administrative review of the proposed suspension.

SECTION 15. EFFECT OF SUSPENSION

.01 An Electronic Filer's suspension will continue for the length of time specified in the suspension letter, or until the conditions for terminating the suspension have been met, whichever is later.

.02 In the case of an Electronic Filer that is an Agent, the following additional rules apply:

(1) if a Form 941 is due (without regard to extensions) within 60 days from the date on the suspension letter, the Agent may file the Form 941 under the Form 941 *e-file* Program;

(2) if a Form 941 is due (without regard to extensions) more than 60 days from the date on the suspension letter, the Agent may not file the Form 941 under the Form 941 *e-file* Program;

(3) if a suspended Agent has a power of attorney from a taxpayer that authorizes the Agent to sign and file Form 941, the suspended Agent will be able to sign and file a paper Form 941 for the taxpayer. See section 10.03 of this revenue procedure. Form 8655 does not authorize the filing of paper Forms 941 outside of the Form 941 *e-file* Program; and

(4) an Agent must provide written notification of a suspension to a taxpayer at least 45 days before the due date of the taxpayer's first return affected by the suspension. This notification must be provided even though the Agent may believe that the Agent will be able to meet the conditions for terminating the suspension before the due date.

.03 A Transmitter that receives a suspension letter from the Service may not accept any further LOAs from prospective On-Line Filers that want to participate in the Form 941 *e-file* Program and must immediately inform current On-Line Filers of its inability to transmit Forms 941 during its suspension

.04 An Electronic Filer will be able to participate in the Form 941 *e-file* Program from which the Electronic Filer was suspended, without reapplying to the Form 941 *e-file* Program, after:

(1) the stated suspension period expires; and

(2) the reason(s) for suspension is corrected.

SECTION 16. APPEAL OF SUSPENSION

.01 If an Electronic Filer receives a suspension letter from the National Coordinator, the Electronic Filer is entitled to appeal, by written protest, to the National Director of Appeals. The written protest must be sent to the National Coordinator, who will forward it to the National Director of Appeals. During the appeals process, the suspension remains in effect.

.02 The written protest must be received by the National Coordinator within 30 calendar days of the date of the suspension letter. The written protest must contain detailed reasons, with supporting documentation, for termination of the suspension.

.03 Within 15 calendar days of receipt of a written protest, the National Coordinator will forward the file on the Electronic Filer and the material described in section 16.02 of this revenue procedure to the National Director of Appeals.

.04 Failure to appeal within the 30-day period described in section 16.02 of this revenue procedure irrevocably terminates the Electronic Filer's right to appeal the suspension.

SECTION 17. PENALTY FOR FAILURE TO TIMELY FILE A RETURN

Section 6651(a)(1) provides that for each month (or part thereof) a return is not filed when required (determined with regard to any extensions of time for filing), there is a penalty of 5 percent of the unpaid tax not to exceed 25 percent, absent reasonable cause. A taxpayer does not establish reasonable cause simply by engaging a competent Electronic Filer to file the taxpayer's return. However, if the Electronic Filer has reasonable cause under § 6651(a) for failing to timely file the taxpayer's return, the taxpayer will also have reasonable cause for that failure, and the failure-to-file penalty will be abated.

SECTION 18. FILING FORMS W-4 WITH THE INTERNAL REVENUE SERVICE

.01 An employer is required to send to the Service by the due date of the quarterly return copies of all Forms W-4, Employee's Withholding Allowance Certificates, received during the quarter from any employee still employed at the end of the quarter who claims:

(1) more than 10 withholding exemptions; or

(2) exemption from withholding and is expected to earn more than $200 per week.

Employers should not send other Forms W-4 unless notified by the Service in writing to do so.

.02 If an employer's Form 941 is filed under the Form 941 *e-file* Program, copies of required paper Forms W-4 along with a cover letter providing the employer's name, address, EIN, and the number of Forms W-4 included, must be sent to the service center that would have received the employer's paper Form 941. See Publication 15, Circular E, Employer's Tax Guide, for more information on sending Forms W-4 to the Service.

.03 Required Forms W-4 information may also be filed on magnetic media (5¼-inch diskettes, 3½-inch diskettes, or magnetic tape). For more information concerning magnetic media filing of Forms W-4, see Publication 1245, Specifications for Filing Form W-4, Employee's Withholding Allowance Certificate, on Magnetic Tape, and 5¼ and 3½-Inch Magnetic Diskettes.

SECTION 19. FILING FORMS W-2 (COPY A) WITH THE SOCIAL SECURITY ADMINISTRATION

Forms W-2 (Copy A), Wage and Tax Statements, must be filed directly with the Social Security Administration on magnetic media or paper. For information on magnetic media reporting of Form W-2 (Copy A), contact the Social Security Administration's Regional Magnetic Media Coordinators.

SECTION 20. INTERNAL REVENUE SERVICE CONTACT

Unless otherwise instructed, all questions regarding this revenue procedure should be directed to the *e-file* Help Desk at the following address, telephone number, or web site:

Address:

Internal Revenue Service
Austin Service Center
Electronic Filing Help Desk
P.O. Box 1231
Stop 6380 AUSC
Austin, TX 78767
Attention: Electronic Filing

Telephone Number:

(512) 460-8900 (not a toll-free number)

Web site for Help Desk:

www.irs.gov/prod/elec_svs/

Web site for Publications:

www.irs.gov

SECTION 21. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 97–47 is amplified, clarified, modified, and superseded.

.02 Section 6.05 of Rev. Proc. 96–17, 1996–1 C.B. 633, is modified to provide the same relief as set forth in section 5.04 of this revenue procedure (regarding an Agent not having to replace a previously submitted Authorization under certain circumstances).

SECTION 22. EFFECTIVE DATE

This revenue procedure is effective for returns due after October 7, 1999 (without regard to extensions).

SECTION 23. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1557.

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

The collections of information in this revenue procedure are in sections 5, 6, 7, 9, 11, and 12. This information is required by the Service to implement the Form 941 *e-file* Program and to enable taxpayers to file their Forms 941 electronically. The information will be used to ensure that taxpayers receive accurate and essential information regarding the filing of their electronic returns and to identify persons involved in the filing of electronic returns. The collections of information are required to retain the benefit of participating in the Form 941 *e-file* Program. The likely respondents are business or other for-profit institutions; federal, state or local governments; nonprofit institutions; and small businesses or organizations.

The estimated total annual reporting and recordkeeping burden is 238,863 hours.

The estimated annual burden per respondent/recordkeeper varies from 10 minutes to 5 hours, depending on individual circumstances, with an estimated average of 37 minutes. The estimated number of respondents and recordkeepers is 390,200.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Averaging of Farm Income

REG-121063-97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations for averaging farm income under section 1301 of the Internal Revenue Code. The regulations reflect the enactment of the provision by the Taxpayer Relief Act of 1997, as amended by the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999. The regulations provide guidance to individuals engaged in a farming business who may elect to reduce their regular tax liability by treating all or a portion of the current year's farming income as if it had been earned in equal proportions over the prior three years. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments and requests to speak (with outlines of oral comments) at a public hearing scheduled for February 15, 2000, must be received by January 14, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-121063-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-121063-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, John M. Moran, at (202) 622-4940; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, at (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by December 7, 1999. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §1.1301-1(c). This collection of information is required by the IRS to verify compliance with section 1301. This information will be used to determine whether the amount of tax has been calculated correctly. The collection of information is required to obtain a benefit. The respondents are certain individuals engaged in the trade or business of farming.

Taxpayers provide the information on Schedule J, Farm Income Averaging, which is attached to Form 1040, U.S. Individual Income Tax Return, for the taxable year in which income averaging is elected. The burden for this requirement is reflected in the burden estimate for Schedule J. The estimated burden for the 1998 Schedule J is 1.31 hours per respondent.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) for averaging farm income under section 1301 of the Internal Revenue Code (Code). Section 1301 was enacted by section 933 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788) (the TRA of 1997), effective for taxable years beginning after December 31, 1997, and ending before January 1, 2001. Section 2011 of the Tax and Trade Relief Extension Act of 1998, which is part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999, Public Law 105-277, 112 Stat. 2681, amended section 933 of the TRA of 1997 by deleting the January 1, 2001 ending date.

Section 1301(c) authorizes the Secretary to prescribe regulations as may be appropriate to carry out the purposes of this section, including regulations regarding (1) the order and manner in which items of income, gain, deduction, or loss, or

limitations on tax, shall be taken into account in computing the tax imposed by chapter 1 (Normal Taxes and Surtaxes) of subtitle A (Income Taxes) of the Code on the income of any taxpayer to whom this section applies for any taxable year, and (2) the treatment of any short taxable year.

Explanation of Provisions

I. In general

Under section 1301, an individual may elect to compute the section 1 tax for the current taxable year by designating all or a portion of the individual's farm income (subject to certain limitations) as elected farm income, and subtracting it from taxable income. One-third of the elected farm income is allocated to each of the three prior years' taxable income and the increase in the section 1 tax that results from these additions is calculated. The prior years are referred to as base years. The tax for the current year is the sum of (1) the section 1 tax for the current year without the elected farm income and (2) the increase in the section 1 tax for the three base years that is attributable to elected farm income.

II. Engaged in a farming business

The proposed regulations provide that the term *farming business* has the same meaning as provided in section 263A(e)(4) and the regulations thereunder. The proposed regulations also provide that an individual engaged in a farming business includes a sole proprietor of a farming business, a partner of a partnership engaged in a farming business, and a shareholder of an S corporation engaged in a farming business.

III. Making, changing, or revoking an election

The proposed regulations provide that a farm income averaging election is made by filing Schedule J, Farm Income Averaging, with an individual's timely filed Federal income tax return (including extensions). In general, the proposed regulations provide that if an individual has an adjustment for an election year or base year, the individual may also make a late farm income averaging election or change or revoke a previous election. An adjustment is any change in taxable income or tax liability that is permitted to be made by filing an amended Federal income tax return, or a change in taxable income or tax liability resulting from an IRS examination. If there is no adjustment for an election year or a base year, a late election, change, or revocation may be made only with the consent of the Commissioner. The IRS and the Treasury Department anticipate that the Commissioner's consent will be obtained by requesting a letter ruling from the national office.

IV. Calculation of section 1 tax

Farm income averaging allocates one-third of elected farm income from an election year to each of the base years only for the purpose of calculating the section 1 tax attributable to the elected farm income allocated to each base year. The proposed regulations provide that the section 1 tax for the election year is determined by allocating elected farm income to the base years only after all other adjustments and determinations have been made. For example, any net operating loss carryover is applied to an election year before allocating elected farm income to the base years.

The regulations provide that the allocation of elected farm income to the base years does not affect any determination (other than the calculation of the section 1 tax attributable to the elected farm income) with respect to the election year or the base years. Thus, for example, in applying the section 68 overall limitation on itemized deductions to the election year, adjusted gross income for the election year includes any elected farm income allocated to the base years. Similarly, the section 68 limitation for a base year is not recomputed to take into account any allocation of elected farm income to such base year.

The proposed regulations provide that calculation of the section 1 tax on elected farm income allocated to a base year is made without any additional adjustments or determinations with respect to that year. For example, if a base year had a partially used capital loss, the remaining capital loss may not be applied to reduce the elected farm income allocated to such year. Similarly, if a base year had a partially used credit, the remaining credit may not applied to reduce the section 1 tax attributable to the elected farm income allocated to such year.

V. Elected farm income

The proposed regulations provide that farm income includes all income, deductions, gains, and losses attributable to an individual's farming business. An individual may designate what type, and how much of each type, of farm income is to be treated as elected farm income. The elected farm income may not exceed an individual's taxable income. In addition, elected farm income from net capital gain attributable to a farming business may not exceed total net capital gain. One-third of each type of elected farm income is then allocated to each base year.

Proposed Effective Date

The regulations, as proposed, apply to any taxable period ending on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register.** However, the rules in these proposed regulations may be relied on by individuals for taxable periods ending before the publication of the Treasury decision.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the collection of information imposed by this regulation is not significant as reflected in the estimated burden of information collection for Schedule J, which is 1.31 hours per respondent. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. In addition, comments are specifically requested regarding whether wages paid to a shareholder of an S corporation may be electible farm income. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 15, 2000, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by January 14, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is John M. Moran, Office of Assistant Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendment to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.1301–1 also issued under 26 U.S.C. 1301(c). * * *

Par. 2. An undesignated center heading and §1.1301–1 are added immediately following the center heading "Readjustment of Tax Between Years and Special Limitations" to read as follows:

INCOME AVERAGING

§1.1301–1 Averaging of farm income.

(a) *Overview.* An individual engaged in a farming business may elect to compute his or her current year (election year) income tax liability under section 1 by averaging, over the prior three-year period (base years), all or a portion of the individual's current year electible farm income (as defined in paragraph (e) of this section. To average farm income, the individual–

(1) Designates all or a portion of his or her electible farm income for the election year as elected farm income;

(2) Allocates one-third of the elected farm income to each of the three base years; and

(3) Determines the election year section 1 tax by determining the sum of–

(i) The election year section 1 tax without regard to the elected farm income; plus

(ii) For each base year, the increase in section 1 tax attributable to the elected farm income allocated to such year.

(b) Individual engaged in a farming business. Farming business has the same meaning as provided in section 263A(e)(4) and the regulations thereunder. An individual engaged in a farming business includes a sole proprietor of a farming business, a partner in a partnership engaged in a farming business, and a shareholder of an S corporation engaged in a farming business. An individual is not required to have been engaged in a farming business in any of the base years in order to make a farm income averaging election.

(c) *Making, changing, or revoking an election*—(1) *Making an election.* A farm income averaging election is made by filing Schedule J, Farm Income Averaging, with an individual's timely filed (including extensions) Federal income tax return for the election year.

(2) *Making a late election, or changing or revoking an election*—(i) *Adjustments in an election or base year.* An individual who has an adjustment for an election year or any base year may make a late farm income averaging election, change the amount of elected farm income in a previous election, or revoke a previous election, if the period of limitation on filing a claim for credit or refund has not expired for the election year. For purposes of this paragraph (c)(2), an adjustment is any change in taxable income or tax liability that is permitted to be made by filing an amended Federal income tax return or a change in taxable income or tax liability made as the result of an IRS examination.

(ii) *No adjustment.* If an individual does not have an adjustment described in paragraph (c)(1)(i) of this section, the individual may not make a late farm income averaging election, change the amount of elected farm income in a previous election, or revoke a previous election, without the consent of the Commissioner.

(d) *Calculation of section 1 tax*—(1) *In general.* The section 1 tax for the election year is determined by allocating elected farm income to the base years only after all other adjustments and determinations have been made. For example, any net operating loss (NOL) carryover or net capital loss carryover is applied to an election year before allocating elected farm income to the base years. Similarly, the determination of whether there is a net section 1231 gain or loss in the election year and the determination of the character of the section 1231 items are made before allocating elected farm income to the base years. The allocation of elected farm income to the base years does not affect

any determination (other than the calculation of the section 1 tax attributable to the elected farm income) with respect to the election year or the base years. Thus, for example, in applying the section 68 overall limitation on itemized deductions to the election year, adjusted gross income for the election year includes any elected farm income allocated to the base years. Similarly, the section 68 limitation for a base year is not recomputed to take into account any allocation of elected farm income to such base year. The calculation of the section 1 tax on elected farm income allocated to a base year is made without any additional adjustments or determinations with respect to such year. For example, if a base year had a partially used capital loss, the remaining capital loss may not be applied to reduce the elected farm income allocated to such year. Similarly, if a base year had a partially used credit, the remaining credit may not applied to reduce the section 1 tax attributable to the elected farm income allocated to such year.

(2) *Base year was previously an election year or another base year.* If a base year for a current farm income averaging election was previously an election year for another farm income averaging election, the base year's section 1 tax is determined after reducing the base year's taxable income by the elected farm income for that prior election year. If a base year for a current farm income averaging election was previously a base year for another farm income averaging election, the base year's section 1 tax is determined after increasing the base year's taxable income by the elected farm income allocated to that year by that prior election.

(3) *Example.* The rules of paragraph (d)(2) of this section are illustrated by the following example:

Example. (i) In each of years 1996, 1997 and 1998, T had taxable income of $20,000. In 1999, T had taxable income of $30,000 (prior to any farm income averaging election) and electible farm income of $10,000. T makes a farm income averaging election with respect to $9,000 of his electible farm income for 1999. Thus, $3,000 of elected farm income is allocated to each of years 1996, 1997 and 1998. T's 1999 tax liability is the sum of—

(A) The section 1 tax on $21,000 (1999 taxable income minus elected farm income); plus

(B) For each of years 1996, 1997, and 1998, the section 1 tax on $23,000 minus the section 1 tax on $20,000 (the increase in section 1 tax attributable to the elected farm income allocated to such year).

(ii) In 2000, T has taxable income of $50,000 and electible farm income of $12,000. T makes a farm income averaging election with respect to all $12,000 of his electible farm income for 2000. Thus, $4,000 of elected farm income is allocated to each of years 1997, 1998 and 1999. T's 2000 tax liability is the sum of—

(A) The section 1 tax on $38,000 (2000 taxable income minus elected farm income); plus

(B) For each of years 1997 and 1998, the section 1 tax on $27,000 minus the section 1 tax on $23,000 (the increase in section 1 tax attributable to the elected farm income allocated to such years after increasing such years' taxable income by the elected income allocated to such year by the 1999 farm income averaging election); plus

(C) For year 1999, the section 1 tax on $25,000 minus the section 1 tax on $21,000 (the increase in section 1 tax attributable to the elected farm income allocated to such year after reducing such year's taxable income by the 1999 elected farm income).

(e) *Electible farm income*—(1) *Identification of items attributable to a farming business*—(i) *In general.* Farm income includes items of income, deduction, gain, and loss attributable to the individual's farming business. Farm losses include a NOL carryover or carryback, or a net capital loss carryover, to an election year that is attributable to a farming business. Income, gain or loss from the sale of development rights, grazing rights, and other similar rights is not treated as attributable to a farming business. Farm income does not include wages.

(ii) *Gain or loss on sale or other disposition of property*—(A) *In general.* Gain or loss from the sale or other disposition of property (other than land, but including a structure affixed to the land) that was regularly used in the individual's farming business for a substantial period of time is treated as attributable to a farming business. Whether property was regularly used for a substantial period of time depends on all of the facts and circumstances.

(B) *Cessation of a farming business.* If gain or loss described in paragraph (e)(1)(ii)(A) of this section is realized after cessation of a farming business, such gain or loss is treated as attributable to a farming business if the property is sold within a reasonable time after cessation of the farming business. A sale or other disposition within one year of cessation of the farming business is presumed to be within a reasonable time. Whether a sale or other disposition that occurs more than one year after cessation of the farming business is within a reasonable time depends on all of the facts and circumstances.

(2) *Determination of amount that may be elected farm income*—(i) *Electible farm income.* The maximum amount of income that an individual may elect to average (electible farm income) is the sum of any farm income and gain minus any farm deductions or losses (including loss carryovers and carrybacks) that are allowed as a deduction in computing the individual's taxable income. However, electible farm income may not exceed taxable income. In addition, electible farm income from net capital gain attributable to a farming business cannot exceed total net capital gain. An individual who has both ordinary and net capital gain farm income may elect (up to electible farm income) any combination of such ordinary and net capital gain farm income.

(ii) *Examples.* The rules of paragraph (e)(2)(i) of this section are illustrated by the following examples:

Example 1. A has farm gross receipts of $200,000 and farm ordinary deductions of $50,000. A's taxable income is $150,000 ($200,000–$50,000). A's electible farm income is $150,000, all of which is ordinary income.

Example 2. B has ordinary farm income of $200,000 and nonfarm losses of $50,000. B's taxable income is $150,000 ($200,000–$50,000). B's electible farm income is $150,000, all of which is ordinary income.

Example 3. C has a farm capital gain of $50,000 and a nonfarm capital loss of $40,000. C also has ordinary farm income of $60,000. C has taxable income of $70,000 ($50,000–$40,000+$60,000). C's electible farm income is $70,000. C can elect up to $10,000 of farm capital gain and up to $60,000 of farm ordinary income.

Example 4. D has a nonfarm capital gain of $40,000 and a farm capital loss of $30,000. D also has ordinary farm income of $100,000. D has taxable income of $110,000 ($40,000–$30,000+ $100,000). D's electible farm income is $100,000 ordinary farm income minus $30,000 farm capital loss, or $70,000, all of which is ordinary income.

Example 5. E has a nonfarm capital gain of $20,000 and a farm capital loss of $30,000. E also has ordinary farm income of $100,000. E has taxable income of $97,000 ($20,000–$23,000 +$100,000). E has a farm capital loss carryover of $7,000 ($30,000–$23,000 allowed as a deduction). E's electible farm income is $100,000 ordinary farm income minus $23,000 farm capital loss, or $77,000, all of which is ordinary income.

(f) *Miscellaneous rules*—(1) *Short taxable year*—(i) *In general.* If a base year or an election year is a short taxable year, the rules of section 443 and the regula-

tions thereunder apply for purposes of calculating the section 1 tax.

(ii) *Base year is a short taxable year.* If a base year is a short taxable year, the increase in section 1 tax attributable to the elected farm income allocated to such year is determined after the taxable income for such year has been annualized.

(iii) *Election year is a short taxable year.* If an election year is a short taxable year, any elected farm income is first annualized before being allocated to the base years. The increase in section 1 tax attributable to the elected farm income allocated to the base years is the same part of the tax computed on an annual basis as the number of months in the short election year is of 12 months.

(2) *Changes in filing status.* An individual is not prohibited from making a farm income averaging election solely because the individual's filing status is not the same in an election year and the base years. For example, an individual who files married filing jointly in the election year, but filed as single in all of the base years, may still elect to average farm income.

(3) *Employment tax.* A farm income averaging election has no effect in determining the amount of wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (Federal income tax withholding), or the amount of net earnings from self-employment for purposes of the Self-Employment Contributions Act (SECA).

(4) *Alternative minimum tax.* A farm income averaging election does not apply for purposes of determining the section 55 alternative minimum tax in the election year or any base year. However, an election will apply for purposes of determining the regular tax under sections 53(c) and 55(c).

(5) *Unearned income of minor child.* In an election year, if a minor child's investment income is taxable under section 1(g) and a parent makes a farm income averaging election, the tax rate used for purposes of applying section 1(g) is the rate determined after application of the election. With respect to a base year, however, the tax on a minor child's investment income is not affected by a farm income averaging election.

(g) *Effective date.* The rules of this section apply to taxable years ending on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register.**

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 7, 1999, 8:45 a.m., and published in the issue of the Federal Register for October 8, 1999, 64 F.R. 54836)

The Department of the Treasury Study Regarding Taxpayer Confidentiality

Announcement 99–101

AGENCY: Department of the Treasury

ACTION: Solicitation for comment.

SUMMARY: This is a solicitation for public comment in connection with a study being conducted by the Department of the Treasury relating to the scope and use of provisions regarding taxpayer confidentiality. This study is required by section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206, 112 Stat. 782).

DATES: Written comments must be submitted by November 15, 1999.

ADDRESSES: Send comments to: Elizabeth P. Askey, Office of Tax Legislative Counsel, Department of the Treasury, 1500 Pennsylvania Avenue, NW, Room 1321A, Washington, DC 20220. Comments may also be submitted to: **taxpolicy@do.treas.gov** – the subject line should contain the phrase "Confidentiality Study." All comments will be available for public inspection and copying.

FOR FURTHER INFORMATION CONTACT: Elizabeth Askey at 202-622-0224 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 6103 of the Internal Revenue Code (Code) prohibits the disclosure of tax returns or return information except as otherwise authorized by the Code. Permitted disclosures include: 1) disclosures to a taxpayer or the taxpayer's designee pursuant to the taxpayer's consent;

2) disclosures for purposes of tax administration (including state tax administration);

3) disclosures to federal, state, or local governmental agencies for nontax purposes such as child support enforcement and verifying taxpayers' eligibility for certain designated needs based programs, including food stamps, and certain Social Security benefits; and 4) disclosures for nontax law enforcement purposes. Permitted disclosures generally are subject to strict procedural safeguards. Unauthorized disclosure or inspection of returns and return information may result in civil damages against the United States and/or criminal penalties against individuals who unlawfully disclose or inspect tax information.

Section 6104 makes available to the public certain tax information related to tax-exempt organizations and certain other entities. In the case of any tax-exempt organization, section 6104 generally provides that the organization's application for tax exemption and supporting documents, IRS determination letter, and annual information returns filed under section 6033 are available for public inspection at certain IRS offices and at the organization's principal office (and certain regional and district offices). In addition, copies of such documents are generally available upon request made to the organization or the IRS. Section 6104 also authorizes the Secretary to disclose to certain state officials charged with overseeing charitable organizations described in section 501(c)(3) information relating to any organization's failure to qualify for, or subsequent loss of, section 501(c)(3) status, or the mailing of certain notices of tax deficiency.

Section 3802 of the IRS Restructuring and Reform Act of 1998 requires the Secretary of the Treasury to study the scope and use of provisions regarding taxpayer confidentiality. Specifically, the study is to examine:

1. the present protections for taxpayer privacy,

2. any need for third parties to use tax return information,

3. whether greater levels of voluntary

compliance may be achieved by allowing the public to know who is legally required to file tax returns, but does not file tax returns,

4. the interrelationship of the taxpayer confidentiality provisions in the Internal Revenue Code of 1986 with provisions in other Federal law, including 5 U.S.C. 552a (commonly known as the Freedom of Information Act),

5. the impact on taxpayer privacy of the sharing of income tax return information for purposes of enforcement of state and local tax laws other than income tax laws, including the impact on the taxpayer privacy intended to be protected at the Federal, state, and local levels under Public Law 105-35, the Taxpayer Browsing Protection Act of 1997, and,

6. whether the public interest would be served by greater disclosure of information relating to tax-exempt organizations described in section 501 of the Internal Revenue Code of 1986.

Request for Public Comment

The Department of the Treasury invites comments relative to the six topics described. In particular, the Department of the Treasury invites comments with respect to the following:

1. How is the privacy protection provided by section 6103 beneficial to taxpayers?

2. How is the section 6103 statutory scheme burdensome for taxpayers? Does section 6103 affect the IRS's ability to deliver quality customer service and, if so, in what ways?

3. Is the statutory structure and/or administration of section 6103 consistent, simple, administrable, and fair? What changes, if any, should be made to the content and/or administration of section 6103?

4. What is the relationship between taxpayer confidentiality as provided by section 6103 and compliance with the internal revenue laws? What effect, if any, might publishing the names of nonfilers have on compliance with the internal revenue laws? What effect, if any, might broadening the scope of permissible disclosures have on compliance with the internal revenue laws?

5. What impact has technology had on the protection of taxpayer privacy and what, if any, additional safeguards may be necessary as a result? As the IRS moves toward electronic filing and maintenance of tax records, what, if any, changes should be made to the confidentiality rules under section 6103?

6. What impact have taxpayer privacy protections had on the ability of federal, state, and local agencies to receive information critical to their operation, particularly information not easily obtainable from other sources?

7. Should tax information be used for nontax purposes? If so, what factors should influence whether agencies and others should be permitted direct access under section 6103 to taxpayer information for nontax purposes? What factors should influence whether agencies and others should be allowed to obtain such information by consent from the taxpayer, for example, as a condition to approval of mortgages or other loans, or for obtaining government benefits? Should there be any conditions or restrictions on the recipient's use of tax information obtained by consent?

8. What factors should influence whether federal, state, or local agencies that receive tax information to carry out particular programs, and who use private contractors for data processing and other services, should be permitted to disclose tax information to those contractors for the purpose of performing those programs?

9. What changes, if any, should be made to either the safeguard program or the consent process?

10. What, if any, additional restrictions should be placed on the ability of those who receive tax information to redisclose the information to other parties? What means should be used to implement any such redisclosure protections?

11. How can taxpayer privacy concerns and a desire for more information-sharing within government be balanced?

12. Would the public interest be served by allowing greater sharing of information between the IRS and other federal and state agencies for joint investigations relating to the enforcement of federal and state laws affecting tax-exempt organizations? What restrictions, if any, should be imposed on use of the information by those agencies?

13. Do the public inspection provisions of section 6104 and section 6110 provide adequate disclosure of IRS determinations affecting tax-exempt organizations? If not, what additional information should be made available?

14. Is the information currently reported by tax-exempt organizations to the IRS adequate to ensure effective oversight? If not, what additional information should be reported? Should there be more detailed disclosure regarding transactions between tax-exempt organizations and their subsidiaries or other affiliates?

Joseph Mikrut,
Tax Legislative Counsel.

Reporting Requirements of Tax-Exempt Owners of Disregarded Entities

Announcement 99-102

On January 13, 1997, final regulations under section 7701 of the Internal Revenue Code pertaining to the classification of certain business organizations under an elective regime were published in the Federal Register. See 26 C.F.R. 301.7701-1 *et seq.* These regulations provide that an entity wholly owned by a single owner may be disregarded as an entity separate from the owner. When an entity is disregarded as separate from its owner its operations are treated as a branch or division of the owner. Therefore, an owner that is exempt from taxation under section 501(a) of the Internal Revenue Code must include, as its own, information pertaining to the finances and operations of a disregarded entity in its annual information return. Accordingly, the instructions to the 1999 Forms 990, 990-EZ, 990-T, and 990-PF will be modified.

The principal authors of this announcement are Lynn Kawecki and Marvin Friedlander. For further information regarding this notice contact Mr. Kawecki at (202) 622-7922 or Mr. Friedlander at (202) 622-8715 (not toll free numbers).

Foundations Status of Certain Organizations

Announcement 99–103

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

2 M & O Counties Head Start, Inc., Boynton, OK
Abode Multi-Service Center, Inc., Detroit, MI
Affordable Home Ownership Corporation, Jacksonville, FL
Agricultural Housing for Georgia, Inc., Lyons, GA
Alabama Boychoir, Inc., Tuscaloosa, AL
Alabama Education Foundation for K Through Grade 12 Public Schools, Montgomery, AL
Alamo Community Telecommunications Initiatives, Inc., DBA Salsa Net, San Antonio, TX
Alchini Binitsekees Naholzhooh Foundation, Inc., Tohatchi, NM
Alexandria Inside Edges, Alexandria, MN
Alumni Chamber Choir, Lapeer, MI
American Institute for Nonprofit Management, Inc., Sarasota, FL
American Institute of Pakistan Studies, State University, AR
Andrews Air Force Base Fisher House, Inc., Andrews AFB, MD
Asociacion de Nayaritas de California, Wilmington, CA
Audubon Recreation Association, Trooper, PA
Bayou la Batre-Coden Tourism Commission, Coden, AL
Bells Loving Care, Inc., Mt. Morris, MI
Berkshire Worker Ownership Center, Inc., Pittsfield, MA
Big Valley 4-H Cluster Fair, Fosston, MN
Birmingham Kwanzaa & Heritage Foundation, Inc., Birmingham, AL
Bloomingdale Civic Association, Washington, DC
Boys and Girls Club of Cheyenne Wyoming, Inc., Cheyenne, WY
Brevard County Alliance Southeastern Consortium Minorities In Engineering, Merritt Island, FL
Broward Affordable Housing Coalition, Inc., Ft. Lauderdale, FL
Building Blocks Child Nutrition, Houston, TX
Burning Bush International, Inc., Englewood, CO
Calhoun County Family Support Network, Homer, MI
Casa de Amigos VIII, Inc., Mission, TX
Cause for Adventure, Inc., Norwood, MA
Center for Community and Economic Development, Fairfield, AL
Central Indiana Baseball Association, Inc., Indianapolis, IN
Charlevoix County Area Love for Children, Charlevoix, MI
Cherrystone Foundation, Inc., Coscob, CT
Chesapeake Youth Organization, Inc., Baltimore, MD
Choice City Wrestling Club, Inc., Fort Collins, CO
Christian Interactive Network, Inc., Fort Lauderdale, FL
Christmas in April-Northern New Mexico, Inc., Santa Fe, NM
Circles Restored, St. Paul, MN
Clarke County Youth Facility 701 Clarke St., Grove Hill, AL
Clinton Riverboat Days Foundation, Clinton, IA
Clinton Valley Softball League, Inc., Mt. Clemens, MI
Colorado Institute of Music, Denver, CO
Committee for New Arts, Incorporated, Fort Myers, FL
Community Project Development Corporation, S. Charleston, WV
Community Special Transportation Svcs., Southfield, MI
Coral-Aires of Southwest Florida, Inc., Port Charlotte, FL
Creative Child Care, Inc., Lafayette, IN
Crime Stoppers of Sumter County, Inc., Livingston, AL
Dade Urban Development Corporation, Miami, FL
Dale County Humane Society, Inc., Ozark, AL
Dan Ashnic, Inc., Inkster, MI
Dayton Aviators, Inc., Brookville, OH
Delaware Indoor Recreation Campaign Committee, Delaware, OH
Dietert Claim Senior Citizens Center, Inc., Kerrville, TX
Diotex Enterprises c/o A Youth Development Foundation, Dallas, TX
District of Columbia Resident Council Advisory Board, Washington, DC
Drug Free Shoals, Inc., Florence, AL
Drug-Off, Memphis, TN
Drum Corps Associates of Pennsylvania, Philadelphia, PA
East Knoxville Athletic Association, Knoxville, TN
Eastern Wisconsin Community Service Corporation, Sheboygan, WI
Economic Opportunity Commission of Rockland County, Inc., Spring Valley, NY
Emergency Fire & Disaster Relief Corporation, Tucson, AZ
Emulate, Inc., Smyrna, GA
Fairview Home Health Services, Inc., Downers Grove, IL
Faith Housing, Inc., Worth, IL
Families Forward, Inc., Greenfield, WI
Forest Meadow East Resident Management Corporation, Jacksonville, FL
Foundation for Immunological Research, Inc., Palm Beach, FL
Freedom Flight International, Inc., Boca Raton, FL
Friends of Boyce Ditto Municipal Library, Mineral Wells, TX
Friends of Onahan School, Chicago, IL
Friends of the Polk County Parks Foundation, Inc., Bartow, FL
Fund for Large Enterprises in Russia, New York, NY
Garland Clean & Green, Inc., Garland, TX
Glimpses of Grace, Inc., Batesville, MS
Golden Angels Drum & Bugle Corps., Midvale, UT
Good Shepherd Society, Inc., St. Clair, MI
Grace Baptist Church Foundation, Inc., Toccoa, GA
Green Globe USA, Columbus, OH

Hawkins McKinley and Stanley Independent Living Center, Houston, TX
Heart-Led Evangelical Church, Pasadena, MD
Heart of Texas Foundation for Mental Health Research, Belton, TX
Helios Arts & Events, Inc., Athens, GA
Heritage Village, Kankakee, IL
Hispanic Educational Telecommunications System, Inc., Edinburg, TX
Hiwasse Fire Auxillary, Hiwasse, AR
Home Hospice Support Systems, Inc., Southfield, MI
Home Vision Youth Charities, Inc., Brunswick, ME
Hospice House of Friends, Inc., a New Jersey Nonprofit Corporation, Denville, NJ
Housing Corporation of Charlotte County, Port Charlotte, FL
Hulbert Area Program for Seniors, Inc., Hulbert, OK
Independent Opportunities of Michigan, Inc., Shelby Township, MI
Intown Arts Center & Gallery, Bangor, ME
Irmo Little League, Bellentine, SC
Isaiah Project, Dallas, TX
Jesus Tapes, Mission Viejo, CA
Kiwanis Club of Botetourt County Charitable Foundation, Troutville, VA
Kiwanis Foundation of Silver Creek, NY, Inc., Silver Creek, NY
L A S T, Inc., Oklahoma City, OK
Lake Como Area Council, Incorporated, Fort Worth, TX
Las Americas, La Feria, TX
Leesburg Downtown Partnership, Inc., Leesburg, FL
Little League Poland Foundation, South Williamsport, PA
Londonderry Police Relief Assoc., Inc., Londonderry, NH
Loving Care Childrens Center and Food Nutritional Program, Houston, TX
Manorly Court, Inc., Provo, UT
Marquette Hockey Club Parents Assoc., Inc., Chesterfield, MO
Mentors and Students, Inc., Fresno, TX
Metro-Broward Economic Development Corporation, Ft. Lauderdale, FL
Metro Disability Coalition, Inc., Simpsonville, KY
Michigan Cities in Schools, Grand Rapids, MI
Michigan Soldiers Aid Society, Comstock Park, MI
Midnight Basketball League of Meridian, Inc., Meridian, MS
Monterey High School Instrumental Music Boosters, Monterey, CA
Mission, Inc., Hattiesburg, MS
Multi-Cultural Resources, Inc., Orlando, FL
N A T U R E Foundation, Inc., Glenwood, CO
National Alliance Against Violence, Washington, DC
National Center to Rehabilitate Violent Youth Inc., Washington, DC
National Institute for Community Enpowerment, Dallas, TX
National Pet Assistance and Adoption Network, Inc., Bowling Green, KY
National Race Car Drivers Memorial Fund, Harrisburg, NC
New Hampshire Water Ski Association, Inc., Manchester, NH
Noahs Arc Transition Center, Inc., Columbia, SC
North Dakota Indian Arts Association, Bismarck, ND
Northwest Area Arts Council, Inc., Crystal Lake, IL
Onondaga Valley Lacrosse Association, Inc., Syracuse, NY
Optimist Foundation of Holiday Texas, Holliday, TX
Ottumwa Sesquicentennial Committee, Inc., Ottumwa, IA
Outreach Institute of Learning, Lakeland, FL
Outreach Unlimited, Inc., Culuota, FL
Pacific Health Institute, Vancouver, WA
Paducah Bank & Trust Co., Paducah, KY
Paulsen & Company, St. Paul, MN
Pennsylvania Association of Community Partnerships, Inc., Shillington, PA
Penquis Rural Health Centers, Inc., Dexter, ME
People Live-In Center, Inc., Bayside, NY
Picture Tomorrow, Missoula, MT
Pikes Peak Amateur Basketball, Inc., Colorado Springs, CO
Pittsylvania County Crime Stoppers, Inc., Chatham, VA
Premier Ask-A-Nurse, Columbia, SC
Progeny, Lancaster, OH
Psi Zeta of Lambda Chi Alpha Educational Foundation, Inc., Lafayette, IN
Pullman Summer Games, Pullman, WA
Randolph Family Day Care Association, Randolph, MA
Rape Crisis Center of Comal County, New Braunfels, TX
Recovery Solutions-Plus, Inc., Arlington, TX
Southeastern Housing Foundation, Inc., Roswell, GA
Region II Regional Support Council, Inc., Carbon Hill, AL
Region V Regional Support Council, Birmingham, AL
Rehabilitation Technology Center, Dayton, OH
Residential Provider Services, Inc., Grosse Pointe, MI
Rhode Island Resource Conservation and Development Area, E. Greenwich, RI
Ricks Institute Alumni Ass. USA, Inc., Silver Spring, MD
Rocky Mountain Student Theater Project, Boulder, CO
Rural Education System Network, Garland, TX
Safety Harbor Alcohol & Drug Objectors, Safety Harbor, FL
Sarapiqui Conservation Learning Institute, Inc., Gainesville, FL
Save A Life Today Foundation, St. Louis, MO
SBC Community Life Center, Inc., Metuchen, NJ
School-Work Program Foundation, Inc., Washington, DC
Secaucus Public Education Fundation, Inc., Secaucus, NJ
Shelter Hope and Dignity of Women Searching, Inc., Natick, MA
Silent Link Society, Inc., Miami, FL
Soaring Unlimited, Lansing, MI
Somerset County Child Abuse and Neglect Council, Skowaegan, ME
Sonoma County Lesbian & Gay Pride Committee, Forestville, CA
South Central Houston Action Council, Inc., Houston, TX
South Elementary Parents Association, Zimmerman, MN
South Mountain JROTC Parents Club, Phoenix, AZ
Special Institute, Detroit, MI
Starbase Oregon, Inc., Salem, OR
State Association of Community Services Block Grant Providers, Provo, UT
Statewide Coalition for Americans with Disabilities Act, Wilmington, DE

Suncoast Epilepsy Services, Inc., Pinellas Park, FL
Sunrise Optimist Foundation of North Topeka, Inc., Topeka, KS
Tampa Smokers, Inc., Tampa, FL
Tateya Topa Ho, Winner, SD
Team Lima Boosters Club, Lima, OH
Teatros Nacionales de Aztlan, Denver, CO
The Center for Minority Business Research and Development, Inc., Baltimore, MD
The Cynthia A Ward Foundation, Incorporated, Newbury, MA
The Energetic Crusaders Incorporated, Washington, DC
The Holy Land Redemption Organization, Inc., Miami, FL
The North America Hispanic Development Corporation – NAHDC, Washington, DC
The Progressive Club of the Blind of New Jersey, Incorporated, Trenton, NJ
The Transplant Educational Foundation, Pittsburgh, PA
Touraine Community Housing Corporation, New Bedford, MA
Trauma Service Area-H Regional Advisory Council, Nacogdoches, TX
Unique Cultural Variations Community Development Corp., Inc., Miami, FL
Urban Network Organization, Inc., Vineland, NJ
Utica Area Community Action Team, Shelby Township, MI
Van Buren County Soil Conservation District Foundation, Inc., Paw Paw, MI
Variety Club of South Dakota, Inc., Sioux Falls, SD
Victims of Violence Memorial, Washington, DC
Vietnam Veterans of the 2nd Battalion, Palermo, NJ
Vineyard Housing Associates, Inc., Cranston, RI
Waco Housing Opportunities Corporation, Waco, TX
Wisconsin Families for the Behavioral Treatment of Autism, Inc., Madison, WI
Women Business Owners of Michigan Educational Alliance, Midland, MI
Your Ride II, Inc., Casper, WY
Youth Achievement Foundation, St. Louis, MO
Youth Center of Central Alabama, Inc., Selma, AL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–7: Interest.

Is interest earned by an Individual Development Account project participant on funds deposited in the participant's personal account includible currently in the participant's gross income under section 61 of the Code? See Rev. Rul. 99–44, on this page.

Section 102.—Gifts and Inheritances

26 CFR 1.102–1: Gifts and inheritances.
(Also section 170; 1.170A–1.)

Gifts; charitable contributions; Individual Development Accounts. This ruling holds that (1) interest earned by an Individual Development Account (IDA) project participant on funds deposited in the participant's personal account is currently includible in the participant's gross income under section 61 of the Code; (2) a project participant may exclude, as a gift under section 102, parallel funds paid for a qualified expense of the project participant; and (3) a donor may deduct under section 170 a contribution to a qualified entity for the qualified entity's IDA project, subject to the limitations of that section.

Rev. Rul. 99–44

ISSUES

(1) Is interest earned on funds deposited in the personal account of an Individual Development Account (IDA) project participant includible in the participant's gross income under § 61 of the Internal Revenue Code?

(2) May a project participant exclude, as a gift under § 102, parallel funds paid for a qualified expense of the project participant?

(3) May a donor deduct under § 170 a contribution to a qualified entity for an IDA project?

ASSETS FOR INDEPENDENCE ACT

Congress established a demonstration program to determine the effects of Individual Development Accounts ("IDAs") on low-income individuals and their families. Assets for Independence Act, Pub. L. No. 105–285, Title IV (Oct. 27, 1998) ("Act"). The Act's purposes include stabilizing families and enabling individuals and families with limited means to increase their economic self-sufficiency. Section 403 of the Act.

IDAs are accounts created under the Act for use by eligible low-income individuals ("project participants") for qualified expenses, which are postsecondary educational expenses (*i.e.*, amounts paid for tuition, fees, books, supplies, and equipment), first-time home purchases, business capitalization, or the transfer of IDA funds directly into another IDA for the benefit of an eligible family member. Section 404(8) of the Act. Under § 408 of the Act, only individuals whose net worth and incomes are below certain levels are eligible to be selected as project participants. Project participants deposit earned income into a personal account, and a qualified entity provides matching contributions (or "parallel funds" as defined below) using Federal and non-Federal funds. "Qualified entity" includes an organization described in § 501(c)(3) of the Code. If a state or local government agency or tribal government submits an application jointly with the § 501(c)(3) organization, the state or local government agency or a tribal government is also a qualified entity. Section 404(7) of the Act.

A qualified entity other than a State or local government agency or tribal government must establish a Reserve Fund to hold all Federal and non-Federal funds received for the project and any investment income generated by the funds. Section 407 of the Act. The Reserve Fund is used to provide parallel funds for project participants, provide training and information to participants as necessary to their achieving economic self-sufficiency, administer the IDA demonstration project, and provide a research organization with relevant information.

An IDA for a project participant consists of two types of funds: "personal funds," and parallel funds. Under the IDA program, a separate custodial bank account ("personal account"), for which the qualified entity is the custodian, holds the deposits of the project participant. Personal funds consist of these deposits and any interest earned on the funds in the personal account. Periodically, the qualified entity will note the amount of recent deposits made by a project participant into the participant's personal account. On the qualified entity's books for the Reserve Fund, the qualified entity will then allocate parallel funds to that participant. Parallel funds consist of (1) a matching amount that corresponds to the amount of the participant's recent deposits, and (2) interest.

Parallel funds remain in the complete control of the qualified entity until they are disbursed. They may be disbursed only for a qualified expense and only upon written request of the project participant and written approval of a responsible official of the qualified entity. Disbursements of parallel funds are made by the qualified entity directly to the "payee," which is the educational institution, the home seller, the business capitalization account, or the family member's IDA, as appropriate. Section 404(8) of the Act.

Personal funds may be withdrawn for a qualified expense upon written request of the project participant and written approval of a responsible official of the qualified entity. Personal funds may also be withdrawn for certain emergency uses specified in § 404(3) of the Act. Further, a project participant may withdraw personal funds for an expense that is not a qualified expense or an emergency use. However, such a withdrawal will terminate the participant's involvement in the IDA program, in which case any bookkeeping allocations of parallel funds to that participant will be reversed on the qualified entity's books. In all circumstances, personal funds (including all interest) are the property of the participant.

Under very limited circumstances described in section 413(b)(5)(B) of the Act, funds not distributed to project participants may be remitted to their sources pro rata. This would occur only if: (1) the Secretary of Health and Human Services ("HHS Secretary") determines that a qualified entity has not operated a project in accordance with its application or the requirements of the Act (and has not implemented any corrective recommendations directed by the HHS Secretary); and

(2) the HHS Secretary has not, within a 1-year period, found another qualified entity to conduct the project.

FACTS

The HHS Secretary selects *O*, a qualified entity under the Act and an entity described in § 170(c)(2) of the Code, to operate a demonstration project under the Act. *O* previously received a commitment of funds for the project from non-Federal sources. One such source is *DR*, a corporation, which contributes cash to *O* for the project. At the time of *DR*'s contribution, and throughout the life of the project, *O* operates the project in accordance with *O*'s application and the requirements of the Act. Pursuant to the Act, *O* receives funds for the project from the Federal government. *O* establishes a Reserve Fund to hold the Federal and non-Federal funds *O* receives for the project.

A, an individual, applies and is selected to be a project participant. As required by the project, *A* opens a personal account. *A* deposits earned income into the interest-bearing account each month. Every three months, *O* determines the total of *A*'s deposits for the preceding three months. On its books, *O* then allocates to *A* from the Reserve Fund a matching amount that corresponds to *A*'s deposits during the preceding three months and interest. Under the applicable state and local law, the parallel funds are beyond the reach of *A*'s creditors.

After participating in the project for three years, *A* incurs qualified expenses. *A* makes a written request to *O* for payment of the parallel and personal funds, and a responsible official of *O* gives written approval. *A*'s personal funds and the parallel funds allocated to *A* are paid directly to the payee. *O*'s payment on behalf of *A* to the payee was made with the intent to help stabilize *A*'s family and enable *A* to increase *A*'s economic self-sufficiency.

LAW AND ANALYSIS

Issue (1)

Section 61 of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived. Section 61(a)(4) specifically includes interest in gross income.

As a general rule, interest earned by a taxpayer constitutes gross income and is fully taxable. Interest income includes interest on savings or other bank deposits. Section 1.61–7(a) of the Income Tax Regulations.

In the instant case, interest will be earned on the funds in *A*'s personal account. Those funds, including the interest, remain the property of *A* in all circumstances. The interest on funds in *A*'s personal account is currently includible in *A*'s gross income under § 61.

Issue (2)

Section 102 provides that the value of property acquired by gift is excluded from gross income. A gift "proceeds from a 'detached and disinterested generosity,' . . . 'out of affection, respect, admiration, charity or like impulses.'" *Commissioner v. Duberstein,* 363 U.S. 278, 285 (1960) (citations omitted). On the other hand, payments that proceed primarily from "the constraining force of any moral or legal duty" are not gifts. 363 U.S. at 285.

A determination of whether a transfer proceeds from detached and disinterested generosity requires an inquiry into the transferor's intention in making the payment. 363 U.S. at 285-86. Insight into a transferor's intention can be gained by examining the factors that the transferor considered in deciding whether to make the transfer and the form of the assistance. *See United States v. Kaiser,* 363 U.S. 299, 304 (1960). In general, a payment made by a charity to an individual that responds to the individual's needs, and does not proceed from any moral or legal duty, is motivated by detached and disinterested generosity.

In the instant case, *A* was eligible to participate in the project in part because *A*'s net worth and income were below levels set forth in the Act. Further, payments pursuant to the Act are designed to stabilize families and to enable individuals and families of limited means to increase their economic self-sufficiency. These facts indicate that *O* selected *A* to be a project participant and paid the parallel funds on behalf of *A* out of charitable and like impulses, and detached and disinterested generosity. Therefore, *O*'s payment of the parallel funds is excluded from *A*'s gross income as a gift under § 102.

Issue (3)

Section 170(a) allows as a deduction, subject to certain limitations, any charitable contribution, as defined in § 170(c), payment of which is made in the taxable year.

If a charity's ownership of property would be defeated by the subsequent happening of some event, but on the date of the gift the possibility of the event occurring appears to be so remote as to be negligible, the deduction is allowable. *See* § 1.170A–1(e).

In the instant case, *DR* contributed cash to *O*, an organization described in § 170(c)(2). At the time *DR* made this contribution, it was fully expected that *O* would operate the project in accordance with its application and the requirements of the Act. If *O* was unable to do so, the Secretary was permitted, within a 1-year period, to find another qualified entity to conduct the project. Therefore, at the time of the contribution, the possibility of any funds being returned to *DR* under § 413(b)(5)(B) of the Act was so remote as to be negligible.

Thus, *DR* may deduct under § 170 a contribution to *O* for *O*'s IDA demonstration project, subject to the limitations of that section.

HOLDINGS

(1) Interest earned by an IDA project participant on funds deposited in the participant's personal account is currently includible in the participant's gross income under § 61.

(2) A project participant may exclude, as a gift under § 102, parallel funds paid for a qualified expense of the project participant.

(3) A donor may deduct under § 170 a contribution to a qualified entity for the qualified entity's IDA project, subject to the limitations of that section.

DRAFTING INFORMATION

The principal author of this revenue ruling is Karin Gross of the Office of the Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling contact Karin Gross at (202) 622-4930 (not a toll-free call).

Section 170.—Charitable, etc., Contributions and Gifts

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

May a donor deduct under section 170 of the Code a contribution to a qualified entity for the qualified entity's Individual Development Account project, subject to the limitations of that section? See Rev. Rul. 99–44, page 549.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Prevention of Abuse of Charitable Remainder Trusts

REG–116125–99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that modify the application of the rules governing the character of certain distributions from a charitable remainder trust. These regulations are necessary to prevent taxpayers from using charitable remainder trusts to achieve inappropriate tax avoidance. The regulations affect charitable remainder trusts described in section 664 and certain beneficiaries of those trusts. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by January 19, 2000. Requests to speak (with outlines of oral comments) at the public hearing scheduled for February 9, 2000, at 10 a.m. must be submitted by January 19, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–116125–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–116125–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Catherine Moore, (202) 622-3070; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

This document proposes to amend sections 643 and 664 of the Income Tax Regulations (26 CFR Part 1) to provide additional rules regarding charitable remainder trusts.

Background

Section 664, added to the Internal Revenue Code (Code) by section 201(e) of the Tax Reform Act of 1969 (Public Law 91–172, (83 Stat. 487, 562-64)), contains the rules for charitable remainder trusts. In general, a charitable remainder trust provides for a specified periodic distribution to one or more noncharitable beneficiaries for life or for a term of years, with an irrevocable remainder interest held for the benefit of charity. The amount distributed to the noncharitable beneficiaries may be either a sum certain, in the case of a charitable remainder annuity trust, or a fixed percentage of the net fair market value of the trust's assets valued annually, in the case of a charitable remainder unitrust. Section 664(b) provides rules for determining the character of amounts distributed by a charitable remainder trust in the hands of the beneficiary to whom the distribution is made. In general, a distribution is taxable to the beneficiary if it represents a distribution of ordinary income or capital gain of the trust. A distribution generally is not taxable to the beneficiary if it represents a distribution of tax-exempt income of the trust or of trust corpus. Section 664(c) provides that a charitable remainder trust is exempt from all taxes under subtitle A of the Code for any taxable year except a taxable year in which the trust has unrelated business taxable income under section 512.

Section 643(a)(7), added to the Code by section 1906(b) of the Small Business Job Protection Act of 1996 (Public Law 104–188, (110 Stat. 1755, 1915)), authorizes the Secretary of the Treasury to issue regulations that may be necessary or appropriate to carry out the purposes of the rules applicable to estates, trusts, and beneficiaries, including regulations to prevent the avoidance of those purposes.

Explanation of Provisions

A. *Tax-Avoidance Arrangements Using Charitable Remainder Trusts*

The IRS and the Treasury Department are aware of certain abusive transactions that attempt to use a section 664 charitable remainder trust to convert appreciated assets into cash while avoiding tax on the gain from the disposition of the assets. In these transactions, a taxpayer typically contributes highly appreciated assets to a charitable remainder trust having a relatively short term and relatively high payout rate. Rather than sell the assets to obtain cash to pay the annuity or unitrust amount to the beneficiary, the trustee borrows money, enters into a forward sale of the assets, or engages in some similar transaction. Because the borrowing, forward sale, or other similar transaction does not result in current income to the trust, the parties attempt to characterize the distribution of cash to the beneficiary as a tax-free return of corpus under section 664(b)(4). Distributions may continue to be funded in this manner for the duration of the trust term (which is usually short, so as to meet the 10-percent remainder requirement of section 664(d)(1)(D) or 664(d)(2)(D)). The appreciated assets may be sold and the transaction closed out (e.g., the loan is repaid) in the last year of the trust, or the trustee may distribute the appreciated assets, subject to a contractual obligation to complete the transaction (e.g., the forward sale contract), to the charitable beneficiary.

A mechanical and literal application of rules and regulations that would yield a result inconsistent with the purposes of the charitable remainder trust provisions will not be respected. When section 664 was amended by the Revenue Reconciliation Act of 1997, Congress indicated that

a scheme that, in effect, attempts to convert appreciated assets to a tax-free cash distribution to the non-charitable beneficiary is "abusive and is inconsistent with the purpose of the charitable remainder trust rules." S. Rep. No. 33, 105th Cong., 1st Sess. 201 (1997). Although the particular scheme that was the focus of Congress's attention in 1997 involved an attempt to exploit the interplay of rules under section 664 governing the timing of income and the character of trust distributions, the attempted result of the scheme (commonly referred to as an "accelerated charitable remainder trust") was the same as that claimed by the promoters of the transactions described above—that is, a literal application of rules governing trust distributions in an attempt to convert appreciated trust assets into tax-free cash in the hands of the non-charitable beneficiary. The latest schemes involving charitable remainder trusts are no less "abusive" or "inconsistent with the purpose of the charitable remainder trust rules" than were the accelerated charitable remainder trust schemes addressed by Congress in 1997.

B. *The Proposed Regulations*

Section 643(a)(7) authorizes the Secretary to prescribe regulations to carry out the purposes of the provisions of the Code relating to the taxation of estates, trusts, and beneficiaries, including regulations to prevent avoidance of such purposes. The proposed regulations exercise this authority by modifying the treatment of certain distributions by charitable remainder trusts for purposes of section 664(b) to prevent a result that, as discussed above, is inconsistent with the purposes of the charitable remainder trust rules.

The proposed regulations provide that, to the extent that a distribution of the annuity or unitrust amount from a charitable remainder trust is not characterized in the hands of the recipient as income from the categories described in section 664(b)(1), (2), or (3) (determined without regard to the rules in these proposed regulations) and was made from an amount received by the trust that was neither a return of basis in any asset sold by the trust (determined without regard to the rules in these proposed regulations) nor attributable to a contribution of cash to the trust with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522, the trust shall be treated as having sold, in the year for which the distribution is due, a pro rata portion of the trust assets. Any transaction that has the purpose or effect of circumventing this rule will be disregarded. For example, a return of basis in an asset sold by a charitable remainder trust does not include basis in an asset purchased by the charitable remainder trust from the proceeds of a borrowing secured by previously contributed assets.

The proposed regulations include examples that illustrate the application of the above rule. The IRS and the Treasury Department request comments on whether there are situations where the application of this rule would be inappropriate.

These proposed regulations adopt a pro-rata sale approach to determine the amount of gain on the distribution of funds acquired in advance of income recognition. The IRS and the Treasury Department also considered an approach that more directly related the distributed funds to the asset that is the subject of the borrowing or forward sale. Comments are requested on this alternative approach.

C. *Proposed Effective Date*

The regulations are proposed to apply to distributions made by charitable remainder trusts after October 18, 1999.

However, to the extent that a charitable remainder trust financed a distribution to a beneficiary by borrowing funds or entering into a forward sale or other similar transaction prior to the effective date of these regulations, the IRS may apply an appropriate legal doctrine to recast the entire transaction, to characterize the distribution as gross income rather than corpus, or to challenge the qualification of the trust under section 664. In appropriate circumstances, the IRS may impose the tax on self-dealing transactions under section 4941. Additionally, the trust may be treated as having unrelated business taxable income under section 512 from the transaction. The IRS will also apply any applicable penalties to the participants in the transaction.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the understanding of the IRS and Treasury Department that the number of charitable remainder trusts engaging in transactions affected by these regulations is not substantial, and none are small entities within the meaning of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 9, 2000, at 10 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit timely written comments and an

outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by January 19, 2000.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Mary Beth Collins and Catherine Moore, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.643(a)–8 also issued under 26 U.S.C. 643(a)(7). * * *

Par. 2. Section 1.643(a)–8 is added to read as follows:

§1.643(a)–8 Certain distributions by charitable remainder trusts.

(a) *Purpose and scope.* This section is intended to prevent the avoidance of the purposes of the charitable remainder trust rules and should be interpreted in a manner consistent with this purpose. This section applies to all charitable remainder trusts described in section 664 and the beneficiaries of such trusts.

(b) *Deemed sale by trust.* (1) For purposes of section 664(b), a charitable remainder trust shall be treated as having sold, in the year for which a distribution of an annuity or unitrust amount from the trust is due, a pro rata portion of the trust assets to the extent that the distribution of the annuity or unitrust amount—

(i) Is not characterized in the hands of the recipient as income from the categories described in section 664(b)(1), (2), or (3), determined without regard to this paragraph (b); and

(ii) Was made from an amount received by the trust that was not—

(A) A return of basis in any asset sold by the trust, determined without regard to this paragraph (b); or

(B) Attributable to cash contributed to the trust with respect to which a deduction was allowable under section 170, 2055, 2106, or 2522.

(2) Any transaction that has the purpose or effect of circumventing the rules in this paragraph (b) shall be disregarded.

(3) For purposes of paragraph (b)(1) of this section, "trust assets" do not include cash or assets purchased with the proceeds of a trust borrowing, forward sale, or similar transaction.

(4) Proper adjustment shall be made to any gain or loss subsequently realized for gain or loss taken into account under paragraph (b)(1) of this section.

(c) *Examples.* The following examples illustrate the rules of paragraph (b) of this section:

Example 1. Deemed sale by trust. Donor contributes stock having a fair market value of $2 million to a charitable remainder unitrust with a unitrust amount of 50 percent of the net fair market value of the trust assets and a two-year term. The stock has a total basis of $400,000. In Year 1, the trust receives dividend income of $20,000. As of the valuation date, the trust's assets have a net fair market value of $2,020,000 ($2 million in stock, plus $20,000 in cash). To obtain additional cash to pay the unitrust amount to the noncharitable beneficiary, the trustee borrows $990,000 against the value of the stock. The trust then distributes $1,010,000 to the beneficiary before the end of Year 1. Under section 664(b)(1), $20,000 of the distribution is characterized in the hands of the beneficiary as dividend income. The rest of the distribution, $990,000, is attributable to an amount received by the trust that did not represent either a return of basis in any asset sold by the trust (determined without regard to paragraph (b) of this section) or a cash contribution to the trust with respect to which a charitable deduction was allowable. Under paragraph (b)(3) of this section, the stock is a trust asset because it was not purchased with the proceeds of the borrowing. Therefore, in Year 1, under paragraph (b)(1) of this section, the trust is treated as having sold $990,000 of stock and as having realized $792,000 of capital gain (the trust's basis in the shares deemed sold is $198,000). Thus, in the hands of the beneficiary, $792,000 of the distribution is characterized as capital gain under section 664(b)(2) and $198,000 is characterized as a tax-free return of corpus under section 664(b)(4).

Example 2. Adjustment to trust's basis in assets deemed sold. The facts are the same as in Example 1. During Year 2, the trust sells the stock for $2,100,000. The trustee uses a portion of the proceeds of the sale to repay the outstanding loan, plus accrued interest. Under paragraph (b)(4) of this section, the trust's basis in the stock is $1,192,000 ($400,000 plus the $792,000 of gain recognized in Year 1). Therefore, the trust recognizes capital gain (as described in section 664(b)(2)) in Year 2 of $908,000.

Example 3. Distribution of cash contributions. Upon the death of D, the proceeds of a life insurance policy on D's life are payable to T, a charitable remainder annuity trust. The terms of the trust provide that, for a period of three years commencing upon D's death, the trust shall pay an annuity amount equal to $x annually to A, the child of D. After the expiration of such three-year period, the remainder interest in the trust is to be transferred to charity Z. In Year 1, the trust receives payment of the life insurance proceeds and pays the appropriate pro rata portion of the $x annuity to A from the insurance proceeds. During Year 1, the trust has no income. Because the entire distribution is attributable to a cash contribution (the insurance proceeds) to the trust for which a charitable deduction was allowable under section 2055 with respect to the present value of the remainder interest passing to charity, the trust will not be treated as selling a pro rata portion of the trust assets under paragraph (b)(1) of this section. Thus, the distribution is characterized in A's hands as a tax-free return of corpus under section 664(b)(4).

(d) *Effective date.* This section is applicable to distributions made by a charitable remainder trust after October 18, 1999.

Par. 3. Section 1.664-1 is amended as follows:

1. Paragraph (d)(1)(iii) is redesignated as paragraph (d)(1)(iv).

2. New paragraph (d)(1)(iii) is added.

The addition reads as follows:

§1.664–1 Charitable remainder trusts.

* * * * *

(d) * * *

(1) * * *

(iii) Application of section 643(a)(7). For application of the anti-abuse rule of section 643(a)(7) to distributions from charitable remainder trusts, see §1.643(a)–8.

* * * * *

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 18, 1999, 11:16 a.m., and published in the issue of the Federal Register for October 21, 1999, 64 F.R. 56718)

Time for Recharacterizing 1998 IRA Contributions

Announcement 99–104

Purpose

The first year for which Roth IRAs could be established was 1998. It has come to the attention of the Internal Revenue Service and Treasury that taxpayers have experienced particular difficulty in properly applying the rules governing Roth IRA conversion contributions and recharacterizations. In view of the tax consequences of excess IRA contributions, the Service and Treasury believe that additional time should be provided for taxpayers who made 1998 Roth IRA conversion contributions or other 1998 IRA contributions and who would like to recharacterize those contributions.

This announcement provides relief to taxpayers who would like to recharacterize 1998 IRA contributions, including amounts contributed to Roth IRAs as conversions when the taxpayers were not eligible. Pursuant to this announcement, these taxpayers have until the end of 1999 to recharacterize their 1998 IRA contributions.

Background

Section 408A(d)(6) of the Internal Revenue Code and § 1.408A–5 of the regulations provide that, except as otherwise provided by the Secretary, a taxpayer may elect to recharacterize an IRA contribution made to one type of IRA as having been made to another type of IRA by making a trustee-to-trustee transfer of the IRA contribution, plus earnings, to the other type of IRA. In a recharacterization, the IRA contribution is treated as having been made to the transferee IRA and not the transferor IRA. Under § 408A(d)(6) and § 1.408A–5, this recharacterization election generally must occur on or before the date prescribed by law, including extensions, for filing the taxpayer's Federal income tax return for the year of the contribution.

Section 1.408A-5, Q&A-6, describes how a taxpayer makes the election to recharacterize an IRA contribution. To recharacterize an amount that has been converted from a traditional IRA to a Roth IRA: (1) the taxpayer must notify the Roth IRA trustee of the taxpayer's intent to recharacterize the amount, (2) the taxpayer must provide the trustee (and the transferee trustee, if different from the transferor trustee) with specified information that is sufficient to effect the recharacterization transfer, and (3) the trustee must make the transfer.

Section 301.9100–2(b) of the regulations generally provides for an automatic extension of 6 months from the due date of a return, excluding extensions, to make elections that otherwise must be made by the due date of the return or the due date of the return plus extensions, provided (1) the taxpayer's return was timely filed for the year the election should have been made and (2) the taxpayer takes appropriate corrective action within this 6-month period. Announcement 99–57, 1999–24 I.R.B. 50 (June 14, 1999) describes the application of § 301.9100–2(b) to recharacterization elections.

Extension of Time to Recharacterize 1998 IRA Contributions

Pursuant to § 408A(d)(6), a taxpayer will be deemed to have timely made an otherwise valid recharacterization of a 1998 IRA contribution, including a Roth IRA conversion for which the taxpayer was not eligible, if (1) the recharacterization occurs on or before December 31, 1999, (2) the taxpayer timely filed his or her 1998 Federal income tax return, and (3) the taxpayer files an amended 1998 return if the recharacterization is not properly reflected on the previously filed return.

Effect on Other Documents

Announcement 99–57 is modified.

Foundations Status of Certain Organizations

Announcement 99–105

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

ABC Program, Buckley, WA
Action for Peace Foundation, Greenwich, CT
Advancing Community Education, Inc., Portland, OR
Amana Foundation, San Diego, CA
Amazing Grace International Multi-Culture Exchange Program, Mattapan, MA
American Foundation for the Visual Arts, Inc., Plainview, NY
American Help for the Blind Fund, Inc., Centerport, NY
American Youth Pathfinders, Inc., Farmers Branch, TX
American Youth Performing Alliance, Inc., Dayton, OH
Archuleta County Civic Center, Pagosa Springs, CO
Bayou Indian Federation, Inc., Elton, LA
Brain Baton Rouge Area Interactive Network, Inc., Baton Rouge, LA
Cancer Prevention and Treatment Research Institute of Arizona, Fountain Hills, AZ
Capital Pullers, Inc., Madison, WI
Center for Traffic Safety and Education, Inc., Lima, OH
Chance English Spanish Publication, Houston, TX
Chelsea Gardens Foundation, Inc., Norwich, CT
Chelsea Street Foundation, Inc., Murray, UT
Cherry Drive Elementary School Parent-Teacher Partnership, Thornton, CO
Chicago Tax Law Assistance Project, River Forest, IL
CJC Services Corporation, Tallahassee, FL
Codependency New Life Seminars, Inc., Dublin, CA
Coming Together To Help Promotions, Inc., Philadelphia, PA
Conservation, Inc., Norfolk, VA
Convivium Educational Foundation, Costa Mesa, CA

Cut Bank Elks Lodge Charitable Corp., Cut Bank, MT
Down to Earth, Fort Wayne, IN
EBN Holding, Inc., Columbia, MD
Ecology, Inc., Salt Lake City, UT
Episcopal Day School Foundation, Inc., Tallahassee, FL
Epperson Foundation, Montgomery, AL
Faith-Way Ministries, Inc., New Washington, IN
Faye Carney Gehl Conservation Trust, Inc., Hartland, WI
Foundation for Applied Research in Visual Disabilities, Arlington Heights, IL
Foundation for Human Helps, Metairie, LA
Friends of Italian Historic Houses, Inc., New York, NY
Geneva Foundation, Chicago, IL
German Cultural Foundation, Commerce City, CO
Global Awareness Foundation, Chicago, IL
Good Ole' Boys, Cincinnati, OH
Grace Fund, Inc., Wooster, OH
Graville Heights, Inc., Chicago, IL
Great Commission News, Inc., Cleveland, TX
Greater Whitestone Missionary Baptist Church Foundation, Inc., Memphis, TN
Great River Foundation Inc., Natchez, MS
Happy Pet Owners Nonprofit Organization., Stockton, CA
Harberfest, Incorporated, Norfolk, VA
Harvest Farms, Inc., Clayton, IN
Highlandtown Cooperative Senior Housing, Inc., Oak Park, MI
Hogar Crea International of New Jersey, Inc., Jersey City, NJ
Home of the Alliance, Inc. Brooklyn, NY
Home Safe, Puyallup, WA
Hope & Help, Inc., Riverside, CA
Igbotek Institute of Educational Services, Inc., Brooklyn, NY
Information Roads Foundation, Inc., Waltham, MA
In Recital, Fort Worth, TX
Institute for Basic Change, Chicago, IL
Institute for Ethics and Health Policy, Inc., Berkeley, CA
International Salute to Greatness, Palm Springs, CA
International Volunteer Expeditions, Sacramento, CA
Jerome Park Conservancy, Bronx, NY
Kentucky Elks Association Charitable Trust, Cold Spring, KY
Kilohana Resident Council, Kaneohe, HI
Kotel Museum Fund, Inc., Brooklyn, NY
Law Enforcement Support Foundation, Brooklyn, NY
The Lee County Housing Corp., Inc., Jonesville, VA
Lifeline Humanitarian Organization, Chicago, IL
McCoy Wildcats, Bond, CO
Metro Town Redevelopment Coalition, Inc., Jackson, MS
Mountair Junior Baseball Association, Lakewood, CO
National Health Foundation, Inc., Atlanta, GA
National Union Veterans Foundation of Ohio, Columbus, OH
Nehemiah Ministries, Charleston, SC
New Yorkers for School Choice Research & Education Committee, Inc., Hempstead, NY
New York State Center for Philosophy & Communication, Inc., Albany, NY
Ohio Turfgrass Research Trust, Inc., Zanesville, OH
Ohio War Memorial, Inc., Perrysburg, OH
Oklahoma Safety Center, Inc., Tulsa, OK
Okner Foundation, Inc., Chicago, IL
Omega Development Corporation, Little Rock, AR
Pan International Co-Pan Family Center for Women and Children, Newark, OH
Penny Morell Productions, Inc., New York, NY
Pike Animal Welfare Society, Inc., Petersburg, IN
Point of Decision, Inc., Columbus, OH
Rainbow Friends Child Care Center, Inc., Gaithersburg, MD
The Riley Foundation, Meridian, MS
Roger J. Gill Memorial Fund, Inc., Seattle, WA
R. Robert Funderburg Educational Trust, Belvidere, IL
Santa Maria Trails & Parks Association, Beverly Hills, CA
Scott MacDonald Memorial Fund, San Diego, CA
The Scriptorium, Wheaton, IL
Servants for Jesus Christ, Cleveland, TN
Share Golf, Inc., Skokie, IL
Showers of Blessings Ministry, Inc., Nashville, TN
Simon Foundation, Inc., Dallas, TX
Sisters Overcoming Struggles, Detroit, MI
Solutions & Possibilities, Inc., Columbus, OH
Stephen E. Packard, Jr. Memorial Fund, Marlborough, NH
Stepping Stones Educational Systems, Fort Wayne, IN
St. John-Endicott Cooperative Schools Foundation, St. John, WA
Sustain America Federation, Inc., Napa, CA
Sustainable Rural Visions, Inc., Cokato, MN
Third Shiloh Housing, Inc., New Orleans, LA
United Environment Fund, Fairfield, IA
United Human Services Agency, Inc., Murray Hill Station, NY
U.S. Africa Trade Alliance, Inc., Henderson, NC
W. Dean Moore Ministries, Inc., Lindsay, OK
West Grace Street Association, Richmond, VA
The Winning Tree, Incorporated, Washington, DC
World Travel & Tourism Council USA, Inc., Washington, DC
Worthington Center Management Company, Inc., Parkersburg, WV
Wren Family Day Care Center, Inc., Memphis, TN
Yemen American Cultural Center, Inc., Dearborn, MI
Youth Services America Corporation, Ellicott City, MD

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The September 1999 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 1999.

Rev. Rul. 99–46

The following Department Store Inventory Price Indexes for September 1999 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, 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, September 30, 1999.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	Sept. 1998	Sept. 1999	Percent Change from Sept. 1998 to Sept. 1999[1]
1. Piece Goods	542.3	543.6	0.2
2. Domestics and Draperies	634.0	629.3	–0.7
3. Women's and Children's Shoes	664.9	645.4	–2.9
4. Men's Shoes	915.1	883.1	–3.5
5. Infants' Wear	621.4	633.6	2.0
6. Women's Underwear	569.3	566.1	–0.6
7. Women's Hosiery	308.7	326.7	5.8
8. Women's and Girls' Accessories	545.7	536.2	–1.7
9. Women's Outerwear and Girls' Wear	419.3	408.9	–2.5
10. Men's Clothing	614.9	619.3	0.7
11. Men's Furnishings	595.5	618.4	3.8
12. Boys' Clothing and Furnishings	511.6	498.5	–2.6
13. Jewelry	973.7	960.4	–1.4
14. Notions	754.8	767.0	1.6
15. Toilet Articles and Drugs	939.8	982.5	4.5
16. Furniture and Bedding	673.8	696.6	3.4
17. Floor Coverings	602.1	602.8	0.1
18. Housewares	807.8	796.1	–1.4
19. Major Appliances	236.9	235.7	–0.5

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS—Continued
(January 1941 = 100, unless otherwise noted)

Groups	Sept. 1998	Sept. 1999	Percent Change from Sept. 1998 to Sept. 1999[1]
20. Radio and Television	71.0	64.6	–9.0
21. Recreation and Education[2]	103.2	96.4	–6.6
22. Home Improvements[2]	129.9	127.8	–1.6
23. Auto Accessories[2]	107.5	107.1	–0.4
Groups 1 – 15: Soft Goods	605.4	605.2	0.0
Groups 16 – 20: Durable Goods	458.1	450.6	–1.6
Groups 21 – 23: Misc. Goods[2]	107.6	102.7	–4.6
Store Total[3]	551.9	547.0	–0.9

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Richard C. Farley, Jr. of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Farley on (202) 622-4970 (not a toll-free call).

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45 on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45 on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45 on this page.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45 on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45 on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth rates for November 1999.

Rev. Rul. 99–45

This revenue ruling provides various prescribed rates for federal income tax purposes for November 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 99–45 TABLE 1

Applicable Federal Rates (AFR) for November 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	5.57%	5.49%	5.45%	5.43%
110% AFR	6.13%	6.04%	6.00%	5.97%
120% AFR	6.70%	6.59%	6.54%	6.50%
130% AFR	7.27%	7.14%	7.08%	7.04%
Mid-Term				
AFR	6.08%	5.99%	5.95%	5.92%
110% AFR	6.70%	6.59%	6.54%	6.50%
120% AFR	7.32%	7.19%	7.13%	7.08%
130% AFR	7.94%	7.79%	7.72%	7.67%
150% AFR	9.19%	8.99%	8.89%	8.83%
175% AFR	10.75%	10.48%	10.35%	10.26%
Long-Term				
AFR	6.39%	6.29%	6.24%	6.21%
110% AFR	7.04%	6.92%	6.86%	6.82%
120% AFR	7.69%	7.55%	7.48%	7.43%
130% AFR	8.35%	8.18%	8.10%	8.04%

REV. RUL. 99–45 TABLE 2

Adjusted AFR for November 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.91%	3.87%	3.85%	3.84%
Mid-term adjusted AFR	4.59%	4.54%	4.51%	4.50%
Long-term adjusted AFR	5.52%	5.45%	5.41%	5.39%

REV. RUL. 99–45 TABLE 3

Rates Under Section 382 for November 1999

Adjusted federal long-term rate for the current month	5.52%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.52%

REV. RUL. 99–45 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for November 1999

Appropriate percentage for the 70% present value low-income housing credit	8.46%
Appropriate percentage for the 30% present value low-income housing credit	3.63%

REV. RUL. 99–45 TABLE 5

Rate Under Section 7520 for November 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.4%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 3221.—Rate of Tax

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning July 1, 1999, shall be at the rate of 27 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning July 1, 1999, 35.8 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 64.2 percent of the taxes collected under such Sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated July 21, 1999.

By Authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on June 29, 1999, 8:45 a.m., and published in the issue of the Federal Register for June 30, 1999, 64 F.R. 35221)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 1999. See Rev. Rul. 99–45, page 558.

Part IV. Items of General Interest

IRA Recharacterizations and Reconversions Using the Same Trustee

Announcement 99–106

Purpose and Background

This announcement provides a 1-year extension of certain alternative methods of reporting IRA recharacterizations and reconversions.

Sections 408(i), 408A(d)(3)(D), and 6047 of the Internal Revenue Code provide that the Secretary of the Treasury shall prescribe rules for the reporting of transactions involving IRAs.

In general, contributions to IRAs are reported on Form 5498 and distributions from IRAs are reported on Form 1099-R. The instructions to these forms provide detailed information on completing these forms.

Section 1.408A–7 of the Income Tax Regulations imposes the general reporting requirements for Roth IRAs.

Notice 98–49, 1998–38 I.R.B. 5 (September 21, 1998), sets forth a general rule for reporting the recharacterization of an amount from an IRA of one type to an IRA of another type.

Announcement 99–5, 1999–3 I.R.B. 16 (January 19, 1999), provides for an alternative method of reporting recharacterizations and reconversions that occur in 1998 and 1999 within the same financial institution.

Section 1.408A–4 prescribes the rules relating to Roth IRA conversions, and § 1.408A–5 prescribes the rules relating to IRA recharacterizations. Section 1.408A–5, Q&A-9, provides that, for years after 1999, an IRA owner who converts an amount to a Roth IRA in a particular year and then recharacterizes the amount back to a traditional IRA may not reconvert the amount to a Roth IRA until the later of 30 days after the recharacterization or the beginning of the next year.

Extension of Announcement 99–5

A trustee, issuer, or custodian (hereinafter referred to as a "trustee") will not fail to satisfy the otherwise applicable IRA reporting requirements for recharacterizations and reconversions occurring in 2000 using the same trustee, provided that the trustee complies with Announcement 99–5 (other than the requirement of Announcement 99–5 that the recharacterization or reconversion occur in 1998 or 1999).

Thus, a trustee will not fail to satisfy the reporting requirements under §§ 408(i) and 6047 for completing Forms 1099-R or Forms 5498 for IRAs merely because, in the event of a recharacterization occurring in 2000 using the same trustee or a reconversion occurring in 2000 using the same trustee, the trustee reports the results of the recharacterization or reconversion on the appropriate forms using a reasonable alternative method in lieu of the method described in Notice 98-49.

Any trustee using an alternative method must provide instructions to the IRA owner, in conjunction with account statements (or other information) the trustee provides to the IRA owner, on how to use the information provided on the forms to properly report the recharacterizations and reconversions on the IRA owner's Federal income tax return for 2000, including how to use the information to complete related forms such as Form 8606 and Form 5329.

For purposes of this announcement, whether a transaction occurs using the same trustee is determined by the trustee's Federal identification number. Thus, a transaction that occurs between trustees that use different Federal identification numbers for purposes of issuing Forms 1099-R and Forms 5498 is not a transaction that occurs using the same trustee.

A recharacterization or reconversion that does not occur using the same trustee must be reported in accordance with the general rules contained in Notice 98-49 and the instructions to Forms 5498 and 1099-R, regardless of the year in which the recharacterization or reconversion occurs.

IRA Reporting Requirements After 2000

The Service will issue guidance in the future regarding the method for reporting recharacterizations and reconversions of IRA contributions made after 2000.

Effect on Other Documents

Announcement 99–5 is modified.

Foundations Status of Certain Organizations

Announcement 99–107

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Center for Alcohol Policy and
Prevention, Syracuse, NY

Quality Support Services for Youth,
Missouri City, TX

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1.—Tax Imposed

The Service provides inflation adjustments to the tax rate tables for individuals, trusts, and estates for taxable years beginning in 2000. In addition, the amounts of certain reductions allowed against the unearned income of minor children in computing the "kiddie tax" are adjusted. Also adjusted are the amounts used to determine whether a parent may elect to report the "kiddie tax" on the parent's return. See Rev. Proc. 99–42, page 568.

Section 32.—Earned Income

The Service provides inflation adjustments to the limitations on the earned income tax credit for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 59.—Other Definitions and Special Rules for the Alternative Minimum Tax

The Service provides an inflation adjustment to the exemption amount used in computing the alternative minimum tax for a minor child subject to the "kiddie tax" for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 63.—Taxable Income Defined

The Service provides inflation adjustments to the standard deduction amounts (including the limitation in the case of certain dependents, and the additional standard deduction for the aged or blind) for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 68.—Overall Limitation on Itemized Deductions

The Service provides inflation adjustments to the overall limitation on itemized deductions for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 132.—Certain Fringe Benefits

The Service provides inflation adjustments to the limitations on the exclusion of income for a qualified transportation fringe benefit for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 135.—Income From United States Savings Bonds Used to Pay Higher Education Tuition and Fees

The Service provides inflation adjustments to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 151.—Allowance of Deductions for Personal Exemptions

The Service provides inflation adjustments to the personal exemption and to the threshold amounts of adjusted gross income above which the exemption amount phases out for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 170.—Charitable, Etc., Contributions and Gifts

The Service provides inflation adjustments to the "insubstantial benefit" guidelines for calendar year 2000. Under the guidelines, a charitable contribution is fully deductible even though the contributor receives "insubstantial benefits" from the charity. See Rev. Proc. 99–42, page 568.

Section 213.—Medical, Dental, Etc., Expenses

The Service provides inflation adjustments to the limitation on the amount of eligible long-term care premiums includible in the term "medical care," for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 220.—Medical Savings Accounts

The Service provides inflation adjustments to the amounts used to determine whether a health plan is a "high deductible health plan" for purposes of determining whether an individual is eligible for a deduction for cash paid to a medical savings account for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 512.—Unrelated Business Taxable Income

The Service provides an inflation adjustment to the maximum amount of annual dues that can be paid to certain agricultural or horticultural organizations without any portion being treated as unrelated trade or business income by reason of any benefits or privileges available to members for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 513.—Unrelated Trade Or Business

The Service provides inflation adjustments to the maximum amount of a "low cost article" for taxable years beginning in 2000. Funds raised through a charity's distribution of "low cost articles" will not be treated as unrelated business income to the charity. See Rev. Proc. 99–42, page 568.

Section 561.—Definition of Deduction for Dividends Paid

26 CFR 1.561–1: Deduction for dividends paid.

If a regulated investment company makes distributions to shareholders that vary as a result of the allocation of certain expenses, as a result of the allocation of the benefit of a waiver or reimbursement of certain expenses, or as a result of the allocation or waiver or reimbursement of a performance fee, may the company include those distributions in the amount of its deduction for dividends paid? See Rev. Proc. 99–40, page 565.

Section 562.—Rules Applicable in Determining Dividends Eligible for Dividends Paid Deduction

26 CFR 1.562–2: Preferential dividends.

If a regulated investment company makes distributions to shareholders that vary as a result of the allocation of certain expenses, as a result of the allocation of the benefit of a waiver or reimbursement of certain expenses, or as a result of the allocation or waiver or reimbursement of a performance fee, may the company include those distributions in the amount of its deduction for dividends paid? See Rev. Proc. 99–40, page 565.

Section 685.—Treatment of Funeral Trusts

The Service provides an inflation adjustment to the maximum amount of contributions that may be made to a qualified funeral trust for contracts entered in calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 852.—Taxation of Regulated Investment Companies and Their Shareholders

26 CFR 1.852–1: Taxation of regulated investment companies.

If a regulated investment company makes distributions to shareholders that vary as a result of the allocation of certain expenses, as a result of the allocation of the benefit of a waiver or reimbursement of certain expenses, or as a result of the allocation or waiver or reimbursement of a performance fee, may the company include those distributions in the amount of its deduction for dividends paid? See Rev. Proc. 99–40, page 565.

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26 CFR 1.852–3: Investment company taxable income.

If a regulated investment company makes distributions to shareholders that vary as a result of the allocation of certain expenses, as a result of the allocation of the benefit of a waiver or reimbursement of certain expenses, or as a result of the allocation or waiver or reimbursement of a performance fee, may the company include those distributions in the amount of its deduction for dividends paid? See Rev. Proc. 99–40, page 565.

Section 877.—Expatriation To Avoid Tax

The Service provides inflation adjustments to amounts used to determine whether an individual's loss of United States citizenship had the avoidance of United Stated tax as one of its principal purposes for calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 2032A.—Valuation of Certain Farm, Etc., Real Property

The Service provides an inflation adjustment to the maximum amount by which the value of certain farm and other qualified real property included in a decedent's gross estate may be decreased for purposes of valuing the estate of a decedent dying in calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 2503.—Taxable Gifts

The Service provides an inflation adjustment to the amount of gifts that may be made to a person in a calendar year without including the amount in taxable gifts for calendar year 2000. See Rev. Proc. 99-42, page 568.

Section 2523.—Gift to Spouse

The Service provides an inflation adjustment to the amount of gifts that may be made in a calendar year to a spouse who is not a citizen of the United States without including the amount in taxable gifts for calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 2631.—GST Exemption

The Service provides an inflation adjustment to the amount of the generation-skipping transfer tax exemption for calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 3221.—Rate of Tax

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning October 1, 1999, shall be at the rate of 27 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning October 1, 1999, 37.1 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 62.9 percent of the taxes collected under such Sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated September 7, 1999.

By Authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on September 15, 1999, 8:45 a.m., and published in the issue of the Federal Register for September 16, 1999, 64 F.R. 50308)

Section 4001.—Passenger Vehicles

The Service provides inflation adjustments to the price above which a passenger vehicle becomes subject to an excise tax for transactions occurring in calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 4003.—Special Rules

The Service provides inflation adjustments to the price above which a passenger vehicle becomes subject to an excise tax for transactions occurring in calendar year 2000. (Price includes the price of installation of parts or accessories on a passenger vehicle within six months of the date after the vehicle was first placed in service.) See Rev. Proc. 99–42, page 568.

Section 4261.—Transportation by Air

The Service provides an inflation adjustment to the amount of the excise tax on passenger air transportation beginning or ending in the United States for calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 6033.—Returns by Exempt Organizations

The Service provides an inflation adjustment to the amount of dues certain exempt organizations with nondeductible lobbying expenditures can charge and still be excepted from reporting requirements for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 6039F.—Notice of Large Gifts Received From Foreign Persons

The Service provides an inflation adjustment to the amount of gifts in a taxable year from foreign person(s) that triggers a reporting requirement for a United States person for taxable years beginning in 2000. See Rev. Proc. 99–42, page 568.

Section 6323.—Validity and Priority Against Certain Persons

The Service provides inflation adjustments for calendar year 2000 to (1) the maximum amount of a casual sale of personal property below which a federal tax lien will not be valid against a purchaser of the property, and (2) the maximum amount of a contract for the repair or improvement of certain residential property at or below which a federal tax lien will not be valid against a mechanic's lienor. See Rev. Proc. 99–42, page 568.

Section 6334.—Property Exempt From Levy

The Service provides inflation adjustments to the value of certain property exempt from levy (fuel, provisions, furniture, household personal effects, arms for personal use, livestock, poultry, and books and tools of a trade, business, or profession) for calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 6601.—Interest on Underpayment, Nonpayment, or Extension of Time for Payment, of Tax

The Service provides an inflation adjustment to the amount used to determine the amount of interest charged on a certain portion of the estate tax payable in installments for the estate of a decedent dying in calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 7430.—Awarding of Costs and Certain Fees

The Service provides an inflation adjustment to the hourly limit on attorney fees that may be awarded in a judgment or settlement of an administrative or judicial proceeding concerning the determination, collection, or refund of tax, interest, or penalty for calendar year 2000. See Rev. Proc. 99–42, page 568.

Section 7702B.—Treatment of Qualified Long-Term Care Insurance

The Service provides an inflation adjustment to the stated dollar amount of the per diem limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual for calendar year 2000. See Rev. Proc. 99–42, page 568.

Part III. Administrative, Procedural, and Miscellaneous

Reporting of Gross Proceeds Payments to Attorneys

Notice 99–53

This notice informs taxpayers that the Internal Revenue Service intends to delay for one year the effective date of the regulations proposed under § 6045 of the Internal Revenue Code (relating to the reporting of payments of gross proceeds to attorneys). The notice of proposed rulemaking (NPRM) was published in the Federal Register on May 21, 1999 (64 F.R. 27730), 1999–23 I.R.B. 14 (REG–105312–98). Section 1.6045–5(h) of the proposed Income Tax Regulations provides that the rules in § 1.6045–5 apply to payments made after December 31, 1999.

The Service has received many comments requesting that the effective date of the regulations be delayed and believes that a delayed effective date for the regulations is appropriate under the circumstances. Accordingly, when finalized, the rules in § 1.6045–5 will apply to payments made after December 31, 2000. Nevertheless, payments of gross proceeds to attorneys made after December 31, 1997, are and continue to be reportable on Form 1099-MISC pursuant to § 6045(f).

The principal author of this notice is A. Katharine Jacob Kiss, of the Office of the Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact Ms. Kiss on (202) 622-4920 (not a toll-free number).

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, sections 561, 562, 852; 1.561–1, 1.562–2, 1.852–1, 1.852–3)

Rev. Proc. 99–40

SECTION 1. PURPOSE

This revenue procedure describes conditions under which distributions made to shareholders of a regulated investment company (RIC) may vary and nevertheless be deductible as dividends under § 562 of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 Section 852(b)(2)(D) allows a RIC a deduction for dividends paid (as defined in § 561 with certain modifications). Section 561 defines the deduction for dividends paid and applies the rules of § 562 to determine which dividends are eligible for the deduction for dividends paid. Section 562(c) provides that the amount of any distribution is not considered a dividend for purposes of computing the dividends paid deduction under § 561 unless the distribution is pro rata, does not prefer any share of stock of a class over any other share of stock of that same class, and does not prefer one class of stock over another class except to the extent that one class is entitled (without reference to waivers of their rights by shareholders) to the preference.

.02 Many RICs have issued groups of shares that represent interests in the same portfolio of securities but have different arrangements for shareholder services or the distribution of shares or both. Because the fees for these arrangements and services may vary, shareholders with equivalent investments in the same fund may receive different distributions. To permit open-end management investment companies to issue these groups of shares, the Securities and Exchange Commission (SEC) has adopted Rule 18f-3, 17 C.F.R. 270.18f-3, under the Investment Company Act of 1940, 15 U.S.C. 80a-1 to -64 (1940 Act).

.03 Rev. Proc. 96–47, 1996-2 C.B. 338, describes conditions under which distributions made to shareholders of a RIC may vary and nevertheless be deductible as dividends under § 562. Rev. Proc. 96–47 does not address the treatment of distributions to shareholders that differ in part as a result of the allocation of the benefit of a waiver or reimbursement of a fee or expense. Furthermore, Rev. Proc. 96–47 does not address variations in distributions that arise as a result of the allocation of performance-based advisory fees.

SECTION 3. SCOPE

This revenue procedure applies to a RIC described in § 851(a) and § 851(b)(1) that issues groups of shares (Qualified Groups) that meet the requirements of this section. The requirements in this section are to be interpreted in a manner consistent with the SEC's interpretation of analogous requirements in the rules under the 1940 Act. See Rule 18f-3(a), 17 CFR 270.18f-3(a), and *Exemptions for Open End Management Investment Companies Issuing Multiple Classes of Shares*, Investment Company Act Release No. 20,915, 60 Fed. Reg. 11,876 at 11,878 (Mar. 2, 1995).

.01 Each Qualified Group shall have a different arrangement for shareholder services or the distribution of shares or both, and shall be allocated and shall pay the fees and expenses of that arrangement.

.02 Each Qualified Group may be allocated and may pay a different share of other fees and expenses, not including advisory or custodial fees or other fees and expenses related to the management of the RIC's assets, if these expenses are actually incurred in a different amount by that Qualified Group, or if the Qualified Group receives services of a different kind or to a different degree than other Qualified Groups.

.03 Each Qualified Group—

(1) Shall be allocated and shall pay an advisory fee and other fees and expenses related to the management of the RIC's assets (including custodial fees and tax return preparation fees) on the basis of the net asset value of the Qualified Group in relation to the net asset value of the RIC, except as described in paragraph (2); and

(2) May be allocated and may pay a different advisory fee to the extent that any difference in amount paid is the result of the application of the same performance fee provisions in the advisory contract to the different investment performance of each Qualified Group.

.04 The rights and obligations of the shareholders of each Qualified Group are set forth in the RIC's organizing documents. Except as otherwise provided in this revenue procedure, each Qualified Group is entitled to distributions calculated under those documents in the same manner and at the same time as all other Qualified Groups. For purposes of this calculation, fees and expenses are allocated under those documents to each Qualified Group at the same time as to all other Qualified Groups. Organizing documents are documents of the RIC that fix the rights and obligations between the

RIC and the shareholders and that are approved by a majority of the directors of the RIC.

.05 Each Qualified Group separately meets the requirements of § 67(c)(2)(B) (defining the required characteristics of shares of a publicly offered RIC).

SECTION 4. WAIVERS AND REIMBURSEMENTS

Any waiver or reimbursement of a fee or expense incurred by the RIC shall meet the following requirements:

.01 *Fees and expenses related to arrangements for shareholder services or the distribution of shares.* The benefit of a waiver or reimbursement of all or part of a fee or expense that is described in section 3.01 of this revenue procedure is allocated to the Qualified Group of shares on behalf of which the fee or expense was incurred. Thus, for example, if a RIC meeting the requirements of this revenue procedure issues Class A shares bearing a Rule 12b-1 fee of .50 percent of net asset value and issues Class B shares bearing a Rule 12b-1 fee of .75 percent of net asset value, a distributor may waive all or part of the Class B Rule 12b-1 fee. Because the Class B Rule 12b-1 fee was allocated to Class B on the basis of the amount incurred by Class B, the benefit of a waiver of the Class B Rule 12b-1 fee is allocated entirely to Class B, and no portion of the waiver may be allocated to Class A.

.02 *Other fees and expenses.* The benefit of a waiver or reimbursement of all or part of a fee or expense described in section 3.02 of this revenue procedure is allocated in accordance with the method of allocation of the fee or expense pursuant to section 3.02. If pursuant to section 3.02 the fee or expense was allocated on the basis of the amount incurred on behalf of each Qualified Group, the benefit of a waiver or reimbursement of the fee or expense described in section 3.02 is allocated to the Qualified Group of shares on behalf of which the expense was incurred. If pursuant to section 3.02 the fee or expense was allocated on the basis of net asset value, the benefit of a waiver or reimbursement of the fee or expense is allocated by net asset value. Thus, for example, if Class A shares are allocated a transfer agency fee pursuant to section 3.02 on the basis of the amount incurred by Class A, and Class B shares are allocated a transfer agency fee pursuant to section 3.02 on the basis of the amount incurred by Class B, the transfer agent may waive all or part of the Class B transfer agency fee. Because the Class B transfer agency fee was allocated to Class B on the basis of the amount incurred by Class B, the benefit of a waiver of the Class B transfer agency fee is allocated entirely to Class B, and no portion of the waiver may be allocated to Class A.

.03 *Advisory fees and other expenses related to the management of the corporation's assets*—(1) *General rule.* The benefit of a waiver or reimbursement of a fee or expense that is described in section 3.03(1) of this revenue procedure is allocated to all shares by net asset value, regardless of Qualified Group, except as provided in paragraph (2) of this section.

(2) *Performance fees.* A RIC whose advisory contract contains performance fee provisions described in section 3.03(2) of this revenue procedure shall comply with the requirement in this section 4.03(2) instead of that contained in section 4.03(1) of this revenue procedure. If, under these performance fee provisions, a Qualified Group is allocated an advisory fee that exceeds the advisory fee that would have been allocated to that Qualified Group if its performance were equivalent to that of the index or other measure of performance under these performance fee provisions, then the benefit of a waiver or reimbursement of all or part of the excess shall be allocated to the Qualified Group to which the excess is allocated. The benefit of any waiver or reimbursement of any other portion of the advisory fee shall comply with section 4.03(1) of this revenue procedure.

SECTION 5. PROCEDURE

If variations in distributions to shareholders of different Qualified Groups exist solely as a result of the allocation and payment of fees and expenses and the allocation of the benefit of waivers and reimbursements of fees and expenses in accordance with the applicable provisions of section 3 and 4 of this revenue procedure, these variations do not prevent the distributions from being dividends under § 562.

SECTION 6. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 96–47, 1996–2 C.B. 338, is amplified and superseded.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective October 28, 1999.

DRAFTING INFORMATION

The principal author of this revenue procedure is Susan Thompson Baker of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Susan Baker at (202) 622-3940 (not a toll-free call).

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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 6662.)

Rev. Proc. 99–41

SECTION 1. PURPOSE

.01 This revenue procedure updates Rev. Proc. 98–62, 1998–52 I.R.B. 23, and identifies circumstances under which the disclosure on a taxpayer's return of a position with respect to an item is adequate for the purpose of reducing the understatement of income tax under § 6662(d) of the Internal Revenue Code (relating to the substantial understatement aspect of the accuracy-related penalty), and for the purpose of avoiding the preparer penalty under § 6694(a) (relating to understatements due to unrealistic positions). This revenue procedure does not apply with respect to any other penalty provision (including the negligence or disregard provisions of the § 6662 accuracy-related penalty).

.02 This revenue procedure applies to any return filed on 1999 tax forms for a taxable year beginning in 1999, and to any return filed on 1999 tax forms in 2000 for short taxable years beginning in 2000.

SECTION 2. CHANGES FROM REV. PROC. 98–62

Editorial changes only have been made in this revenue procedure.

SECTION 3. BACKGROUND

.01 If § 6662 applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies is added to the tax. (The penalty rate is 40 percent in the case of certain gross valuation misstatements.) Under § 6662(b)(2), § 6662 applies to the portion of an underpayment that is attributable to a substantial understatement of income tax.

.02 Section 6662(d)(1) provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount of tax required to be shown on the return for the taxable year or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) defines an understatement as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax that is shown on the return reduced by any rebate (within the meaning of § 6211(b)(2)).

.03 In the case of an item not attributable to a tax shelter, § 6662(d)(2)(B)(ii) provides that the amount of the understatement is reduced by the portion of the understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed on the return or on a statement attached to the return, and there is a reasonable basis for the tax treatment of such item by the taxpayer.

.04 In general, this revenue procedure provides guidance in determining when disclosure is adequate for purposes of § 6662(d). For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms must be verifiable. Guidance under § 6662(d) for returns filed in 1998, 1997, and 1996 is provided in Rev. Proc. 98–62; Rev. Proc. 97–56, 1997–2 C.B. 582; and Rev. Proc. 96–58, 1996–2 C.B. 390, respectively.

SECTION 4. PROCEDURE

.01 Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under § 6662(d) provided that the forms and attachments are completed in a clear manner and in accordance with their instructions. The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form.

(1) Form 1040, Schedule A, Itemized Deductions:

(a) Medical and Dental Expenses: Complete lines 1 through 4, supplying all required information.

(b) Taxes: Complete lines 5 through 9, supplying all required information. Line 8 must list each type of tax and the amount paid.

(c) Interest Expense: Complete lines 10 through 14, supplying all required information. This section 4.01(1)(c) does not apply to (i) amounts disallowed under § 163(d) unless Form 4952, Investment Interest Expense Deduction, is completed, or (ii) amounts disallowed under § 265.

(d) Contributions: Complete lines 15 through 18, supplying all required information. Merely entering the amount of the donation on Schedule A, however, will not constitute adequate disclosure if the taxpayer receives a substantial benefit from the donation shown. If a contribution of property other than cash is made and the amount claimed as a deduction exceeds $500, a properly completed Form 8283, Noncash Charitable Contributions, must be attached to the return. This section 4.01(1)(d) will not apply to any contribution of $250 or more unless the contemporaneous written acknowledgment requirement of § 170(f)(8) is satisfied.

(e) Casualty and Theft Losses: Complete Form 4684, Casualties and Thefts, and attach to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Certain Trade or Business Expenses (including, for purposes of this section 4.01(2), the following six expenses as they relate to the rental of property):

(a) Casualty and Theft Losses: The procedure outlined in section 4.01(1)(e) above must be followed.

(b) Legal Expenses: The amount claimed must be stated. This section 4.01(2)(b) does not apply, however, to amounts properly characterized as capital expenditures, personal expenses, or nondeductible lobbying or political expenditures, including amounts that are required to be (or that are) amortized over a period of years.

(c) Specific Bad Debt Charge-off: The amount written off must be stated.

(d) Reasonableness of Officers' Compensation: Form 1120, Schedule E, Compensation of Officers, must be completed when required by its instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section 4.01(2)(d) does not apply to "golden parachute" payments, as defined under § 280G. This section 4.01(2)(d) will not apply to the extent that remuneration paid or incurred exceeds the $1 million-employee-remuneration limitation, if applicable.

(e) Repair Expenses: The amount claimed must be stated. This section 4.01(2)(e) does not apply, however, to any repair expenses properly characterized as capital expenditures or personal expenses.

(f) Taxes (other than foreign taxes): The amount claimed must be stated.

(3) Form 1120, Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return, provided:

(a) The amount of the deviation from the financial books and records is not the result of a computation that includes the netting of items; and

(b) The information provided reasonably may be expected to apprise the Internal Revenue Service of the nature of the potential controversy concerning the tax treatment of the item.

(4) Foreign Tax Items:

(a) International Boycott Transactions: Transactions disclosed on Form 5713, International Boycott Report.

(b) Intercompany Transactions: Transactions and amounts shown on Schedule M (Form 5471), Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons, lines 19 and 20; and Form 5472,

Part IV, Monetary Transactions Between Reporting Corporations and Foreign Related Party, lines 7 and 18.

(c) Treaty-Based Return Position: Transactions and amounts under § 6114 or 7701(b) as disclosed on Form 8833, Treaty-Based Return Position Disclosure.

(5) Other:

(a) Moving Expenses: Complete Form 3903, Moving Expenses, and attach to the return.

(b) Employee Business Expenses: Complete Form 2106, Employee Business Expenses, or Form 2106-EZ, Unreimbursed Employee Business Expenses, and attach to the return. This section 4.01(5)(b) does not apply to club dues, or to travel expenses for any non-employee accompanying the taxpayer on the trip.

(c) Fuels Credit: Complete Form 4136, Credit for Federal Tax Paid on Fuels, and attach to the return.

(d) Investment Credit: Complete Form 3468, Investment Credit, and attach to the return.

SECTION 5. EFFECTIVE DATE

This revenue procedure applies to any return filed on 1999 tax forms for a taxable year beginning in 1999, and to any return filed on 1999 tax forms in 2000 for short taxable years beginning in 2000.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Renay France of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. France on (202) 622-4940 (not a toll-free call).

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26 CFR 601.602: Tax forms and instructions.
(Also Part I, sections 1, 32, 59, 63, 68, 132, 135, 151, 170, 213, 220, 512, 513, 685, 877, 2032A, 2503, 2523, 2631, 4001, 4003, 4261, 6033, 6039F, 6323, 6334, 6601, 7430, 7702B)

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SECTION 4. EFFECTIVE DATE

SECTION 5. DRAFTING INFORMATION

SECTION 1. PURPOSE

This revenue procedure sets forth inflation adjusted items for 2000.

SECTION 2. CHANGES MADE FROM PRECEDING YEAR

.01 The limitations in § 132(f) on the exclusion from gross income for qualified transportation fringes, as amended by section 9010(b) of the Transportation Equity Act for the 21st Century, Pub. L. 105-178, 112 Stat. 107 (1998), are adjusted for inflation for tax years beginning in 2000 (section 3.07).

.02 The value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) and under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer), as amended by section 3431 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998), are adjusted for inflation for tax years beginning in 2000 (section 3.24).

SECTION 3. 2000 ADJUSTED ITEMS

.01 *Tax Rate Tables.* For tax years beginning in 2000, the tax rate tables under § 1 are as follows:

TABLE 1 – Section 1(a). — MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is:	The Tax Is:
Not Over $43,850	15% of the taxable income
Over $43,850 but not over $105,950	$6,577.50 plus 28% of the excess over $43,850
Over $105,950 but not over $161,450	$23,965.50 plus 31% of the excess over $105,950
Over $161,450 but not over $288,350	$41,170.50 plus 36% of the excess over $161,450
Over $288,350	$86,854.50 plus 39.6% of the excess over $288,350

TABLE 2 – Section 1(b). — HEADS OF HOUSEHOLDS

If Taxable Income Is:	The Tax Is:
Not Over $35,150	15% of the taxable income
Over $35,150 but not over $90,800	$5,272.50 plus 28% of the excess over $35,150
Over $90,800 but not over $147,050	$20,854.50 plus 31% of the excess over$90,800
Over $147,050 but not over $288,350	$38,292 plus 36% of the excess over $147,050
Over $288,350	$89,160 plus 39.6% of the excess over $288,350

TABLE 3 – Section 1(c). — UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is:	The Tax Is:
Not Over $26,250	15% of the taxable income
Over $26,250 but not over $63,550	$3,937.50 plus 28% of the excess over $26,250
Over $63,550 but not over $132,600	$14,381.50 plus 31% of the excess over $63,550
Over $132,600 but not over $288,350	$35,787 plus 36% of the excess over $132,600

Over $288,350	$91,857 plus 39.6% of the excess over $288,350

TABLE 4 – Section 1(d). — MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is:	The Tax Is:
Not Over $21,925	15% of the taxable income
Over $21,925 but not over $52,975	$3,288.75 plus 28% of the excess over $21,925
Over $52,975 but not over $80,725	$11,982.75 plus 31% of the excess over $52,975
Over $80,725 but not over $144,175	$20,585.25 plus 36% of the excess over $80,725
Over $144,175	$43,427.25 plus 39.6% of the excess over $144,175

TABLE 5 – Section 1(e). — ESTATES AND TRUSTS

If Taxable Income Is:	The Tax Is:
Not Over $1,750	15% of the taxable income
Over $1,750 but not over $4,150	$262.50 plus 28% of the excess over $1,750
Over $4,150 but not over $6,300	$934.50 plus 31% of the excess over $4,150
Over $6,300 but not over $8,650	$1,601 plus 36% of the excess over $6,300
Over $8,650	$2,447 plus 39.6% of the excess over $8,650

.02 *Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax").* For tax years beginning in 2000, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is $700. (This amount is the same as the $700 standard deduction amount provided in section 3.05(2) of this revenue procedure.) In the alternative, the same $700 amount is used for purposes of § 1(g)(7) (that is, determining whether a parent may elect to include a child's gross income in the parent's gross income and for calculating the "kiddie tax").

.03 *Earned Income Credit.*

(1) *In general.* For tax years beginning in 2000, the following amounts are used to determine the earned income credit under § 32(b). The "earned income amount" is the amount of earned income at or above which the maximum amount of the earned income credit is allowed. The "threshold phaseout amount" is the amount of modified adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out. The "completed phaseout amount" is the amount of modified adjusted gross income (or if greater, earned income) at or above which no credit is allowed.

Number of Children	Maximum Amount of the Credit	Earned Income Amount	Threshold Phaseout Amount	Completed Phaseout Amount
1	$2,353	$6,920	$12,690	$27,413
2 or more	$3,888	$9,720	$12,690	$31,152
None	$ 353	$4,610	$ 5,770	$10,380

The Internal Revenue Service, in the instructions for the Form 1040 series, provides tables showing the amount of the earned income credit for each type of taxpayer.

(2) *Excessive investment income.* For tax years beginning in 2000, the earned income credit is denied under § 32(i) if the aggregate amount of certain investment income exceeds $2,400.

.04 *Alternative Minimum Tax Exemption for a Child Subject to the "Kiddie Tax."* For tax years beginning in 2000, in the case of a child to whom the § 1(g) "kiddie tax" applies, the exemption

amount under § 55 and § 59(j) for purposes of the alternative minimum tax under § 55 may not exceed the sum of (A) such child's earned income for the taxable year, plus (B) $5,200.

.05 *Standard Deduction.*

(1) *In general.* For tax years beginning in 2000, the standard deduction amounts under § 63(c)(2) are as follows:

Filing Status	*Standard Deduction*
MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES (§ 1(a))	$7,350
HEADS OF HOUSEHOLDS (§ 1(b))	$6,450
UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS) (§ 1(c))	$4,400
MARRIED INDIVIDUALS FILING SEPARATE RETURNS (§ 1(d))	$3,675

(2) *Dependent.* For tax years beginning in 2000, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of $700, or the sum of $250 and the individual's earned income.

(3) *Aged and blind.* For tax years beginning in 2000, the additional standard deduction amounts under § 63(f) for the aged and for the blind are $850 for each. These amounts are increased to $1,100 if the individual is also unmarried and not a surviving spouse.

.06 *Overall Limitation on Itemized Deductions.* For tax years beginning in 2000, the "applicable amount" of adjusted gross income under § 68(b), above which the amount of otherwise allowable itemized deductions is reduced under § 68, is $128,950 (or $64,475 for a separate return filed by a married individual).

.07 *Qualified Transportation Fringe.* For tax years beginning in 2000, the monthly limitation under § 132(f)(2)(A), regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass, is $65. The monthly limitation under § 132(f)(2)(B) regarding the fringe benefit exclusion amount for qualified parking is $175.

.08 *Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses.* For tax years beginning in 2000, the exclusion under § 135, regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses, begins to phase out for modified adjusted gross income above $81,100 for joint returns and $54,100 for other returns. This exclusion completely phases out for modified adjusted gross income of $111,100 or more for joint returns and $69,100 or more for other returns.

.09 *Personal Exemption.*

(1) *Exemption amount.* For tax years beginning in 2000, the personal exemption amount under § 151(d) is $2,800.

(2) *Phaseout.* For tax years beginning in 2000, the personal exemption amount begins to phase out at, and is completely phased out after, the following adjusted gross income amounts:

Filing Status	*Threshold Phaseout Amount*	*Completed Phaseout Amount After*
Code § 1(a)	$193,400	$315,900
Code § 1(b)	$161,150	$283,650
Code § 1(c)	$128,950	$251,450
Code § 1(d)	$ 96,700	$157,950

.10 *Eligible Long-Term Care Premiums.* For tax years beginning in 2000, the limitations under § 213(d), regarding eligible long-term care premiums includible in the term "medical care," are as follows:

Attained age before the close of the taxable year:	
40 or less	$ 220
More than 40 but not more than 50	$ 410
More than 50 but not more than 60	$ 820
More than 60 but not more than 70	$2,200
More than 70	$2,750

.11 *Medical Savings Accounts.*

(1) *Self-only coverage.* For tax years beginning in 2000, the term "high deductible health plan" as defined in § 220(c)(2)(A) means, in the case of self-only coverage, a health plan which has an annual deductible that is not less than $1,550 and not more than $2,350, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $3,100.

(2) *Family coverage.* For tax years beginning in 2000, the term "high deductible health plan" means, in the case of family coverage, a health plan which has an annual deductible that is not less than $3,100 and not more than $4,650, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $5,700.

.12 *Treatment of Dues Paid to Agricultural or Horticultural Organizations.* For tax years beginning in 2000, the limitation under § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is $112.

.13 *Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns.*

(1) *Low cost article.* For tax years beginning in 2000, the unrelated business income of certain exempt organizations under § 513(h)(2) does not include a "low cost article" of $7.40 or less.

(2) *Other insubstantial benefits.* For tax years beginning in 2000, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90–12, 1990–1 C.B. 471 (as amplified and modified), for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution under § 170, are $7.40, $37, and $74, respectively.

.14 *Funeral Trusts.* For a contract entered into during calendar year 2000 for a "qualified funeral trust," as defined in

§ 685, the trust may not accept aggregate contributions by or for the benefit of an individual in excess of $7,200.

.15 *Expatriation to Avoid Tax.* For calendar year 2000, the thresholds used under § 877(a)(2), regarding whether an individual's loss of United States citizenship had the avoidance of United States taxes as one of its principal purposes, are more than $112,000 for "average annual net income tax" and $562,000 or more for "net worth."

.16 *Valuation of Qualified Real Property in Decedent's Gross Estate.* For an estate of a decedent dying in calendar year 2000, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A that is taken into account for purposes of the estate tax may not exceed $770,000.

.17 *Annual Exclusion for Gifts.*

(1) For calendar year 2000, the first $10,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.

(2) For calendar year 2000, the first $103,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under §§ 2503 and 2523(i)(2) made during that year.

.18 *Generation-Skipping Transfer Tax Exemption.* For calendar year 2000, the generation-skipping transfer tax exemption under § 2631, which is allowed in determining the "inclusion ratio" defined in § 2642, is $1,030,000.

.19 *Luxury Automobile Excise Tax.* For calendar year 2000, the excise tax under §§ 4001 and 4003 is imposed on the first retail sale of a passenger vehicle (including certain parts or accessories installed within six months of the date after the vehicle was first placed in service), to the extent the price exceeds $38,000.

.20 *Passenger Air Transportation Excise Tax.* For calendar year 2000, the tax under § 4261(c) on any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins or ends in the United States, generally is $12.40. However, in the case of a domestic segment beginning or ending in Alaska or Hawaii as described in § 4261(c)(3), the tax only applies to departures and is at the rate of $6.20.

.21 *Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures.* For tax years beginning in 2000, the annual per person, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 5.05 of Rev. Proc. 98–19, 1998–7 I.R.B. 30), regarding certain exempt organizations with nondeductible lobbying expenditures, is $78 or less.

.22 *Notice of Large Gifts Received from Foreign Persons.* For tax years beginning in 2000, recipients of gifts from certain foreign persons may have to report these gifts under § 6039F if the aggregate value of gifts received in a taxable year exceeds $10,931.

.23 *Persons against Which a Federal Tax Lien is Not Valid.* For calendar year 2000, a federal tax lien is not valid against (1) certain purchasers under § 6323(b)(4) that purchased personal property in a casual sale for less than $1,060, or (2) a mechanic's lienor under § 6323(b)(7) that repaired or improved certain residential property if the contract price with the owner is not more than $5,320.

.24 *Property Exempt from Levy.* For calendar year 2000, the value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) may not exceed $6,360. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) may not exceed $3,180.

.25 *Interest on a Certain Portion of the Estate Tax Payable in Installments.* For an estate of a decedent dying in calendar year 2000, the dollar amount used to determine the "2-percent portion" (for purposes of calculating interest under § 6601(j)) of the estate tax payable in installments under § 6166 is $1,030,000.

.26 *Attorney Fee Awards.* For fees incurred in calendar year 2000, the attorney fee award limitation under § 7430(c)(1)-(B)(iii) is $140 per hour.

.27 *Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts.* For calendar year 2000, the stated dollar amount of the per diem limitation under § 7702B(d)(4), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $190.

SECTION 4. EFFECTIVE DATE

.01 *General Rule.* Except as provided in section 4.02, this revenue procedure applies to tax years beginning in 2000.

.02 *Calendar Year Rule.* This revenue procedure applies to transactions or events occurring in calendar year 2000 for purposes of section 3.14 (funeral trusts), section 3.15 (expatriation to avoid tax), section 3.16 (valuation of qualified real property in decedent's gross estate), section 3.17 (annual exclusion for gifts), section 3.18 (generation-skipping transfer tax exemption), section 3.19 (luxury automobile excise tax), section 3.20 (passenger air transportation excise tax), section 3.23 (persons against which a federal tax lien is not valid), section 3.24 (property exempt from levy), section 3.25 (interest on a certain portion of the estate tax payable in installments), section 3.26 (attorney fee awards), and section 3.27 (periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts).

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is John Moran of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Moran on (202) 622-4940 (not a toll-free call).

Part IV. Items of General Interest

Withdrawal of Notice of Federal Tax Lien in Certain Circumstances; Hearing

Announcement 99–108

SUMMARY: This document contains a notice of public hearing on proposed regulations relating to the withdrawal of notice of federal tax liens in certain circumstances.

DATES: The public hearing is being held on November 30, 1999, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by November 16, 1999.

ADDRESSES: The public hearing is being held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building.

Mail outlines to: CC:DOM:CORP:R (REG–101519–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Hand deliver outlines Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–101519–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Submit outlines electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting them directly to the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html.

FOR FURTHER INFORMATION: Concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, contact LaNita Van Dyke, (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION: The subject of the public hearing is the notice of proposed regulations (REG–101519–97, 1999–29 I.R.B. 114) that was published in the **Federal Register** on Wednesday, June 30, 1999 (64 F.R. 35102).

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who have submitted written comments and wish to present oral comments at the hearing, must submit an outline of the topics to be discussed and the amount of time to be devoted to each topic (signed original and eight (8) copies) by Tuesday, November 16, 1999.

A period of 10 minutes is allotted to each person for presenting oral comments.

After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

Because of access restrictions, the IRS will not admit visitors beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION" section of this document.

Cynthia E. Grigsby,
Chief, Regulations Unit,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on October 27, 1999, 8:45 a.m., and published in the issue of the Federal Register for October 28, 1999, 64 F.R. 58006)

Foundations Status of Certain Organizations

Announcement 99–109

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Augustine Foundation, Ames, IA
Born Free MC Toy Run, Inc., Kent, OH
Brandwein-Morholt Trust, New York, NY
Celestial Harvest Foundation, New York, NY
Christian Education Forum, Nashville, TN
Ellis Island of Baltimore Foundation, Inc., Baltimore, MD
Global Arts, Ltd., Denver, CO
Harry Chapin Foundation, Huntington, NY
The Hydrogen Foundation, Edina, MN
Inland Boat Works, Inc., Sausalito, CA
International Center for Disarmament and Conversion, Davidson, NC
Investment Education Institute, Detroit, MI
Joy Hanbury Home, Inc., Hampton, VA
Kairos Ministries, Inc., Walnut Cove, NC
Light Club 7, Incorporated, New Port Richey, FL
Louis Cunningham Scholarship Foundation, Southfield, MI
Mentor Plus, Inc., Fairfield, AL
Moonlight Theatre, Inc., New Rochelle, NY
Roseau Youth Activities Association, Inc., Roseau, MN
Schraalenburgh Housing Nonprofit Corporation, Teaneck, NJ
Thomas County Christian Brotherhood, Inc., Ochlocknee, GA
Bob L. Thomas Ministries, Inc., Pryor, OK
World of Friends, Inc., Phoenix, AZ
Yad Ezra, Inc., West Hempstead, NY
Yalobusha County Educational Fund, Inc., Water Valley, MS

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as pro-

vided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Missing Children Photos Appear in IRS Tax Products

Announcement 99–110

The ability of the Internal Revenue Service to reach tens of millions of American households each year is being put to an unprecedented use–the search for missing children. The IRS is partnering with the National Center for Missing and Exploited Children (NCMEC) to dramatically expand the distribution of photos of lost, abducted, and runaway children.

The IRS will post pictures of missing children in its walk-in centers and print their pictures on otherwise blank pages of IRS tax form instructions and taxpayer information publications, including the Internal Revenue Bulletin. The photos will be provided by NCMEC and will be accompanied by information about the children and the NCMEC's 24-hour, toll-free hotline number **1-800-THE-LOST** (1-800-843-5678). The IRS is also establishing a link from its Web site (*www.irs.gov*) to the NCMEC Web site (*www.missingkids.com*).

"One in six missing children is found as a direct result of someone recognizing their photos, and we count ourselves extremely fortunate to have the IRS as a powerful new partner in our Picture Them Home campaign," said Ernie Allen, president of NCMEC. "We are confident this new program will help us resolve cases and reunite more missing children with their families."

"The IRS is proud to participate in this important program," said IRS Commissioner Charles O. Rossotti. "By utilizing space in tax products, the IRS has an opportunity to bring these pictures to the public in an effective and unprecedented way."

"The initiative represents a long-term commitment by the IRS to NCMEC's cause," Rossotti said.

Created in 1984, the private, nonprofit NCMEC has aided law enforcement officials in the search for over 67,000 missing children. More than 48,000 children have been returned to their families as a result.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1275.—Other Definitions and Special Rules

26 CFR 1.1275–2T: Special rules relating to debt instruments (temporary).

T.D. 8840

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Reopenings of Treasury Securities; Original Issue Discount

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the Federal income tax treatment of reopenings of Treasury securities. The temporary regulations change the definition of a qualified reopening. The text of the temporary regulations also serves as the text of the proposed regulations set forth in REG–115932–99 on page 583 of this Bulletin. The regulations in this document provide needed guidance to holders of reopened Treasury securities.

DATES: The regulations are effective November 5, 1999.

FOR FURTHER INFORMATION CONTACT: William E. Blanchard, (202) 622-3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Sections 163(e) and 1271 through 1275 of the Internal Revenue Code (Code) provide rules for the Federal income tax treatment of interest and original issue discount (OID). On February 2, 1994, final regulations relating to these sections of the Code (T.D. 8517, 1994–1 C.B. 38) were published in the **Federal Register** (59 F.R. 4799). Section 1.1275–2(d)(2) of the regulations provides rules for the treatment of certain reopenings of Treasury securities.

On January 6, 1997, temporary regulations relating to the Federal income tax treatment of inflation-indexed debt instruments (T.D. 8709, 1997–1 C.B. 167) were published in the **Federal Register** (62 F.R. 615). Section 1.1275–7T(g) of those temporary regulations provided rules for the treatment of certain reopenings of Treasury Inflation-Indexed Securities. On September 7, 1999, §1.1275–7T was redesignated as §1.1275–7 (T.D. 8838, 1999–38 I.R.B. 424 [64 F.R. 48545]).

Explanation of Provisions

The Secretary of the Treasury is authorized to issue Treasury securities, including Treasury Inflation-Indexed Securities, and to prescribe terms and conditions for their issuance and sale. The Treasury Department sells securities throughout the year.

In January 1992, the Treasury Department determined that it will be prepared to provide additional quantities of a security to the public when an acute, protracted shortage develops. These reopenings are necessary to preserve the integrity and efficient functioning of the market in Treasury securities. See Department of the Treasury, Securities and Exchange Commission, and Board of Governors of the Federal Reserve System, *Joint Report on the Government Securities Market* (January 1992).

In order to ensure that the original and additional Treasury securities are fungible, §1.1275–2(d) provides that the additional Treasury securities issued in a reopening are part of the same issue as the original Treasury securities if (1) the additional Treasury securities have the same terms as the original Treasury securities, (2) the additional Treasury securities are issued not more than 12 months after the original Treasury securities were first issued to the public, and (3) the additional Treasury securities are issued in a reopening intended to alleviate an acute, protracted shortage of the original Treasury securities (a qualified reopening). As a result, any discount generated upon the issuance of the additional Treasury securities in the reopening is market discount rather than OID.

Under §1.1275–7(g), a reopening of Treasury Inflation-Indexed Securities is a qualified reopening for purposes of §1.1275–2(d) even though the reopening is not intended to alleviate an acute, protracted shortage of the original Treasury securities.

For debt management and liquidity concerns, the Treasury Department has decided that it needs the ability to reopen an issue of Treasury securities within one year. Therefore, the temporary regulations in this document (§1.1275–2T) revise the rules for when a reopening is a qualified reopening by eliminating the acute, protracted shortage requirement. As a result, the Treasury Department can reopen an issue of outstanding Treasury securities at any time within 12 months after the issue date of the securities for any reason and the securities will be fungible for Federal income tax purposes.

The temporary regulations also revise the rules to determine the issue price and issue date of an issue of Treasury securities auctioned on or after November 2, 1998, to reflect changes in how Treasury securities are sold. On November 2, 1998, the Treasury Department switched from an average price auction to a single price auction for selling Treasury securities.

In response to comments, the IRS is proposing rules for reopenings of debt instruments other than Treasury securities. See the proposed rules in REG–115932–99 on page 583.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of the regulations is William E. Blanchard, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * * Section 1.1275–2T also issued under 26 U.S.C. 1275(d). * * *

Par. 2. Section 1.1271–0 is amended by:

1. Revising the entry for §1.1275–2(d) in paragraph (b).
2. Adding an entry for §1.1275–2T in numerical order in paragraph (b).
3. Revising the entry for §1.1275–7(g) in paragraph (b).

The revisions and additions read as follows:

§1.1271–0 Original issue discount; effective date; table of contents.

* * * * *

(b) * * *

* * * * *

§1.1275–2 Special rules relating to debt instruments.

* * * * *

(d) [Reserved]

* * * * *

§1.1275–2T Special rules relating to debt instruments (temporary).

(a) through (c) [Reserved]
(d) Special rules for Treasury securities.
(1) Issue price and issue date.
(2) Reopenings of Treasury securities.

* * * * *

§1.1275–7 Inflation-indexed debt instruments.

* * * * *

(g) [Reserved]

* * * * *

Par. 3. Section 1.1275–2 is amended by revising paragraph (d) to read as follows:

§1.1275–2 Special rules relating to debt instruments.

* * * * *

(d) [Reserved] For further guidance, see §1.1275–2T(d).

* * * * *

Par. 4. Section 1.1275–2T is added to read as follows:

§1.1275–2T Special rules relating to debt instruments (temporary).

(a) through (c) [Reserved] For further guidance, see §1.1275–2(a) through (c).

(d) *Special rules for Treasury securities*—(1) *Issue price and issue date*—(i) *In general.* The issue price of an issue of Treasury securities is the price of the securities sold at auction. In addition, the issue date of the issue is the first settlement date of a substantial amount of the securities.

(ii) *Treasury securities auctioned before November 2, 1998.* For an issue of Treasury securities auctioned before November 2, 1998, the issue price of the issue is the average price of the securities sold. In addition, the issue date of the issue is the first settlement date on which a substantial amount of the securities in the issue is sold.

(2) *Reopenings of Treasury securities*—(i) *Treatment of additional Treasury securities.* Additional Treasury securities issued in a qualified reopening are part of the same issue as the original Treasury securities and have the same issue price and issue date as the original Treasury securities. This paragraph (d)(2) applies to qualified reopenings that occur on or after March 25, 1992.

(ii) *Definitions*—(A) *Additional Treasury securities.* Additional Treasury securities are Treasury securities with terms that are in all respects identical to the terms of the original Treasury securities.

(B) *Original Treasury securities.* Original Treasury securities are securities comprising any issue of outstanding Treasury securities.

(C) *Qualified reopening.* A qualified reopening is a reopening that occurs not more than one year after the original Treasury securities were first issued to the public. For reopenings of Treasury securities (other than Treasury Inflation-Indexed Securities) that occur prior to November 5, 1999, a qualified reopening is a reopening of Treasury securities that satisfies the preceding sentence and that was intended to alleviate an acute, protracted shortage of the original Treasury securities.

§1.1275–7 [Amended]

Par. 5. Section 1.1275–7 is amended by removing and reserving paragraph (g).

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

Approved October 29, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 3, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 5, 1999, 64 F.R. 60342)

Section 1502.—Regulations

26 CFR 1.1502–76: Taxable year of members of group.

T.D. 8842

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Acquisition of an S Corporation by a Member of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 1502 of the Internal Revenue Code. These final regu-

lations provide specific rules that apply to the acquisition of the stock of an S corporation by a member of a consolidated group. These rules eliminate the compliance burdens associated with filing a separate return for the day that an S corporation is acquired by a consolidated group. Additionally, the regulations clarify the rules for the filing of the separate return for a corporation's items for the period not included in the consolidated return.

DATES: *Effective Date:* These regulations are effective November 10, 1999.

Applicability Date: For dates of applicability, see §1.1502–76(b)(6)(i).

FOR FURTHER INFORMATION CONTACT: Vincent Daly, (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On December 17, 1998, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–106219–98, 1999–9 I.R.B. 51 [63 F.R. 69581]), concerning acquisitions by a consolidated group of at least eighty percent of the stock of an S corporation. Although a comment was received questioning the advisability of a special rule for the acquisition of an S corporation, the IRS and Treasury have determined the rules are necessary to eliminate the administrative burden of filing a separate tax return for the day the S corporation is acquired. The proposed regulations are adopted by this Treasury decision.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations will provide administrative relief to small entities by removing the administrative burden of filing a separate one-day return currently required for certain acquisitions. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jeffrey L. Vogel of the Office of the Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1362–3 is amended by adding a sentence to the end of paragraph (a) to read as follows:

§1.1362–3 Treatment of S termination year.

(a) *In general.* * * * See, however, §1.1502–76(b)(1)(ii)(A)(*2*) for special rules for an S election that terminates under section 1362(d) immediately before the S corporation becomes a member of a consolidated group (within the meaning of §1.1502–1(h)).

* * * * *

Par. 3. Section 1.1502–76 is amended as follows:

1. The text of paragraph (b)(1)(ii)(A) following the paragraph heading is redesignated as paragraph (b)(1)(ii)(A)(*1*).

2. A paragraph heading for newly designated paragraph (b)(1)(ii)(A)(*1*) is added.

3. The first sentence of newly designated paragraph (b)(1)(ii)(A)(*1*) is revised.

4. Paragraph (b)(1)(ii)(A)(*2*) is added.

5. Paragraph (b)(2)(v) is redesignated as paragraph (b)(2)(vi).

6. New paragraph (b)(2)(v) is added.

7. Paragraphs (b)(4) and (b)(5) are redesignated as paragraphs (b)(5) and (b)(6), respectively.

8. New paragraph (b)(4) is added.

9. Newly designated paragraph (b)(5) is amended as follows:

a. *Example 6*(b), first sentence is revised.

b. *Example 6*(c), second sentence is revised.

c. *Example 7* is added.

10. Newly designated paragraph (b)(6)(i) is revised.

The revisions and additions read as follows:

§1.1502–76 Taxable year of members of group.

* * * * *

(b) * * * (1) * * *

(ii) * * *(A) End of the day rule. (*1*) *In general.* If a corporation (S), other than one described in paragraph (b)(1)(ii)(A)(*2*) of this section, becomes or ceases to be a member during a consolidated return year, it becomes or ceases to be a member at the end of the day on which its status as a member changes, and its tax year ends for all Federal income tax purposes at the end of that day. * * *

(*2*) *Special rule for former S corporations.* If S becomes a member in a transaction other than in a qualified stock purchase for which an election under section 338(g) is made, and immediately before becoming a member an election under section 1362(a) was in effect, then S will become a member at the beginning of the day the termination of its S corporation election is effective. S's tax year ends for all Federal income tax purposes at the end of the preceding day. This paragraph (b)(1)(ii)(A)(*2*) applies to transactions occurring after November 10, 1999.

* * * * *

(2) * * *

(v) *Acquisition of S corporation.* If a corporation is acquired in a transaction to which paragraph (b)(1)(ii)(A)(*2*) of this section applies, then paragraphs (b)(2)(ii) and (iii) of this section do not apply and items of income, gain, loss, deduction, and credit are assigned to each short taxable year on the basis of the corporation's normal method of accounting as deter-

mined under section 446. This paragraph (b)(2)(v) applies to transactions occurring after November 10, 1999.

* * * * *

(4) *Determination of due date for separate return.* Paragraph (c) of this section contains rules for the filing of the separate return referred to in this paragraph (b). In applying paragraph (c) of this section, the due date for the filing of S's separate return shall also be determined without regard to the ending of the tax year under paragraph (b)(1)(ii) of this section or the deemed cessation of its existence under paragraph (b)(2)(i) of this section.

(5) * * *

Example 6. Allocation of partnership items. * * *

(b) *Analysis.* Under paragraph (b)(2)(vi)(A) of this section, T is treated, solely for purposes of determining T's tax year in which the partnership's items are included, as selling or exchanging its entire interest in the partnership as of P's sale of T's stock. * * *

(c) *Controlled partnership.* * * * Under paragraph (b)(2)(vi)(B) of this section, T's distributive share of the partnership items is treated as T's items for purposes of paragraph (b)(2) of this section. * * *

Example 7. Acquisition of S corporation. (a) *Facts.* Z is a small business corporation for which an election under section 1362(a) was in effect at all times since Year 1. At all times, Z had only 100 shares of stock outstanding, all of which were owned by individual A. On July 1 of Year 3, P acquired all of the Z stock. P does not make an election under section 338(g) with respect to its purchase of the Z stock.

(b) *Analysis.* As a result of P's acquisition of the Z stock, Z's election under section 1362(a) terminates. See sections 1361(b)(1)(B) and 1362(d)(2). Z is required to join in the filing of the P consolidated return. See §1.1502–75. Z's tax year ends for all Federal income tax purposes on June 30 of Year 3. If no extension of time is sought, Z must file a separate return for the period from January 1 through June 30 of Year 3 on or before March 15 of Year 4. See paragraph (b)(4) of this section. Z will become a member of the P consolidated group as of July 1 of Year 3. See paragraph (b)(1)(ii)(A)(2) of this section. P group's Year 3 consolidated return will include Z's items from July 1 to December 31 of Year 3.

(6) *Effective date*—(i) *General rule.* Except as provided in paragraphs (b)(1)(ii)(A)(2) and (b)(2)(v) of this section, this paragraph (b) applies to corporations becoming or ceasing to be members of consolidated groups on or after January 1, 1995.

* * * * *

Bob Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 29, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 9, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 10, 1999, 64 F.R. 61205)

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment, of Tax

26 CFR 301.6601–1: Interest on underpayments.

How is the net interest rate of zero in section 6621(d) of the Code applied to interest accruing before October 1, 1998, with respect to overlapping tax underpayments and tax overpayments. See Rev. Proc. 99–43, page 579.

Section 6611.—Interest on Overpayments

26 CFR 301.6611–1: Interest on overpayments.

How is the net interest rate of zero in section 6621(d) of the Code applied to interest accruing before October 1, 1998, with respect to overlapping tax underpayments and tax overpayments. See Rev. Proc. 99–43, page 579.

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621–1: Interest rate.

How is the net interest rate of zero in section 6621(d) of the Code applied to interest accruing before October 1, 1998, with respect to overlapping tax underpayments and tax overpayments. See Rev. Proc. 99–43, page 579.

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 99–54

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for October 1999 is 6.26 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
November	1999	5.99	5.39 to 6.29	5.39 to 6.59

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number).

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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, sections 6601, 6611, 6621; 301.6601–1, 301.6611–1, 301.6621–1.)

Rev. Proc. 99–43

SECTION 1. PURPOSE

.01 *In general.* This revenue procedure provides guidance regarding the application of § 6621(d) of the Internal Revenue Code with respect to interest accruing before October 1, 1998, and modifies and supersedes Rev. Proc. 99–19, 1999–13 I.R.B. 10. Section 6621(d) was enacted by § 3301 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA), Pub. L. No. 105-206, 112 Stat. 741, and was amended by § 4002(d) of the Tax and Trade Relief Extension Act of 1998, Pub. L. No. 105-277, 112 Stat. 2681. Section 6621(d) provides for a net interest rate of zero to the extent of overlapping tax underpayments and tax overpayments, and generally applies to interest for periods beginning after July 22, 1998 (*i.e.*, interest accruing on or after October 1, 1998). However, the net interest rate of zero in § 6621(d) also applies to interest for periods beginning before July 22, 1998 (*i.e.*, interest accruing before October 1, 1998), provided certain conditions (described in section 4.01 of this revenue procedure) are met. Among these conditions is a requirement that a taxpayer request the application of § 6621(d) by December 31, 1999. This revenue procedure provides guidance on, and discusses how to comply with, those conditions.

.02 *Comments received in response to Rev. Proc. 99–19.* In Rev. Proc. 99–19, the Service asked for comments regarding what taxpayers should be required to submit to the Service by December 31, 1999, when taxpayers cannot provide a final computation on the application of the net rate of zero by that date. Commentators made recommendations regarding the amount of information that would be sufficient to make a request by December 31, 1999, that would reasonably identify and establish overlapping periods. Commentators also suggested that taxpayers should not be required to take any action by December 31, 1999, if taxpayers could not reasonably identify and establish overlapping periods by that date. In response to these comments, this revenue procedure provides that:

(1) taxpayers must file a claim requesting application of the net rate of zero by December 31, 1999, only if both applicable periods of limitation (as described in sections 4.02(1) and 4.02(2) of this revenue procedure) will be closed on or before December 31, 1999 (section 4.03(1)); and

(2) taxpayers need not take any action by December 31, 1999, if at least one of the applicable periods of limitation (as described in sections 4.02(1) and 4.02(2) of this revenue procedure) will be open after December 31, 1999; such taxpayers must file a claim requesting application of the net rate of zero on or before the date on which the last applicable period of limitation closes (section 4.03(2)).

.03 *Modification to Rev. Proc. 99–19 regarding application procedures.* Claims requesting the application of the net rate of zero:

(1) should be sent to a specific address (section 5.02);

(2) should be specifically labeled (section 5.03); and

(3) should generally be made using a computation that reduces underpayment interest, except as otherwise expressly provided (section 5.04(5)(f)).

SECTION 2. BACKGROUND

.01 *Interest computations in general.*

(1) Section 6601(a) provides, in general, that if any amount of tax imposed by the Code is not paid on or before the last date prescribed for payment, interest on such amount must be paid for the period from such last date to the date paid at the underpayment rate established under § 6621.

(2) Section 6611(a) provides that interest must be allowed and paid on any overpayment in respect of any internal revenue tax at the overpayment rate established under § 6621. Section 6611(b)(1) provides that, in the case of a credit, interest must be allowed and paid from the date of

the overpayment to the due date of the amount against which the credit is taken. Section 6611(b)(2) provides that, in the case of a refund, interest must be allowed and paid from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days.

.02 *Interest rates in general.*

(1) For interest accruing before January 1, 1999, § 6621(a)(1) provides that the overpayment rate is the federal short-term rate (determined under § 6621(b)) plus 2 percentage points. To the extent that an overpayment of tax by a corporation exceeds $10,000, the overpayment rate is the federal short-term rate plus 0.5 percent.

(2) Section 6621(a)(2) provides that the underpayment rate is the federal short-term rate (determined under § 6621(b)) plus 3 percentage points. Special rules in § 6621(c) increase the underpayment rate on large corporate underpayments by an additional 2 percentage points.

.03 *Interest for overlapping periods.*

(1) Section 6621(d), as enacted by the RRA on July 22, 1998, provides that, to the extent that for any period interest is payable under subchapter A (§§ 6601 and 6602) and allowable under subchapter B (§ 6611) on equivalent underpayments and overpayments by the same taxpayer of tax imposed by the Code, the net rate of interest under § 6621 on such amounts is zero for such period.

(2) The Conference Report, H. R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 257 (1998), accompanying the RRA provides that the net interest rate of zero is applied without regard to whether the overpayment or underpayment is currently outstanding. Further, each overpayment or underpayment is considered only once in determining whether equivalent amounts of overpayment and underpayment overlap for a particular period. That report also provides that the net interest rate of zero applies even when special rules increase the rate of interest for large corporate underpayments under § 6621(c), or decrease the rate of interest for large corporate overpayments under § 6621(a).

SECTION 3. SCOPE

.01 *Applicability.* This revenue procedure applies to the application of the net interest rate of zero in § 6621(d) to interest for periods beginning before July 22, 1998 (*i.e.*, interest accruing before October 1, 1998), provided:

(1) both applicable periods of limitation described in sections 4.02(1) and 4.02(2) of this revenue procedure were open on July 22, 1998;

(2) the periods of tax overpayments and underpayments for which the net interest rate of zero applies are reasonably identified and established (as described in section 5 of this revenue procedure); and

(3) the request is made not later than as described in section 4.03 of this revenue procedure.

.02 *Inapplicability.* This revenue procedure does not apply to:

(1) the application of the net interest rate of zero in § 6621(d) to interest for periods beginning after July 22, 1998 (*i.e.*, interest accruing on or after October 1, 1998). The Service intends to provide further guidance for those periods;

(2) an overpayment or underpayment for any period during which interest on the overpayment or underpayment was not allowable or payable by law (*e.g.*, the 45-day interest disallowance rule under § 6611(e)); or

(3) to the extent of an offset made pursuant to §§ 6402(a) and 6601(f), regarding the crediting of an outstanding overpayment against an outstanding underpayment.

SECTION 4. SPECIAL EFFECTIVE DATE RULE

.01 *Special Rule.* Section 6621(d) generally applies to interest for periods (calendar quarters) beginning after July 22, 1998 (*i.e.*, interest accruing on or after October 1, 1998). *See* H. R. Rep. No. 364 (Part 1), 105th Cong., 1st Sess. 64 (1998); S. Rep. No. 174, 105th Cong., 2d Sess. 62 (1998); H. R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 257 (1998). However, § 3301(c)(2) of the RRA provides that § 6621(d) applies to interest for periods beginning before July 22, 1998 (*i.e.*, interest accruing before October 1, 1998), provided certain conditions are met. First, both periods of limitation applicable to the tax underpayment and to the tax overpayment (as described in section 4.02 of this revenue procedure) must have been open on July 22, 1998. Second, the taxpayer must:

(a) reasonably identify and establish periods of tax overpayments and underpayments for which the net interest rate of zero applies, and

(b) not later than December 31, 1999, request the Secretary of the Treasury to apply § 6621(d) to such periods.

.02 *Applicable periods of limitation.* The applicable periods of limitation are as follows:

(1) *Underpayment interest.* A claim for credit or refund of interest paid on an underpayment pursuant to § 6601 or 6602 generally must be filed within 3 years from the time the tax return was filed or 2 years from the time the interest was paid, whichever period expires later, pursuant to § 6511.

(2) *Overpayment interest.* A claim for payment of additional interest allowable on an overpayment pursuant to § 6611 must be filed within the 6-year period in which a suit must be filed pursuant to 28 U.S.C. §§ 2401 and 2501. *See* Rev. Rul. 56–506, 1956–2 C.B. 959.

(3) *Claims filed on or before December 31, 1999.* If both applicable periods of limitation described in sections 4.02(1) and 4.02(2) of this revenue procedure were open on July 22, 1998, and both close on or before December 31, 1999, a claim requesting the application of the net interest rate of zero (as described in sections 5.01 through 5.04 of this revenue procedure) will be considered timely if filed on or before December 31, 1999.

.03 *Requirement to make a request by December 31, 1999.* A taxpayer will satisfy the requirement in the special rule to make a request for the application of the net rate of zero not later than December 31, 1999, as follows:

(1) If both applicable periods of limitation described in sections 4.02(1) and 4.02(2) of this revenue procedure were open on July 22, 1998, but both will be closed on or before December 31, 1999, the taxpayer must file a claim requesting the application of the net rate of zero (as described in sections 5.01 through 5.04 of this revenue procedure) on or before December 31, 1999.

(2) If both applicable periods of limitation described in sections 4.02(1) and 4.02(2) of this revenue procedure were open on July 22, 1998, and at least one of the applicable periods of limitation will be open after December 31, 1999, the tax-

payer need not take any action on or before December 31, 1999. In order to obtain the net rate of zero, the taxpayer must file a claim requesting application of the net rate of zero (as described in sections 5.01 through 5.04 of this revenue procedure) or make a written request (as described in section 5.06 of this revenue procedure) on or before the date on which the last applicable period of limitation closes.

.04 *Net Rate of Zero.* In general, the Service will apply the net rate of zero as follows:

(1) If the period of limitation for refunding underpayment interest (as described in section 4.02(1) of this revenue procedure) is open at the time a claim (as described in sections 5.01 through 5.04 of this revenue procedure) is filed or a written request (as described in section 5.06 of this revenue procedure) is made, the Service will apply the net rate of zero by decreasing underpayment interest owed by the taxpayer.

(2) Except as provided in 4.04(3) of this revenue procedure, if the period of limitation for refunding underpayment interest (as described in section 4.02(1) of this revenue procedure) is closed at the time a claim (as described in sections 5.01 through 5.04 of this revenue procedure) is filed or a written request (as described in section 5.06 of this revenue procedure) is made, but the period for paying additional overpayment interest (as described in section 4.02(2) of this revenue procedure) is open, the Service will apply the net rate of zero by increasing overpayment interest owed to the taxpayer.

(3) If both applicable periods of limitation (as described in sections 4.02(1) and 4.02(2) of this revenue procedure) are open on July 22, 1998, and a claim requesting the application of the net interest rate of zero (as described in sections 5.01 through 5.04 of this revenue procedure) is filed on or before December 31, 1999, the Service will apply the net rate of zero by decreasing underpayment interest owed by the taxpayer.

SECTION 5. PROCEDURES FOR REQUESTING THE NET RATE OF ZERO

.01 *Form to file.* Except as provided in section 5.06 of this revenue procedure, requests for the application of the net interest rate of zero in § 6621(d) to interest accruing before October 1, 1998, should be made on Form 843, Claim for Refund and Request for Abatement.

.02 *Where to file.* A Form 843 requesting the net rate of zero should be sent to the following address:

Internal Revenue Service
Net Rate Interest Netting Claim
P.O. Box 9987
Mail Stop 6800
Ogden, UT 84409

or, if sent by other than U. S. mail, to the following address:

Internal Revenue Service
Net Rate Interest Netting Claim
1160 West 1200 South
Mail Stop 6800
Ogden, UT 84201

.03 *Label.* The taxpayer should label the top of the Form 843: "Request for Net Interest Rate of Zero Under Rev. Proc. 99–43."

.04 *Filing requirements for Form 843.*

(1) Line 1 should be left blank.

(2) The taxpayer may, but is not required to, place a dollar amount on Line 2.

(3) Line 3 should indicate the type of tax and type of return covered by the request. More than one box may be checked if more than one type of tax or return is covered by the request. In addition, any taxes imposed by the Code (or returns for those taxes) for which there is no box on Line 3 should be written in on that line.

(4) Line 4 should be left blank.

(5) Line 5 should:

(a) identify the taxable periods for which the taxpayer overpaid and underpaid its tax liability. A separate Form 843 is not required for each separate taxable period involved in the request;

(b) state when the taxpayer paid the tax if the underpayment is no longer outstanding;

(c) state when the taxpayer received a refund of tax if the overpayment is no longer outstanding;

(d) identify and establish the period(s) for which the taxpayer's overpayment and underpayment overlapped and the overlapping amount. For this purpose, the taxpayer should provide any background material (such as copies of examination reports, notices, or prior interest computations provided by the Service) relating to the overpayments and underpayments. The background material is needed to assist the Service in determining the period(s) for which the overpayment and underpayment overlap, and the amount of such overlap;

(e) state that, to the extent of equivalent amounts of underpayment and overpayment for the period(s) identified and established under section 5.04(5)(d) of this revenue procedure, the period(s) has (have) been used only once in a request to obtain the net interest rate of zero under § 6621(d); however, if the full amount of the overpayment or underpayment is not used in a netting calculation, the remaining portion may be used in another netting calculation; and

(f) provide a computation, to the extent possible, of the amount of interest to be credited, refunded, or abated to provide a net interest rate of zero for the period(s) of overlap. This computation generally should be made by applying 6621(d) to reduce the taxpayer's underpayment interest payable to the Service. However, if the Form 843 is filed after December 31, 1999, and only the period of limitation for claiming additional overpayment interest is open on that filing date, the computation should be made by applying § 6621(d) to increase the taxpayer's overpayment interest payable by the Service.

.05 *Verification.* The amounts used in a computation provided under section 5.04(5)(f) of this revenue procedure are subject to verification by the Service and may be subject to adjustment for purposes of computing the net interest rate of zero pursuant to § 6621(d).

.06 *Special procedure.* No Form 843 is required when a computation of interest using the net interest rate of zero under § 6621(d) for interest accruing before October 1, 1998, is requested by a taxpayer in connection with a return (or returns) of the taxpayer under consideration by any function of the Service (including Examination, Appeals, or a case before a federal court that requires a computation of interest by any function of the Service). Rather than filing a Form 843, the taxpayer must furnish a letter or written statement to such function that:

(1) states that the taxpayer is requesting the net interest rate of zero under § 6621(d);

(2) indicates the type of tax and type of return that affects the interest computation for the taxable period under consideration;

(3) states when and for what period(s) the refund or payment (that affects the interest computation for the taxable period under consideration) was made; and

(4) states that, to the extent of equivalent amounts of overpayment or underpayment, the period(s) set forth under section 5.06(3) of this revenue procedure has (have) not previously been applied to obtain a net interest rate of zero under § 6621(d).

.07 *Special procedure verification.* The refund or payment provided under section 5.06(3) of this revenue procedure is subject to verification by the Service and may be subject to adjustment for purposes of computing the net interest rate of zero pursuant to § 6621(d).

SECTION 6. EXAMPLES

.01 *Example 1.* *X* is a calendar year corporation. The Service examined *X*'s Form 1120, Corporation Income Tax Return, for the 1992 and 1994 taxable years. For the 1994 taxable year, the Service determined that *X* was entitled to a refund of $30,000. This Service-initiated refund was made on September 21, 1997, with interest computed from March 15, 1995, to July 29, 1997. For the 1992 taxable year, the Service determined that *X* underpaid its income tax by $80,000. The Service sent *X* a notice and demand for payment dated May 3, 1998, which *X* paid on May 12, 1998, with interest computed from March 15, 1993, to May 3, 1998. On July 22, 1998, both the 6-year period of limitation for claiming additional overpayment interest on *X*'s 1997 refund and the 2-year period of limitation for claiming a refund of underpayment interest paid in 1998 were open. On December 27, 1999, *X* files a Form 843 requesting the net interest rate of zero under § 6621(d) for the overlap period from March 15, 1995, to July 29, 1997. The Service will refund underpayment interest to *X* in an amount equal to the difference between the underpayment interest paid on $30,000 for the period from March 15, 1995, to July 29, 1997, and the overpayment interest computed and paid on $30,000 for that period.

.02 *Example 2.* The facts are the same as in *Example 1,* except that the Service sent *X* a notice and demand for payment dated May 3, 1996, which *X* paid on May 12, 1996, with interest computed from March 15, 1993, to May 3, 1996. On December 27, 1999, *X* files a Form 843 requesting the application of § 6621(d) for the overlap period from March 15, 1995, to May 3, 1996. On July 22, 1998, the 6-year period of limitation for claiming additional overpayment interest on *X*'s 1997 refund was open, but the 2-year period of limitation for claiming a refund of underpayment interest paid in 1996 was not open. Therefore, the net interest rate of zero under § 6621(d) does not apply to the overlap period and no adjustment will be made.

.03 *Example 3.* *Y* is a calendar year corporation. The Service examined *Y*'s Form 1120, Corporation Income Tax Return, for the 1990 and 1992 taxable years. For the 1990 taxable year, the Service determined that *Y* was entitled to a refund of $40,000. The Service-initiated refund was made on November 21, 1993, with interest computed from March 15, 1991, to September 28, 1993. For the 1992 taxable year, the Service determined that *Y* underpaid its income tax by $60,000. The Service sent *Y* a notice and demand for payment dated October 3, 1996, which *Y* paid on October 12, 1996, with interest computed from March 15, 1993, to October 3, 1996. On July 22, 1998, both the 6-year period of limitation for claiming additional overpayment interest on *Y*'s 1993 refund and the 2-year period of limitation for claiming a refund of underpayment interest paid in 1996 were open. However, both of these periods of limitation will be closed before December 31, 1999. *Y* files a Form 843 after both these periods close and on or before December 31, 1999, requesting the net interest rate of zero under § 6621(d) for the overlap period from March 15, 1993, to September 28, 1993. The Service will refund underpayment interest to *Y* in an amount equal to the difference between the underpayment interest paid on $40,000 for the period from March 15, 1993, to September 28, 1993, and the overpayment interest computed and paid on $40,000 for that period.

.04 *Example 4.* The facts are the same as in *Example 3* except that the Service-initiated refund was made on November 21, 1994, with interest computed from March 15, 1991, to September 28, 1994. On December 31, 1999, the 6-year period of limitation for claiming additional overpayment interest will be open, but the 2-year period of limitation for claiming a refund of underpayment interest paid in 1996 will not be open. After December 31, 1999, but on or before the close of the 6-year period of limitation for claiming additional overpayment interest on *Y*'s 1994 refund, *Y* files a Form 843 requesting the net interest rate of zero under § 6621(d) for the overlap period from March 15, 1993, to September 28, 1994. The Service will pay additional overpayment interest to *Y* in an amount equal to the difference between the underpayment interest paid on $40,000 for the period from March 15, 1993, to September 28, 1994, and the overpayment interest computed and paid on $40,000 for that period.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxpayer requests made for the application of the net interest rate of zero in § 6621(d) to interest accruing before October 1, 1998.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Revenue Procedure 99–19 is modified and superseded; however, the procedures in Revenue Procedure 99–19 will remain effective for any taxpayer requests for the application of the net interest rate of zero in § 6621(d) to interest accruing before October 1, 1998, made prior to November 22, 1999.

DRAFTING INFORMATION

The principal author of this revenue procedure is John J. McGreevy of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. McGreevy on (202) 622-4910 (not a toll- free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Reopenings of Treasury Securities and Other Debt Instruments; Original Issue Discount

REG–115932–99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations, notice of proposed rulemaking, and notice of public hearing.

SUMMARY: This document proposes, by cross-reference to temporary regulations in T.D. 8840, amendments to the final regulations concerning the federal income tax treatment of certain reopenings of Treasury securities. In the temporary regulations in T.D. 8840, on page 575 of this Bulletin, remove the requirement that the issuance of the Treasury securities in the reopening must be intended to alleviate an acute, protracted shortage of the original securities. The text of the temporary regulations also serves as the text of the proposed regulations. This document also contains proposed regulations that would provide guidance on the Federal income tax treatment of reopenings of debt instruments other than Treasury securities. The proposed regulations would provide guidance to holders and issuers of debt instruments. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written and electronic comments must be received by February 3, 2000. Requests to appear and outlines of topics to be discussed at the public hearing scheduled for March 22, 2000, at 10 a.m., must be received by March 1, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–115932–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–115932–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page or by submitting comments directly to the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html. A public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, William E. Blanchard, (202) 622-3950; concerning submissions and the hearing, Michael L. Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in T.D. 8840, page 575, amend the Income Tax Regulations (26 CFR part 1) relating to section 1275 of the Internal Revenue Code (Code). The temporary regulations provide rules for qualified reopenings of Treasury securities. See §1.1275–2T(d).

This document also proposes new rules under sections 163(e) and 1275 of the Code for qualified reopenings of debt instruments other than Treasury securities.

Explanation of Provisions

Reopenings of Treasury Securities.

The text of the temporary regulations (§1.1275–2T(d)) also serves as the text of the proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

Reopenings of Debt Instruments Other Than Treasury Securities.

A. In General.

Over the past few years, a number of issuers have developed programs or practices where debt instruments with identical terms and CUSIP numbers are sold subsequent to their original issue date. These subsequent sales are often called "reopenings." The original issue discount (OID) rules generally accommodate reopenings during periods of stable or falling market interest rates. As is explained in more detail below, during periods of rising market interest rates, the OID rules can effectively prohibit reopenings. The proposed regulations in this document would modify the OID rules to accommodate certain qualified reopenings.

Under §1.1275–1(f), two or more debt instruments are part of the same issue if they have the same payment and credit terms and are sold reasonably close in time either pursuant to a common plan or as part of a single transaction or series of related transactions. Usually, there is little doubt as to what constitutes an issue because all of the relevant debt instruments have identical terms, have the same CUSIP number, and are sold on the same day. When the third condition is not met, however, there is a question as to whether the subsequently sold debt instruments are part of the original issue or are themselves a new issue.

This question—whether the subsequently sold debt instruments are part of the original issue—has important tax consequences. If the subsequently sold debt instruments are considered part of the original issue, they have OID only to the extent the debt instruments in the original issue have OID. Thus, if the original debt instruments were issued without OID, the subsequently sold debt instruments also do not have OID. In this case, any discount on the subsequently sold debt instruments generally is market discount, not OID. Conversely, if the subsequently sold debt instruments are a separate issue for tax purposes, any discount that arises as part of their issuance is OID if it equals or exceeds the OID *de minimis* amount for the debt instruments. See §1.1273–1(d) to determine the *de minimis* amount.

The holder and issuer have different tax consequences depending upon whether the discount is characterized as OID or market discount. For the holder, the primary difference is whether the holder has to include the discount in income on a current basis as it accrues. If it is OID, the holder must include the accruals in income currently; if it is market discount, the holder generally does not have to in-

clude discount in income until the debt instrument is disposed of or redeemed. The issuer's tax consequences also depend on whether the discount is OID or market discount. If the subsequently sold debt instruments are part of a separate issue and if the discount is OID, the issuer (or a broker or middleman) generally is required to make OID information reports for these debt instruments. See §1.6049–5. To comply with this reporting obligation, the issuer must be able to distinguish the subsequently sold debt instruments (which require OID information reports) from the originally sold debt instruments. As a practical matter, the only way the subsequently sold debt instruments can be distinguished is if they are assigned new CUSIP numbers. The assignment of new CUSIP numbers prevents the debt instruments from being fungible and, thereby, defeats the purpose of the reopening.

B. Qualified Reopenings.

This document proposes new qualified reopening rules. Under these rules, additional debt instruments sold in a qualified reopening would be part of the same issue as the original debt instruments. As a result, the additional debt instruments would have the same issue date, the same issue price, and (with respect to holders) the same adjusted issue price as the original debt instruments.

A qualified reopening would be a reopening of original debt instruments that meets the following conditions: (1) The original debt instruments are publicly traded; (2) The issue date of the additional debt instruments (treated as a separate issue) is not more than 6 months after the issue date of the original debt instruments; (3) Seven days before the date on which the price of the additional debt instruments is established, the yield of the original debt instruments (based on their fair market value) is not more than 107.5 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate); and (4) The yield of the additional debt instruments (based on the sales price of the additional debt instruments) is not more than 115 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate).

A qualified reopening also would include a reopening of original debt instruments if the first two conditions described above are met and the additional debt instruments (treated as a separate issue) were issued with no more than a *de minimis* amount of OID. A qualified reopening, however, would not include a reopening of tax-exempt obligations or contingent payment debt instruments.

The qualified reopening rules attempt to strike a balance between tax policy concerns about the conversion of OID into market discount and the need to have the tax rules reflect current capital market practices. The IRS and the Treasury Department believe the appropriate balance is to provide reopening rules for situations where the issuer can prove by objective, market-based information that the reopening will convert, at most, only a small amount of OID into market discount. To clearly and accurately measure the conversion benefit across different interest rate environments and debt instrument terms, the proposed regulations use a yield-based standard. The 107.5 percent standard was designed to give some relief to the reopening of relatively short-term issues (that is, issues with a remaining term of 10 years or less). These issues tend to be the most impacted by the OID *de minimis* rule standard.

The two yield-based rules are designed to work in tandem. The 107.5 percent of yield restriction is tested 7 days before the anticipated pricing date. This rule is designed to give the issuer a preliminary indication that its reopening will be a qualified reopening prior to the issuer's announcement of the reopening. Importantly, this preliminary indication is not controlling. Absent the 115 percent rule, if market interest rates were to move sharply upward in the week between the announcement date and the pricing date, the reopened debt instruments would go out with a significant amount of market discount (instead of OID) notwithstanding the fact that seven days before the pricing date the instruments satisfied the 107.5 percent rule. In this presumably rare and unusual case, the tax policy concern of converting a significant amount of OID into market discount becomes relatively more important. The proposed regulations, therefore, limit the total amount of discount that can be converted into market discount with the 115 percent rule.

C. Definition of Issue.

The proposed regulations also change the definition of *issue* that is currently in §1.1275–1(f) of the final OID regulations (described above). Essentially, the proposed regulations limit the "reasonably close in time" standard of current law to 13 days. The IRS and the Treasury Department believe that reopenings should be done through the proposed qualified reopening rule (discussed above), not through an expansive interpretation of the regulatory definition of issue. The 13-day limitation was chosen to prevent an issuer that comes to market every two weeks from stretching the definition of issue to cover two consecutive market sales. If an issuer wants to reopen more than 13 days after the initial offering, the sole test should be whether the reopening qualifies under the proposed qualified reopening rules.

D. Issuer's Treatment.

This document also proposes rules that clarify the issuer's treatment of the debt instruments comprising an issue when there is a qualified reopening. The proposed regulations require the issuer to take into account, as an adjustment to its interest expense, any difference between the amounts paid by the holders to acquire the additional debt instruments issued in the qualified reopening and the adjusted issue price of the original debt instruments. This difference would either increase or decrease the aggregate adjusted issue prices of all of the debt instruments in the issue (both original and additional) with respect to the issuer (but not the holder). The issuer would then, as of the reopening date, recompute the yield of the debt instruments in the issue based on this aggregate adjusted issue price and the remaining payment schedule of the debt instruments. The issuer would use this redetermined yield for purposes of applying the constant yield method to determine its accruals of interest expense over the remaining term of the debt instruments in the issue.

During the consideration of the issuer's treatment of the additional debt instruments, a question arose as to whether the

issuer's all-in-cost-of-capital should be used to determine the issuer's interest expense for a particular borrowing. Under current law, the costs of anticipatory hedges and bond issuance costs (such as underwriter fees) are not treated as interest expense even though they affect the issuer's cost of acquiring funds (the issuer's all-in-cost-of-capital). The IRS and the Treasury Department request comments on whether the issuer's all-in-cost-of-capital should be used to determine the issuer's interest expense for a particular borrowing.

E. Proposed Effective Dates.

Section 1.163–7(e) of the proposed regulations would apply to qualified reopenings where the reopening date is on or after the date that is 60 days after the date final regulations are published in the **Federal Register.** Section 1.1275–2(k) of the proposed regulations would apply to debt instruments that are part of a reopening where the reopening date is on or after the date that is 60 days after the date final regulations are published in the **Federal Register.**

The proposed revision to the definition of the term *issue* would apply to debt instruments whose issue date is on or after the date that is 60 days after the date final regulations are published in the **Federal Register.** For debt instruments issued prior to the effective date of the regulations, no inference is intended as to how the term *issue* should be interpreted under the current final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments (a signed original and eight (8) copies, if written) that are submitted timely (in the manner described in the ADDRESSES portion of this preamble) to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how the regulations may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 22, 2000, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identifications to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments by February 3, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 1, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is William E. Blanchard, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.163-7 is amended by:

1. Redesignating paragraph (e) as paragraph (f).

2. Adding a new paragraph (e).

3. Revising newly designated paragraph (f).

The revision and addition read as follows:

§1.163–7 Deduction for OID on certain debt instruments.

* * * * *

(e) *Qualified reopening*—(1) *In general.* In a qualified reopening of an issue of debt instruments, if a holder pays more or less than the adjusted issue price of the original debt instruments to acquire an additional debt instrument, the issuer treats this difference as an adjustment to the issuer's interest expense for the original and additional debt instruments. As provided by paragraphs (e)(2) through (e)(5) of this section, the adjustment is taken into account over the term of the instrument using constant yield principles.

(2) *Positive adjustment.* If the difference is positive (that is, the holder pays more than the adjusted issue price of the original debt instrument), then, with respect to the issuer but not the holder, the difference increases the aggregate adjusted issue prices of all of the debt instruments in the issue, both original and additional.

(3) *Negative adjustment.* If the difference is negative (that is, the holder pays less than the adjusted issue price of the original debt instrument), then, with respect to the issuer but not the holder, the difference reduces the aggregate adjusted issue prices of all of the debt instruments in the issue, both original and additional.

(4) *Determination of issuer's interest accruals.* As of the reopening date, the issuer must redetermine the yield of the debt instruments in the issue for purposes of applying the constant yield method described in §1.1272–1(b) to determine the

issuer's accruals of interest expense over the remaining term of the debt instruments in the issue. This redetermined yield is based on the aggregate adjusted issue prices of the debt instruments in the issue (as determined under this paragraph (e)) and the remaining payment schedule of the debt instruments in the issue. If the aggregate adjusted issue prices of the debt instruments in the issue (as determined under this paragraph (e)) are less than the aggregate stated redemption price at maturity of the instruments (determined as of the reopening date) by a *de minimis* amount (within the meaning of §1.1273–1(d)), the issuer may use the rules in paragraph (b) of this section to determine the issuer's accruals of interest expense.

(5) *Effect of adjustments on issuer's adjusted issue price.* The adjustments made under this paragraph (e) are taken into account for purposes of determining the issuer's adjusted issue price under §1.1275–1(b).

(6) *Definitions.* The terms *additional debt instrument, original debt instrument, qualified reopening,* and *reopening date* have the same meanings as in §1.1275–2(k).

(f) *Effective dates.* This section (other than paragraph (e) of this section) applies to debt instruments issued on or after April 4, 1994. Taxpayers, however, may rely on this section (other than paragraph (e) of this section) for debt instruments issued after December 21, 1992, and before April 4, 1994. Paragraph (e) of this section applies to qualified reopenings where the reopening date is on or after the date that is 60 days after the date final regulations are published in the **Federal Register.**

Par. 3. In §1.1275–1, paragraph (f) is revised to read as follows:

§1.1275–1 Definitions.

* * * * *

(f) *Issue*—(1) *Definition.* Two or more debt instruments are part of the same issue if the debt instruments—

(i) Have the same credit and payment terms;

(ii) Are issued either pursuant to a common plan or as part of a single transaction or a series of related transactions; and

(iii) Are issued within a period of 13 days beginning with the date on which the first debt instrument that would be part of the issue is issued to a person other than a bond house, broker, or similar person or organization acting in the capacity of an underwriter, placement agent, or wholesaler.

(2) *Cross-references for reopening and aggregation rules.* See §1.1275–2(d) and (k) for rules that treat debt instruments issued in certain reopenings as part of an issue of original (outstanding) debt instruments. See §1.1275–2(c) for rules that treat two or more debt instruments as a single debt instrument.

(3) *Effective date.* This paragraph (f) applies to debt instruments whose issue date is on or after the date that is 60 days after the date final regulations are published in the **Federal Register.**

* * * * *

Par. 4. In §1.1275-2, paragraph (d) is revised and paragraph (k) is added to read as follows:

§1.1275–2 Special rules relating to debt instruments.

* * * * *

(d) [The text of this proposed paragraph (d) is the same as the text of §1.1275–2T(d) published in T.D. 8840.]

* * * * *

(k) *Reopenings*—(1) *In general.* Notwithstanding §1.1275–1(f), additional debt instruments issued in a qualified reopening are part of the same issue as the original debt instruments. As a result, the additional debt instruments have the same issue date, the same issue price, and (with respect to holders) the same adjusted issue price as the original debt instruments.

(2) *Definitions*—(i) *Original debt instruments.* Original debt instruments are debt instruments comprising any single issue of outstanding debt instruments. For purposes of determining whether a particular reopening is a qualified reopening, debt instruments issued in prior qualified reopenings are treated as original debt instruments and debt instruments issued in the particular reopening are not so treated.

(ii) *Additional debt instruments.* Additional debt instruments are debt instruments that, without the application of this paragraph (k)—

(A) Are part of a single issue of debt instruments;

(B) Are not part of the same issue as the original debt instruments; and

(C) Have terms that are in all respects identical to the terms of the original debt instruments as of the reopening date.

(iii) *Reopening date.* The reopening date is the issue date of the additional debt instruments (determined without the application of this paragraph (k)).

(iv) *Qualified reopening.* A qualified reopening is a reopening of original debt instruments (other than tax-exempt obligations, as defined in section1275(a)(3), and contingent payment debt instruments, within the meaning of §1.1275–4) that meets all of the following conditions:

(A) The original debt instruments are publicly traded (within the meaning of §1.1273–2(f)).

(B) The reopening date of the additional debt instruments is not more than 6 months after the issue date of the original debt instruments.

(C) The debt instruments satisfy either the test described in paragraph (k)(3) of this section or the test described in paragraph (k)(4) of this section.

(3) *Yield test.* For purposes of paragraph (k)(2)(iv)(C) of this section—

(i) Seven days before the date on which the price of the additional debt instruments is established, the yield of the original debt instruments (based on their fair market value) is not more than 107.5 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate); and

(ii) The yield of the additional debt instruments (based on the sales price of the additional debt instruments) is not more than 115 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate).

(4) *De minimis OID test.* For purposes of paragraph (k)(2)(iv)(C) of this section, the additional debt instruments are issued with no more than a *de minimis* amount of OID (determined without the application of this paragraph (k)).

(5) *Special rule for Treasury reopenings.* See paragraph (d) of this section for special rules for reopenings of Treasury securities.

(6) *Issuer's treatment of a qualified reopening.* See §1.163–7(e) for the issuer's treatment of the debt instruments that are part of a qualified reopening.

(7) *Effective date.* This paragraph (k) applies to debt instruments that are part of a reopening where the reopening date is on or after the date that is 60 days after the date final regulations are published in the **Federal Register.**

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 3, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 5, 1999, 64 F.R. 60395)

Removal of Regulations Providing Guidance Under Subpart F, Relating to Partnerships and Branches; Correction

Announcement 99–111

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction of temporary and final regulations.

SUMMARY: This document contains corrections to the temporary and final regulations (T.D. 8827, 1999–30 I.R.B. 120), which were published in the **Federal Register** on Tuesday, July 13, 1999, (64 F.R. 37677). The regulations relate to the treatment under subpart F of certain payments involving branches of a controlled foreign corporation that are treated as separate entities for foreign tax purposes or partnerships in which CFCs are partners.

DATES: These corrections are effective July 13, 1999.

FOR FURTHER INFORMATION CONTACT: Valerie Mark, (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary and final regulations that are the subject of these corrections are under sections 904, 954, and 7701.

Need for Correction

As published, the temporary and final regulations (T.D. 8827) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the temporary and final regulations (T.D. 8827), which are the subject of FR Doc. 99–17369, is corrected as follows:

§1.904–5 [Corrected]

1. On page 37677, column 3, amendatory instructions "**Par. 2.**", last line, the language "amended by removing the last sentence" is corrected to read "amended by removing the last two sentences".

2. On page 37678, column 1, amendatory instruction "**Par. 7.**", the language "**Par. 7.**" is corrected to read "**Par. 6.**".

3. On page 37678, column 1, amendatory instruction "**Par. 9.**", the language "**Par. 9.**" is corrected to read "**Par. 7.**".

§301.7701–3 [Corrected]

4. On page 37678, column 1, amendatory instruction "**Par. 10.**", the language "**Par. 10.**" is corrected to read "**Par. 8.**".

5. On page 37678, column 1, the amendatory instruction for "**Par. 11.**" is corrected to read as follows:

Par. 9. In §301.7701–3, the last two sentences in paragraph (f)(1) are removed.

6. On page 37678, column 1, amendatory instruction "**Par. 12.**", the language "**Par. 12.**" is corrected to read "**Par. 10.**".

Cynthia E. Grigsby,
Chief, Regulations Unit, Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on October 29, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 1, 1999, 64 F.R. 58782)

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–1: Gross income.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), and 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(l)–1: Permitted disparity in employer-provided contributions or benefits.

Covered compensation tables for 2000. The covered compensation tables for the year 2000 used for determining contributions to defined benefit plans and permitted disparity are set forth.

Rev. Rul. 99–47

This revenue ruling provides tables of covered compensation under § 401(l)-(5)(E) of the Internal Revenue Code (the "Code") and the Income Tax Regulations, thereunder, for the 2000 plan year.

Section 401(l)(5)(E)(i) defines covered compensation with respect to an employee, as the average of the contribution and benefit bases in effect under section 230 of the Social Security Act (the "Act") for each year in the 35-year period ending with the year in which the employee attains social security retirement age.

Section 401(l)(5)(E)(ii) of the Code states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(l)–1(c)(34) defines the taxable wage base as the contribution and benefit base under section 230 of the Act.

Section 1.401(l)–1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35-year period applicable under §1.401(l)–1(c)(7)(i) is the employee's covered compensation for a plan year during which the 35-year period ends. An employee's covered compensation for a plan year beginning before the 35-year period applicable under §1.401(l)–1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(l)–1(c)(7)(ii) provides that, for purposes of determining the amount of an employee's covered compensation under § 1.401(l)–1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 2000 year the taxable wage base is $76,200.

The following tables provide covered compensation for 2000:

2000 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2000 COVERED COMPENSATION
1907	1972	$4,488
1908	1973	4,704
1909	1974	5,004
1910	1975	5,316
1911	1976	5,664
1912	1977	6,060
1913	1978	6,480
1914	1979	7,044
1915	1980	7,692
1916	1981	8,460
1917	1982	9,300
1918	1983	10,236
1919	1984	11,232
1920	1985	12,276
1921	1986	13,368
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312

2000 COVERED COMPENSATION TABLE—Continued

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2000 COVERED COMPENSATION
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	35,100
1936	2001	37,092
1937	2002	39,072
1938	2004	42,984
1939	2005	44,940
1940	2006	46,896
1941	2007	48,816
1942	2008	50,688
1943	2009	52,488
1944	2010	54,252
1945	2011	55,992
1946	2012	57,708
1947	2013	59,376
1948	2014	60,900
1949	2015	62,340
1950	2016	63,660
1951	2017	64,920
1952	2018	66,072
1953	2019	67,164
1954	2020	68,220
1955	2022	70,116
1956	2023	71,004
1957	2024	71,820
1958	2025	72,528
1959	2026	73,176
1960	2027	73,764
1961	2028	74,304
1962	2029	74,748
1963	2030	75,180
1964	2031	75,564
1965	2032	75,864
1966	2033	76,092
1967 or later	2034	76,200

2000 Rounded Covered Compensation Table

Year of Birth	Covered Compensation
1934	$33,000
1935 – 1936	36,000
1937	39,000
1938	42,000
1939	45,000
1940 – 1941	48,000
1942 – 1943	51,000
1944	54,000
1945 – 1946	57,000
1947 – 1948	60,000
1949 – 1950	63,000
1951 – 1953	66,000
1954 – 1955	69,000
1956 – 1959	72,000
1960 – 1964	75,000
1965 or later	76,200

The principal author of this revenue ruling is Todd Newman of the Employee Plans Division. For further information regarding this revenue ruling, call (202) 622-6076 between 2:30 and 3:30 Eastern time (not a toll free number) Monday thru Thursday. Mr. Newman's number is (202) 622-8458 (also not a toll free number).

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(a)–1: Taxability of beneficiary under a qualified annuity plan.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

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26 CFR 1.403(b)–1: Taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 408.—Individual Retirement Accounts

26 CFR 1.408–1: General rules.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 817.—Treatment of Variable Contracts

26 CFR 1.817–5: Diversification requirements for variable annuity, endowment, and life insurance contracts.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 818.—Other Definitions and Special Rules

26 CFR 1.818–2: Accounting provisions.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 301.6011–3: Required use of magnetic media for partnership returns.

T.D. 8843

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Partnership Returns Required on Magnetic Media

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the requirements for filing partnership returns on magnetic media. These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. These regulations affect partnerships with more than 100 partners.

DATES: *Effective Date:* These regulations are effective January 1, 2000.

Applicability Date: These regulations apply to partnership returns for taxable years ending on or after December 31, 2000. However, the regulations will not apply to electing large partnership returns under section 775 or partnership returns with foreign addresses for taxable years ending before January 1, 2001.

FOR FURTHER INFORMATION CONTACT: Bridget E. Finkenaur, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Regulations on Procedure and Administration (26 CFR part 301) relating to filing partnership returns on magnetic media under section 6011(e)(2). In addition, this document contains conforming amendments to the Regulations on Procedure and Administration (26 CFR part 301) relating to information reporting penalties under section 6721.

A notice of proposed rulemaking (REG–102023–98, 1998–48 I.R.B. 6) was published in the **Federal Register** (63 F.R. 56878) on October 23, 1998. The public hearing scheduled for January 13, 1999, was canceled in the **Federal Register** (64 F.R. 1148) on January 8, 1998. No public hearing was requested or held. Two written comments were received. After consideration of the comments, the proposed regulations are adopted as modified by this Treasury decision. The comments are discussed below.

Explanation of Revisions and Summary of Comments

Both commentators requested that the IRS and the Treasury Department post-

pone the effective date of the regulations. The commentators were concerned that, given the various manners and formats that nominees use to submit partner information to publicly traded partnerships, these partnerships would be unable to create computer programs that would reformat the partner information in time to file their 1999 tax returns on magnetic media. In addition, partnerships required to file their returns on magnetic media beginning in 2000 will be focusing their computer resources on ensuring that their computer systems are year 2000 compliant. The commentators suggested that the effective date of the regulations be postponed to take into account these programming considerations.

In considering these comments, the IRS and the Treasury Department have decided to postpone the general effective date of the regulations for one year. This will allow partnerships additional time to develop systems that accommodate IRS processing requirements and integrate third party information while not interfering with efforts to ensure year 2000 compliance. Therefore, the final regulations are generally effective for taxable years ending on or after December 31, 2000. However, the effective date for electing large partnerships and partnerships using foreign addresses on their Series 1065 forms remains the same as the proposed regulations. Accordingly, electing large partnerships and partnerships using foreign addresses will not be required to file their returns on magnetic media for taxable years ending before January 1, 2001.

Although the general effective date of the regulations has been postponed, on March 15, 2000, the IRS will begin accepting partnership returns for taxable years ending on or after December 31, 1999, on magnetic media. The magnetic media filing of partnership returns for taxable years ending before December 31, 2000, is voluntary; partnerships will not be penalized for submitting a partnership return on paper for taxable years ending before this date. However, partnerships with the capability of submitting their partnership tax returns on magnetic media are encouraged to do so.

Partnerships with 100 or fewer partners also may voluntarily submit partnership returns on magnetic media beginning on March 15, 2000. These regulations do not require partnerships with 100 or fewer partners to file their returns on magnetic media; therefore, such partnerships will not be penalized for their failure to do so. In addition, partnerships with 100 or fewer partners participating in the magnetic media filing program may discontinue their participation at any time.

One commentator suggested that the IRS and the Treasury Department publish regulations under section 6031(c) to require nominees holding partnership interests to submit partner information to partnerships in the same manner and format that the IRS requires partnerships to file their returns under §301.6011-3 of the regulations. However, by postponing the effective date, it is anticipated that partnerships and nominees will have adequate time to establish satisfactory guidelines for sharing information. Accordingly, this comment has not been adopted by the final regulations.

Finally, one commentator asked whether fiscal year and short year returns will be required to be filed on magnetic media by the general effective date. Again, because the IRS and the Treasury Department have postponed the general effective date for one year, it is anticipated that partnerships will be able to meet the systems requirements set forth in IRS revenue procedures and other published guidance by the effective date. However, due to issues relating to creation of the system for accepting returns on magnetic media, the IRS will not be able to accept fiscal and short year returns prior to the general effective date. Therefore, partnerships that use a fiscal year and partnerships that must file a short year return may not voluntarily file their returns on magnetic media before January 1, 2001.

As indicated in the preamble to the proposed regulations, although the regulations define magnetic media broadly, the Service currently plans, in prescribed procedures for participation in the mandatory magnetic media filing program, to require partnerships with more than 100 partners to file their partnership returns electronically.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Bridget E. Finkenaur, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in the development of these regulations.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read in part as follows:

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

Section 301.6011–3 also issued under 26 U.S.C. 6011; * * *

Par. 2. Section 301.6011–3 is added to read as follows:

§301.6011–3 Required use of magnetic media for partnership returns.

(a) *Partnership returns required on magnetic media.* If a partnership with more than 100 partners is required to file a partnership return pursuant to §1.6031(a)–1 of this chapter, the information required by the applicable forms and schedules must be filed on magnetic media, except as otherwise provided in paragraph (b) of this section. Returns filed on magnetic media must be made in accordance with applicable revenue procedures or publications. In prescribing

revenue procedures or publications, the Commissioner may determine that partnerships will be required to use any one form of magnetic media filing. For example, the Commissioner may determine that partnerships with more than 100 partners must file their partnership returns electronically. In filing its return, a partnership must register to participate in the magnetic media filing program in the manner prescribed by the Internal Revenue Service in applicable revenue procedures or publications.

(b) *Waiver.* The Commissioner may waive the requirements of this section if hardship is shown in a request for waiver filed in accordance with this paragraph (b). A determination of hardship will be based upon all of the facts and circumstances. One factor in determining hardship will be the reasonableness of the incremental cost to the partnership of complying with the magnetic media filing requirements. Other factors, such as equipment breakdowns or destruction of magnetic media filing equipment, also may be considered. A request for waiver must be made in accordance with applicable revenue procedures or publications. The waiver will specify the type of partnership return and the period to which it applies. The waiver will also be subject to such terms and conditions regarding the method of filing as may be prescribed by the Commissioner.

(c) *Failure to file.* If a partnership fails to file a partnership return on magnetic media in the manner required and when required to do so by this section, the partnership will be deemed to have failed to file the return in the manner prescribed for purposes of the information return penalty under section 6721. See §301.6724–1(c)(3) for rules regarding the waiver of penalties for undue economic hardship relating to filing returns on magnetic media.

(d) *Meaning of terms.* The following definitions apply for purposes of this section:

(1) *Magnetic media.* The term magnetic media means any *magnetic media* permitted under applicable regulations, revenue procedures, or publications. These generally include magnetic tape, tape cartridge, and diskette, as well as other media (such as electronic filing) specifically permitted under the applicable regulations, procedures, or publications.

(2) *Partnership.* The term *partnership* means a partnership as defined in §1.761–1(a) of this chapter.

(3) *Partner.* The term *partner* means a member of a partnership as defined in section 7701(a)(2).

(4) *Partnership return.* The term *partnership return* means a form in Series 1065 (including Form 1065, U.S. Partnership Return of Income, and Form 1065-B, U.S. Return of Income for Electing Large Partnerships), along with the corresponding Schedules K-1 and all other related forms and schedules that are required to be attached to the Series 1065 form.

(5) *Partnerships with more than 100 partners.* A partnership has more than 100 partners if, over the course of the partnership's taxable year, the partnership had more than 100 partners, regardless of whether a partner was a partner for the entire year or whether the partnership had over 100 partners on any particular day in the year. For purposes of this paragraph (d)(5), however, only those persons having a direct interest in the partnership must be considered partners for purposes of determining the number of partners during the partnership's taxable year.

(e) *Examples.* The following examples illustrate the provisions of paragraph (d)(5) of this section. In the examples, the partnerships utilize the calendar year, and the taxable year in question is 2000:

Example 1. Partnership P had five general partners and 90 limited partners on January 1, 2000. On March 15, 2000, 10 more limited partners acquired an interest in P. On September 29, 2000, the 10 newest partners sold their individual partnership interests to C, a corporation which was one of the original 90 limited partners. On December 31, 2000, P had the same five general partners and 90 limited partners it had on January 1, 2000. P had a total of 105 partners over the course of partnership taxable year 2000. Therefore, P must file its 2000 partnership return on magnetic media.

Example 2. Partnership Q is a general partnership that had 95 partners on January 1, 2000. On March 15, 2000, 10 partners sold their individual partnership interests to corporation D, which was not previously a partner in Q. On September 29, 2000, corporation D sold one-half of its partnership interest in equal shares to five individuals, who were not previously partners in Q. On December 31, 2000, Q had a total of 91 partners, and on no date in the year did Q have more than 100 partners. Over the course of the year, however, Q had 101 partners. Therefore, Q must file its 2000 partnership return on magnetic media.

Example 3. Partnership G is a general partnership with 100 partners on January 1, 2000. There are no new partners added to G in 2000. One of G's partners, A, is a partnership with 53 partners. A is one partner, regardless of the number of partners A has. Therefore, G has 100 partners and is not required to file its 2000 partnership return on magnetic media.

(f) *Effective date.* In general, this section applies to partnership returns for taxable years ending on or after December 31, 2000. However, electing large partnerships under section 775 and partnerships using foreign addresses on their Series 1065 forms are not required to file using magnetic media for taxable years ending before January 1, 2001.

Par. 3. Section 301.6721–1 is amended by removing the third, fourth, and fifth sentences of paragraph (a)(2)(ii) and adding four sentences in their place to read as follows:

§301.6721–1 Failure to file correct information returns.

(a) * * *

(2) * * *

(ii) * * * However, no penalty is imposed under paragraph (a)(1) of this section solely by reason of any failure to comply with the requirements of section 6011(e)(2), except to the extent that such a failure occurs with respect to more than 250 information returns (the 250-threshold requirement) or in the case of a partnership with more than 100 partners, more than 100 information returns (the 100-threshold requirement) (collectively, the threshold requirements). Each Schedule K-1 considered in applying the 100-threshold requirement will be treated as a separate information return. These threshold requirements apply separately to each type of information return required to be filed. Further, these threshold requirements apply separately to original and corrected returns. * * *

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 29, 1999.

Joseph Mikrut,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 10, 1999, 8:45 a.m., and published in the

issue of the Federal Register for November 12, 1999, 64 F.R. 61502)

Section 6031.—Return of Partnership Income

26 CFR 1.6031(a)–1: Return of partnership income.

T.D. 8841

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 301, and 602

Return of Partnership Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations revising the partnership filing requirement. These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 (TRA). All partnerships required to file partnership returns, including certain foreign partnerships, are affected by these regulations.

DATES: *Effective Dates:* These regulations are effective January 1, 2000, except that §1.6031(a)–1(b)(3) is effective January 1, 2001.

Applicability Dates: For dates of applicability, see §§1.6031(a)–1(f) and 1.6063–1(c)(2).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Martin Schäffer, 202-622-3070; concerning foreign partnerships, Guy A. Bracuti, 202-622-3860 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1583.

The collection of information in these final regulations is in §1.6031(a)–1. This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income or gain or claiming the correct amount of losses, deductions, or credits from that taxpayer's interest in the partnership.

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

The burden is reflected in the burden estimate of Form 1065.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, T:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On January 26, 1998, the IRS and Treasury published in the **Federal Register** (63 F.R. 3677) proposed amendments to the regulations (REG–209322–82, 1998–15 I.R.B. 26) under sections 6031 and 6063 of the Internal Revenue Code (Code). These amendments were designed, in part, to reflect changes made to section 6031 of the Code by section 1141 of TRA, Public Law 105-34 (111 Stat. 788). Written comments responding to these proposed regulations were received. No public hearing was requested or held. After consideration of all the comments, the proposed regulations under sections 6031 and 6063 of the Code are adopted as revised by this Treasury decision, and the current final regulations under section 6031 of the Code are removed.

Explanation of Revisions and Summary of Comments

A. General Filing Requirements for Foreign Partnerships

Section 6031(a) of the Code requires every partnership to file a partnership return. However, section 6031(e) of the Code provides that a foreign partnership is not required to file a return for a taxable year unless during that year it derives gross income from sources within the United States (U.S.-source income) or has gross income that is effectively connected with the conduct of a trade or business within the United States (ECI).

Consistent with section 6031(e) of the Code, the proposed regulations generally required a foreign partnership to file a return under section 6031 of the Code if it had either U.S.-source income or ECI. This general rule is adopted without change in the final regulations.

B. Exceptions to General Filing Requirements

Under the proposed regulations, a foreign partnership that had no ECI, and that otherwise was required to file a partnership return only because it had U.S.-source income, was exempt from the requirement to file a partnership return if (i) no United States person had a direct or indirect interest in the partnership; (ii) the U.S.-source income was either fixed or determinable annual or periodical income described in §1.1441–2(b) or other amounts subject to withholding described in §1.1441–2(c); (iii) Forms 1042 and 1042-S were filed with respect to all such gross income by the partnership, or by another withholding agent (or agents) if the partnership was not required to file such forms; and (iv) the tax liability of the partners with respect to such gross income was fully satisfied by the withholding of tax at source. Most of the written comments received with respect to the proposed regulations requested that the IRS and Treasury modify this proposed exception to the foreign partnership filing requirement.

In response to these comments, the final regulations liberalize the exceptions in certain instances for foreign partnerships that have U.S.-source income but no ECI. The changes are designed to reduce duplicative filing requirements where other information reporting and withholding requirements provide adequate protection for the tax system and to recognize that where there is de minimis ownership in a foreign partnership by U.S. partners, the return filing requirements should not be invoked merely because the partnership earns any amount of U.S.-source income.

The final regulations contain three rules that modify the reporting obligations

of certain foreign partnerships that have no ECI. These modified reporting rules, with the exception of the de minimis exception, are applicable for partnership taxable years beginning after December 31, 2000, because they are dependent on rules contained in §§1.1441–5(c) and 1.1461–1, which will be applicable only after December 31, 2000. See Notice 99–27 (1999–20 I.R.B. 75). The de minimis exception, however, will be effective for partnership taxable years beginning after December 31, 1999, the general effective date of these regulations.

The modified reporting rules contain some common requirements. None of these rules will apply to a withholding foreign partnership (as defined in §1.1441–5(c)(2)(i)). Also, with the exception of the de minimis rule, the modified reporting rules will apply only when one or more withholding agents file the required Forms 1042 and 1042-S and pay the associated withholding tax.

The first modified reporting rule is the *de minimis* exception. This rule provides that a foreign partnership (other than a withholding foreign partnership, as defined in §1.1441–5(c)(2)(i)) with $20,000 or less of U.S.-source income and no ECI is required to file a partnership return only if one percent or more of any item of partnership gain, loss, deduction, or credit is allocable in the aggregate to direct U.S. partners.

The second modified reporting rule, which also was contained in the proposed regulations, provides that a foreign partnership with U.S.-source income but no ECI and no U.S. partners is not required to file a partnership return. Under the third rule, a foreign partnership with U.S.-source income and one or more U.S. partners but no ECI must file a partnership return. However, such a partnership need file Schedules K-1 only for its direct U.S. partners and for its passthrough partners through which U.S. partners hold an interest in the foreign partnership.

The final regulations do not require a foreign partnership to provide Schedules K-1 for foreign partners deriving U.S.-source income that is not ECI, because the foreign partners are subject to information reporting on Forms 1042-S under the rules contained in §§1.1441–5(c) and 1.1461–1 of the regulations. These rules generally subject the foreign partners, and not the partnership, to an information reporting regime with respect to U.S.-source income (that is not ECI) paid to a foreign partnership. To the extent that information returns are not required for foreign partners under section 1461 of the Code, the IRS and Treasury have determined that reporting under section 6031 of the Code is unnecessary as long as the foreign partnership has no ECI. Accordingly, a foreign partnership with no ECI need not report on a Schedule K-1 a foreign partner's allocable share of items of income, including U.S.-source gains that are not subject to Form 1042-S reporting, deposit interest under section 871(i) of the Code, and interest or OID on short-term obligations under section 871(g) of the Code.

In contrast to the rule for U.S.-source income, the exception to Schedule K-1 reporting does not apply to a foreign partner's allocable share of ECI. Under the information reporting rules in §§1.1441–5(c)(1)(ii)(B) and 1.1461–1(c) of the regulations, ECI must be reported to a foreign partnership rather than to the foreign partners directly. In addition, because ECI is subject to tax on a net basis, a foreign partnership must provide a foreign partner's allocable share of other items of partnership income, gain, loss, or deduction to properly calculate the net taxable income. Therefore, if a foreign partnership has ECI, it must file a complete partnership return (with Schedules K-1 for all partners) reflecting all items of partnership income, gain, loss, deduction, and credit.

C. Partners That are Controlled Foreign Corporations

One commentator suggested that a foreign partnership should not have to file under section 6031 of the Code if it has no direct U.S. partners and its only U.S.-source income is bank deposit interest under section 871(i) of the Code. The exception to the filing requirement in §1.6031(a)–1(b)(2) of the proposed regulations did not apply to foreign partnerships with direct or indirect U.S. partners. Thus, according to the commentator, this exception did not apply to a common, nonabusive situation in which a controlled foreign corporation (CFC) is a partner in a foreign partnership whose only U.S.-source income is interest earned on a U.S. bank account. (Foreign partners do not owe U.S. tax on this interest income; see section 871(i) of the Code and §1.1441–2(a) of the regulations (final sentence). In addition, a U.S. person who controls a CFC must report such income on Form 5471; see §1.6038–2.)

The term indirect interest was not defined in the proposed regulations. Thus, whether a U.S. shareholder of a CFC partner held an indirect interest in the foreign partnership was not clear. These final regulations define the term *United States partner* as any U.S. person owning a direct or indirect interest in the foreign partnership. An indirect interest is defined as any interest held through one or more passthrough partners (as defined in section 6231(a)(9) of the Code). A passthrough partner is a partnership, estate, trust, S corporation, nominee, or other similar person. Because a CFC is not a passthrough partner, the U.S. shareholder of a CFC has no indirect interest in the foreign partnership under these final regulations. Accordingly, a partnership with no ECI need not file a return solely as a result of having a CFC partner.

D. Responsibility to Ensure Filing of Forms 1042 and 1042-S and Payment of Associated Tax

As stated above, a foreign partnership may avail itself of the modified filing requirements in §1.6031(a)–1(b)(3) of these regulations, for partnership taxable years beginning after December 31, 2000, only if it or another withholding agent actually files the Forms 1042 and 1042-S and pays the associated tax. A commentator suggested that a foreign partnership with no withholding responsibility should not have the burden of ensuring that another withholding agent has properly filed Forms 1042-S in order to invoke the modified filing requirements.

Where a withholding agent fails to withhold (and to file the requisite forms) with respect to a partner in a foreign partnership, the Service might be unable to assess and collect the proper tax without information from a partnership return. A partnership return provides the Service with the name of the foreign partner and the amount subject to withholding. Accordingly, these final regulations do not adopt the comment.

While this comment is not adopted, certain relief still may be available. Each

person who has control, receipt, custody, or payment of an amount subject to withholding is a withholding agent and is responsible for withholding tax and filing Forms 1042 and 1042-S. Generally, a foreign partnership is a withholding agent and must withhold tax and file the requisite forms. Under §1.1461–1(b) and (c), one withholding agent among several may be relieved of its responsibility to withhold if another withholding agent withholds tax and files the proper returns. However, §1.1441–5(c)(3)(v) augments this rule by deeming a foreign partnership (other than a withholding foreign partnership as defined in §1.1441–5(c)(2)(i)) to have satisfied its withholding responsibilities for an amount with respect to a partner to the extent that the partner's distributive share of the payment can be reliably associated with a withholding certificate described in §1.1441–5(c)(3)(iii) pertaining to the partner that the partnership has furnished to a withholding agent, and the partnership does not know or has no reason to know that the correct amount has not been withheld. These final regulations do not alter the result under §1.1441–5(c)(3)(v). In addition, if a foreign partnership reasonably relies on a modified filing requirement under these regulations, but the modification is inapplicable because no party has satisfied withholding responsibilities, the partnership should be able to show that its failure to file a partnership return was due to reasonable cause for purposes of section 6698 of the Code if the foreign partnership is deemed to have satisfied its withholding responsibilities under §1.1441–5(c)(3)(v).

E. Partnership Level Elections under Section 703 of the Code

A commentator suggested that an abbreviated return should be permitted where a foreign partnership would be exempt from the filing requirement but for a partnership level election under section 703 of the Code. These final regulations clarify that a return filed solely to make an election under section 703 of the Code need contain only information identifying the partnership and the type of election. In general, such a return is not considered to be a return filed under section 6031(a) of the Code. Therefore, a return filed solely to make an election is not a partnership return for purposes of section 6501 (regarding the statute of limitations) and sections 6231(a)(1)(A) and 6233 (regarding the partnership audit rules) of the Code.

Section 1.6031(a)–1(b)(3)(ii) of the proposed regulations provided that a return filed by or for a foreign partnership to make a section 703 election must be signed by each partner who was a partner at the time of election or by any partner who was authorized (under local law or the partnership's organizational documents) to make the election and who represented having such authority under penalties of perjury. A commentator suggested that the signature requirement for returns filed solely to make a partnership level election should be restricted to partners who are U.S. persons or are owned directly or indirectly by U.S. persons. These final regulations do not adopt this comment but maintain the signature requirement as proposed. Cf. §301.7701–3(c)(2) setting forth the same signature requirement for entity classification elections.

F. Electing Out of Subchapter K under Section 761 of the Code

A commentator suggested that the final regulations should provide a default rule under which a foreign partnership with no direct U.S. partners that is eligible to elect out of subchapter K of the Code would be deemed to have elected exclusion. Under §1.6031(a)–1(c)(2) of the proposed regulations, a partnership that was deemed to have elected exclusion from subchapter K, as specified in §1.761–2(b)(2)(ii), would be exempt from the partnership filing requirement. According to the commentator, for joint ventures in which all the direct owners are foreign, it is often difficult to clearly demonstrate an intention to exclude the entity from U.S. partnership treatment, as required by the section 761 regulations. To avoid inconsistency with the requirements for deemed exclusion under section 761 of the Code, these final regulations maintain the rule as proposed.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations would reduce (rather than increase) the number of small entities that are required to file a partnership return. Specifically, the regulations eliminate the filing requirements for certain foreign partnerships that are fully subject to withholding in order to prevent duplicative filing requirements. In addition to eliminating the filing requirements in these circumstances, for ease of reference, the regulations update and restate the general requirements to file a partnership return as set forth in existing regulations. Because these regulations do not impose any new reporting requirements that are not imposed by the existing regulations, and the only significant modification of the existing regulations is to eliminate the filing requirement for certain foreign partnerships, the regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Martin Schäffer, Office of Assistant Chief Counsel (Passthroughs and Special Industries), and Guy A. Bracuti, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.6031(a)-1 also issued under 26 U.S.C. 6031. * * *

§1.6031–1 [Removed]

Par. 2. Section 1.6031–1 is removed.

Par. 3. Section 1.6031(a)–1 is added to read as follows:

§1.6031(a)–1 Return of partnership income.

(a) *Domestic partnerships*—(1) *Return required.* Except as provided in paragraphs (a)(3) and (c) of this section, every domestic partnership must file a return of partnership income under section 6031 (partnership return) for each taxable year on the form prescribed for the partnership return. The partnership return must be filed for the taxable year of the partnership regardless of the taxable years of the partners. For taxable years of a partnership and of a partner, see section 706 and §1.706–1. For the rules governing partnership statements to partners and nominees, see §1.6031(b)–1T.

(2) *Content of return.* The partnership return must contain the information required by the prescribed form and the accompanying instructions.

(3) *Special rule.* A partnership that has no income, deductions, or credits for federal income tax purposes for a taxable year is not required to file a partnership return for that year.

(4) *Failure to file.* For the consequences of a failure to comply with the requirements of section 6031(a) and this paragraph (a), see sections 6229(a), 6231(f), 6698, and 7203.

(b) *Foreign partnerships*—(1) *General rule.* A foreign partnership is not required to file a partnership return, if the foreign partnership does not have gross income that is (or is treated as) effectively connected with the conduct of a trade or business within the United States (ECI) and does not have gross income (including gains) derived from sources within the United States (U.S.-source income). Except as provided in paragraphs (b)(2) and (3) of this section, a foreign partnership that has ECI or has U.S.-source income that is not ECI must file a partnership return for its taxable year in accordance with the rules for domestic partnerships in paragraph (a) of this section.

(2) *Foreign partnerships with de minimis U.S.-source income and de minimis U.S. partners.* A foreign partnership (other than a withholding foreign partnership, as defined in §1.1441–5(c)(2)(i)) that has $20,000 or less of U.S.-source income and has no ECI during its taxable year is not required to file a partnership return if, at no time during the partnership taxable year, one percent or more of any item of partnership income, gain, loss, deduction, or credit is allocable in the aggregate to direct United States partners. The United States partners must directly report their shares of the allocable items of partnership income, gain, loss, deduction, and credit.

(3) *Filing obligations for certain other foreign partnerships with no ECI*—(i) *General requirements for modified filing obligations.* A foreign partnership will be subject to the modified filing obligations in paragraphs (b)(3)(ii) and (iii) of this section if, in addition to satisfying the requirements contained in paragraph (b)(3)(ii) and (iii) of this section—

(A) The partnership is not a withholding foreign partnership as defined in §1.1441–5(c)(2)(i);

(B) Forms 1042 and 1042-S are filed by the partnership with respect to the amounts subject to reporting under §1.1461–1(b) and (c), unless the partnership is not required to file such returns under §1.1461–1(b)(2) and (c)(4), in which case Forms 1042 and 1042-S must be filed by another withholding agent or agents; and

(C) The tax liability of the partners with respect to such amounts has been fully satisfied by the withholding of tax at the source, if applicable, under chapter 3 of the Internal Revenue Code.

(ii) *Foreign partnerships with U.S.-source income but no U.S. partners.* A foreign partnership that has U.S.-source income is not required to file a partnership return if the partnership has no ECI and no United States partners at any time during the partnership's taxable year.

(iii) *Foreign partnerships with U.S.-source income and U.S. partners.* Except as provided in paragraph (b)(2) of this section, a foreign partnership with one or more United States partners that has U.S.-source income but no ECI must file a partnership return. However, such a foreign partnership need not file Statements of Partner's Share of Income, Credit, Deduction, Etc. (Schedules K-1) for any partners other than its direct United States partners and its passthrough partners (whether U.S. or foreign) through which United States partners hold an interest in the foreign partnership. Schedules K-1 that are not excepted from filing under this paragraph (b)(3)(iii) must contain the same information required of a domestic partnership filing under paragraph (a) of this section.

(4) *Information or returns required of partners who are United States persons*—(i) *In general.* If a United States person is a partner in a partnership that is not required to file a partnership return, the district director or director of the relevant service center may require that person to render the statements or provide the information necessary to verify the accuracy of the reporting by that person of any items of partnership income, gain, loss, deduction, or credit.

(ii) *Controlled foreign partnerships.* Certain United States persons who are partners in a foreign partnership controlled (within the meaning of section 6038(e)(1)) by United States persons may be required to provide information with respect to the partnership under section 6038.

(5) *Certain partnership elections.* For a partnership that is not otherwise required to file a partnership return, if an election that can only be made by the partnership under section 703 (affecting the computation of taxable income derived from a partnership) is to be made by or for the partnership, a return on the form prescribed for the partnership return must be filed for the partnership. Unless otherwise provided in the form or the accompanying instructions, a return filed solely to make an election need only contain a written statement citing paragraph (b)(5)(ii) of this section, listing the name and address of the partnership making the election, and clearly identifying the specific election being made. A return filed under paragraph (b)(5)(ii) of this section solely to make an election is not a partnership return. Thus, such a return is not a return filed under section 6031(a) for pur-

poses of sections 6501 (except regarding the specific election issue), 6231(a)-(1)(A), and 6233. The return must be signed by—

(i) Each partner that is a partner in the partnership at the time the election is made; or

(ii) Any partner of the partnership who is authorized (under local law or the partnership's organizational documents) to make the election and who represents to having such authorization under penalties of perjury.

(6) *Exclusion for certain organizations.* The return requirement of section 6031 and this section does not apply to the International Telecommunications Satellite Organization, the International Maritime Satellite Organization, or any organization that is a successor of either.

(c) *Partnerships excluded from the application of subchapter K of the Internal Revenue Code*—(1) *Wholly excluded*—(i) *Year of election.* An eligible partnership as described in §1.761-2(a) that elects to be excluded from all the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified by §1.761–2(b)(2)(i) must timely file the form prescribed for the partnership return for the taxable year for which the election is made. In lieu of the information otherwise required, the return must contain or be accompanied by the information required by §1.761–2(b)(2)(i).

(ii) *Subsequent years.* Except as otherwise provided in paragraph (c)(1)(i) of this section, an eligible partnership that elects to be wholly excluded from the application of subchapter K is not required to file a partnership return.

(2) *Deemed excluded.* An eligible partnership that is deemed to have elected exclusion from the application of subchapter K beginning with its first taxable year, as specified in §1.761–2(b)(2)(ii), is not required to file a partnership return.

(d) *Definitions*—(1) *Partnership.* For the meaning of the term partnership, see §1.761–1(a).

(2) *United States person.* In applying this section, a United States person is a person described in section 7701(a)(30); the government of the United States, a State, or the District of Columbia (including an agency or instrumentality thereof); or a corporation created or organized in Guam, the Commonwealth of Northern Mariana Islands, the U.S. Virgin Islands, and American Samoa, if the requirements of section 881(b)(1)(A), (B), and (C) are met for such corporation. The term does not include an alien individual who is a resident of Puerto Rico, Guam, the Commonwealth of Northern Mariana Islands, the U.S. Virgin Islands, or American Samoa, as determined under §301.7701(b)–1(d) of this chapter.

(3) *United States partner.* In applying this section, a United States partner is any United States person who holds a direct or indirect interest in the partnership.

(4) *Indirect interest.* An indirect interest is any interest held through one or more passthrough partners, as defined in section 6231(a)(9).

(e) *Procedural requirements*—(1) *Place for filing.* The return of a partnership must be filed with the service center prescribed in the relevant IRS revenue procedure, publication, form, or instructions to the form (see §601.601(d)(2)).

(2) *Time for filing.* The return of a partnership must be filed on or before the fifteenth day of the fourth month following the close of the taxable year of the partnership.

(3) *Magnetic media filing.* For magnetic media filing requirements with respect to partnerships, see section 6011(e)(2) and the regulations thereunder.

(f) *Effective dates.* This section applies to taxable years of a partnership beginning after December 31, 1999, except that paragraph (b)(3) of this section applies to taxable years of a foreign partnership beginning after December 31, 2000.

Par. 4. Section 1.6063–1 is amended by adding paragraph (c) to read as follows:

§1.6063–1 Signing of returns, statements, and other documents made by partnerships.

* * * * *

(c) *Certain partnership elections*—(1) *In general.* For rules regarding the authority of a partner to sign a partnership return filed solely for the purpose of making certain partnership-level elections, see §1.6031(a)–1(b)(5)(ii).

(2) *Effective date.* Paragraph (c) of this section applies to taxable years of a partnership beginning after December 31, 1999.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 5. The authority citation for part 301 continues to read in part as follows:

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

§301.6031–1 [Removed]

Par. 6. Section 301.6031–1 is removed.

Par. 7. Section 301.6031(a)–1 is added to read as follows:

§301.6031(a)–1 Return of partnership income.

For provisions relating to the requirement of returns of partnership income, see §1.6031(a)–1 of this chapter.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is amended by removing the entry "1.6031–1" from the table and adding the entry "1.6031(a)–1 . . . . 1545–1583" in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.6031(a)–1	1545–1583
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 29, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 10, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 12, 1999, 64 F.R. 61498)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters. (Also sections 61, 403(a), 403(b), 408(b), 817(h), 818(a); 1.61–1, 1.403(a)–1, 1.403(b)–1, 1.408–1, 1.817–5, 1.818–2)

Rev. Proc. 99–44

SECTION 1. PURPOSE

This revenue procedure sets forth the circumstances under which the Internal Revenue Service will treat a contract as an annuity contract described in §§ 403(a), 403(b) or 408(b) of the Internal Revenue Code ("Code") notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities.

SECTION 2. BACKGROUND

Rev. Rul. 77–85, 1977–1 C.B. 12, concludes that if a contract holder retains control over the assets in a custodial account associated with a purported "annuity" contract, then the contract holder is the owner of those assets for federal income tax purposes. The contract holder's gross income, therefore, includes any interest, dividends, and other income generated by those assets. In the ruling, the contract holder's control over the assets in the custodial account is manifested by the ability to direct the custodian: (1) to invest amounts in the account in any of an approved list of investments, and (2) to sell, purchase, or exchange securities or other assets held in the account. Through the interaction of the custodial agreement and the annuity contract, the contract holder enjoys any increase or suffers any decrease in the value of the assets in the account as well as any income from the assets. The contract holder also has the right to vote account securities either through the custodian or personally. Rev. Rul. 77–85 generally applies to contracts entered into after March 9, 1977.

In Rev. Rul. 80–274, 1980–2 C.B. 27, an insurance company and a savings and loan association enter into a group annuity contract under which the association's depositors are issued annuity certificates. The certificate holders' premiums (net of sales and other expenses) are invested in certificates of deposit issued by the savings and loan association, with maturity dates designated by the certificate holders. When a certificate of deposit matures, the proceeds generally are invested in another certificate of deposit with the savings and loan association. Prior to the annuity starting date, a holder of an annuity certificate can withdraw part or all of his or her investment (including the investment income thereon) by partially or completely surrendering the certificate. Due to fees imposed by the insurance company, annuity certificate holders receive a lower rate of return than if they were to invest directly in the certificates of deposit. The ruling concludes, however, that, prior to the annuity starting date, the position of holders of the annuity certificates is substantially identical to what their position would have been if investments were directly maintained or established with the savings and loan association, with the insurance company acting merely as a conduit.

Rev. Rul. 81–225, 1981–2 C.B. 12, analyzes five situations involving purported variable "annuity" contracts. In four of the situations, the ruling concludes that the contracts are not annuity contracts described in §§ 403(a), 403(b), or 408(b) and that prior to the annuity starting date the contract holders are the owners of the assets held by the insurance company with regard to the contracts. In these situations, the insurance company holds shares of mutual funds that are directly or indirectly available to the public. In the fifth situation, the contract holder can invest only in a non-publicly-available mutual fund managed by the insurance company or one of its affiliates. The shares in that mutual fund are available only through the purchase of an annuity contract. In this situation, the ruling concludes that the insurance company is treated as the owner of the mutual fund shares held by the company for the contracts. Rev. Rul. 80–274 did not address the treatment of contracts described in §§ 403(a), 403(b) or 408(b). For that reason, Rev. Rul. 81–225 contains a special transition rule for such contracts. This rule provides that any contract entered into on or before September 25, 1981, is treated as an annuity contract if the arrangement would have met the requirements imposed by those sections without taking the holding or rationale of Rev. Rul. 81–225 into account, and no contributions are made on behalf of any individual who was not included under the contract on or before September 25, 1981.

In Rev. Rul. 82–54, 1982–1 C.B. 11, a variable annuity contract holder can direct that the consideration paid for the contracts be invested in any or all of three non-publicly-available mutual funds managed by the insurance company. Each of the funds has a different general investment strategy. One fund invests primarily in common stocks, another in bonds, and the third in money market instruments. A contract holder is free to allocate payments among the three funds and to reallocate account values among the three funds at any time before the annuity starting date. The ruling concludes that the contract holder's ability to choose among broad general investment strategies, either at the time of the initial purchase of the annuity contract or subsequent thereto, does not constitute sufficient control over individual investment decisions so as to cause the contract holder to be the owner of the mutual fund shares.

Rev. Rul. 82–55, 1982–1 C.B. 12, clarifies that, if an annuity contract holder's premiums are invested in a separate account that holds mutual fund shares and the mutual fund's shares were originally available to the public but are unavailable to the public when the contract holder's premiums are invested, then the contract holder is not treated as the owner of the mutual fund shares.

In *Christofferson v. United States,* 749 F.2d 513 (8th Cir. 1984), an individual purchased a purported deferred "annuity" contract that permitted the contract holder to allocate the consideration paid for the contract among various mutual funds. The contract holder could reallocate funds among the mutual funds at any time, and could withdraw part or all of the funds with seven days notice. The contract also gave the contract holder an option to purchase an immediate life annuity at guaranteed rates. The contract holder did not have to exercise the option. The court found that the contract holder had surrendered few of the rights of ownership or control over the assets, and therefore con-

cluded that the contract holder was the owner of the mutual fund shares for tax purposes. As the contract holder could surrender the contract for cash prior to annuitization, the possibility that the mutual fund shares could be converted into an immediate annuity at rates guaranteed in the contract did not cause the contract holder to lack ownership or control.

Section 817(h) of the Internal Revenue Code was added by §211(a) of the Tax Reform Act of 1984, 1984–3 (Vol. 1) C.B. 259–60, effective for taxable years beginning after December 31, 1983. Section 817(h) provides that a variable contract (other than a pension plan contract described in § 818(a)) is not treated as a life insurance, endowment, or annuity contract if the investments of a segregated asset account upon which the contract is based are not adequately diversified in accordance with regulations prescribed by the Secretary. Pension plan contracts described in § 818(a) are subject to a variety of statutory limits, including limits on annual contributions, that do not apply to other variable contracts.

The legislative history explains the purpose underlying the § 817(h) diversification requirement as follows:

> In authorizing Treasury to prescribe diversification standards, the conferees intend that standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors and investments that are made, in effect, at the direction of the investor.

H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1055, 1984–3 (Vol. 2) C.B. 309.

Section 1.817–5 of the Income Tax Regulations provides guidance related to the minimum level of diversification applicable to the investments underlying variable annuity and life insurance contracts. Satisfying the diversification requirements, however, does not prevent a contract holder's control of the investments of a segregated asset account from causing the contract holder, rather than the insurance company, to be treated as the owner of the assets in the account.

SECTION 3. SCOPE

This revenue procedure applies to a contract that otherwise would qualify as an annuity contract for purposes of §§ 403(a) or 403(b), or as an individual retirement annuity for purposes of § 408(b), but for the fact that contract premiums are invested at the direction of the contract holder in publicly available securities.

SECTION 4. APPLICATION

Notwithstanding that contract premiums are invested at the contract holder's direction in publicly available securities, the Service will treat a contract described in section 3 of this revenue procedure as an annuity contract and will not treat the contract holder as owning the assets associated with the contract, provided the following conditions are met:

1. For a contract that is intended to qualify as an annuity contract for purposes of §§ 403(a) or 403(b), no additional federal tax liability would have been incurred if the employer of the contract holder had instead paid an amount into a trust or a custodial account in an arrangement that satisfied the requirements of §§ 401(a) or 403(b)(7)(A), respectively; or

2. For a contract that is intended to qualify as an individual retirement annuity for purposes of § 408(b), no additional federal tax liability would have been incurred if consideration for the contract had instead been held as part of a trust that would satisfy the requirements of § 408(a), except that the general account of an insurance company shall be treated as a common investment fund for purposes of satisfying § 408(a)(5).

EFFECTIVE DATE

This revenue procedure is effective on November 16,1999, with respect to all taxable years.

Under the authority of § 7805(b) of the Code, this revenue procedure will not be applied adversely to an issuer or holder of a contract issued before November 16, 1999.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 81–225 is modified.

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine Hossofsky of the Office of Assistant Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contract Ms. Hossofsky on (202) 622-3477 (not a toll-free call).

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

A revenue procedure describes certain changes to the funding method used to determine the minimum funding standard for defined benefit plans for plan years beginning on or after January 1, 1999. See Rev. Proc. 99–45, page 603.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48 on this page.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for December 1999.

Rev. Rul. 99–48

This revenue ruling provides various prescribed rates for federal income tax purposes for December 1999 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2000 interest rate for purposes of sections 846 and 807.

REV. RUL. 99–48 TABLE 1

Applicable Federal Rates (AFR) for December 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	5.74%	5.66%	5.62%	5.59%
110% AFR	6.33%	6.23%	6.18%	6.15%
120% AFR	6.91%	6.79%	6.73%	6.70%
130% AFR	7.50%	7.36%	7.29%	7.25%
Mid-Term				
AFR	6.20%	6.11%	6.06%	6.03%
110% AFR	6.83%	6.72%	6.66%	6.63%
120% AFR	7.46%	7.33%	7.26%	7.22%
130% AFR	8.10%	7.94%	7.86%	7.81%
150% AFR	9.38%	9.17%	9.07%	9.00%
175% AFR	10.98%	10.69%	10.55%	10.46%
Long-Term				
AFR	6.47%	6.37%	6.32%	6.29%
110% AFR	7.13%	7.01%	6.95%	6.91%
120% AFR	7.79%	7.64%	7.57%	7.52%
130% AFR	8.45%	8.28%	8.20%	8.14%

REV. RUL. 99–48 TABLE 2

Adjusted AFR for December 1999

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.02%	3.98%	3.96%	3.95%
Mid-term adjusted AFR	4.76%	4.70%	4.67%	4.65%
Long-term adjusted AFR	5.72%	5.64%	5.60%	5.57%

REV. RUL. 99–48 TABLE 3

Rates Under Section 382 for December 1999

Adjusted federal long-term rate for the current month	5.72%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.72%

REV. RUL. 99–48 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 1999

Appropriate percentage for the 70% present value low-income housing credit	8.49%
Appropriate percentage for the 30% present value low-income housing credit	3.64%

REV. RUL. 99–48 TABLE 5

Rate Under Section 7520 for December 1999

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.4%

REV. RUL. 99–48 TABLE 6

Rate under Sections 846 and 807

Applicable rate of interest for 2000 for purposes of sections 846 and 807	6.09%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48, page 600.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48, page 600.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 1999. See Rev. Rul. 99–48, page 600.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also, Part I, section 412.)

Rev. Proc. 99–45

Section 1. Purpose and Scope

This revenue procedure modifies Rev. Proc. 95–51, 1995–2 C.B. 431, which provides approval to change the funding method (including the asset valuation method) used for a defined benefit pension plan. This revenue procedure modifies Rev. Proc. 95–51 to provide approval for a change in funding method in connection with certain mergers; to clarify that the prohibition of a change in method where there is a negative unfunded liability applies only in certain circumstances with respect to a change in funding method involving a spread gain method; to provide that the comparison of the results of new valuation software to the results of old valuation software may be made on the basis of the prior year; and to provide, in certain situations, that the requirement that the plan administrator approve of the change in funding method will be satisfied if the plan administrator is made aware of the change.

Section 2. Background

.01 Section 412(c)(5)(A) of the Internal Revenue Code ("the Code"), as amended, and section 302(c)(5)(A) of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974–3 C.B. 1, 40, as amended, state that if the funding method of a plan is changed, the new funding method shall become effective only if the change is approved by the Secretary.

.02 Section 1.412(c)(2)–1 of the Income Tax Regulations generally provides that a change in the actuarial valuation method used to value the assets of a plan is a change in funding method that requires approval under § 412(c)(5) of the Code.

.03 Rev. Proc. 95–51 provides approval for certain changes in funding method. Section 3 of Rev. Proc. 95–51 provides approval for changes to certain specific methods including certain asset valuation methods. Section 4 of Rev. Proc. 95–51 provides various special approvals for changes. Section 5 of Rev. Proc. 95–51 provides rules relating to the establishment and maintenance of amortization bases upon changing methods. Section 6 of Rev. Proc. 95–51 provides restrictions under the revenue procedure.

.04 Rev. Proc. 98–10, 1998–2 I.R.B. 35, modified Rev. Proc. 95–51 to provide approval for additional changes in asset valuation method and for certain changes in valuation software. Rev. Proc. 98–10 also clarified and modified other provisions of Rev. Proc. 95–51.

Section 3. Additional Approvals under Rev. Proc. 95–51

.01 Section 4 of Rev. Proc. 95–51 (Special Approvals) is modified to add a new section 4.06 as follows:

.06 Approval for *De Minimis* Mergers

(1) Approval is granted for a change in method in connection with a merger described in paragraph (2) where the procedures set forth in paragraphs (3) through (5) below are followed.

(2) The merger involves the merger of a smaller plan (within the meaning of § 1.414(l)–1(h)(1)) and a larger plan (within the meaning of § 1.414(l)–1(h)(1)). For purposes of this paragraph (2), the rules of §§ 1.414(l)–1(h)(2), 1.414(l)–1(h)(3), and 1.414(l)– 1(h)(4) apply in determining whether a merger is *de minimis*.

(3) For the period from the beginning of the plan year of the smaller plan to the date of the merger, the charges and credits to the funding standard account for the smaller plan are determined without regard to the merger. If that period is less than a full 12-month plan year, the charges and credits to the funding standard account for the smaller plan for this period are ratably adjusted using the principles of Rev. Rul. 79–237, 1979–2 C.B. 190, in the same manner as if the date of the merger was the date of plan termination of the smaller plan. The deductible limit under § 404 for contributions to the smaller plan is determined by treating the period from the beginning of the plan year to the date of merger as a short plan year and following the procedure set forth in section 5 of Rev. Proc. 87–27, 1987–1 C.B. 769. Schedule B of Form 5500 is filed for the smaller plan for the period from the beginning of the plan year of the smaller plan to the date of the merger. Any contributions made for the smaller plan after the date of the merger, but not later than 8½ months after the date of the merger, are credited to the funding standard account of the smaller plan for this period. For purposes of applying § 4971(b) (but not § 4971(a)) with respect to the smaller plan, any funding deficiency that existed for the smaller plan is considered corrected as of the date of merger.

(4) If the valuation date for the larger plan for the plan year in which the merger occurs precedes the date of the merger, the charges and credits to the funding standard account for the larger plan for that plan year are determined without regard to the merger. Consequently, Schedule B of Form 5500 for the plan year of the larger plan in which the merger occurs is filed without regard to the merger in such a case. Similarly, the deductible limit determined under § 404 with respect to the plan year of the larger plan in which the merger occurs is determined without regard to the merger.

(5) For the actuarial valuation of the larger plan as of the valuation date coincident with or next following the date of the merger, the funding method (including asset valuation method) used is that for the larger plan, and the funding method (including asset valuation method) used for the smaller plan is disregarded. The charges and credits to the funding standard account for the larger plan are determined by treating the net effect of the change in assets and liabilities due to the merger in the same manner as any other gain or loss experienced by the larger plan. Consequently, any amortization bases, credit balances, or funding de-

ficiencies with respect to the smaller plan are disregarded for purposes of applying § 412 and § 4971 with respect to the larger plan.

.02 Section 4 of Rev. Proc. 95–51 (Special Approvals) is modified to add a new section 4.07 as follows:

.07 Approval for Mergers Other Than *De Minimis* Mergers

(1) Approval is granted for a change in method that results from a merger of one plan with another plan in a given plan year where all the conditions set forth in paragraphs (2) through (6) are satisfied, and the procedures set forth in paragraphs (7) through (13) are followed.

(2) The merger is not a de minimis merger within the meaning of § 1.414(l)–(h).

(3) The funding method (without regard to the asset valuation method) used for each of the plans is a method described in section 3.

(4) Both plans have the same plan year and a valuation date that is either the first or last day of the plan year.

(5) The date of the merger is either the first day of the plan year or the last day of the plan year of the two plans.

(6) In a case in which the date of the merger is the first day of the plan year, neither plan has a funding deficiency for the prior plan year. In a case in which the date of the merger is the last day of the plan year, neither plan has a funding deficiency for the plan year of the merger (after taking into account contributions made after the date of the merger as provided in paragraph (13) below).

(7) If the date of the merger is the first day of the plan year, the minimum funding standard of § 412 and the deductible limit of § 404 are determined for the merged plan for the entire plan year in which the merger occurs in the manner provided in paragraphs (8), (9), (10), (11), and (12) below. Consequently, for the plan year in which the merger occurs, only one Schedule B of Form 5500 is filed for the merged plan in such a case.

(8) If the same asset valuation method (in all respects) is used for each of the two plans, the asset valuation method of the merged plan is that method. If the same asset valuation method (in all respects) is not used for each of the two plans (for example, the smoothing period is three years for one of the plans, and five years for the other plan), the asset valuation method used for the merged plan must be an asset valuation method described in section 3.

(9) If the funding method (without regard to the asset valuation method) used for each of the two plans is the same, that funding method is continued for the plan after the merger. If the funding method (without regard to the asset valuation method) used for each of the two plans is not the same, then the funding method used for the ongoing plan is continued after the merger. For this purpose, the ongoing plan is the plan as designated by the plan administrator (within the meaning of § 414(g)), whose name and plan number will continue to be reported on Schedule B of Form 5500 for years after the merger. The funding method used for the plan which is not the ongoing plan is disregarded.

(10) An experience gain or loss is determined separately for each of the two plans, for the period prior to the date of the merger, without regard to the merger and any associated change in funding method. The preceding sentence applies only to the extent that an experience gain or loss would have been determined under the methods used for the plans prior to the merger.

(11) All amortization bases that were maintained for the two plans continue to be maintained for the merged plan to the extent they would be maintained under the funding method used for the merged plan. The credit balances, if any, of each of the two plans from the prior year are carried forward to the current plan year, and combined.

(12) If an unfunded liability is determined under the funding method used for the ongoing plan, it must be determined after any change in actuarial assumptions and methods (including a change in asset valuation method pursuant to paragraph (8)). In the case of such a funding method that is a spread gain method, the unfunded liability is redetermined in the same manner that the unfunded liability was originally determined for the ongoing plan. Therefore, the amortization base established pursuant to the rules of section 5.01(2) will reflect any change of actuarial assumptions and methods. For purposes of this paragraph, a spread gain method is any method that does not directly calculate an accrued liability. See Rev. Rul. 81–13, 1981–1 C.B. 229, for whether a funding method directly calculates an accrued liability.

(13) If the date of the merger is the last day of the plan year, the minimum funding standard under § 412 and the deductible limit under § 404 for each of the plans for the plan year in which the merger occurs are determined without regard to the merger. Consequently, separate Schedules B of Form 5500 are filed for the plans for the plan year in which the merger occurs without regard to the merger in such a case. Any contribution for the plan year that is made to the trust after the date of the merger may be credited on either of the Schedules B provided that the contribution is made for such plan within the period described in § 412(c)(10). For the plan year following the plan year in which the merger occurs, the minimum funding standard and the deductible limit are determined for the plan after the merger by following the procedures set forth in paragraphs (8), (9), (10), (11) and (12) above as if the merger occurred on the first day of such following plan year.

Section 4. Clarification and Modification of Rev. Proc. 95–51

.01 Section 4.05(5) of Rev. Proc. 95–51 (Approval for Change in Valuation Software) is modified to read as follows:

(5) The net charge to the funding standard account for the year (or for the prior year) determined using the new software does not differ from the net charge to the funding standard determined using the old soft-

ware (all other factors being held constant) by more than two percent (2%).

.02 Section 6.01(2) of Rev. Proc. 95–51 is modified to read as follows:

(2) This revenue procedure does not apply unless the plan administrator (within the meaning of § 414(g)) or an authorized representative of the plan sponsor indicates as part of the series Form 5500 for the plan year for which the change is effective that the plan administrator or plan sponsor agrees to the change in funding method. In the case of a special approval for a change in funding method described in § 4, other than the approval described in § 4.03 (Approval for Change in Funding Method for Fully Funded Terminated Plans), the requirement that the plan administrator or authorized representative of the plan sponsor agree to the change will be satisfied if the plan administrator or an authorized representative of the plan sponsor is made aware of the change before the Schedule B is filed.

.03 Section 6.02(6) of Rev. Proc. 95–51 (Non-Applicability if Negative Normal Cost or Negative Unfunded Liability Results From the Change) is modified to read as follows:

Approval to change to a method described in section 3 does not apply if, after the change in method, a negative normal cost exists. Also, approval to change to a method described in section 3 does not apply if, after the change in method, a negative unfunded liability exists, and the method (a) is a spread gain method, and (b) uses an unfunded liability in determining the normal cost. For purposes of the preceding sentence, a spread gain method is any method that does not directly calculate an accrued liability. See Rev. Rul. 81-13 for whether a funding method directly calculates an accrued liability.

.04 Section 6.02(7) of Rev. Proc. 95–51 (Non-Applicability if Change in Method is Being Made Pursuant to a Spin-off or Merger) is modified to read as follows:

Approval to change to a method described in section 3 does not apply if the funding method for a plan year is being changed in connection with a plan spin-off or merger, unless the change is made as provided in § 4.06 or § 4.07.

Section 5. Effective Date

This revenue procedure is effective for plan years commencing on or after January 1, 1999.

Section 6. Effect on Other Revenue Procedures

Rev. Proc. 95–51, as clarified and modified by Rev. Proc. 98–10, is modified.

Section 7. Drafting Information

The principal author of this revenue procedure is James E. Holland, Jr. of the Employee Plans Division. For further information regarding this revenue procedure, call (202) 622-6076 between 2:30 and 3:30 Eastern time (not a toll free number) Monday through Thursday. Mr. Holland's number is (202) 622-6730 (also not a toll free number).

Publication 1239 (Rev. 8–99)
Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips Magnetically/Electronically

Rev. Proc. 99–46

Reprinted from IR Bulletin 1999–49
dated December 6, 1999

(Contains copies of Forms 4419, 4804, 4802, 8508 and 8809 for taxpayers' use.)

NOTE: Use this revenue procedure to prepare Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, for submission to Internal Revenue Service (IRS) using any of the following:

- Magnetic Tape
- 3 ½-inch Diskette
- Tape Cartridges
- 8mm, 4mm and Quarter Inch Cartridges (QIC)
- Electronic Filing

Please read this publication carefully. Persons required to file may be subject to penalties if they do not follow the instructions in this revenue procedure.

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26 CFR 601.602: Tax forms and instructions.

PART A. GENERAL

SEC. 1. PURPOSE

.01 Form 8027 is used by large food or beverage establishments when the employer is required to make annual reports to the IRS on receipts from food or beverage operations and tips reported by employees.

Note: All employees receiving $20.00 or more a month in tips must report 100% of their tips to their employer

.02 The Internal Revenue Service Martinsburg Computing Center (IRS/MCC) has the responsibility of processing Forms 8027 submitted magnetically/electronically. The purpose of this revenue procedure is to provide the specifications for filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, magnetically or electronically. This revenue procedure is updated when legislative changes occur or reporting procedures are modified. Major changes have been emphasized by italics.

.03 This revenue procedure supersedes the following: Rev. Proc. 98–52 published as Publication 1239 (9–98), Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically.

SEC. 2. NATURE OF CHANGES

.01 Numerous editorial changes have been made to the revenue procedure. Please read the publication carefully and in its entirety before attempting to prepare your magnetic/electronic file for submission. Major changes have been emphasized by using italics. The changes are as follows:

(a) Updated information on IRS/MCC's mailing addresses, telephone numbers and the Call Site is provided in Part A, Sec. 3.

(b) Part A, Sec. 7 Test Files has been deleted.

(c) The due date for Forms 8027 filed ***electronically*** has been changed to March 31.

(d) Copies of approved extension letters should be sent with paper filings to Andover Service Center. See Part A, Sec. 9 for complete instructions.

(e) The Information Reporting Program-Bulletin Board System (IRP-BBS) is no longer in use. The information in Part B, Sec. 6 Asynchronous (IRP-BBS) electronic filing specifications has been completely revised to provide instructions on the new electronic filing system known as the Filing Information Returns Electronically (FIRE) system.

(f) The new number for the electronic filing system is 304-262-2400

(g) The following types of media are no longer acceptable by IRS/MCC:

(1) 5 ¼ inch diskettes

(2) 3 ½ inch diskettes created on a non-MS-DOS systems

(3) 3 ½ inch diskettes created on a System 36 or AS400.

(h) The following QIC (quarter inch cartridge) sizes has been deleted from Part B, Section 5:

Size	Tracks	Density	Capacity
QIC-11	4/5	4 (8000 BPI)	22Mb or 30Mb
QIC-320	26	17 (16000 BPI)	320Mb
QIC-1350	30	18 (51667 BPI)	1.3Gb

SEC. 3. WHERE TO FILE AND HOW TO CONTACT THE IRS MARTINSBURG COMPUTING CENTER

.01 All Forms 8027 filed magnetically or electronically are processed at IRS/MCC and are to be sent to the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
230 Murall Dr
Kearneysville WV 25430

.02 Requests for paper forms and publications should be requested by calling the "Forms Only Number" listed in your local telephone directory or by calling the IRS toll-free number **1-800-TAX-FORM (1-800-829-3676).**

.03 Questions pertaining to magnetic media filing of Forms W-2 **must** be directed to the Social Security Administration (SSA). Filers can call *1-800-SSA-6270* to obtain the phone number of the SSA Employer Services Liaison Officers for their area.

.04 A taxpayer or authorized representative may request a copy of a tax return or a Form W-2 filed with a return by submitting Form 4506, Request for Copy or Transcript of Tax Form, to IRS. This form may be obtained by calling **1-800-TAX-FORM (1-800-829-3676).**

.05 The Information Reporting Program (IRP) Call Site, located at the Martinsburg Computing Center, provides service to the payer/employer community (financial institutions, employers, and other transmitters of information returns). The IRP Call Site answers questions concerning tax law and magnetic/electronic filing of Forms 8027 and other information returns (Forms 1096, 1098, 1099, 5498, W-2G, W-3, 1042-S), questionable Forms W-4, inquiries dealing with backup withholding due to missing and incorrect taxpayer identification numbers and questions concerning paper filing of Forms W-2. Recipients of information returns (payees) should continue to contact 1-800-829-1040 or other numbers specified in the tax return instructions with any questions on how to report tax returns.

The Call Site accepts calls from all areas of the country. The number to call is **304-263-8700** or Telecommunications Device for the Deaf **(TDD) 304-267-3367.** These are toll calls. Hours of operation for the Call Site are Monday through Friday, 8:30 a.m. to 4:30 p.m. Eastern Time. The Call Site is in operation throughout the year to handle the questions of payers, transmitters, and employers. Due to the high demand for assistance at the end of January and February, it is advisable to call as soon as possible to avoid these peak filing seasons.

.06 The telephone numbers for magnetic media inquiries or electronic submissions are:

304-263-8700 - Call Site
304-262-2400 - Electronic Filing
304-267-3367 - TDD (Telecommunication Device for the Deaf)
304-264-5602 - Fax Machine
(These are not toll-free telephone numbers.)

TO OBTAIN FORMS & PUBLICATIONS, CALL:
1-800-TAX-FORM(1-800-829-3676)

TO OBTAIN FORMS & PUBLICATIONS VIA THE INTERNET:
www.irs.gov

SEC. 4. FILING REQUIREMENTS

.01 Section 6011(e)(2)(A) of the Internal Revenue Code requires that any person, including corporations, partnerships, individuals, estates, and trusts, required to file 250 or more information returns must file such returns on magnetic media.

.02 The filing requirements apply separately to both original and corrected returns.

.03 Filing electronically through the FIRE system with IRS/MCC fulfills the magnetic media filing requirement.

.04 The above requirements do not apply if you establish undue hardship (see Part A, Sec. 5).

SEC. 5. REQUEST FOR WAIVER FROM FILING INFORMATION RETURNS ON MAGNETIC MEDIA

.01 If an employer is required to file on magnetic media but fails to do so (or fails to file electronically, in lieu of magnetic media filing) and does not have an approved waiver on record, the employer will be subject to a penalty of $50 per return in excess of 250.

.02 If employers are required to file original or corrected returns on magnetic media, but such filing would create a hardship, they may request a waiver from these filing requirements by submitting Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media, to IRS/MCC.

.03 Even though an employer may submit as many as 250 corrections on paper, IRS encourages magnetically or electronically submitted corrections. Once the 250 threshold has been met, filers are required to submit any additional returns magnetically or electronically. However, if a waiver for an original filing is approved, any corrections for the same type of returns will be covered under this waiver.

.04 Generally, only the employer may sign the Form 8508. A transmitter may sign if given power of attorney; however, a letter signed by the employer stating this fact must be attached to the Form 8508.

.05 A transmitter must submit a separate Form 8508 for each employer. Do not submit a list of employers.

.06 All information requested on the Form 8508 must be provided to IRS for the request to be processed.

.07 The waiver, if approved, will provide exemption from magnetic media filing for the current tax year only. Employers may not apply for a waiver for more than one tax year at a time; application must be made each year a waiver is necessary.

.08 Form 8508 may be photocopied or computer-generated as long as it contains all the information requested on the original form.

.09 Filers are encouraged to submit Form 8508 to IRS/MCC at least 45 days before the due date of the returns.

.10 **File Form 8508 for Forms W-2 with IRS/MCC, not SSA.**

.11 Waivers are evaluated on a casebycase basis and are approved or denied based on criteria set forth under section 6011(e) of the Internal Revenue Code. The transmitter must allow a minimum of 30 days for IRS/MCC to respond to a waiver request.

.12 If a waiver request is approved, the transmitter should keep the approval letter on file.

.13 An approved waiver from filing Forms 8027 on magnetic media does not provide exemption from all filing. The employer must timely file Form 8027 on acceptable paper forms with the Andover Service Center. ***The transmitter should also send a copy of the approved waiver to the Andover Service Center where the paper returns are filed.***

SEC. 6. APPLICATION FOR MAGNETIC/ELECTRONIC 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/electronic file and/or sending the file to IRS/MCC. The employer and the transmitter may be the same entity. Employers or their transmitters are required to complete Form 4419, Application for Filing Information Returns Magnetically/Electronically.

.02 Form 4419 can be submitted at any time during the year; however, it should be submitted to IRS/MCC at least 30 days before the due date of the return(s). IRS will act on an application and notify the applicant, in writing, of authorization to file. A five-character alpha/numeric Transmitter Control Code (TCC) will be assigned and included in an acknowledgment letter within 15 to 45 days of receipt of the application. Magnetic/electronic returns may not be filed with IRS until the application has been approved and a TCC assigned. Include your TCC in any correspondence with IRS/MCC.

.03 If you file information returns other than Form 8027 on magnetic media, you must obtain a separate TCC for those types of returns. The TCC assigned for Forms 8027 is to be used for the processing of these forms only.

.04 Upon approval, a magnetic media reporting package containing the current revenue procedure, forms, and instructions will be sent to the attention of the contact person indicated on Form 4419. Annually, thereafter, IRS/MCC will send the transmitter a package containing the current revenue procedure and forms. This package will continue to be sent to the contact person indicated on the Form 4419 unless IRS/MCC has been notified in writing of any changes or updates. After you have received approval to file magnetically/electronically, you do not need to reapply each year; however, notify IRS in writing if:

(a) You change your name or the name of your organization, so that your files may be updated to reflect the proper name;

(b) You discontinue filing on magnetic media for two years (your TCC may have been reassigned).

.05 For filers who plan to submit for multiple employers, IRS encourages transmitters to submit one application and to use one TCC for all employers.

.06 Only employers or transmitters using equipment compatible with IRS equipment will have their application approved.

.07 If your magnetic media files have been prepared for you in the past by a transmitter, and you now have computer equipment compatible with that of IRS and wish to prepare your own files, you must request your own five-character alpha/numeric TCC by filing an application, Form 4419, as described in Sec. 6.02.

SEC. 7. FILING OF FORM 8027 MAGNETICALLY/ELECTRONICALLY

.01 Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically, must accompany **all** magnetic media shipments. If you file for multiple employers and have the authority to sign the affidavit on Form 4804, you should also submit Form 4802, Transmittal of Information Returns Reported Magnetically/Electronically (Continuation). For electronic transmissions, the Form 4804 and Form 4802, if applicable, must be mailed or faxed the same day as the electronic transmission.

.02 The employer **MUST** sign Form 4804; however, an agent (transmitter, service bureau, paying agent, or disbursing agent) may sign Form 4804 for the employer. To do this, the agent must have the authority to sign for the employer under an agency agreement (either oral, written, or implied) that is valid under the state law and must add to his or her signature the caption "For: (name of employer)".

NOTE: Failure to sign the Form 4804 may delay processing or will result in your file being returned to you unprocessed.

.03 Although a duly authorized agent may sign the Form 4804, the employer is responsible for the accuracy of the Form 4804 and the returns filed. The employer will be liable for penalties for failure to comply with filing requirements.

.04 Be sure to include Form 4804, 4802 or computer-generated substitutes with your magnetic media shipment. **DO NOT MAIL YOUR MAGNETIC MEDIA AND THE TRANSMITTAL DOCUMENTS SEPARATELY.**

.05 Indicate on Form 4804, in the block captioned "Combined Total Payee Records," the total number of establishments being reported in this shipment. This figure should match the total number of records in your magnetic/electronic file.

.06 **DO NOT SUBMIT THE SAME INFORMATION ON PAPER FORMS THAT YOU SUBMIT MAGNETICALLY/ ELECTRONICALLY.** This does not mean that corrected documents are not to be filed. If a return has been prepared and submitted improperly, you must file a corrected return as soon as possible. Refer to Part A, Sec. 12 for requirements and instructions for filing corrected returns.

.07 If an allocation of tips is based on a good faith agreement, a copy of this agreement must accompany the submission.

.08 If, under Rev. Proc. 86–21, 1986–1 C.B. 560, the District Director granted the establishment a percentage of gross receipts of less than 8%, a copy of the determination letter must be sent with the submission. Employers with more than one establishment can receive approval from one district in each Internal Revenue Service region where the establishments are located (See sec. 31.6053–3(h)(4) of the Employment Tax Regulations).

.09 Before submitting your magnetic/electronic file, include the following:

(a) A **signed** Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically, along with a Form 4802, Transmittal of Information Returns Reported Magnetically/Electronically(Continuation), if you submit data for multiple employers. These forms must be mailed or faxed the same day electronic files are submitted.

(b) Your media (tape, diskette, or cartridge) with an external identifying label. Notice 210 describes the information which should be included on this self-prepared label.

(c) On the outside of the shipping container, affix the label, IRB Special Projects. This label is included in this publication.

Note: See Part B, Sec. 6 for electronic submission requirements.

.10 IRS/MCC will not pay or accept "Collect on Delivery" or "Charged to IRS" shipments of reportable tax information that an individual or organization is legally required to submit.

SEC. 8. FILING DATES

.01 Magnetic/electronic reporting to IRS for Form 8027 must be on a calendar year basis. The due date of either paper or magnetically reported Forms 8027 is the last day of February. *However, Forms 8027 filed* ***electronically*** *are due March 31.*

.02 If the due date falls on a Saturday, Sunday, or legal holiday, filing Form 8027 on the next day that is not a Saturday, Sunday, or legal holiday will be considered timely.

SEC. 9. EXTENSIONS OF TIME TO FILE

.01 An extension of time to file may be requested for Forms 8027, 1099, 1098, 5498, W-2G, W-2, and 1042-S.

.02 Form 8809, Request for Extension of Time To File Information Returns, should be submitted to IRS/MCC. This form may be used to request an extension of time to file information returns submitted on paper, magnetically or electronically.

.03 Requesting an extension of time for multiple employers may be done by submitting Form 8809 and attaching a list of the employer names and their TINs (EIN or SSN). **The listing must be attached to ensure the extension is recorded for all employers.** Form 8809 may be computer-generated or photocopied. Be sure that all the pertinent information is included.

.04 Requests for extensions of time for multiple employers will be responded to with one approval letter, accompanied by a list of employers covered under that approval.

.05 **As soon as it is apparent** that an extension of time to file is needed, Form 8809 may be submitted. When granted, the extension will be for 30 days. It will take a minimum of 30 days for IRS/MCC to respond to an extension request. Under certain circumstances, a request for an extension of time could be denied. When a denial letter is received, any additional or necessary information may be resubmitted within 20 days. When requesting an extension of time, **do not** hold your files waiting for a response.

.06 While very difficult to obtain, if an additional extension of time is needed, a second Form 8809 must be submitted before the end of the initial extension period. Line 7 on the form should be checked to indicate that an additional extension is being requested. A second 30-day extension will be approved only in cases of extreme hardship or catastrophic events.

.07 **Form 8809 must be** postmarked no later than the due date of the return for which an extension is requested. If requesting an extension of time to file several types of forms, use one Form 8809, but the Form 8809 must be postmarked no later than the earliest due date. For example, if requesting an extension of time to file both Forms 8027 and 5498, submit Form 8809 postmarked on or before the last day of February.

.08 If an extension request is approved, the approval letter should be kept on file. The approval letter or copy of the approval letter for extension of time should **not** be sent to IRS/MCC with the magnetic/electronic file. *When submitting Form 8027 on* ***paper only*** *to the Andover Service Center, attach a copy of the approval letter. If an approval letter has not been received, send a copy of the timely filed Form 8809.*

.09 Request an extension for only one tax year.

.10 The extension request must be signed by the employer or a person who is duly authorized to sign a return, statement or other document for the employer.

.11 Failure to properly complete and sign the Form 8809 may cause delays in processing the request or result in a denial. Carefully read and follow the instructions on the back of the Form 8809.

.12 Form 8809 may be obtained by calling **1-800-TAX-FORM (1-800-829-3676).**

Note: AN EXTENSION OF TIME TO FILE IS NOT AN EXTENSION TO ISSUE FORM W-2 COPY "A" TO THE EMPLOYEE.

.13 Request an extension of time to furnish the statements to recipients of Forms W-2 by submitting a letter to IRS/MCC containing the following information:

(a) Employer name
(b) TIN
(c) Address
(d) Type of return (W-2)
(e) Specify that the extension request is to provide W-2 statements to recipients.
(f) Reason for delay
(g) Signature of employer or person duly authorized.

Requests for an extension of time to furnish the statements for Forms W-2 to recipients are not automatically approved; however, if approved, generally an extension will allow a maximum of 30 additional days from the due date to furnish the statements to the recipients. The request must be postmarked no later than the date on which the statements are due to the recipients.

SEC. 10. PROCESSING OF MAGNETIC/ELECTRONIC RETURNS

.01 All data received at IRS/MCC for processing will be given the same protection as individual returns (Form 1040). IRS/MCC will process your magnetic/electronic files to ensure the records were formatted and coded according to this revenue procedure.

.02 If the data is formatted incorrectly, the file will be returned for replacement accompanied by a letter of explanation along with a Media Tracking Slip (Form 9267). When media is returned, it is because IRS/MCC encountered errors (not limited to format) and was unable to process the media; therefore, requiring a replacement. Open all packages immediately.

.03 Files must be corrected and returned with the Media Tracking Slip (Form 9267) to IRS/MCC within 45 days from the date of the letter IRS/MCC included with the returned media. A penalty for failure to file correct information returns by the due date will be assessed if the file is not corrected and returned within the 45 days **or if the incorrect file is returned by IRS/MCC for replacement more than two times.** A penalty for intentional disregard of filing requirements will be assessed if a replacement file is not received.

.04 Files will not be returned to you after successful processing. Therefore, if you want proof that IRS/MCC received your shipment, you may use a carrier that provides proof of delivery.

.05 To distinguish between a correction and a replacement, the following definitions are provided:

(a) A **correction** is a record submitted by the employer/transmitter to correct a record that was successfully processed by IRS, but contained erroneous information.

(b) A **replacement** is a file that IRS has returned because of format errors or data discrepancies encountered during processing. After necessary changes have been made, the file must be returned to IRS/MCC for processing.

SEC. 11. PENALTIES

.01 The Revenue Reconciliation Act of 1989 changed the penalty provisions for any documents, including corrections, which are filed after the original filing date for the return. The penalty for failure to file correct information returns is "time sensitive," in that prompt correction of failures to file, or prompt correction of errors on returns that were filed, can lead to reduced penalties.

— The penalty generally is $50 for each information return that is not filed, or is not filed correctly, by the prescribed filing date, with a maximum penalty of $250,000 per year ($100,000 for certain small businesses with average annual gross receipts, over the most recent 3-year period, not in excess of $5,000,000). The penalty generally is reduced to:

— $30 for each failure to comply if the failure is corrected more than 30 days after the return was due, but on or before August 1 of the calendar year in which the return was due, with a maximum penalty of $150,000 per year ($50,000 for certain small businesses with average annual gross receipts, over the most recent 3-year period, not in excess of $5,000,000).

— $15 for each failure to comply if the failure is corrected within 30 days after the date the return was due, with a maximum penalty of $75,000 per year ($25,000 for certain small businesses with average annual gross receipts, over the most recent 3-year period, not in excess of $5,000,000).

.02 Penalties can be waived if failures were due to reasonable cause and not to willful neglect. In addition, section 6721(c) of the Code provides a de minimis rule that if:

(a) information returns have been filed but were filed with incomplete or incorrect information, and

(b) the failures are corrected on or before August 1 of the calendar year in which the returns were due, then the penalty for filing incorrect returns (but not the penalty for filing late) will not apply to the greater of 10 returns or one-half of 1 percent of the total number of information returns you are required to file for the calendar year.

.03 **Intentional Disregard of Filing Requirements** — If any failure to file a correct information return is due to intentional disregard of the filing and correct information requirements, the penalty is at least $100 per information return with no maximum penalty.

SEC. 12. CORRECTED RETURNS, SUBSTITUTE FORMS, AND COMPUTERGENERATED FORMS

.01 If returns must be corrected, approved magnetic/electronic filers must provide such corrections magnetically/electronically if you have 250 or more. If your information is filed magnetically/electronically, corrected returns are identified by using the "Corrected 8027 Indicator" in field position 370 of the employer record. Form 4804 must accompany the shipment, and the box for correction should be marked in Block 1 of the form. (See Part A, Sec. 10.05 for the definition of corrections.)

.02 If corrections are not submitted on magnetic media, employers must submit them on official Forms 8027. Substitute forms that have been previously approved by IRS, or computergenerated forms that are exact facsimiles of the official form (except for minor page size or print style deviations), may be submitted without obtaining IRS approval before using the form.

.03 Employers/establishments may send corrected paper Forms 8027 to IRS at the address shown in Part A, Sec. 13.01. Corrected paper returns are identified by marking the "AMENDED" check box on Form 8027.

SEC. 13. EFFECT ON PAPER RETURNS

.01 If you are filing more than one paper Form 8027, you must attach a completed Form 8027T, Transmittal of Employer's Annual Information Return of Tip Income and Allocated Tips, to the Forms 8027 and send to:

Internal Revenue Service Center
Andover, MA 05501

IRS/MCC processes Forms 8027 submitted magnetically/electronically only. Do not send paper Forms 8027 to IRS/MCC.

.02 If part of a submission is filed magnetically/electronically and the rest of the submission is filed on paper Forms 8027, send the paper forms to the Andover Service Center. For example, you filed your Forms 8027 magnetically/electronically with IRS/MCC, and later you found that some of the forms you filed need correcting. Because of the low volume of corrections, you submit the corrections on paper Forms 8027. You must send these corrected Forms 8027 along with Form 8027-T to the Andover Service Center.

SEC. 14. DEFINITIONS

ELEMENT	DESCRIPTION
EIN	A nine-digit Employer Identification Number which has been assigned by IRS to the reporting entity.
Employer	The organization supplying their information.
Establishment	A large food or beverage establishment that provides food or beverage for consumption on the premises; where tipping is a customary practice; and where there are normally more than 10 employees who work more than 80 hours on a typical business day during the preceding calendar year.
More than 10 employees	An employer is considered to have more than 10 employees on a typical business day during the calendar year if half the sum of: the average number of employee hours worked per business day in the calendar month in which the aggregate gross receipts from food and beverage operations were greatest, **plus** the average number of employee hours worked per business day in the calendar month in which the total aggregate gross receipts from food and beverage operations were the least, **equals** more than 80 hours.
Employees hours worked	The average number of employee hours worked per business day during a month is figured by dividing the total hours worked during the month by all your employees who are employed in a food or beverage operation by the average number of days in the month that each food or beverage operation at which these employees worked was open for business.
File	For the purpose of this revenue procedure, a file consists of all magnetic/electronic records submitted by an Employer or Transmitter.
Transmitter	Person or organization preparing magnetic/electronic file(s). May be Employer or agent of Employer.
Transmitter Control Code (TCC)	A five-character alpha/numeric code assigned by IRS to the transmitter prior to actual filing magnetically/electronically. This number is inserted in the record and must be present. An application (Form 4419) must be filed with IRS to receive this number.
Replacement	A replacement is an information return that IRS/MCC has returned to the transmitter due to errors encountered during processing.
Correction	A correction is an information return submitted by the transmitter to correct an information return that was previously submitted to and processed by IRS/MCC, but contained erroneous information.

PART B. MAGNETIC/ELECTRONIC SPECIFICATIONS

SEC. 1. GENERAL

.01 The magnetic/electronic specifications contained in this part of the revenue procedure define the required format and contents of the records to be included in the file.

.02 A self-prepared media label must be affixed to each piece of media submitted for processing. Notice 210 provides instructions on how to complete a self-prepared media label.

.03 The record format in Part B, Sec. 7, applies to both magnetic and electronic files.

SEC. 2. TAPE SPECIFICATIONS

.01 In most instances, IRS/MCC can process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 9-track EBCDIC (Extended Binary Coded Decimal Interchange Code) with;
  (1) Odd Parity and
  (2) A density of 1600 or 6250 BPI.
  (3) If you use Unisys Series 1100, you must submit an interchange tape.

(b) 9-track ASCII (American Standard Coded Information Interchange) with;
  (1) Odd Parity and
  (2) A density of 1600 or 6250 BPI.

Please be consistent in the use of recording codes and density on your files. If files are generated in more than one recording code and/or density, multiple shipments would be appreciated.

.02 All compatible tape files must have the following characteristics:

(a) ½ inch mylar base, oxide coated; computer grade magnetic tape on reels 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).

.03 All records have a fixed record length of 372 positions.

.04 The tape record defined in this revenue procedure may be blocked or unblocked, subject to the following:

(a) All records except the header and trailer labels may be blocked.

(b) If records are blocked, the block can not exceed 32,736 tape positions. The block length must be evenly divisible by 372

(c) 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.** Padding a block with blanks will result in a short record, which will cause math computation errors. Your tape will then be returned for replacement.

.05 For the purposes of this revenue procedure, the following conventions must be used:

Header label:

(a) Transmitters may use standard headers provided they begin with 1HDR, HDR1, VOL1, or VOL2.

(b) Consists of a maximum of 80 positions.

(c) 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. IRS/MCC PREFERS STANDARD OR ANSI LABELED TAPES. IF YOU SUBMIT AN UNLABELED TAPE, THIS MUST BE INDICATED ON THE EXTERNAL LABEL AND ON THE FORM 4804 OR COMPUTERGENERATED SUBSTITUTE.

Trailer label:

(a) Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOV1, or EOV2.

(b) Consists of a maximum of 80 positions.

(c) 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.

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) May follow the header label and precede and/or follow the trailer label.

SEC. 3. DISKETTE SPECIFICATIONS

IRS/MCC has discontinued processing 5 ¼ inch diskettes. Filers who use 5 ¼ inch diskettes must now use another method of submitting information returns magnetically/electronically.

.01 To be compatible, a diskette file must meet the following specifications:

(a) 3 ½ inches in diameter.

(b) Data must be recorded in standard ASCII code.

(c) Records must be fixed length of 372 bytes.

(d) Delimiter character commas (,) must not be used.

(e) Positions 371 and 372 of each record have been reserved for carriage return/line feed (cr/lf) characters.

(f) Filename of ATMTAX must be used. Do not enter any other data in this field. If a file will consist of more than one diskette, the filename will contain a 3-digit extension. This extension will indicate the sequence of the diskette within the file. For example, the first diskette will be named ATMTAX.001, the second diskette will be ATMTAX.002, etc.

(g) A file may contain more than one diskette as long as the filename conventions are adhered to.

(h) Diskettes must meet one of the following specifications:

Capacity	Tracks	Sides/Density	Sector Size
1.44 mb	96tpi	hd	512
1.44 mb	135tpi	hd	512
1.2 mb	96tpi	hd	512

.02 IRS requires that 3 ½ inch diskettes be created using MS/DOS. *Diskettes created using other operating systems are not acceptable.*

.03 *Deviations from the prescribed format are not acceptable.*

SEC. 4. TAPE CARTRIDGE SPECIFICATIONS

.01 In most instances, IRS/MCC can process tape cartridges that meet the following specifications:

(a) Must be IBM 3480, 3490, 3490E, or AS400 compatible.

(b) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Tape cartridges must be ½-inch tape contained in plastic cartridges which are approximately 4-inches by 5-inches by 1-inch in dimension.

(2) Magnetic tape must be chromium dioxide particle based ½-inch tape.

(3) Cartridges must be 18-track or 36-track parallel (See **Note**).

(4) Cartridges must contain 37,871 CPI or 75,742 CPI (characters per inch).

(5) Mode must be full function.

(6) The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

(7) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used.

.02 The tape cartridge records defined in this revenue procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,736 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 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item b above). The block length must be evenly divisible by 372.

(d) Records may not span blocks.

.03 Tape cartridges may be labeled or unlabeled.

.04 For the purposes of this revenue procedure, the following must be used:

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

Note: Filers should indicate on the external media label and transmittal Form 4804 whether the cartridge is 36-track or 8-track.

SEC. 5. 8MM, 4MM, AND QUARTER INCH CARTRIDGE SPECIFICATIONS

.01 In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

(a) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics.

(b) Created from an AS400 operating system only.

(c) 8mm (.315-inch) tape cartridges must be 2 ½-inch by 3 ¾-inch.

(d) The 8mm tape cartridges must meet the following specifications:

Tracks	Density	Capacity
1	20 (43245 BPI)	2.5 Gb
1	21 (45434 BPI)	5 Gb

(e) Mode must be full function.

(f) Compressed data is not acceptable.

(g) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used. However, IRS/MCC encourages the use of EBCDIC. This information must appear on the external media label affixed to the cartridge.

(h) A file may consist of more than one cartridge, however, no more than 250,000 documents may be transmitted per file or per cartridge. The filename, for example; ATMTAX, will contain a three digit extension. The extension will indicate the sequence of the cartridge within the file 1 of 3, 2 of 3, and 3 of 3 and would appear in the header label ATMTAX.001, ATMTAX.002, and ATMTAX.003 on each cartridge of the file.

.02 The 8mm (.315-inch) tape cartridge records defined in this revenue procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,736 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; however, the last block of the file may be filled with 9's or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record must not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 372.

(d) Records must not span blocks.

(e) No more than 250,000 documents per cartridge and per file.

.03 Various COPY commands have been successful; however, the SAVE OBJECT COMMAND is not acceptable.

.04 For faster processing, IRS/MCC encourages transmitters to use header labeled cartridges. ATMTAX may be used as a suggested filename.

.05 For the purposes of this revenue procedure, the following must be used:

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

.06 IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but must end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

.07 4mm (.157-inch) cassettes are now acceptable with the following specifications:

(a) 4mm cassettes must be 2 ¼-inch by 3-inch.

(b) The tracks are 1 (one).

(c) The density is 19 (61000 BPI).

(d) The typical capacity is DDS (DAT data storage) at 1.3 Gb or 2 Gb, or DDS-2 at 4 Gb.

(e) The general specifications for 8mm cartridges will also apply to the 4mm cassettes.

.08 Various Quarter Inch Cartridges (QIC) (¼-inch) are also acceptable.

(a) QIC cartridges must be 4″ by 6″.

(b) QIC cartridges must meet the following specifications:

Size	Tracks	Density	Capacity
QIC-24	8/9	5 (8000 BPI)	45Mb or 60Mb
QIC-120	15	15 (10000 BPI)	120Mb or 200Mb
QIC-150	18	16 (10000 BPI)	150Mb or 250Mb
QIC-525	26	17 (16000 BPI)	525Mb
QIC-1000	30	21 (36000 BPI)	1Gb
QIC-2Gb	42	34 (40640 BPI)	2Gb

(c) The general specifications that apply to 8mm cartridges will also apply to QIC cartridges.

SEC. 6. ELECTRONIC FILING SPECIFICATIONS

01. *IRS/MCC is in the process of updating all of its hardware and software for electronic filing. As a result, effective October 31, 1999, the Information Reporting Program Bulletin Board System (IRP-BBS) and 3780 bisynchronous electronic filing systems will be discontinued. Starting November 1, 1999, users will be able to access the new electronic system via analog and ISDN BRI connections. Bisynchronous electronic filing will no longer be supported. The new system is designed to support the electronic filing of information returns only. The new telephone number for electronic filing is* ***1-304-262-2400.*** *Publications and forms will no longer be electronically available from MCC. Users needing the publications and forms that were formerly available on the IRP-BBS will need to download them from the IRS website at www.irs.gov or by calling 1-800-TAX-FORM (1-800-829-3676).*

.02 Electronic filing of Forms 8027, originals' replacements and corrections, is offered as an alternative to magnetic media (tape, tape cartridge, or diskette) or paper filing, but is not a requirement. Transmitters filing electronically will fulfill the magnetic media requirements for those payers who are required to file magnetically. It may also be used by payers who are under the filing threshold requirement, but would prefer to file their information returns this way. If the original file was sent magnetically, but was returned for replacement, the replacement may be transmitted electronically.

.03 The electronic filing of Forms 8027 is not affiliated with the Form 1040 electronic filing program. These two programs are totally independent, and filers must obtain separate approval to participate in each of them. All inquiries concerning the electronic filing of information returns should be directed to IRS/MCC. IRS/MCC personnel cannot answer questions or assist taxpayers in the filing of Form 1040 tax returns. Filers with questions of this nature will be directed to the Customer Service toll-free number (**1-800-829-1040**) for assistance.

.04 Filers participating in the electronic filing program for Forms 8027 will submit their returns to IRS/MCC electronically and not through magnetic media or paper filing. Files submitted in this manner must be in standard ASCII code.

.05 The format of the record is the same for electronically filed records as they are for 3 ½-inch diskettes, tapes, and tape cartridges and must be in standard ASCII code.

.06 Filers must obtain, or already have, a Transmitter Control Code (TCC) assigned to them prior to submitting their files electronically. (Filers who currently have a TCC for magnetic media filing do not have to request a second TCC for electronic filing.) Refer to Part A, Sec. 6, for information on how to obtain a TCC.

.07 Once a TCC is obtained, electronic filers assign their own passwords and do not need prior or special approval.

.08 With all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. *Passwords are user assigned at first logon and are up to 8 alpha/numerics, which are case sensitive.* However, if filers do forget their password, call **304-263-8700** for assistance.

Note: Passwords are case sensitive.

.09 Electronically filed Forms 8027 may be submitted to IRS/MCC 24 hours a day, 7 days a week. Technical assistance will be available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern Time by calling 304-263-8700.

.10 Do not transmit data electronically from January 1 through January 5. This will allow time for IRS/MCC to update its system to reflect current year changes.

.11 Data compression is encouraged when submitting Forms 8027 electronically. MCC has the ability to decompress files created using several popular software compression programs such as ARC, COMPRESS, LHARC, and PKZIP. The time required to transmit Forms 8027 electronically will vary depending on the modem speed and the type of data compression used, if any. **The time required to transmit a file can be reduced by as much as 85 percent by using software compression and hardware compression.** The following are actual transmission rates for Forms 1099 achieved in test uploads at MCC using compressed files. The actual transmission rates will vary depending on the modem speeds.

Transmission Speed in bps	1000 Records	10,000 Records	100,000 Records
19.2K	34 Sec.	6 Min.	60 Min.
56K	20 Sec.	3 ½ Min.	33 Min.
128K (ISDN)	8 Sec.	1 Min.	10 Min.

.12 Files submitted electronically will be assigned a unique filename by the FIRE system (users may name the file anything they choose from their end). The IRS assigned filename will consist of submission type [ORIG (original), CORR (correction), and REPL (replacement)], the filer's TCC, and a four digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your first original file for the calendar year and your TCC is 44444, the IRS assigned filename would be ORIG.44444.0001. ***Record the filename.*** *This information will be needed by MCC in order to identify the file if assistance is required and to complete Form 4804.*

.13 ***Filers are advised not to resubmit an entire file if records were omitted from the original transmission. This will result in duplicate filing. A new file should be sent consisting of the records that had not previously been submitted.***

.14 The results of the electronic transmission will be available in the (F)ile Status area of the electronic system within 2 weeks; however, no further processing will occur until the signed Form 4804 is received. The transmitter must mail or fax the signed Form 4804 the same day the electronic transmission is made. No return is considered filed until a Form 4804 is received by IRS/MCC.

.15 Form 4804 can be ordered by calling the IRS toll-free forms and publication order number **1-800-TAX-FORM, (1-800-829-3676)**, or it may be computer-generated. *It may also be obtained from the Internet at www.irs.gov.* If a filer chooses to computer-generate Form 4804, all of the information contained on the original form, including the affidavit, must also be contained on the computer-generated form. This form is also contained in the back of this publication.

.16 Forms 4804 may be mailed to the following address:

If by Postal Service, air or truck freight:
IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Electronic Filing Coordinator
230 Murall Drive
Kearneysville, WV 25430

Please indicate on the envelope the following message:
CONTAINS FORM 4804 INFORMATION – NO MAGNETIC MEDIA

.17 Contact the Electronic Filing System by dialing ***304-262-2400.*** *This number supports analog connections from 1200bps to 56Kbps or ISDN BRI 128Kbps connections. The system can be accessed via Dial-up network/web browser or a communications software package such as Hyperterminal, Procomm, PCAnywhere, etc. The Dial-up network/web browser will provide an Internet-like look without going through the Internet (point to point). If you do not have this capability, a text interface will be provided that can be accessed via typical communications software and will perform similar to the former IRP-BBS.*

.18 Due to the large number of communication products available, it is impossible to provide specific information on a particular software package or hardware configuration. Filers should contact their software or hardware supplier for assistance. Your browser will need to be capable of file uploads (i.e., Internet Explorer 4.0, Netscape Navigator 2.0 or higher). The following are some general instructions (many of these settings may already be set by default in your software):

(a) Dial-up network settings:

(1) Set dial-up server type to PPP

(2) Set network protocol to TCP/IP

(3) Enable software compression

(4) Enable PPP LCP extensions

(b) Browser settings:

(1) Set to receive "cookies"

(2) Enable JavaScript or Jscript

(3) Browser must be capable of file uploads (i.e. Internet Explorer 4.0, Netscape 2.0 or higher)

(4) Enter the URL Address of http://10.225.224.2

(c) Communications software settings should be:

- *No parity*
- *Eight data bits*
- *One stop bit*
- *Full duplex*

(d) Hardware features

(1) Enable hardware flow control

(2) Enable modem error control

(3) Enable modem compression

.19 The first time you log on to the electronic system, you will need to create a new account. After completing the registration information, you will be prompted for a user name and password. Passwords are assigned by the user at first logon and are up to 8 alpha/numerics which are case sensitive. Remember your ***exact*** *logon name and password for future reference. If you forget your logon name and/or password, call IRS/MCC at 304-263-8700 for assistance.*

.20 Once you are an established user, select the logon option and then you will be prompted for your logon name and password. Once you have entered this information, you will be at the Main Menu. Select one of the following options:

(a) Electronic Filing - this option will allow you to send your files and provide us with current mailing address information in case we need to send any correspondence.

(b) File Status - this option will display the results of your file transfer and will be posted in this area.

Common Problems Associated with Electronic Filing

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1. ***No Form 4804, Transmittal of Information Returns Reported Magnetically/Electronically.***

Even though you have sent your Forms 8027 electronically, you still need to fax or mail the Form 4804. See Part B, Sec. 6.16 for the mailing address. The fax number is 304-264-5602.

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2. ***Transmitter does not dial back to the electronic system to determine file acceptability.***

Within 2 weeks the results of your file transmission will be posted under the option called File Status. It is very important that you check this option because if your file is bad we must receive a replacement within 45 days.

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3. ***Transmitter compresses several files into one.***

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately and send 10 separate compressed files.

---

4. Transmitter sends a file and File Status indicates that the file is good, but the transmitter wants to send a replacement or correction file to replace the original/correction/replacement file.

Once a file has been transmitted, you cannot send a replacement file unless File Status indicates the file is bad. If you do not want us to process the file, you must first contact us at 304-263-8700 to see if this is a possibility.

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5. Transmitter sends an original file that is good, then sends a correction file for the entire file even though there are only a few changes.

The correction file, containing the proper coding, should only contain the records needing correction, not the entire file.

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6. File format is formatted as EBCDIC.

File must be standard ASCII code. All files submitted electronically must be in standard ASCII Code.

SEC. 7. RECORD FORMAT AND LAYOUT

FORM 8027 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
1	Establishment Type	1	**REQUIRED.** This 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.
2–6	Establishment Serial Numbers	5	**REQUIRED.** These five digit Serial Numbers are for identifying individual establishments of an employer reporting under the same EIN. The employer shall assign each establishment a unique number. **NUMERICS ONLY.**
7–46	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.**
47–86	Establishment Street Address	40	**REQUIRED.** Enter the mailing address of the establishment. Street address should include number, street, apartment or suite number (or P O Box if mail is not delivered to street address). Left justify and blank fill.

Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the address 210 N. Queen St., Suite #300 must be entered as 210 N Queen St Suite 300.

87–111	Establishment City	25	**REQUIRED.** Enter the city, town, or post office. Left justify and blank fill.

Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the city St. Louis must be entered as St Louis.

Field Position	Field Title	Length	Description and Remarks
112–113	Establishment State	2	**REQUIRED.** Enter state code of the establishment; must be one of the following:

STATE	CODE	STATE	CODE
Alabama	AL	Montana	MT
Alaska	AK	Nebraska	NE
Arizona	AZ	Nevada	NV
Arkansas	AR	New Hampshire	NH
California	CA	New Jersey	NJ
Colorado	CO	New Mexico	NM
Connecticut	CT	New York	NY
Delaware	DE	North Carolina	NC
District of Columbia	DC	North Dakota	ND
Florida	FL	Ohio	OH
Georgia	GA	Oklahoma	OK
Hawaii	HI	Oregon	OR
Idaho	ID	Pennsylvania	PA
Illinois	IL	Rhode Island	RI
Indiana	IN	South Carolina	SC
Iowa	IA	South Dakota	SD
Kansas	KS	Tennessee	TN
Kentucky	KY	Texas	TX
Louisiana	LA	Utah	UT
Maine	ME	Vermont	VT
Maryland	MD	Virginia	VA
Massachusetts	MA	Washington	WA
Michigan	MI	West Virginia	WV
Minnesota	MN	Wisconsin	WI
Mississippi	MS	Wyoming	WY
Missouri	MO		

114–122	Establishment ZIP Code	9	**REQUIRED.** Enter the complete nine-digit ZIP Code of the establishment. If using a five-digit ZIP Code, left justify the five-digit ZIP Code and fill the remaining four positions with blanks.

Note: MUST BE NINE NUMERICS OR FIVE NUMERICS AND FOUR BLANKS. DO NOT ENTER THE DASH.

123–131	Employer Identification Number	9	**REQUIRED.** Enter the nine-digit number assigned to the employer by IRS. DO **NOT ENTER HYPHENS, ALPHAS, ALL 9's, OR ALL ZEROS.**
132–171	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.**
172–211	Employer Street Address	40	**REQUIRED.** Enter mailing address of employer. Street address should include number, street, apartment or suite number (or P O Box if mail is not delivered to street address). Left justify and blank fill.

Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the address 210 N. Queen St., Suite #300 must be entered as 210 N Queen St Suite 300.

Field Position	Field Title	Length	Description and Remarks
212–236	Employer City	25	**REQUIRED.** Enter the city, town, or post office. Left justify and blank fill. **Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the city St. Louis must be entered as St Louis.**
237–238	Employer State	2	**REQUIRED.** Enter state code of employer. Must be one of the abbreviations shown in the state abbreviation table for Establishment State (field positions 112–113).
239–247	Employer ZIP Code	9	**REQUIRED.** Enter the complete nine-digit ZIP Code of the employer. If using a five-digit ZIP Code, left justify the five-digit ZIP Code and fill the remaining four positions with blanks. **Note: MUST BE NINE NUMERICS OR FIVE NUMERICS AND FOUR BLANKS. DO NOT ENTER THE DASH.**
248–259	Charged Tips	12	**REQUIRED.** Enter the total amount of tips that are shown on charge receipts for the calendar year. Amount must be entered in U.S. dollars and cents. The right most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT ENTER DECIMAL POINTS, DOLLAR SIGNS, OR COMMAS.**
260–271	Charged Receipts	12	**REQUIRED.** Enter the total sales for the calendar year other than carry-out sales or sales with an added service charge of 10 percent or more, that are on charge receipts with a charged tip shown. 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. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT INCLUDE DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
272–283	Service Charge Less Than 10 Percent	12	**REQUIRED.** Enter the total amount of service charges less than 10 percent added to customer's bills and were distributed to your employees for the calendar year. In general, service charges added to the bill are year. 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 Rev. Rul. 1928, 19691 C.B. 270. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
284–295	Indirect Tips Reported	12	**REQUIRED.** Enter the total amount of tips reported by indirectly tipped employees (e.g., busboys, service bartenders, cooks) for the calendar year. Do not include tips received by employees in December of the prior tax year but not reported until January. Include tips received by employees in December of the tax year being reported, but not reported until January of the subsequent year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**

Field Position	Field Title	Length	Description and Remarks
296–307	Direct Tips Reported	12	**REQUIRED.** Enter the total amount of tips reported by directly tipped employees (e.g., waiters, waitresses, bartenders) for the calendar year. Do not include tips received by employees in December of the prior tax year but not reported until January. Include tips received by employees in December of the tax year being reported, but not reported until January of the subsequent year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
308–319	Total Tips Reported	12	**REQUIRED.** Enter the total amount of tips reported by all employees (both indirectly tipped and directly tipped) for the calendar year. Do not include tips received in December of the prior tax year but not reported until January. Include tips received in December of the tax year being reported, but not reported until January of the subsequent year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
320–331	Gross Receipts	12	**REQUIRED.** Enter the total gross receipts from the provision of food and/or beverages for this establishment for the calendar year. Do not include receipts for carry-out sales or sales with an added service charge of 10 percent or more. Do not include in gross receipts charged tips (field positions 248–259) shown on charge receipts unless you have reduced the cash sales amount because you have paid cash to tipped employees for tips they earned that were charged. Do not include state or local taxes in gross receipts. If you do not charge separately for food or beverages along with other services (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 must reflect the cost of providing the food or beverages plus a reasonable profit factor. Include the retail value of complimentary food or beverages served to customers if tipping for them is customary and they are provided in connection with an activity engaged in for profit whose receipts would not be included as gross receipts from the provision of food or beverages (e.g., complimentary drinks served to customers at a gambling casino). Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. If no entry, zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
332–343	Tip Percentage Rate Times	12	**REQUIRED.** Enter the amount determined by multiplying Gross Receipts for the year (field positions 320–331) by the Tip Percentage Rate (field positions 344–347). For example, if the value of Gross Receipts is "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 calendar year, enter zeros; this may occur if you allocated tips based on the time period for which wages were paid or allocated on a quarterly basis. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
344–347	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/electronic submission. **NUMERICS ONLY. DO NOT ENTER DECIMAL POINT.**

FORM 8027 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
348–359	Allocated Tips	12	**REQUIRED.** If Tip Percentage Rate times Gross Receipts (field positions 332–343) is greater than Total Tips Reported (field positions 308–319), then the difference becomes Allocated Tips. Otherwise, enter all zeros. If tips are allocated using other than the calendar year, enter the amount of allocated tips from your records. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right justify and zero fill. **NUMERICS ONLY. DO NOT ENTER DOLLAR SIGNS, DECIMAL POINTS, OR COMMAS.**
360	Allocation Method	1	**REQUIRED.** Enter the allocation method used if Allocated Tips (field positions 348–359) are 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/electronic submission. If Allocated Tips are equal to zero, enter 0 (zero).

Note: Under Section 1571 of the Tax Reform Act of 1986, the method of allocation of tips based on the number of hours worked as described in Section 31.6053–3(f)(1)(iv) may be utilized only by an employer that employs less than the equivalent of 25 fulltime employees at the establishment during the payroll period. Section 31.6053–3(j)(19) provides that an employer is considered to employ less than the equivalent of 25 fulltime employees at an establishment during a payroll period if the average number of employee hours worked per business day during the payroll period is less than 200 hours.

361–364	Number of Directly Tipped Employees	4	**REQUIRED.** Enter the total number (must be greater than zero) of directly tipped employees employed by the establishment for the calendar year. Right justify and zero fill. **NUMERICS ONLY.**
365–369	Transmitter Control Code (TCC)	5	**REQUIRED.** Enter the 5-digit Transmitter Control Code assigned by the IRS.
370	Corrected 8027 Indicator	1	**REQUIRED.** Enter blank for original return. Enter "G" for corrected return. A corrected return must be a complete new return replacing the original return.
371–372	Blank or cr/lf	2	Magnetic/electronic filers are required to enter blanks. Diskette filers may enter blanks or the carriage line feed characters (cr/lf).

FORM 8027 RECORD LAYOUT

Establishment Type	Establishment Serial Number	Establishment Name	Establishment Street Address
1	2–6	7–46	47–86

Establishment City	Establishment State	Establishment ZIP Code	Employer Identification Number
87–111	112–113	114–122	123–131

FORM 8027 RECORD LAYOUT

Employer Name	Employer Street Address	Employer City	Employer State
132–171	172–211	212–236	237–238

Employer Zip Code	Charged Tips	Charged Receipts	Service Charge Less Than 10 Percent
239–247	248–259	260–271	272–283

Indirect Tips Reported	Direct Tips Reported	Total Tips Reported	Gross Receipts
284–295	296–307	308–319	320–331

Tip Percentage Rate Times Gross Receipts	Tip Percentage Rate	Allocated Tips	Allocation Method
332–343	344–347	348–359	360

Number of Directly Tipped Employees	Transmitter Control Code (TCC)	Corrected 8027 Indicator	Blank or cr/lf
361–364	365–369	370	371–372

SEC. 8. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 98–52 is superseded.

SEC. 9. EFFECTIVE DATE

.01 This revenue procedure is effective for Forms 8027 due the last day of February 2000 and any returns filed thereafter.

623

Publication 1245 (Rev. 10–99)
Specifications for Filing Form W-4, Employee's Withholding Allowance Certificate, Magnetically or Electronically

Rev. Proc. 99–47

Reprinted from IR Bulletin 1999–49
dated December 6, 1999

(Contains copies of Forms 4419, 6466, 6467, and notice 1027 for taxpayers' use.)

Rev. Proc. 99–47

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PART A. GENERAL

SEC. 1. PURPOSE

.01 The purpose of this revenue procedure is to update Rev. Proc. 98-26, March 30, 1998, (IRS Pub. 1245), which outlines the requirements and conditions for submitting certain Forms W4, Employee's Withholding Allowance Certificate, magnetically or electronically to the Internal Revenue Service (IRS), Martinsburg Computing Center (MCC).

.02 Revenue procedures are generally revised to reflect legislative and form changes. Comments concerning this revenue procedure or suggestions for making it more helpful can be addressed to Internal Revenue Service, Martinsburg Computing Center, ATTN: IRB Information Support Section, *230 Murall Dr, Kearneysville, WV 25430.*

.03 The following revenue procedures and publications provide more detailed filing procedures for certain information returns and can be obtained by contacting your local IRS office or by calling 1-800-829-3676:

(a) "Instructions for Forms 1099, 1098, 5498, and W-2G" provides specific instructions on completing and submitting information returns to IRS.
(b) Rev. Proc. 84–33, 1984–1 C.B. 502, regarding the optional method for agents to report and deposit backup withholding.
(c) Publication 1179, Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099 Series, 5498, and W-2G.

(d) Publication 1220, Specifications for Filing Form 1098, 1099, 5498, and W-2G Magnetically or Electronically.
(e) Publication 1239, Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically.
(f) Publication 1187, Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, Magnetically or Electronically

.04 Refer to Part A, Sec. 10, for definitions of terms used in this publication.

SEC. 2. NATURE OF CHANGES

In this publication, major changes have been emphasized by using italics. This has been done to assist filers in identifying new information. Filers are still advised to read the publication in its entirety.
The changes are as follows:

.01 EDITORIAL CHANGES

(a) Under Part A, Sec. 3, "WHERE TO FILE AND HOW TO CONTACT THE IRS, MARTINSBURG COMPUTING CENTER", the address is now 230 Murall Dr, Kearneysville, WV 24530.
(b) The Information Reporting Program-Bulletin Board System (IRP-BBS) is no longer in use. The information in Part B, Sec. 6 Asynchronous (IRP-BBS) electronic filing specifications has been completely revised to provide instructions for the Filing Information Returns Electronically (FIRE) system.
(c) The new number for the electronic filing system is 304-262-2400.
(d) The following types of media are no longer acceptable by IRS/MCC:
  (1) 5 ¼ inch diskettes;
  (2) 3 ½ inch diskettes created on a non-MS-DOS system;
  (3) 3 ½ inch diskettes created on a System 36 or AS400;
(e) The following QIC (quarter inch cartridge) sizes have been deleted from Part B, Sec. 5:

Size	Tracks	Density	Capacity
QIC-11	4/5	4(8000BPI)	22Mb or 30Mb
QIC-320	26	17(16000 BPI)	320Mb
QIC-1350	30	18(51667 BPI)	1.3Gb

.02 PROGRAMMING CHANGES

There are no programming changes for tax year 1999. Corrections to Rev. Proc. 98–26 printed in Internal Revenue Bulletin No. 1998–24, dated June 15, 1998, Announcement 98–48 have been incorporated into this revision.

SEC. 3. WHERE TO FILE AND HOW TO CONTACT THE IRS, MARTINSBURG COMPUTING CENTER

.01 All Forms W-4 filed magnetically or electronically are processed at IRS/MCC. Magnetic media containing Forms W-4 is to be sent to the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
230 Murall Dr
Kearneysville WV 25430

.02 Requests for paper forms and publications can be made by calling the "Forms Only Number" listed in your local telephone directory or by calling the IRS toll-free number **1-800-TAX-FORM (1-800-829-3676).**

.03 Questions pertaining to magnetic media/electronic filing of Forms W-2 must be directed to the Social Security Administration (SSA). Filers can call 1-800-SSA-6270 to obtain the phone number of the SSA Employer Service Liaison Officer for their area.

.04 A taxpayer or authorized representative may request a copy of a tax return or a Form W-2 filed with a return by submitting Form 4506, Request for Copy or Transcript of Tax Form, to IRS. This form may be obtained by **calling 1-800-TAX-FORM (1-800-829-3676).**

.05 The IRS/MCC Call Site, located in Kearneysville, WV, provides service to the payer/employer community (financial institutions, employers, and other transmitters of information returns). The IRS/MCC Call Site answers questions concerning tax law and the magnetic/electronic filing of questionable Forms W-4 as well as information returns (Forms 1096, 1098, 1099, 5498, 5498-MSA, 8027, W-2G, W-3, and 1042-S), inquiries dealing with backup withholding due to missing and incorrect taxpayer identification numbers and questions concerning paper filing of Forms W-2. Recipients of information returns (payees) should continue to contact 1-800-829-1040 or other numbers specified in the tax return instructions with any questions on how to report information returns.

The Call Site accepts calls from all areas of the country. The number to call is **304-263-8700** or Telecommunications Device for the **Deaf (TDD) 304-267-3367.** These are toll calls. The Call Site is in operation throughout the year to handle the questions of payers, transmitters, and employers. Due to the high demand for assistance at the end of January and February, it is advisable to call as soon as possible to avoid these peak filing seasons.

.06 Telephone inquiries may be made Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time. The telephone numbers for magnetic media/electronic inquiries or electronic submissions are:

304-263-8700 – Call Site
304-262-2400 – Electronic Filing
304-267-3367 – TDD (Telecommunication Device for the Deaf)
304-264-5602 – Fax Machine
(These are not toll-free telephone numbers.)

TO OBTAIN FORMS & PUBLICATIONS CALL:
1-800-TAX-FORM (1-800-829-3676)

TO OBTAIN FORMS & PUBLICATIONS INTERNET:
www.irs.gov

SEC. 4. FILING REQUIREMENTS

.01 Employers are required to send to IRS quarterly, copies of all Forms W-4 received during the quarter from employees still employed at the end of the quarter who claim the following:

(a) More than 10 withholding allowances, or

(b) Exempt status and are expected to earn more than $200 a week.

.02 Employers are not required to send other Forms W-4 unless notified by IRS in writing to do so.

.03 Employers may submit all information magnetically or electronically; or a combination of magnetic/electronic files and paper documents is acceptable, provided there are no duplications or omissions of documents. However, magnetic/electronic filing is preferred and strongly encouraged.

.04 A Form W-4 with a written statement attached from the employee must be filed on paper, not on magnetic media. If filing paper Forms W-4, the employer may send them in each quarter with paper Forms 941. If the employer submits the paper Forms W-4 at any time other than quarterly, a cover letter must be submitted giving the employer's name, address, employer identification number (EIN), and the number of Forms W-4 included.

NOTE: MCC DOES NOT PROCESS PAPER RETURNS. PAPER RETURNS MUST BE FILED WITH THE APPROPRIATE SERVICE CENTER. SEE FORM 941 INSTRUCTIONS FOR THE APPROPRIATE SERVICE CENTER.

SEC. 5. FORM 4419, APPLICATION FOR FILING INFORMATION RETURNS MAGNETICALLY/ ELECTRONICALLY

.01 Employers, or their transmitters, who wish to file magnetically or electronically, must submit a Form 4419, Application for Filing Information Returns Magnetically/Electronically. Instructions for its completion are on the reverse of the form.

.02 Magnetic/electronic files may not be filed with IRS/MCC until authorization to file is received. Requests will be approved or disapproved within 30 days of receipt.

.03 Only applications of employers or transmitters whose equipment meets the specifications in Part B, Sec. 2, 3, 4, 5 or 6 will be approved.

.04 Once authorization to file has been granted, a five-character alpha/numeric Transmitter Control Code (TCC) will be assigned. Approval will continue in effect in succeeding years provided the requirements of the current revenue procedure are met and there are no equipment changes by the employer or transmitter. Although a TCC may have already been assigned to a transmitter for the filing of information returns, the Form W-4 requires a separate TCC of its own. This TCC must appear on all transmittal forms submitted with magnetic/electronic files, as well as other correspondence. The TCC must also be coded into positions 319-323 of the Form W-4 record. (See Part B, Sec. 7.)

.05 New applications (Forms 4419) are required whenever

(a) You discontinue filing magnetically/electronically for two years, in which case your TCC may have been reassigned. You may call IRS/MCC to verify if your TCC is still valid.

(b) You have used a service agency in the past, and they had their own TCC, to prepare your files but you now have computer equipment compatible with that of IRS, in which case you must request your own TCC.

SEC. 6. FILING DUE DATES

.01 Magnetic/electronic reporting of Forms W-4 to IRS must be at least quarterly (monthly reporting is encouraged). The following are the quarter end dates:

Period Covered	Due Date
January 1 thru March 31	April 30
April 1 thru June 30	July 31
July 1 thru September 30	October 31
October 1 thru December 31	January 31

.02 If any due date falls on a Saturday, Sunday, or legal holiday, the Forms W-4 are considered timely if they are filed on the next day that is not a Saturday, Sunday, or legal holiday.

SEC. 7. FILING FORMS W-4 MAGNETICALLY/ELECTRONICALLY

.01 A Magnetic Media/Electronic Reporting Package which includes the current revenue procedure and the necessary transmittal forms will be mailed to approved filers each year.

.02 If the employer chooses to file magnetically/electronically, then a Form 6466, Transmittal of Forms W-4 Reported Magnetically/Electronically, must be sent to the IRS/MCC as prescribed in Part A, Sec. 3.

.03 Form 6466 MUST be signed by the employer or the transmitter, service bureau, paying agent, or disbursing agent (all hereafter referred to as agent), on behalf of the employer if the agent has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under state law and adds the caption "FOR: (name of employer)."

.04 Although a duly authorized agent signs the affidavit, the employer(s) is held responsible for the accuracy of the Forms W-4 filed magnetically or electronically.

.05 **DO NOT REPORT THE SAME INFORMATION ON PAPER DOCUMENTS THAT YOU REPORT MAGNETICALLY/ELECTRONICALLY.** If you report part of your returns on paper and part magnetically or electronically, be sure that duplicate returns are not included on both.

.06 Before submitting your magnetic/electronic file, include the following:

(a) A signed Form 6466, Transmittal of Forms W-4 Reported Magnetically/Electronically along with a Form 6467, Transmittal of Forms W-4 Reported Magnetically/Electronically(Continuation), if you submit data for multiple employers. These forms must be mailed or faxed the same day electronic files are submitted.

(b) Your media (tape, diskette, or cartridge) with an external identifying label. Notice 1027 describes the information which should be included on this self-prepared label.

(c) On the outside of the shipping container, affix the label IRB Special Projects. This label is included in the publication.

.07 IRS/MCC will not return filers' magnetic media after it has been successfully processed. Should filers wish to know if their media was received by IRS/MCC, a delivery service that provides certification of delivery is recommended.

.08 IRS cannot accept any Cash-On-Delivery (COD) or Charged-to-IRS shipments of reportable tax information that an individual or organization is legally required to file. Because of the high volume of data received and shipping cost involved, special shipping containers will not be returned.

.09 Use this record format and processing capabilities to file Forms W-4 submitted for the quarter ending March 31, 2000 and for all subsequent filings.

SEC. 8. REPLACEMENT FILES

THE MAGNETIC MEDIA/ELECTRONIC SPECIFICATIONS CONTAINED IN PART B OF THIS REVENUE PROCEDURE MUST BE STRICTLY ADHERED TO. If files are not processable, they will be returned to you for replacement and resubmission, or submission of paper Forms W-4. Replacement files must be resubmitted to IRS/MCC within 45 days of the date of the enclosed letter. The media should be identified as replacement data by writing, typing or printing "Magnetic Media Replacement" on the external label used on the magnetic media and marking the replacement box on the Form 6466. *If filing electronically, you should choose replacement when asked for the type of submission to identify a replacement file before transmission begins.*

SEC. 9. EFFECT ON PAPER DOCUMENTS

.01 Magnetic/electronic reporting to IRS eliminates the need to submit copies of paper Forms W-4.

.02 If part of the Forms W-4 are reported magnetically/electronically and the remainder are reported on paper forms, the paper Forms W-4 must be mailed to the appropriate service center.

SEC. 10. DEFINITION OF TERMS

Employer	Generally, an employer is a person or organization for whom a worker performs a service as an employee. The employer has the right to direct and control the worker. A person or organization paying wages to a former employee after the work ends is also considered an employer.
Employee	One who performs services for an employer.
EIN	Employer Identification Number that has been assigned by IRS.
File	For purposes of this procedure, a file consists of all magnetic/electronic records submitted by an employer or transmitter.
Special Character	Any character that is not a numeric, an alpha or a blank.
Taxpayer Identification Number (TIN)	May be either an Employer Identification Number (EIN); a Social Security Number (SSN); an IRS Individual Taxpayer Identification Number (ITIN) issued to an alien individual; or an IRS Adoption Taxpayer Identification Number(ATIN) assigned to children who are in the process of being adopted.
Transmitter	Person or organization preparing and/or submitting magnetic/electronic file(s).
Transmitter Control Code (TCC)	A five-character alpha/numeric number assigned by IRS to the transmitter prior to actual filing magnetically/electronically. This number is inserted in Positions 319–323 of your files and must be present before the file can be processed. An application Form 4419 must be filed with IRS to receive this number.

PART B. MAGNETIC MEDIA/ELECTRONIC SPECIFICATIONS

SEC. 1. GENERAL

.01 The specifications contained in this part of the revenue procedure define the required format and content of the records to be included in the magnetic/electronic file. Use this revenue procedure to file Forms W-4 submitted for the quarter ending March 31, 2000 and all subsequent filings.

.02 An external label must appear on each tape, tape cartridge and diskette submitted. Notice 1027 details what information must be on the label. The diskettes used must be MS/DOS compatible.

SEC. 2. TAPE SPECIFICATIONS

.01 IRS/MCC can process most magnetic tape files if the following specifications are followed:
- (a) 9-track EBCDIC (Extended Binary Coded Decimal Interchange Code) with
  - (1) Odd parity
  - (2) Recording density—1600 or 6250 BPI
  - (3) If you use UNISYS Series 1100, you must submit an interchange tape.
- (b) 9-track ASCII (American Standard Coded Information Interchange) with:
  - (1) Odd parity
  - (2) Recording density—1600 or 6250 BPI

.02 All tape files must have the following characteristics:
- (a) 0.5 inch (12.7 mm) wide computer grade magnetic tape,
- (b) Tape thickness: 1.0 or 1.5 mils,
- (c) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm) and
- (d) Reel of tape up to 2400 feet (731.52 m).

.03 All records, including Header and Trailer Labels (if used) must be transmitted using the same density.

.04 The tape records defined in this revenue procedure may be blocked subject to the following:
- (a) A block must not exceed 32,550 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; however, the last block of the file may be filled with 9's or truncated. **Do not pad a block with blanks.**
- (c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of log-

ical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 350.

(d) All data records are a fixed record length of 350 positions and may not span blocks.

.05 Labeled or unlabeled tapes may be submitted.

.06 For the purposes of this revenue procedure the following must be used:

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111(8421).

(c) May follow the header label and precede and/or follow the trailer label.

.07 Do not submit an employee Form W-4 record without the required employer identification information. Every record must contain both employee and employer data.

SEC. 3. 3 ½-INCH DISKETTE SPECIFICATIONS

.01 To be compatible, a diskette file must meet the following specifications:

(a) 3 ½-inches in diameter.

(b) Data must be recorded in standard ASCII code.

(c) Records must be a fixed length of 350 bytes per record.

(d) Delimiter character commas (,) must not be used.

(e) Positions 349 and 350 of each record have been reserved for carriage return/line feed (cr/lf) characters.

(f) Filename of QWFTAX must be used. Do not enter any other data in this field. The extension will indicate the sequence of the diskettes within the file. For example, the first diskette will be named QWFTAX.001, the second diskette will be QWFTAX.002, etc.

(g) A diskette file may consist of multiple diskettes as long as the file naming conventions are adhered to.

(h) Diskettes must meet one of the following specifications:

Capacity	Tracks	Sides/Density	Sector Size
1.44 mb	96tpi	hd	512
1.44 mb	135tpi	hd	512
1.2 mb	96tpi	hd	512

.02 3 ½-inch diskettes are only acceptable if they were created using MS/DOS.

SEC. 4. TAPE CARTRIDGE SPECIFICATIONS

.01 In most instances, IRS/MCC can process tape cartridges that meet the following specifications:

(a) Must be IBM 3480, 3490, 3490E, or AS400 compatible.

(b) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Tape cartridges will be ½-inch tape contained in plastic cartridges which are approximately 4-inches by 5-inches by 1-inch in dimension.

(2) Magnetic tape will be chromium dioxide particle based ½-inch tape.

(3) Cartridges must be 18-track or 36-track parallel (See **Note**).

(4) Cartridges will contain 37,871 CPI (characters per inch) or 75,742 CPI.

(5) Mode will be full function.

(6) The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

(7) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used.

.02 The tape cartridge records defined in this revenue procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,550 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 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks**.

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 350.

(d) Records may not span blocks.

.03 Tape cartridges may be labeled or unlabeled.

.04 For the purposes of this revenue procedure, the following must be used:

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111(8421).

(c) May follow the header label and precede and/or follow the trailer label.

Note: Filers should indicate on the external media label and transmittal Form 6466 whether the cartridge is 36-track or 18-track.

SEC. 5. 8MM, 4MM, AND QUARTER INCH CARTRIDGE SPECIFICATIONS

.01 In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

(a) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Created from an AS400 operating system only.

(2) 8mm (.315-inch) tape cartridges will be 2 ½-inch by 3 ¾-inch.

(3) The 8mm tape cartridges must meet the following specifications:

Tracks	Density	Capacity
1	20 (43245 BPI)	2.3 Gb
1	21 (45434 BPI)	5 Gb

(4) Mode will be full function.

(5) Compressed data is not acceptable.

(6) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used. However, IRS/MCC encourages the use of EBCDIC. This information must appear on the external media label affixed to the cartridge.

.02 The 8mm (.315-inch) tape cartridge records defined in this revenue procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,550 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; however, the last block of the file may be filled with 9's or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 350.

(d) Various COPY commands have been successful, however, the SAVE OBJECT COMMAND is not acceptable.

(e) Records may not span blocks.

.03 For faster processing, IRS/MCC encourages transmitters to use header labeled cartridges. QWFTAX may be used as a suggested filename.

.04 For the purposes of this revenue procedure, the following must be used:

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111(8421).

(c) May follow the header label and precede and/or follow the trailer label.

.05 IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but must end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

.06 4mm (.157-inch) cassettes are acceptable with the following specifications:

(a) 4mm cassettes will be 2 ¼-inch by 3-inch.

(b) The tracks are 1 (one).

(c) The density is 19 (61000 BPI).

(d) The typical capacity is DDS (DAT data storage) at 1.3 Gb or 2 Gb, or DDS-2 at 4Gb.

(e) The general specifications for 8mm cartridges will also apply to the 4mm cassettes.

.07 Various Quarter Inch Cartridges (QIC) (¼-inch) are also acceptable.

(a) QIC cartridges will be 4" by 6".

(b) QIC cartridges must meet the following specifications:

Size	Tracks	Density	Capacity
QIC-24	8/9	5 (8000 BPI)	45Mb or 60Mb
QIC-120	15	15 (10000 BPI)	120Mb or 200Mb
QIC-150	18	16 (10000 BPI)	150Mb or 250Mb
QIC-525	26	17 (16000 BPI)	525Mb
QIC-1000	30	21 (36000 BPI)	1Gb
QIC-2Gb	42	34 (40640 BPI)	2Gb

SEC. 6. ELECTRONIC FILING SPECIFICATIONS

01. IRS/MCC is in the process of updating all of its hardware and software for electronic filing. Effective October 31, 1999, the Information Reporting Program Bulletin Board System (IRP-BBS) electronic filing system will be discontinued. Starting November 1, 1999, users will be able to access the new electronic system via analog and ISDN BRI connections. The new system is designed to support the electronic filing of information returns only. The new telephone number for electronic filing is ***(1-304-262-2400).*** *Publications and forms will no longer be electronically available from MCC. Users needing the publications and forms that were formerly available on the IRP-BBS will need to download them from the IRS website at www.irs.gov or by calling 1-800-TAX-FORM (1-800-829-3676).*

.02 Electronic filing of Form W-4 originals and replacements is offered as an alternative to magnetic media (tape, tape cartridge, or diskette) or paper filing, *but is not a requirement.* If the original file was sent magnetically, but was returned for replacement, the replacement may be transmitted electronically.

.03 The electronic filing of Forms W-4 is not affiliated with the Form 1040 electronic filing program. These two programs are totally independent, and filers must obtain separate approval to participate in each of them. All inquiries concerning the electronic filing of information returns should be directed to IRS/MCC. IRS/MCC personnel cannot answer questions or assist taxpayers in the filing of Form 1040 tax returns. Filers with questions of this nature will be directed to the Customer Service toll-free number (**1-800-829-1040**) for assistance.

.04 Filers participating in the electronic filing program for Forms W-4 will submit their returns to IRS/MCC electronically and not through magnetic media or paper filing. Files submitted in this manner must be in standard ASCII code.

.05 The format of the record is the same for electronically filed records as they are for 3 ½-inch diskettes, tapes, and tape cartridges and must be in standard ASCII code.

.06 Filers must obtain, or already have, a Transmitter Control Code (TCC) assigned to them prior to submitting their files electronically. (Filers who currently have a TCC for magnetic media filing of Forms W-4 do not have to request a second TCC for electronic filing.) Refer to Part A, Sec. 5, for information on how to obtain a TCC.

.07 Once a TCC is obtained, electronic filers assign their own passwords and do not need prior or special approval.

.08 With all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. Passwords are user assigned at first logon and are up to 8 alpha/numerics, which are case sensitive. However, if filers do forget their password, call **304-263-8700** for assistance.

Note: Passwords are case sensitive.

.09 Electronically filed Forms W-4 may be submitted to IRS/MCC 24 hours a day, 7 days a week. Technical assistance will be available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern Time by calling 304-263-8700.

.10 ***Do not transmit data electronically from January 1 through January 5.*** *This will allow time for IRS/MCC to update their system to reflect current year changes.*

.11 Data compression is encouraged when submitting Forms W-4 electronically. MCC has the ability to decompress files created using several popular software compression programs such as ARC, COMPRESS, LHARC, and PKZIP. The time required to transmit Forms W-4 electronically will vary depending on the modem speed and the type of data compression used, if any. ***The time required to transmit a file can be reduced by as much as 85 percent by using software compression and hardware compression.*** *The following are actual transmission rates achieved in test uploads of 1099 information at MCC using compressed files. The actual transmission rates will vary depending on the modem speeds.*

Transmission Speed in bps	*1000 Records*	*10,000 Records*	*100,000 Records*
19.2K	*34 Sec.*	*6 Min.*	*60 Min.*
56K	*20 Sec.*	*3 ½ Min.*	*33 Min.*
128K (ISDN)	*8 Sec.*	*1 Min.*	*10 Min.*

.11 Files submitted electronically will be assigned a unique filename by the IRS system (the user can name the file anything they choose from their end). The IRS assigned filename will consist of the filers TCC, the submission type [ORIG (original), and REPL (replacement)], and a four digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your first original file for the calendar year and your TCC is 44444, the IRS assigned filename would be ORIG.44444.0001. Record the filename. This information will be needed by MCC in order to identify the file, if assistance is required, and to complete Form 6466.

.12 ***Filers are advised not to resubmit an entire file if records were omitted from the original transmission. This will result in duplicate filing. A new file should be sent consisting of the records that had not previously been submitted.***

.13 The results of the electronic transmission will be available in the File Status area of the electronic system within two weeks; however, no further processing will occur until the signed Form 6466 is received. The transmitter must mail or fax the signed Form 6466 the same day the electronic transmission is made. No return is considered filed until a Form 6466 is received by IRS/MCC.

.14 Form 6466 can be ordered by calling the IRS toll-free forms and publications order number 1-800-TAX-FORM, (1-800-829-3676), or it may be computer-generated. *It may also be obtained from the Internet at www.irs.gov.* If a filer chooses to computer-generate Form 6466, all of the information contained on the original form, including the affidavit, must also be contained on the computer-generated form.

.15 Forms 6466 may be mailed to the following address:

If by Postal Service, air or truck freight:
IRS-Martinsburg Computing Center
Information Reporting Program
Attn: Electronic Filing Coordinator
230 Murall Drive
Kearneysville, WV 25430

Please indicate on the envelope the following message:
CONTAINS FORM 6466 INFORMATION - NO MAGNETIC MEDIA

.16 Contact the Electronic Filing System by dialing ***304-262-2400.*** *This number supports analog connections from 1200bps to 56Kbps or ISDN BRI 128Kbps connections. The system can be accessed via Dial-up network/web browser or a communications software package such as Hyperterminal, Procomm, PCAnywhere, etc. The Dial-up network/web browser will provide an Internet-like look without going through the Internet (point to point). If you do not have this capability, a text interface will be provided that can be accessed via typical communications software and will perform similar to the former IRP-BBS.*

.17 Due to the large number of communication products available, it is impossible to provide specific information on a particular software package or hardware configuration. Filers should contact their software or hardware supplier for assistance. Your browser will need to be capable of file uploads (i.e., Internet Explorer 4.0, Netscape Navigator 2.0 or higher). The following are some general instructions (many of these settings may already be set by default in your software):

(a) Dial-up network settings:
(1) Set dial-up server type to PPP
(2) Set network protocol to TCP/IP
(3) Enable software compression
(4) Enable PPP LCP extensions

(b) Browser settings:
(1) Set to receive "cookies"
(2) Enable JavaScript or Jscript
(3) Browser must be capable of file uploads (i.e. Internet Explorer 4.0, Netscape 2.0 or higher)
(4) Enter the URL Address of http://10.225.224.2

(c) Communications software settings should be:
– No parity
– Eight data bits
– One stop bit
– Full duplex

(d) Hardware features
(1) Enable hardware flow control
(2) Enable modem error control
(3) Enable modem compression

.18 The first time you log on to the electronic system, you will need to create a new account. After completing the registration information, you will be prompted for a user name and password. Passwords are assigned by the user at first logon and are up to 8 alpha/numerics which are case sensitive. Remember your ***exact*** *logon name and password for future reference. If you forget your logon name and/or password, call IRS/MCC at 304-263-8700 for assistance.*

.19 Once you are an established user, select the logon option and then you will be prompted for your logon name and password. Once you have entered this information, you will be at the Main Menu. Select one of the following options:

(a) Electronic Filing - this option will allow you to send your files and provide us with current mailing address information in case we need to send any correspondence.

(b) File Status - this option will display the results of your file transfer and will be posted in this area within 2 weeks.

Common Problems Associated with Electronic Filing

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1. No Form 6466, Transmittal of Forms W-4 Reported Magnetically/Electronically.

Even though you have sent your Forms W-4 electronically, you still need to fax or mail the Form 6466. See Part B, Sec. 6.15 for the mailing address. The fax number is 304-264-5602.

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2. Transmitter does not dial back to the electronic system to determine file acceptability.

Within 2 weeks the results of your file transmission will be posted under the option called File Status. It is very important that you check this option because if your file is bad we must receive a replacement within 45 days.

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3. Transmitter compresses several files into one.

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately and send 10 separate compressed files.

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4. Transmitter sends a file and File Status indicates that the file is good, but the transmitter wants to send a replacement file to replace the original/replacement file.

Once a file has been transmitted, you cannot send a replacement file unless File Status indicates the file is bad. If you do not want us to process the file, you must first contact us at 304-263-8700 to see if this is a possibility.

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5. File format is formatted as EBCDIC.

All files submitted electronically must be in standard ASCII Code.

SEC. 7. FORM W-4 RECORD FORMAT AND RECORD LAYOUT

.01 This record is used to identify the employer, the employee, number of allowances, and other information that is reported on the paper Form W-4.

.02 ALL RECORDS MUST BE A FIXED LENGTH OF 350 POSITIONS.

.03 Do not begin any record at the end of a block or diskette and continue the same record into the next block or diskette.

FORM W-4 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
1–9	Employee Tax Identification Number (TIN)	9	**REQUIRED.** Enter the 9-digit TIN assigned to the employee. DO NOT ENTER HYPHENS or ALPHA CHARACTERS. All zeroes, ones, twos, etc. will have the effect of an incorrect TIN.
10–44	Employee Name Line 1	35	**REQUIRED.** Enter the name of the employee whose TIN appears in field positions 1-9. Enter the 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 the field.) If fewer than 35 characters are used, left-justify and fill unused positions with blanks.

(1) A blank must be surrounded by alphas or continued to the end of the field (e.g., ab...b, aba).
(2) A hyphen in the first position is to identify an employee with surname only. Hyphens must be surrounded by alphas or numerics and must never occur in the first position of a name unless immediately followed by a caret.
(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<MD).

Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. A minimum of one and a maximum of two carets (<) can be used. Punctuation, such as, periods and commas are not allowed and will cause your file to be returned.

45–79	Employee Name Line 2	35	Optional. This line is designated for an "in care of" (c/o) situation. Left-justify and fill unused positions with blanks. Hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).

Note: The same exceptions apply as set forth in "Employee Name Line 1"; also the use of a percent sign (%) is not valid—use c/o if necessary.

80–114	Employee Street Address	35	**REQUIRED.** Enter mailing address of employee. Street address should include number, street, apartment or suite number (or P O Box if mail is not delivered to street address). Left-justify and fill unused positions with blanks. Position 80 must be an alpha or numeric; hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).

Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the address 210 N. Queen St., Suite #300 must be entered as 210 N Queen St Suite 300.

115–139	Employee City	25	**REQUIRED.** Enter the city, town or post office. If a foreign address, see Note 2. Leftjustify and fill unused positions with blanks. Enter APO or FPO, if applicable. Do not enter state and ZIP Code information in this field. Position 115 must be an alpha or numeric; hyphens must be surrounded by alphas or numerics; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).

Note 1: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the city St. Louis must be entered as St Louis.

Note 2: For foreign addresses, you may use the 25 position Employee City field to provide the following information: city and country name.

140–141	Employee State	2	**REQUIRED.** Enter the two character location code of employee address; must be one of the following:

Note: For foreign addresses, enter XX from table below.

Location	Code	Location	Code	Location	Code
Alabama	AL	Kentucky	KY	Ohio	OH
Alaska	AK	Louisiana	LA	Oklahoma	OK
American Samoa	AS	Maine	ME	Oregon	OR
Arizona	AZ	Marshall Islands	MH	Pennsylvania	PA
Arkansas	AR	Maryland	MD	Puerto Rico	PR
California	CA	Massachusetts	MA	Rhode Island	RI
Colorado	CO	Michigan	MI	South Carolina	SC

Field Position	Field Title	Length	Description and Remarks

Location	Code	Location	Code	Location	Code
Connecticut	CT	Minnesota	MN	South Dakota	SD
Delaware	DE	Mississippi	MS	Tennessee	TN
District of Columbia	DC	Missouri	MO	Texas	TX
Federated States of Micronesia	FM	Montana	MT	Utah	UT
Florida	FL	Nebraska	NE	Vermont	VT
Georgia	GA	Nevada	NV	Virginia	VA
Guam	GU	New Hampshire	NH	Virgin Islands	VI
Hawaii	HI	New Jersey	NJ	Washington	WA
Idaho	ID	New Mexico	NM	West Virginia	WV
Illinois	IL	New York	NY	Wisconsin	WI
Indiana	IN	North Carolina	NC	Wyoming	WY
Iowa	IA	North Dakota	ND	Foreign Address, All Others	XX
Kansas	KS	Northern Mariana Islands	MP		

142–150	Employee ZIP Code	9	**REQUIRED.** Enter the valid nine-digit ZIP Code of employee. **IF YOU ONLY HAVE FIVE (5) DIGITS AVAILABLE, LEFT-JUSTIFY AND ZERO FILL.** Blank fill only if the employee's ZIP Code is unavailable.
151	Marital Status	1	**REQUIRED.** Enter appropriate code from the table below: Marital Status Designated — Code Single — S Married — M Married, withhold at single rate — W No marital status designated — A
152	Exempt Status	1	**REQUIRED.** Enter "E" if employee claims exempt status; otherwise, enter blank.
153	BLANK	1	Enter Blank.
154–156	Allowances	3	**REQUIRED.** Must be a three (3) digit numeric field corresponding to the number of allowances claimed by employee. (It is necessary to file this Form W-4 with IRS if the number of allowances is more than ten (10) or exempt status is claimed.) Field must be right justified and zero filled. If no entry, or employee claimed exempt status, enter blanks.
157–163	Additional Amount	7	**REQUIRED.** Enter any additional amount of withholding the employee wants deducted from each pay. Amount must be entered in U.S. dollars and cents. The rightmost two positions represent cents. Do not enter dollar signs, commas, decimal points, or negative numbers. Right-justify and zero fill. If no entry, zero fill.
164–169	BLANK	6	Enter Blanks.

Field Position	Field Title	Length	Description and Remarks
170–178	Employer Identification Number	9	**REQUIRED.** The 9-digit EIN assigned to the employer. DO NOT ENTER HYPHENS, ALPHA CHARACTERS. All zeroes, ones, twos, etc. will have the effect of an incorrect TIN.
179–213	Employer Name Line 1	35	**REQUIRED.** Enter the name of the employer as it appears on employment tax forms (e.g., Form 941). Any extraneous information must be deleted from this name line. Left-justify and fill with blanks. Position 179 must be alpha or numeric; hyphens and slashes must be surrounded by alphas or numerics; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).
			Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation, such as periods and commas, are not allowed and will cause your file to be returned.
214–247	Employer Name Line 2	34	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. Position 214 must be alpha or numeric; hyphens must be surrounded by alphas or numerics; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).
			Note: The same exceptions apply as set forth in "Employer Name Line 1"; also, the use of a percent sign (%) is not valid—use c/o if necessary.
248–282	Employer Street	35	**REQUIRED.** Enter mailing address of employer. Street address should include number, street, apartment or suite number (or P O Box if mail is not delivered to street address). Left-justify and fill unused positions with blanks. Position 248 must be alpha or numeric; hyphens must be surrounded by alphas or numerics; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).
			Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the address 210 N. Queen St., Suite #300 must be entered as 210 N Queen St Suite 300.
283–307	Employer City	25	**REQUIRED.** Enter the city, town or post office. Enter APO or FPO if applicable. Do not enter state and ZIP Code information in this field. Position 283 must be alpha or numerics; hyphens must be surrounded by alphas or numerics; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., ab...b, aba).
			Note: The only allowable characters are alphas, blanks, numerics, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the city St. Louis must be entered as St Louis.
308–309	Employer State Code	2	**REQUIRED.** Enter location code of employer. Must use abbreviation shown in the location abbreviation table for Employee Location Code (field positions 140–141).
310–318	Employer ZIP Code	9	**REQUIRED.** Enter the valid nine digit ZIP Code of employer. **IF YOU ONLY HAVE FIVE (5) DIGITS AVAILABLE, LEFT-JUSTIFY AND ZERO FILL.** Blank fill only if employer's ZIP Code is unavailable.
319–323	Transmitter Control Code	5	**REQUIRED.** Enter 5-character Transmitter Control Code (TCC) assigned by IRS/MCC.

FORM W-4 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
324–331	Form W-4 Date	8	**REQUIRED.** Enter date located on signature line Form W-4. If no date entered, generate current system date. Format as YYYYMMDD (e.g.19981231). Exempt Status Form W-4 compare "year effective date" on Line 7 to signature date. If year entered on Line 7 is later than signature date, use Form W-4 date as a 01/01 receipt for subsequent calendar year (e.g., Line 7 of Form W-4 shows an exempt status date of 2000 but signature date is 19991031, use 20000101 as Form W-4 date.)
332–348	BLANK	17	Enter Blanks.
349–350	BLANK	2	Enter blanks, or carriage return/line feed (CR/LF) characters.

FORM W-4 RECORD LAYOUT

Employee Tax Identification Number	Employee Name Line 1	Employee Name Line 2	Employee Street Address	Employee City
1–9	10–44	45–79	80–114	115–139

Employee State	Employee ZIP Code	Marital Status	Exempt Status	BLANK	Allowances
140–141	142–150	151	152	153	154–156

Additional Amount	BLANK	Employer Identification Number	Employer Name Line 1	Employer Name Line 2
157–163	164–169	170–178	179–213	214–247

Employer Street	Employer City	Employer State Code	Employer ZIP Code	Transmitter Control Code
248–282	283–307	308–309	310–318	319–323

Form W-4 Date	BLANK	BLANK or CR/LF
324–331	332–348	349–350

SEC. 8. EFFECT ON OTHER DOCUMENTS

Revenue Procedure 98–24, Publication 1245 (Rev. 3–98), is superseded.

SEC. 9. EFFECTIVE DATE

Use the record length and processing capabilities of this revenue procedure to file Forms W-4 submitted for the quarter ending March 31, 2000 and for all subsequent filings.

Limitations on Benefits and Contributions under Qualified Plans; Cost-of-Living Adjustments for 2000[1]

Notice 99–55

Section 415 of the Internal Revenue Code (the Code) provides for dollar limitations on benefits and contributions under qualified retirement plans. Section 415 also requires that the Commissioner annually adjust these limits for cost-of-living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments.

Effective January 1, 2000, the limitation for the annual benefit under § 415(b)(1)(A) for a defined benefit plan is increased from $130,000 to $135,000. For participants who separated from service before January 1, 2000, the limitation for defined benefit plans under § 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 1999 by 1.0235. The limitation for defined contribution plans under § 415(c)(1)(A) remains unchanged at $30,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of § 415(b)(1)(A) is adjusted. These dollar amounts and the adjusted amounts are as follows:

The limitation under § 402(g)(1) on the exclusion for elective deferrals described in § 402(g)(3) is increased from $10,000 to $10,500.

The dollar amount under § 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period is increased from $735,000 to $755,000, while the dollar amount used to determine the lengthening of the 5-year distribution period is increased from $145,000 to $150,000.

The limitation used in the definition of a highly compensated employee under § 414(q)(1)(B) is increased from $80,000 to $85,000.

The annual compensation limit under §§ 401(a)(17) and 404(l) is increased from $160,000 to $170,000. The annual compensation limit under § 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan under § 401(a)(17) to be taken into account, is increased from $270,000 to $275,000.

The compensation amount under § 408(k)(2)(C) regarding simplified employee pension plans (SEPs) is increased from $400 to $450. The compensation amount under § 408(k)(3)(C) for SEPs is increased from $160,000 to $170,000.

The limitation under § 408(p)(2)(A) regarding simple retirement accounts remains unchanged at $6,000.

The limitation on deferrals under § 457(b)(2) and (c)(1) concerning eligible deferred compensation plans of state and local governments and of tax-exempt organizations remains unchanged at $8,000.

The compensation amounts under § 1.61–21(f)(5)(i) and (iii) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes are increased from $70,000 and $145,000, respectively, to $75,000 and $150,000, respectively.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

[1] Based on News Release IR-1999-80, dated October 19, 1999.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Generation-Skipping Transfer Issues

REG-103841-99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the application of the effective date rules of the generation-skipping transfer (GST) tax imposed under chapter 13 of the Internal Revenue Code. The proposed regulations provide guidance with respect to the type of trust modifications that will not affect the exempt status of a trust. In addition, the proposed regulations clarify the application of the effective date rules in the case of property transferred pursuant to the exercise of a general power of appointment. The proposed regulations are necessary to provide guidance to taxpayers so that they may properly determine if chapter 13 of the Code is applicable to a particular trust.

DATES: Written and electronic comments must be received by February 16, 2000. Outlines of topics to be discussed at the public hearing scheduled for March 15, 2000 at 10:00, must be received by February 23, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–103841–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–103841–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.gov/tax regs/reglist.html. The public hearing will be held in room 2615, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, James F. Hogan, (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Michael L. Slaughter, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The GST tax provisions were enacted as part of the Tax Reform Act of 1986 (TRA), Pub. L. 99–514, 1986–3 (Vol. 1) C.B. 1, 634. Under section 1433(a) of the TRA, the GST tax generally applies to all generation-skipping transfers made after October 22, 1986, the date the TRA was enacted.

Section 1433(b)(2) of the TRA exempts transfers from certain trusts from the GST tax. Hereinafter, a trust that is exempt under section 1433(b)(2) is referred to as an "exempt trust."

First, under section 1433(b)(2)(A) of the TRA, the GST tax does not apply to any transfer from a trust that was irrevocable on September 25, 1985, to the extent the transfer is not made out of additions to the trust after September 25, 1985 (the day before the House Ways and Means Committee began considering the bill containing the GST provisions). Under §26.2601–1(b)(1)(ii) of the Generation-skipping Transfer Tax Regulations, a trust created on or before September 25, 1985, is considered irrevocable on that date unless: (1) the settlor retained a power that would cause the trust to be included in the settlor's gross estate for federal estate tax purposes by reason of section 2038 of the Code, if the settlor had died on September 25, 1985; or (2) the property held in the trust is a life insurance policy transferred by the insured and the insured possessed, on September 25, 1985, any incident of ownership that would have caused the value of the trust to be included in the insured's gross estate under section 2042 of the Code if the insured had died on September 25, 1985.

Second, under section 1433(b)(2)(B) of the TRA, as amended by the Technical and Miscellaneous Revenue Act of 1988, the GST tax does not apply to any generation-skipping transfer under a will or revocable trust executed before October 22, 1986, if the decedent died before January 1, 1987.

Third, under section 1433(b)(2)(C) of the TRA, the GST tax does not apply to any generation-skipping transfer under a trust to the extent such trust consists of property included in the gross estate of a decedent or reinvestments thereof, but only if the decedent was, on October 22, 1986, under a mental disability to change the disposition of the decedent's property and did not regain competence to dispose of the property before death.

Numerous taxpayers have requested private letter rulings regarding the effect that a proposed modification or construction will have on an exempt trust for GST tax purposes. In rulings in this area, the IRS has held that a modification will not cause the trust to lose its exempt status if the modification does not result in any change in the quality, value, or timing of any beneficial interest under the trust. Although the statute does not specifically address modifications to trusts that are exempt under section 1433(b)(2) of the TRA, Treasury and the IRS believe that a trust that is modified such that none of the beneficial interests change can be viewed as the same trust that was in existence on September 25, 1985.

The majority of the ruling requests received by the Service concern proposed modifications intended to enable the trust to adapt to changed circumstances or to enable the trustee to administer the trust properly. These proposed modifications often are not inconsistent with the purpose of the TRA effective date provisions. Accordingly, as discussed below, these proposed regulations adopt a more liberal standard with respect to changes that may be made to the trust without the loss of exempt status. Treasury and the IRS intend that the regulations, when finalized, provide sufficient guidance concerning modifications that the need for private letter rulings will be greatly diminished. Comments are requested regarding whether the proposed regulations will achieve this result.

In addition, the proposed regulations clarify the application of the effective date provisions when the exercise or lapse of a general power of appointment over an otherwise grandfathered trust results in property passing to a skip person.

Explanation of Provisions

1. *Modifications to Trusts*

The proposed regulations provide guidance regarding the types of modifications, constructions, and settlements of controversies that will not cause a trust to lose its exempt status. However, the rules contained in these proposed regulations apply only for GST tax purposes. Thus, the rules do not apply in determining, for example, whether a modification will result in a gift for gift tax purposes, or may cause inclusion of the trust assets in the gross estate, or may result in the realization of gain for purposes of section 1001 of the Code.

Under the proposed regulations, a court order in a construction proceeding that resolves an ambiguity in the terms of a trust instrument will not cause the trust to lose its exempt status. The judicial action, however, must involve a bona fide issue and the court's decision must be consistent with applicable state law that would be applied by the highest court of the state. *Commissioner v. Estate of Bosch,* 387 U.S. 456 (1967). Construction proceedings determine a settlor's intent as of the date the instrument became effective, and thus, a court order construing an instrument that satisfies these requirements does not alter or modify the terms of the instrument.

Similarly, under the proposed regulations, a court-approved settlement of a bona fide controversy relating to the administration of a trust or the construction of terms of the governing instrument of a trust will not cause a trust to lose its exempt status. This will be the case, however, only if the settlement is the product of arm's length negotiations, and the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. *See Ahmanson Foundation v. United States,* 674 F.2d 761 (9th Cir. 1981); *Estate of Suzuki v. Commissioner,* T.C. Memo. 1991–624. For example, *A* and *B* are the sole remainder beneficiaries of a trust established by their parent. They disagree as to the portion of the remainder each is entitled to under the terms of the trust when the trust terminates. A settlement dividing the corpus equally among *A*, *B*, and *C*, *B*'s child and the grandchild of the parent who established the trust, would not be considered within the range of reasonable outcomes because *C* is not a potential remainderman under any construction of the trust agreement.

The proposed regulations also address the situation in which a trustee distributes trust principal to a new trust for the benefit of succeeding generations. In some cases, the governing instrument grants the trustee broad discretionary powers to distribute principal to or for the benefit of the trust beneficiaries, outright or in trust. Under these circumstances, distributions by the trustee to trusts for the benefit of trust beneficiaries will not cause the original trust or the new trusts to lose exempt status provided the vesting of trust principal is not postponed beyond the perpetuities period applicable to the original trust.

Finally, under the proposed regulations, a trust may be modified and remain exempt for GST purposes. The modification, however, must not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification and must not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

2. *Exercise of a General Power of Appointment after September 25, 1985.*

In *Simpson v. United States,* 183 F.3d 812 (8th Cir. 1999), the decedent exercised a testamentary general power of appointment granted under a marital trust that was created in 1966. Pursuant to the decedent's exercise of the general power of appointment, the property passed to her grandchildren who were skip persons under section 2612. The court concluded that the transfer to the grandchildren was exempt from the GST tax under section 1433(b)(2)(A) of the TRA, because the transfer was "under a trust" that was irrevocable on September 25, 1985.

The facts in Simpson are similar to those presented in *Peterson Marital Trust v. Commissioner,* 78 F.3d 795 (2nd Cir. 1996). In *Peterson,* the decedent had a testamentary general power to appoint property in a pre-September 25, 1985 marital trust created under her husband's will. Rather than appointing the property outright, the taxpayer allowed the power to lapse and the property passed to her husband's grandchildren, who were skip persons under section 2612. The court concluded that the transfer was subject to the GST tax. The court noted that the effective date provisions in section 1433(b)(2) of the TRA were "designed . . . to protect those taxpayers who, on the basis of pre-existing rules, made arrangements from which they could not reasonably escape and which, in retrospect, had become singularly undesirable." *Peterson Marital Trust,* at 801 (footnote omitted). The court concluded that there was no basis to apply the protection provided in section 1433(b)(2) to the marital trust because the arrangement could have been changed to avoid the GST tax through the exercise of the decedent's general power of appointment.

Treasury and the IRS believe that there is no substantive difference between the situation in *Simpson* where property passed pursuant to the exercise of a general power of appointment and the situation in *Peterson Marital Trust* where property passed pursuant to a lapse of a general power of appointment. An individual who has a general power of appointment has the equivalent of outright ownership in the property. *Estate of Kruz v. Commissioner,* 101 T.C. 44, 50-51, 59-60 (1993). The value of the property subject to the general power is includible in the powerholder's gross estate at death under section 2041(a). In either case, the powerholder can avoid the consequences of the GST tax by appointing the property to nonskip persons. Therefore, as the court noted in *Peterson Marital Trust,* there is no basis for exempting such dispositions from the GST tax under the TRA effective date provisions.

Accordingly, the proposed regulations clarify that the transfer of property pursuant to the exercise, release, or lapse of a general power of appointment created in a pre-September 25, 1985 trust is not a transfer under the trust, but rather is a

transfer by the powerholder occurring when the exercise, release, or lapse of the power becomes effective, for purposes of section 1433(b)(2)(A) of the TRA.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the regulations will be submitted to the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely (in the manner described in ADDRESSES) to the IRS. Treasury and the IRS specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 15, 2000 at 10:00 a.m. in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit comments by February 16, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by February 23, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is James F. Hogan, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 26— GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Par. 1. The authority citation for part 26 continues to read in part as follows:

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

Par. 2. In §26.2600–1 the Table is amended under §26.2601 by revising the entry for paragraphs (b) and (b)(4) and adding an entry for paragraph (b)(5) to read as follows:

§26.2600–1. Table of contents.

§26.2601–1. *Effective dates.*

* * * * *

(b) Exceptions

* * * * *

(4) Retention of trust's exempt status in the case of modifications, etc.

(5) Exceptions to additions rule.

* * * * *

Par. 3. Section 26.2601–1 is amended as follows:

1. Adding four sentences to the end of paragraph (b)(1)(i).

2. Redesignating paragraph (b)(4) as paragraph (b)(5).

3. Adding a new paragraph (b)(4).

4. Paragraph (c) is amended by adding a new sentence to the end of the paragraph.

The additions read as follows:

§26.2601–1 Effective Dates.

* * * * *

(b) * * *

(1) * * *

(i) * * * Further, the rule in the first sentence of this paragraph (b)(1)(i) does not apply to a transfer of property pursuant to the exercise, release, or lapse of a general power of appointment that is treated as a taxable transfer under chapter 11 or chapter 12. The transfer is made by the person holding the power at the time the exercise, release, or lapse of the power becomes effective, and is not considered a transfer under a trust that was irrevocable on September 25, 1985. *See* §26.2601-1(b)(1)(v)(B) regarding the treatment of the release, exercise, or lapse of a power of appointment that will result in a constructive addition to a trust. See §26.2652–1(a) for the definition of a transferor.

* * * * *

(4) *Retention of trust's exempt status in the case of modifications, etc.* (i) *In general.* This paragraph provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under paragraphs (b)(1), (b)(2), or (b)(3) of this section (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. The rules contained in this paragraph (b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of section 1001 of the Code.

(A) *Trustee's discretionary powers.* The distribution of trust principal from an

exempt trust to a new trust will not cause the new trust to be subject to the provisions of chapter 13, if—

(*1*) The terms of the governing instrument of the exempt trust authorize the trustee to make distributions to the new trust without the consent or approval of any beneficiary or court, and

(*2*) The terms of the governing instrument of the new trust do not extend the time for vesting of any beneficial interest in the trust in a manner that may postpone or suspend the vesting, absolute ownership, or power of alienation of an interest in property for a period, measured from the date of creation of the original trust, extending beyond any life in being at the date of creation of the original trust plus a period of 21 years, plus if necessary, a reasonable period of gestation. For purposes of this paragraph (b)(4)(i)(A), the exercise of a trustee's distributive power that validly postpones or suspends the vesting, absolute ownership, or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the original trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership, or the power of alienation beyond the perpetuities period. If a trustee's distributive power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

(B) *Settlement.* A court-approved settlement of a bona fide controversy regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if—

(*1*) The settlement is the product of arm's length negotiations, and

(*2*) The settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement.

(C) *Judicial construction.* A judicial construction of a governing instrument to resolve an ambiguity in the terms of the instrument or to correct a scrivener's error will not cause an exempt trust to be subject to the provisions of chapter 13, if—

(*1*) The judicial action involves a bona fide issue, and

(*2*) The construction is consistent with applicable state law that would be applied by the highest court of the state.

(D) *Other changes.* A modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraphs (b)(4)(i)(A), (B), or (C) of this subsection) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, but only if—

(*1*) The modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the modification, and

(*2*) The modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

(E) *Examples.* The following examples illustrate the application of this paragraph (b)(4). In each example, assume that the trust established in 1980 was irrevocable for purposes of §26.2601–1(b)(1)(ii) and that there have been no additions to any trust after September 25, 1985.

Example 1. Trustee's power to distribute principal authorized under trust instrument. In 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor's child, *A*, *A*'s spouse, and *A*'s issue. At the time Trust was established, *A* had two children, *B* and *C*. A corporate fiduciary was designated as trustee. Under the terms of Trust, the trustee has the discretion to distribute all or part of the trust income to one or more of the group consisting of *A*, *A*'s spouse or *A*'s issue. The trustee is also authorized to distribute all or part of the trust principal to one or more trusts for the benefit of *A*, *A*'s spouse, or *A*'s issue under terms specified by the trustee in the trustee's discretion. Any trust established under Trust, however, must terminate 21 years after the death of the last child of *A* to die who was alive at the time Trust was executed. Trust will terminate on the death of *A*, at which time the remaining principal will be distributed to *A*'s issue, per stirpes. In 2000, the trustee distributed part of Trust's principal to a new trust for the benefit of *B* and *C* and their issue. The new trust will terminate 21 years after the death of the survivor of *B* and *C*, at which time the trust principal will be distributed to the issue of *B* and *C*, per stirpes. The terms of the governing instrument of Trust authorize the trustee to make the distribution to a new trust without the consent or approval of any beneficiary or court. In addition, the terms of the governing instrument of the new trust do not extend the time for vesting of any beneficial interest in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of Trust, extending beyond any life in being at the date of creation of Trust plus a period of 21 years, plus if necessary, a reasonable period of gestation. Accordingly, neither Trust nor the new trust will be subject to the provisions of chapter 13 of the Code.

Example 2. Trustee's power to distribute principal pursuant to state statute. In 1980, Grantor established an irrevocable trust (Trust) for the benefit of Grantor's child, *A*, *A*'s spouse, and *A*'s issue. At the time Trust was established, *A* had two children, *B* and *C*. A corporate fiduciary was designated as trustee. Under the terms of Trust, the trustee has the discretion to distribute all or part of the trust income or principal to one or more of the group consisting of *A*, *A*'s spouse or *A*'s issue. Trust will terminate on the death of *A*, at which time the trust principal will be distributed to *A*'s issue, per stirpes. Under a state statute applicable to Trust, a trustee who has the absolute discretion under the terms of a testamentary instrument or irrevocable inter vivos trust agreement to invade the principal of a trust for the benefit of the income beneficiaries of the trust, may exercise the discretion by appointing so much or all of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created, or under the same instrument. The trustee may take the action either with consent of all the persons interested in the trust but without prior court approval, or with court approval, upon notice to all of the parties. The exercise of the discretion, however, must not reduce any fixed income interest of any income beneficiary of the trust and must be in favor of the beneficiaries of the trust. In 2000, the trustee distributes one-half of Trust's principal to a new trust that provides for the payment of trust income to *A* for life and further provides that, at *A*'s death, one-half of the trust remainder will pass to *B* or *B*'s issue and one-half of the trust will pass to *C* or *C*'s issue. Because the state statue requires the consent of all of the parties, the transaction constitutes a modification of Trust. However, because the modification does not shift any beneficial interest in Trust to a beneficiary or beneficiaries who occupy a lower generation than the person or persons who held the beneficial interest prior to the modification, neither Trust nor the new trust will be subject to the provisions of chapter 13 of the Code.

Example 3. Construction of an ambiguous term in the instrument. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's children, *A* and *B*, and their issue. The trust is to terminate on the death of the last to die of *A* and *B*, at which time the principal is to be distributed to their issue. However, the provision governing the termination of the trust is ambiguous regarding whether the trust principal is to be distributed per stirpes, only to the children of *A* and *B*, or per capita among the children, grandchildren, and more remote issue of *A* and *B*. The trustee files a construction suit with the appropriate local court to resolve the ambiguity. The court issues an order construing the instrument to provide for per capita distributions to the children, grandchildren, and more remote issue of *A* and *B* living at the time the trust terminates. The court's construction is consistent with applicable state law as it

would be interpreted by the highest court of the state and resolves a bona fide controversy regarding the proper interpretation of the instrument. Therefore, the trust will not be subject to the provisions of chapter 13 of the Code.

Example 4. Change in trust situs. In 1980, Grantor, who was domiciled in State *X*, executed an irrevocable trust for the benefit of Grantor's issue, naming a State *X* bank as trustee. Under the terms of the trust, the trust is to terminate, in all events, no later than 21 years after the death of the last to die of certain designated individuals living at the time the trust was executed. The provisions of the trust do not specify that any particular state law is to govern the administration and construction of the trust. In State *X*, the common law rule against perpetuities applies to trusts. In 2000, a State *Y* bank is named as sole trustee. The effect of changing trustees is that the situs of the trust changes to State *Y*, and the laws of State *Y* govern the administration and construction of the trust. State *Y* law contains no rule against perpetuities. In this case, however, in view of the terms of the trust, the trust will terminate at the same time before and after the change in situs. Accordingly, the change in situs does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the transfer. Furthermore, the change in situs does not extend the time for vesting of any beneficial interest in the trust beyond that provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13 of the Code. If, in this example, as a result of the change in situs, State Y law governed such that the time for vesting was extended beyond the period prescribed under the terms of the original trust instrument, the trust would not retain exempt status.

Example 5. Division of a trust. In 1980, Grantor established an irrevocable trust for the benefit of his two children, *A* and *B*, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to *A*, *B*, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of *A* and *B*, the trust principal is to be distributed to the living issue of *A* and *B*, per stirpes. In 2000, the appropriate local court approved the division of the trust into two equal trusts, one for the benefit of *A* and *A*'s issue and one for the benefit of *B* and *B*'s issue. The trust for *A* and *A*'s issue provides that the trustee has the discretion to distribute trust income and principal to *A* and *A*'s issue in such amounts as the trustee deems appropriate. On *A*'s death, the trust principal is to be distributed equally to *A*'s issue, per stirpes. The trust for *B* and *B*'s issue is identical (except for the beneficiaries), and terminates at *B*'s death at which time the trust principal is to be distributed equally to *B*'s issue, per stirpes. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13 of the Code.

Example 6. Merger of two trusts. In 1980, Grantor established an irrevocable trust for Grantor's child and the child's issue. In 1983, Grantor's spouse also established a separate irrevocable trust for the benefit of the same child and issue. The terms of the spouse's trust and Grantor's trust are identical. In 2000, the appropriate local court approved the merger of the two trusts into one trust to save administrative costs and enhance the management of the investments. The merger of the two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in section 2651) than the person or persons who held the beneficial interest prior to the merger. In addition, the merger does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust that resulted from the merger will not be subject to the provisions of chapter 13 of the Code.

Example 7. Modification that does not shift an interest to a lower generation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's grandchildren, *A*, *B*, and *C*. The trust provides that income is to be paid to *A*, *B*, and *C*, in equal shares for life. The trust further provides that, upon the death of the first grandchild to die, one-third of the principal is to be distributed to that grandchild's issue, per stirpes. Upon the death of the second grandchild to die, one-half of the remaining trust principal is to be distributed to that grandchild's issue, per stirpes, and upon the death of the last grandchild to die, the remaining principal is to be distributed to that grandchild's issue, per stirpes. In 2000, *A* became disabled. Subsequently, the trustee, with the consent of *B* and *C*, petitioned the appropriate local court and the court approved a modification of the trust that increased *A*'s share of trust income. The modification does not shift a portion of the income interest to a beneficiary who occupies a generation lower than the generation occupied by *A*, *B* and *C*, and does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Accordingly, the trust as modified will not be subject to the provisions of chapter 13 of the Code. However, the modification increasing *A*'s share of trust income is a transfer by *B* and *C* to *A* for federal gift tax purposes.

(ii) *Effective date.* The rules in this paragraph (b)(4) are effective as of [THE DATE OF PUBLICATION IN THE FEDERAL REGISTER AS A FINAL REGULATION].

* * * * *

(c) * * * The last four sentences in paragraph (b)(1)(i) of this section are effective as of November 18, 1999.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 17, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 18, 1999, 64 F.R. 62997)

Notice of Proposed Rulemaking

Definition of Last Known Address

REG-104939-99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations defining "last known address" in relation to the mailing of notices of deficiency and other notices, statements, and documents sent to a taxpayer's last known address. The proposed regulations affect taxpayers who receive notices of deficiency and other notices, statements, and documents sent to taxpayers' last known addresses.

DATES: Written or electronic comments and requests for a public hearing must be received by February 22, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-104939-99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-104939-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to http://www.irs.gov/tax_regs/regslist.html (the IRS Internet site).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, Michael Slaughter, (202) 622-7180; concerning the regulations, Charles A. Hall, (202) 622-4940 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

In General

This document contains proposed amendments to the Regulations on Procedure and Administration (26 CFR part 301) under section 6212(b) relating to the sufficiency of a notice of deficiency if it is mailed to the last known address of a taxpayer. This document also contains proposed amendments to the Income Tax Regulations (26 CFR part 1) and the Regulations on Procedure and Administration (26 CFR part 301) to provide cross-references to the proposed last known address rules under section 6212(b) in order to apply those rules to other notices, statements, and documents required to be sent to the last known address of a taxpayer.

Last Known Address

Many statutory and regulatory provisions refer to the last known address of a taxpayer. However, current law with respect to the last known address of a taxpayer has developed under section 6212(b), relating to the address for mailing a notice of deficiency. Generally, under section 6501, the IRS has three years from the date a Federal tax return is filed, or the due date for the return if the return is filed early, to assess a deficiency. Under section 6213, the IRS may not assess or collect a deficiency until after the notice of deficiency has been mailed to the taxpayer giving the taxpayer an opportunity to petition the United States Tax Court. Under section 6212(b), an otherwise valid notice of deficiency is sufficient if it is mailed to the taxpayer's last known address, even if it is not received by the taxpayer.

The term *last known address* is not defined by statute or current regulations. However, case law defines *last known address* as the "address which appears on the taxpayer's most recently filed return, unless [the IRS] has been given clear and concise notification of a different address." *Abeles v. Commissioner,* 91 T.C. 1019, 1035 (1988), *acq.* 1989–2 C.B. 1. The taxpayer's most recently filed return for this purpose is the last return filed by the taxpayer from which, if the return was properly processed, the address on the return was available to the IRS agent mailing a notice of deficiency. *Id.* at 1035.

The taxpayer provides the IRS with clear and concise notification of a change of address by affirmatively informing the IRS that the former address is not to be used. See *King v. Commissioner,* 857 F.2d 676, 681 (9th Cir. 1988); *Monge v. Commissioner,* 93 T.C. 22, 32 (1989). Although the IRS must exercise due diligence in ascertaining the last known address and in mailing the notice of deficiency to the correct address after having become aware of a taxpayer's change of address, that duty does not require the IRS to change the taxpayer's last known address based on information from third party sources. See *Grencewicz v. Commissioner,* 60 T.C.M. (CCH) 1300, 1302 (1990). Accordingly, under current law, clear and concise notification does not include taxpayer notification to third parties, such as payors or the United States Postal Service (USPS). See *Adams v. Commissioner,* 68 T.C.M. (CCH) 291, 294 (1994), *aff'd sub nom., Miller v. Commissioner,* 76 A.F.T.R.2d (RIA) 95-5903 (10th Cir. 1995) (forwarding order filed with USPS not clear and concise notice to IRS); *Selman v. Commissioner,* 61 T.C.M. (CCH) 2184, 2186 (1991) (USPS change of address form not notice to IRS because no evidence IRS received form); *Martin v. Commissioner,* 64 T.C.M. (CCH) 1529, 1531 (1992) (citing *Selman*); *Grencewicz v. Commissioner,* 60 T.C.M. (CCH) 1300, 1302 (1990) (IRS not required to review Forms 1099 and Schedule K-1); *Greenstein v. Commissioner,* 60 T.C.M. (CCH) 379, 382 (1990) (Forms W-2G and Form 1099-DIV not sufficient notice).

Current IRS Procedures for Changing Last Known Address

The IRS has prescribed rules for providing clear and concise notification of a different address in Rev. Proc. 90–18 (1990–1 C.B. 491). Under Rev. Proc. 90–18, a taxpayer must give clear and concise written notification of a change of address to the Internal Revenue Service Center that serves the taxpayer's old address or to the Chief, Taxpayer Service Division, in the local district office. The revenue procedure applies to notices required to be sent to a taxpayer's last known address under sections 982(c)(1), 6110(f)(3)(B), 6212(b), 6303(a), 6325(f)(2)(A), 6331(d)-(2)(C), 6332(b)(1), 6335(a) and (b), 6901(g), and 7609(a)(2). Rev. Proc. 90–18, section 2.01. Although not included in Rev. Proc. 90–18, section 6110(f)(4)(B) also requires a notice to be sent to a taxpayer's last known address. Since publication of Rev. Proc. 90–18, four new sections have been added to the Code that reference last known address. See sections 6245(b)(1), 6320(a)(2)(C), 6330(a)-(2)(C), and 7603(b)(1). Future updates of Rev. Proc. 90–18 will incorporate these new sections, as well as section 6110(f)-(4)(B).

Under section 5.04 of Rev. Proc. 90–18, taxpayers may provide the IRS with clear and concise notification of a different address in one of three ways. First, a taxpayer may send the IRS a signed statement informing the IRS that the taxpayer wants the address of record changed to a new address. In addition to the new address, this notification must contain the taxpayer's full name, signature, old address, and social security number and/or employer identification number. Filers of a joint return should provide both names, social security numbers, and signatures. Individuals who have changed last names, for instance, due to marriage, should provide the last name shown on the most recently filed return and the new last name. In all cases, clear and concise written notification must be specific as to a change of address. Thus, a new address reflected in the letterhead of taxpayer correspondence will not by itself change a taxpayer's address of record.

Second, if the IRS sends correspondence to the taxpayer that solicits or requires a response by the taxpayer and the taxpayer returns the correspondence to the IRS with corrections marked on the taxpayer's address information, the return of the correspondence will constitute clear and concise written notification of a change of address. The taxpayer's signature on the correspondence is not required.

Third, the taxpayer may file a Form 8822, "Change of Address," with the IRS.

In addition to the rules prescribed in Rev. Proc. 90–18, the IRS currently accepts oral notification of a different address, provided the request is made in the context of an inquiry about the taxpayer's account. Courts have acknowledged the validity of oral notification of a change of

address for purposes of last known address under section 6212(b), provided the notification is sufficiently clear, is given to a proper representative of the IRS, and is established by competent proof. See Mollet v. Commissioner, 82 T.C. 618, 625–26 (1984). Future updates of Rev. Proc. 90–18 will permit the oral notification of a change of address.

Explanation of Provisions

The proposed regulations define last known address consistent with the definition set forth in *Abeles*. Accordingly, the proposed regulations provide that the taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the IRS is given clear and concise notification of a different address.

The proposed regulations also provide that the IRS will use an address obtained from the United States Postal Service (USPS) as a taxpayer's last known address in the absence of a more recent address. Although current law does not require the IRS to treat a taxpayer's notification to a third party, such as a payor or the USPS, as clear and concise notification of a different address for purposes of determining a last known address, the IRS and the Treasury Department are not prohibited from prescribing a rule that would allow the IRS to consult a third party source for the taxpayer's most current address.

Thus, the proposed regulations provide that beginning in May 2000, the IRS will refer to the USPS's National Change of Address (NCOA) database to obtain a taxpayer's address for purposes of determining the taxpayer's last known address. The proposed regulations also provide that the rules for last known address under §301.6212–2 apply for purposes of other notices, statements, and documents mailed by the IRS to a taxpayer's last known address pursuant to the Internal Revenue Code or regulations. In addition, the regulations propose to amend existing regulations that use the term "last known address" to cross reference the regulations to §301.6212–2.

NCOA Database

The NCOA database is a computerized record of changes of address maintained by the USPS. This database retains address changes for a thirty-six month period. USPS obtains the change of address information from a properly submitted USPS Form 3575, "Official Mail Forwarding Change of Address Form." Both businesses and individuals use the Form 3575. Individuals may indicate whether the change of address applies to the individual or, if applicable, the individual's entire family.

Updating Master File

In May 2000, and again in November 2000, and annually thereafter in each November, the Martinsburg Computing Center (MCC) in Martinsburg, West Virginia, will access the NCOA database to update all taxpayer address records maintained in the IRS's automated master file for purposes of updating the IRS's mailing list. Generally, if the taxpayer's name and the last known address maintained in the automated master file match the taxpayer's name and old mailing address contained in the NCOA database, within certain tolerances, the IRS will use the new address obtained from the NCOA database to update the automated master file. The updated address will be the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address. However, due to IRS system limitations, if taxpayers file jointly, but the NCOA database contains change of address information for only one spouse, the earliest this rule will apply is January 2001. The IRS will publish further guidance as to when this rule will apply to these joint filers.

In addition, beginning in May 2000, prior to mailing correspondence to any particular taxpayer from an IRS Service Center, the IRS will access the NCOA database to determine if the taxpayer submitted a Form 3575 to the USPS with a more recent address. If so, the following will occur: (1) the correspondence will be mailed to the address obtained from the NCOA database, and (2) the IRS will use the new address from the NCOA database to update the automated master file. This updated address will be the taxpayer's last known address. Similar to the exception relating to the annual update, however, this rule will not be effective any earlier than January 2001 if taxpayers file jointly, but the NCOA database contains change of address information for only one spouse.

If the taxpayer subsequently files a return with an address other than the address on the Form 3575, the taxpayer's last known address will be the address on the subsequently filed and properly processed return. Similarly, if the taxpayer submits a Form 8822, "Change of Address," (or other clear and concise notification of a change of address) to the IRS after the taxpayer submits a Form 3575 to the USPS, the taxpayer's last known address will be the address on the Form 8822 (or on the clear and concise notification). In each instance, the IRS's master file will be updated to reflect the taxpayer's new last known address.

The IRS will not access the NCOA database prior to mailing correspondence from district offices and posts of duty. Unlike Service Centers, these locations do not have the systems capability to check the NCOA database for individual mailings at this time. Instead, the IRS will use the address stored in the automated master file. For purposes of correspondence mailed from district offices and posts of duty, the address on the IRS automated master file, as updated through the use of the NCOA database, will be the taxpayer's last known address.

Using the NCOA database will increase customer service by allowing faster delivery of IRS correspondence to a taxpayer. Rather than mailing correspondence to an address which is no longer a taxpayer's address and relying on the USPS to forward mail to the taxpayer's most recent address, the IRS will mail the correspondence directly to the taxpayer's most recent address. In addition, by updating the automated master file with the most recent address, future IRS correspondence will be mailed to the taxpayer's most recent address.

Although use of the NCOA database will result in improved delivery in most cases, such use does not completely eliminate the taxpayer's need to provide the IRS with clear and concise notification of a different address. For instance, if the taxpayer changes the address of a residence or business and submits a Form 3575 with the USPS, but does not wish to change the taxpayer's address for purposes of IRS correspondence, then the taxpayer must notify the IRS as provided

in Rev. Proc. 90–18. It should be noted, however, that even if the taxpayer notifies the IRS to continue using the old address for IRS correspondence, the USPS may forward the correspondence to the address on the USPS Form 3575.

Licensing Agreement with USPS

To gain access to the NCOA database, the IRS has applied to the USPS to become a limited licensee of the NCOA database. As a limited licensee, the IRS will receive from the USPS a copy of the entire thirty-six month NCOA database and periodic updates thereto in electronic format. The USPS will not have access to confidential return information as a result of this process. Moreover, unlike organizations that have entered into general licensing agreements with the USPS for use of the NCOA database, the IRS will not provide name and address matching services to commercial customers. Rather, the IRS will only use the NCOA database to update taxpayers' addresses maintained in the automated master file in the manner prescribed by these regulations. The IRS and the Treasury Department invite comments regarding whether the IRS should become a licensee for the limited purpose of updating its automated master file.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Charles A. Hall, Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1–INCOME TAXES

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

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

Par. 2. In §1.468A–5, paragraph (c)(1)(ii) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.468A–5 Nuclear decommissioning fund qualification requirements; prohibitions against self-dealing; disqualification of nuclear decommissioning fund; termination of fund upon substantial completion of decommissioning.

* * * * *

(c) * * *

(1) * * *

(ii) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

* * * * *

Par. 3. In §1.503(a)–1 is amended by adding a sentence at the end of the concluding text of paragraph (c) to read as follows:

§1.503(a)–1 Denial of exemption to certain organizations engaged in prohibited transactions.

* * * * *

(c) * * *

* * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

* * * * *

Par. 4. In §1.547–2, paragraph (b)(1)(v) is amended by adding a sentence after the third sentence of the paragraph to read as follows:

§1.547–2 Requirements for deficiency dividends.

* * * * *

(b) * * *

(1) * * *

(v) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

* * * * *

Par. 5. In §1.856-6, paragraph (g)(5) is amended by adding a sentence after the first sentence of the paragraph to read as follows:

§1.856–6 Foreclosure property.

* * * * *

(g) * * *

(5) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

* * * * *

Par. 6. In §1.860–2, paragraph (b)(1)(ii) is amended by adding a sentence after the fourth sentence of the paragraph to read as follows:

§1.860–2 Requirements for deficiency dividends.

* * * * *

(b) * * *

(1) * * *

(ii) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

* * * * *

Par. 7. In §1.963–6, paragraph (c)(5) is amended by adding a sentence after the second sentence of the paragraph to read as follows:

§1.963–6 Deficiency distribution.

* * * * *

(c) * * *

(5) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

* * * * *

Par. 8. In §1.992–3, paragraph (c)(3)(iv) is amended by adding a sentence after the third sentence of the paragraph to read as follows:

§1.992–3 Deficiency distributions to meet qualification requirements.

* * * * *

(c) * * *

(3) * * *

(iv) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter. * * *

* * * * *

Par. 9. In §1.6081–2, paragraph (f) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–2 Automatic extension of time to file partnership return of income.

* * * * *

(f) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

* * * * *

Par. 10. In §1.6081–3, paragraph (d) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–3 Automatic extension of time for filing corporation income tax returns.

* * * * *

(d) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

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Par. 11. In §1.6081–4, paragraph (c) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081-4 Automatic extension of time for filing individual income tax returns.

* * * * *

(c) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

* * * * *

Par. 12. In §1.6081-6, paragraph (d) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–6 Automatic extension of time to file trust income tax return.

* * * * *

(d) * * * For further guidance regarding the definition of last known address, see §301.6212–2 of this chapter.

* * * * *

Par. 13. In §1.6081–7, paragraph (d) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.6081–7 Automatic extension of time to file Real Estate Mortgage Investment Conduit (REMIC) income tax return.

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(d) * * * For further guidance regarding the definition of last known address, see §301.6212-2 of this chapter.

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PART 301—PROCEDURE AND ADMINISTRATION

Par. 14. The authority citation for part 301 continues to read in part as follows:

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

Par. 15. In §301.6110–4, paragraph (c)(3) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6110-4 Communications from third parties.

* * * * *

(c) * * *

(3) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 16. In §301.6110–5, paragraph (b)(4) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6110–5 Notice and time requirements; actions to restrain disclosure; actions to obtain additional disclosure.

* * * * *

(b) * * *

(4) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 17. In §301.6110–6, paragraph (b)(2)(v) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6110–6 Written determinations issued in response to requests submitted before November 1, 1976.

* * * * *

(b) * * *

(2) * * *

(v) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 18. Section 301.6212–2 is added to read as follows:

§301.6212–2 Definition of last known address.

(a) *General rule.* Except as provided in paragraph (b)(2) of this section, a taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address.

(b) *Address obtained from third party—*(1) *In general.* Except as provided in paragraph (b)(2) of this section, change of address information that a taxpayer provides to a third party, such as a payor or another government agency, is not clear and concise notification of a different address for purposes of determining a last known address under this section.

(2) *Exception for address obtained from the United States Postal Service—*(i) *Annual update.* Annually, the IRS will

update taxpayer addresses maintained in IRS records by referring to data accumulated and maintained in the United States Postal Service (USPS) National Change of Address database that retains change of address information for thirty-six months (NCOA database). Except as provided in paragraph (b)(2)(ii) of this section, if the taxpayer's name and last known address in IRS records match the taxpayer's name and old mailing address contained in the NCOA database, within certain tolerances, the new address in the NCOA database is the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address.

(ii) *Update prior to mailing any notice, statement or document from an IRS Service Center.* Prior to mailing any notice, statement, or other document, including a notice of deficiency, to the taxpayer from an IRS Service Center, the IRS will update the taxpayer's last known address by referring to the NCOA database. If the taxpayer's name and last known address in IRS records match the taxpayer's name and old mailing address contained in the NCOA database, within certain tolerances, the new address in the NCOA database is the taxpayer's last known address, unless the IRS is given clear and concise notification of a different address.

(iii) *Duration of address obtained from NCOA database.* The address obtained from the NCOA database under paragraph (b)(2)(i) or (ii) of this section is the taxpayer's last known address until one of the following events occurs—

(A) The taxpayer files and the IRS properly processes a Federal tax return with an address different from the address obtained from the NCOA database; or

(B) The taxpayer provides the IRS with clear and concise notification of a change of address, as defined in procedures prescribed by the Commissioner, that is different from the address obtained from the NCOA database.

(3) *Examples.* The following examples illustrate the rules of paragraph (b)(2) of this section:

Example 1. (i) A is an unmarried taxpayer. The address on A's 1999 Form 1040, U.S. Individual Income Tax Return, filed on April 14, 2000, and 2000 Form 1040 filed on April 13, 2001, is 1234 Anyplace Street, Anytown, USA 43210. On May 15, 2001, A informs the USPS of a new permanent address (9876 Newplace Street, Newtown, USA 12345) using the USPS Form 3575, "Official Mail Forwarding Change of Address Form." The change of address is included in the USPS NCOA database.

(ii) In June 2001 the IRS determines a deficiency for A's 1999 tax year and prepares to issue the notice of deficiency. When the IRS mails the notice of deficiency from the Service Center, the IRS refers to the NCOA database and updates the taxpayer's last known address to 9876 Newplace Street, Newtown, USA 12345. On June 15, 2001, the IRS mails a notice of deficiency to A at 9876 Newplace Street, Newtown, USA 12345. For purposes of section 6212(b), the notice of deficiency mailed on June 15, 2001, is mailed to A's last known address.

Example 2. (i) The facts are the same as in *Example 1*, except that instead of determining a deficiency for A's 1999 tax year in June 2001, the IRS determines a deficiency for A's 1999 tax year in December 2001. The IRS performs its annual update of addresses in November 2001. At this time the taxpayer's address maintained in IRS records was changed to 9876 Newplace Street, Newtown, USA 12345.

(ii) On December 14, 2001, the IRS mails a notice of deficiency to A at 9876 Newplace Street, Newtown, USA 12345. For purposes of section 6212(b), the notice of deficiency mailed on December 14, 2001, is mailed to A's last known address.

Example 3. (i) B is an unmarried taxpayer. The address on B's 1999 Form 1040, U.S. Individual Income Tax Return, filed on April 14, 2000, is 1234 Main Street, Mytown, USA 56789. In September 2000, B informs the USPS of a new permanent address (4321 Maple Street, Ourtown, USA 54321) using the USPS Form 3575, "Official Mail Forwarding Change of Address Form."

(ii) In September 2000, the IRS determines a deficiency for B's 1998 tax year and prepares to issue the notice of deficiency in the Service Center. On September 15, 2000, the IRS refers to the NCOA database to update the taxpayer's last known address. Because B did not inform the USPS of a change of address in sufficient time to be included in the NCOA database on September 15, 2000, the NCOA database does not yet contain any address information for B. On September 15, 2000, the IRS mails a notice of deficiency to B at 1234 Main Street, Mytown, USA 56789. For purposes of section 6212(b), the notice of deficiency mailed on September 15, 2000, is mailed to B's last known address.

Example 4. (i) C is an unmarried taxpayer. The address on C's 1998 Form 1040, U.S. Individual Income Tax Return, filed on April 15, 1999, and 1999 Form 1040 filed on April 14, 2000, is 2468 Spring Street, Little City, USA 97531. On August 15, 2001, C informs the USPS of a new permanent address (8642 Peachtree Street, Big City, USA 13579) using the USPS Form 3575, "Official Mail Forwarding Change of Address Form." The IRS performs its annual update of addresses in November 2001.

(ii) In September 2001 the IRS district office for Little City, USA determines a deficiency for C's 1998 tax year and prepares to issue the notice. When the IRS mails the notice of deficiency from the district office, the IRS does not refer to the NCOA database because IRS systems are not capable of checking the NCOA database for individual mailings other than for Service Center correspondence. On September 17, 2001, the IRS mails a notice of deficiency for tax year 1998 to C at 2468 Spring Street, Little City, USA 97531. For purposes of section 6212(b), the notice of deficiency mailed on September 17, 2001, is mailed to C's last known address.

(iii) Also in September 2001, the IRS determines a deficiency for C's 1999 tax year. When the IRS mails this notice of deficiency from the IRS Service Center, the IRS refers to the NCOA database and updates the taxpayer's last known address to 8642 Peachtree Street, Big City, USA 13579. On September 18, 2001, the IRS mails a notice of deficiency for tax year 1999 to C at 8642 Peachtree Street, Big City, USA 13579. For purposes of section 6212(b), the notice of deficiency mailed on September 18, 2001, is mailed to C's last known address.

Example 5. The facts are the same as in *Example 4*, except that the IRS Service Center mails the notice of deficiency for C's 1999 tax year on September 10, 2001, after updating the taxpayer's last known address by referring to the NCOA database. On September 17, 2001, when the district office prepares to mail the notice of deficiency for C's 1998 tax year by referring to the IRS's automated master file, the taxpayer's address will appear as 8642 Peachtree Street, Big City, USA 13579. Thus, in both cases, for purposes of section 6212(b), the taxpayer's last known address is 8642 Peachtree Street, Big City, U.S.A. 13579.

(c) *Last known address for all notices, statements, and documents.* The rules in paragraphs (a) and (b) of this section apply for purposes of determining whether all notices, statements, or other documents are mailed to a taxpayer's last known address whenever the term last known address is used in the Internal Revenue Code or the regulations thereunder.

(d) *Effective Date*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, the rules prescribed by this section apply to all notices, statements, and other documents mailed on or after May 1, 2000.

(2) *Individual moves in the case of joint filers.* In the case of taxpayers who file joint returns under section 6013, if the NCOA database contains change of address information for only one spouse, paragraphs (b)(2) and (3) of this section will not apply to notices, statements, and other documents mailed before January 1, 2001.

Par. 19. In §301.6303–1, paragraph (a) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6303–1 Notice and demand for tax.

* * * * *

(a) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 20. In §301.6305–1, paragraph (b)(2)(ii) is revised to read as follows:

§301.6305–1 Assessment and collection of certain liability.

* * * * *

(b) * * *

(2) * * *

(ii) The name, social security number, and last known address of the individual owing the assessed amount. For further guidance regarding the definition of last known address, see §301.6212–2;

* * * * *

Par. 21. In §301.6320–1T, paragraph (a)(1) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6320–1T Notice and opportunity for hearing upon filing of notice of Federal tax lien (temporary).

(a) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 22. In §301.6325–1, paragraph (f)(2)(ii)(a) is revised to read as follows:

§301.6325–1 Release of lien or discharge of property.

* * * * *

(f) * * *

(2) * * *

(ii) * * *

(*a*) Mailing notice of the revocation to the taxpayer at his last known address (see §301.6212–2 for further guidance regarding the definition of last known address); and

* * * * *

Par. 23. In §301.6330–1T, paragraph (a)(1) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6330–1T Notice and opportunity for hearing prior to levy (temporary).

(a) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 24. In §301.6331–2, paragraph (a)(1) is amended by adding a sentence after the second sentence of the paragraph to read as follows:

§301.6331–2 Procedures and restrictions on levies.

(a) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *

* * * * *

Par. 25. Section 301.6332–2 is amended as follows:

1. Paragraphs (b)(1) introductory text, (b)(1)(i), and (b)(1)(ii) are redesignated as paragraphs (b)(1)(i) introductory text, (b)(1)(i)(A), and (b)(1)(i)(B), respectively.

2. In newly designated paragraph (b)(1)(i)(B), the text beginning with the second sentence is redesignated as paragraph (b)(1)(ii).

3. Newly designated paragraph (b)(1)(ii) is amended by adding a sentence after the second sentence of the paragraph.

The addition reads as follows:

§301.6332–2 Surrender of property subject to levy in the case of life insurance and endowment contracts.

* * * * *

(b) * * * (1) *In general.* (i) * * *

(ii) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *

* * * * *

Par. 26. In §301.6335–1, paragraph (b)(1) is amended by adding a sentence after the third sentence of the paragraph to read as follows:

§301.6335–1 Sale of seized property.

* * * * *

(b) * * * (1) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 27. In §301.6503(c)–1, paragraph (a) is amended by adding a sentence at the end of the paragraph to read as follows:

§301.6503(c)–1 Suspension of running of period of limitation; location of property outside the United States or removal of property from the United States; taxpayer outside of United States.

(a) * * * For further guidance regarding the definition of last known address, see §301.6212–2.

* * * * *

Par. 28. In §301.6903–1, paragraph (c) is amended by adding a sentence after the first sentence of the paragraph to read as follows:

§301.6903–1 Notice of fiduciary relationship.

* * * * *

(c) * * * For further guidance regarding the definition of last known address, see §301.6212–2. * * *

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 19, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 22, 1999, 64 F.R. 63768)

Announcement 99–112

This announcement corrects certain errors which appear in Rev. Proc. 99–29, 1999–31, I.R.B. 138, which provides specifications for filing Forms 1098, 1099, 5498, and W-2G, magnetically or electronically. Revenue Procedure 99–29 is reprinted as Publication 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Magnetically or Electronically. Corrections to forms are also included in this announcement.

Changes are listed by part, section and form number. The actual wording changes are highlighted using ***italics*** and ***bold print.***

Part A. General

Sec. 9. Filing of Information Returns Magnetically/Electronically and Retention Requirements

.02 IRS/MCC allows for the use of computer-generated substitutes for Form 4804/4802. The substitutes must contain all information requested on the original forms including the affidavit and signature line. Photocopies are acceptable ***but an*** original signature ***is required***. . .

Sec. 19. Major Problems Encountered

4. The Payment Amount Fields in the "B" Record Do Not Correspond to the Amount Codes in the "A" Record

If codes 2, 4, and 7 appear in the Amount Codes Field of the "A" Record, then the "B" Record must show payment amounts in only Payment Amount Fields 2, 4, and 7, right-justified and unused positions must be zero (0) filled.
EXAMPLE: "A" RECORD 247␣␣␣␣␣␣␣␣␣␣ ('␣' denotes a blank)
(Pos. 28-39)

Part B. Magnetic Media Specifications

Sec. 3. Tape Cartridge Specifications

0.2 The tape cartridge records defined in this revenue procedure may be blocked subject to the following:

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descripter fields, which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter [see item (b) above]. The block length must be ***evenly*** divisible by 750.

Sec. 4. 8mm, 4mm, and Quarter Inch Cartridge Specifications

.01 In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

(3) The 8mm tape cartridge must meet the following specifications:

TRACKS	DENSITY	CAPACITY
1	20 (43245 BPI	***2.3*** Gb (10Gb)
1	21 (45434 BPI)	5 Gb (20Gb)

Sec. 10. Payee "B" Record – General Field Description and Record Layouts

(14) Payee "B" Record Layout Positions 544–750 for Form 1099-R

Field Position	Field Title	Length	Description and Remarks
545–546	Distribution Code (For a detailed explanation of the distribution codes see the "1999 Instructions for Forms 1099, 1098 5498, and W-2G.")	2	**Required.** Enter at least one distribution code from the table below. More than one code may apply. If only one code is required, it must be entered in position 545 and position 546 must be blank. A blank in position 545 is not acceptable. Position 545 must contain a numeric code in all cases except when using Code D, E, F, G, H, J, L, M, P, ***R***, or S...

Part C. Electronic Filing Specifications

Sec. 6. Electronic Submissions

.05 If a file was submitted timely and is bad, the filer will have up to 60 days from the day the file was transmitted or 4 replacement attempts within that 60 days period, whichever comes first, to transmit an acceptable file. If an acceptable file is not received within 60 days or within 4 replacement attempts, within that 60 day period, then the payer could be subject to late filing penalities. This only applies to files originally sent electronically.

Corrections to Form 4419 and Form 8508

The following forms, for the filer's use, were printed incorrectly in the back of the Publication 1220. The correct wording below is highlighted using ***italics*** and ***bold print.*** These forms may be photocopied.

Form 4419: Application for Filing Information Returns Magnetically/Electronically

Type of Return To Be Reported (Check appropriate box(s))	
Important: Form W-2 information is sent to the Social Security Administration only. Do not use Form 4419 to request authorization to file information magnetically. Contact SSA to request the appropriate application.	
☐ Forms 1098, 1099-series, 5498, 5498-MSA, and ***W-2G*** (Tape, Tape Cartridges, ***3-½"*** Diskette or Electronic)	☐ 1042-S, (Tape, Tape Cartridges, ***3-½"*** Diskette or Electronic) ☐ 8027 (Tape, Tape Cartridges, ***3-½"*** Diskette or Electronic) ☐ 8596 (Tape, Tape Cartridges, ***3-½"*** Diskette or Electronic) ☐ W-4 (Tape, Tape Cartridges, ***3-½"*** Diskette or Electronic)

Form 8508: Request for Waiver From Filing Information Returns on Magnetic Media

Box 3. Payer name and complete address (A separate ***8508*** form must be filed for each payer requesting a waiver.)

Box 7. ☐ ***W-2VI***

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 401.—Pension, Profit-Sharing, Stock Bonus Plans, etc.

26 CFR 1.401(a)(4)–1: Nondiscrimination requirements of section 401(a)(4).

Nondiscrimination; duplicate benefits. This ruling provides that the duplication of benefits for highly compensated employees may result in the failure of plans to satisfy the nondiscrimination requirements of section 401(a)(4) of the Code.

Rev. Rul. 99–51

Employer A maintained one plan, Plan X, a calendar year defined benefit plan, benefiting all of A's highly compensated employees within the meaning of § 414(q) of the Internal Revenue Code of 1986 (HCEs) and all of A's employees who are not highly compensated employees (NHCEs). Under Plan X, each employee's accrued benefit equals an annual benefit commencing at normal retirement age of one percent of average annual compensation per year of service. A "year of service" includes all years of service with Employer A. There are no related or predecessor employers nor is service under any other plan taken into account under Plan X.

In November 1997, Plan X was amended effective as of December 31, 1997 (the spin-off date) to become two plans: Plan X-H covering Employer A's HCEs and Plan X-N covering Employer A's NHCEs. The assets and benefit liabilities under Plan X as of the spin-off date were allocated between Plan X-H and Plan X-N in accordance with § 414(l). Pursuant to the terms of the amendment, NHCEs were excluded from participation in Plan X-H and HCEs were excluded from participation in Plan X-N. In addition, the amendment provided that there would be no benefit accruals under Plan X-H with respect to periods after the spin-off date (i.e., Plan X-H was "frozen" as of the spin-off date). Benefit accruals continued under Plan X's original formula for participants in Plan X-N.

Employer A later amended Plan X-N to include the HCEs and to provide the HCEs with an annual benefit commencing at normal retirement age equal to one percent of average annual compensation per year of service with Employer A. The years of service included in the computation of the HCEs' accrued benefit under Plan X-H were included in the computation of their benefits under Plan X-N as well. Benefits employees accrued under Plan X-N were not offset by their accrued benefits under Plan X-H.

Plan X, Plan X-H and Plan X-N are the only plans that have been maintained by Employer A, and none of these plans have been top-heavy within the meaning of § 416 for any plan year.

Section 401(a)(4) provides that contributions or benefits under a plan qualified under § 401(a) must not discriminate in favor of HCEs.

Section 1.401(a)(4)–1(c)(2) of the Income Tax Regulations provides that the regulations under § 401(a)(4) must be interpreted in a reasonable manner consistent with the purpose of preventing discrimination in favor of HCEs.

Section 1.401(a)(4)–5(a)(1)&(2) provides that, for determining whether the timing of a plan amendment or series of amendments has the effect of discriminating significantly in favor of HCEs, a plan amendment includes the establishment or termination of the plan, and any change in the benefits, rights, features or benefit formulas under the plan. Whether the timing of a plan amendment or series of plan amendments has the effect of discriminating significantly in favor of HCEs is determined at the time the plan amendment first becomes effective based on all relevant facts and circumstances. These include the relative numbers of current HCEs and NHCEs affected by the plan amendment, the relative accrued benefits of current HCEs and NHCEs before and after the plan amendment and any additional benefits provided to current HCEs and NHCEs under other plans.

Section 1.401(a)(4)–11(d)(2) provides that, on the basis of all relevant facts and circumstances, the manner in which employees' service is credited for all purposes under the plan must not discriminate in favor of HCEs.

Section 1.401(a)(4)–11(d)(3) provides that, except as otherwise provided, service for periods in which an employee did not participate in the plan may not be taken into account in determining whether the plan satisfies § 401(a)(4).

Held, under the facts of this case there is a duplication of service and benefits that discriminates in favor of HCEs in violation of § 401(a)(4).

DRAFTING INFORMATION

The principal author of this revenue ruling is Kenneth Conn of the Employee Plans Division. For further information regarding this revenue ruling, call the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday, or Mr. Conn at (202) 622-6214 (also not a toll-free number).

Section 483.—Interest on Certain Deferred Payments

26 CFR 1.483–1: Computation of interest on certain deferred payments.

As defined by section 1274A, the definitions for both "qualified debt instruments" and "cash method debt instruments" have dollar ceilings on the stated principal amount. The limits to the stated principal amount are adjusted for inflation for sales or exchanges occurring in the 2000 calendar year. See Rev. Rul. 99–50, page 656.

Section 995.—Taxation of DISC Income to Shareholders

1999 base period T-bill rate. The base period T-bill rate, under section 995 of the Code, is 4.80 percent for the period ending September 30, 1999.

Rev. Rul. 99–52

Section 995(f)(l) of the Internal Revenue Code provides that a shareholder of a DISC shall pay interest each taxable year in an amount equal to the product of the shareholder's DISC-related deferred tax liability for the year and the "base period T-bill rate." Under section 995(f)(4), the base period T-bill rate is the annual rate of interest determined by the Secretary to be equiva-

lent to the average investment yield of United States Treasury bills with maturities of 52 weeks which were auctioned during the one-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder. The base period T-bill rate for the period ending September 30, 1999, is 4.80 percent.

Pursuant to section 6622 of the Code, interest must be compounded daily. The table below provides factors for compounding the base period T-bill rate daily for any number of days in the shareholder's taxable year (including a 52-53 week accounting period) for the 1999 base period T-bill rate. To compute the amount of the interest charge for the shareholder's taxable year, multiply the amount of the shareholder's DISC-related deferred tax liability (as defined in section 995(f)(2)) for that year by the base period T-bill rate factor corresponding to the number of days in the shareholder's taxable year for which the interest charge is being computed. Generally, one would use the factor for 365 days. One would use a different factor only if the shareholder's taxable year for which the interest charge being determined is a short taxable year, if the shareholder uses the 52-53 week taxable year, or if the shareholder's taxable year is a leap year.

For the base period T-bill rates for the periods ending in prior years, *see:* Rev. Rul. 86–132, 1986–2 C.B. 137; Rev. Rul. 87–129, 1987-2 C.B. 196; Rev. Rul. 88–94, 1988–2 C.B. 301; Rev. Rul. 89–116, 1989–2 C.B. 197; Rev. Rul. 90–96, 1990–2 C.B. 188; Rev. Rul. 91–59, 1991–2 C.B. 347; Rev. Rul. 92–98, 1992–2 C.B. 201; Rev. Rul. 93–77, 1993–2 C.B. 253; Rev. Rul. 94–68, 1994–2 C.B. 177; Rev. Rul. 95–77, 1995–2 C.B. 122; Rev. Rul. 96–55, 1996–2 C.B. 57; Rev. Rul. 97–49, 1997–2 C.B. 89; and Rev. Rul. 98–54, 1998–56 I.R.B. 5.

DRAFTING INFORMATION

The principal author of this revenue ruling is David Bergkuist of the Office of the Associate Chief Counsel (International). For further information about this revenue ruling, contact Mr. Bergkuist on (202) 622-3850 (not a toll-free call).

1999 ANNUAL RATE COMPOUNDED DAILY

DAYS	4.80 PERCENT FACTOR
1	.000131507
2	.000263031
3	.000394572
4	.000526131
5	.000657707
6	.000789301
7	.000920911
8	.001052539
9	.001184184
10	.001315847
11	.001447527
12	.001579224
13	.001710939
14	.001842670
15	.001974420
16	.002106186
17	.002237970
18	.002369771
19	.002501590
20	.002633425
21	.002765279
22	.002897149
23	.003029037
24	.003160942
25	.003292865
26	.003424805
27	.003556762
28	.003688736
29	.003820728
30	.003952738
31	.004084764
32	.004216808
33	.004348870
34	.004480948
35	.004613045
36	.004745158
37	.004877289
38	.005009437
39	.005141603
40	.005273786
41	.005405986
42	.005538204
43	.005670439
44	.005802692
45	.005934962
46	.006067249
47	.006199554
48	.006331876
49	.006464215
50	.006596572
51	.006728947
52	.006861338
53	.006993748
54	.007126174
55	.007258618
56	.007391080
57	.007523558
58	.007656055
59	.007788568
60	.007921099
61	.008053648
62	.008186214
63	.008318797
64	.008451398
65	.008584016
66	.008716652
67	.008849305
68	.008981976
69	.009114664
70	.009247369
71	.009380092
72	.009512833
73	.009645591
74	.009778366
75	.009911159
76	.010043969
77	.010176797
78	.010309642
79	.010442504
80	.010575384
81	.010708282
82	.010841197
83	.010974130
84	.011107080
85	.011240047
86	.011373032
87	.011506035
88	.011639055
89	.011772092
90	.011905147
91	.012038220

DAYS	4.80 PERCENT FACTOR	DAYS	4.80 PERCENT FACTOR	DAYS	4.80 PERCENT FACTOR
92	.012171309	140	.018580253	187	.024894996
93	.012304417			188	.025029776
94	.012437542	141	.018714203	189	.025164575
95	.012570684	142	.018848171	190	.025299391
		143	.018982156		
96	.012703844	144	.019116159	191	.025434225
97	.012837022	145	.019250180	192	.025569076
98	.012970217			193	.025703946
99	.013103429	146	.019384219	194	.025838833
100	.013236659	147	.019518275	195	.025973738
		148	.019652348		
101	.013369907	149	.019786439	196	.026108660
102	.013503172	150	.019920548	197	.026243601
103	.013636455			198	.026378559
104	.013769755	151	.020054675	199	.026513534
105	.013903072	152	.020188819	200	.026648528
		153	.020322981		
106	.014036408	154	.020457160	201	.026783539
107	.014169760	155	.020591357	202	.026918568
108	.014303131			203	.027053615
109	.014436518	156	.020725572	204	.027188680
110	.014569924	157	.020859805	205	.027323762
		158	.020994055		
111	.014703347	159	.021128322	206	.027458862
112	.014836787	160	.021262608	207	.027593980
113	.014970245			208	.027729116
114	.015103721	161	.021396911	209	.027864269
115	.015237214	162	.021531231	210	.027999440
		163	.021665570		
116	.015370724	164	.021799926	211	.028134629
117	.015504253	165	.021934299	212	.028269836
118	.015637798			213	.028405061
119	.015771362	166	.022068691	214	.028540303
120	.015904943	167	.022203100	215	.028675563
		168	.022337527		
121	.016038541	169	.022471971	216	.028810841
122	.016172157	170	.022606433	217	.028946137
123	.016305791			218	.029081450
124	.016439442	171	.022740913	219	.029216781
125	.016573111	172	.022875410	220	.029352130
		173	.023009925		
126	.016706797	174	.023144458	221	.029487497
127	.016840501	175	.023279009	222	.029622882
128	.016974222			223	.029758284
129	.017107961	176	.023413577	224	.029893705
130	.017241718	177	.023548163	225	.030029143
		178	.023682766		
131	.017375492	179	.023817388	226	.030164599
132	.017509284	180	.023952027	227	.030300072
133	.017643094			228	.030435564
134	.017776921	181	.024086683	229	.030571073
135	.017910765	182	.024221358	230	.030706600
		183	.024356050		
136	.018044628	184	.024490760	231	.030842145
137	.018178507	185	.024625487	232	.030977708
138	.018312405			233	.031113289
139	.018446320	186	.024760233		

DAYS	4.80 PERCENT FACTOR
234	.031248887
235	.031384503
236	.031520138
237	.031655790
238	.031791459
239	.031927147
240	.032062852
241	.032198576
242	.032334317
243	.032470076
244	.032605853
245	.032741648
246	.032877460
247	.033013291
248	.033149139
249	.033285005
250	.033420889
251	.033556791
252	.033692711
253	.033828649
254	.033964604
255	.034100578
256	.034236569
257	.034372578
258	.034508605
259	.034644650
260	.034780713
261	.034916794
262	.035052892
263	.035189009
264	.035325143
265	.035461296
266	.035597466
267	.035733654
268	.035869860
269	.036006084
270	.036142326
271	.036278586
272	.036414864
273	.036551159
274	.036687473
275	.036823804
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277	.037096521
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279	.037369310
280	.037505731
281	.037642170
282	.037778627
283	.037915102
284	.038051595
285	.038188106
286	.038324635
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288	.038597746
289	.038734329
290	.038870930
291	.039007548
292	.039144185
293	.039280840
294	.039417512
295	.039554203
296	.039690911
297	.039827638
298	.039964382
299	.040101144
300	.040237925
301	.040374723
302	.040511540
303	.040648374
304	.040785226
305	.040922097
306	.041058985
307	.041195892
308	.041332816
309	.041469758
310	.041606719
311	.041743697
312	.041880694
313	.042017708
314	.042154741
315	.042291791
316	.042428860
317	.042565946
318	.042703051
319	.042840173
320	.042977314
321	.043114473
322	.043251649
323	.043388844
324	.043526057
325	.043663288
326	.043800536
327	.043937803
328	.044075088
329	.044212391
330	.044349712
331	.044487052
332	.044624409
333	.044761784
334	.044899177
335	.045036589
336	.045174018
337	.045311466
338	.045448931
339	.045586415
340	.045723917
341	.045861437
342	.045998975
343	.046136531
344	.046274105
345	.046411697
346	.046549307
347	.046686936
348	.046824582
349	.046962247
350	.047099930
351	.047237630
352	.047375349
353	.047513086
354	.047650841
355	.047788615
356	.047926406
357	.048064216
358	.048202043
359	.048339889
360	.048477753
361	.048615635
362	.048753535
363	.048891453
364	.049029390
365	.049167344
366	.049305317
367	.049443308
368	.049581317
369	.049719344
370	.049857389
371	.049995453

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

26 CFR 1.1274A–1: Special rules for certain transactions where stated principal amount does not exceed $2,800,000.

As defined by section 1274A, the definitions for both "qualified debt instruments" and "cash method debt instruments" have dollar ceilings on the stated principal amount. The limits to the stated principal amount are adjusted for inflation for sales or exchanges occurring in the 2000 calendar year. See Rev. Rul. 99-50, on this page.

Section 1274A.—Special Rules for Certain Transactions Where Stated Principal Amount Does Not Exceed $2,800,000

(Also, sections 1274, 483; 1.1274A–1, 1.483–1.)

Section 1274A inflation-adjusted numbers for 2000. This ruling provides the dollar amounts, increased by the 2000 inflation adjustment, for section 1274A of the Code. Rev. Rul. 98–58 supplemented and superseded.

Rev. Rul. 99–50

This revenue ruling provides the dollar amounts, increased by the 2000 inflation adjustment, for § 1274A of the Internal Revenue Code.

BACKGROUND

In general, §§ 483 and 1274 determine the principal amount of a debt instrument given in consideration for the sale or exchange of nonpublicly traded property. In addition, any interest on a debt instrument subject to § 1274 is taken into account under the original issue discount provisions of the Code. Section 1274A, however, modifies the rules under §§ 483 and 1274 for certain types of debt instruments.

In the case of a "qualified debt instrument," the discount rate used for purposes of §§ 483 and 1274 may not exceed 9 percent, compounded semiannually. Section 1274A(b) defines a qualified debt instrument as any debt instrument given in consideration for the sale or exchange of property (other than new § 38 property within the meaning of § 48(b), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990) if the stated principal amount of the instrument does not exceed the amount specified in § 1274A(b). For debt instruments arising out of sales or exchanges before January 1, 1990, this amount is $2,800,000.

In the case of a "cash method debt instrument," as defined in § 1274A(c), the borrower and lender may elect to use the cash receipts and disbursements method of accounting. In particular, for any cash method debt instrument, § 1274 does not apply, and interest on the instrument is accounted for by both the borrower and the lender under the cash method of accounting. A cash method debt instrument is a qualified debt instrument that meets the following additional requirements: (A) In the case of instruments arising out of sales or exchanges before January 1, 1990, the stated principal amount does not exceed $2,000,000; (B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged; (C) § 1274 would have applied to the debt instrument but for an election under § 1274A(c); and (D) an election under § 1274A(c) is jointly made with respect to the debt instrument by the borrower and lender. Section 1.1274A–1(c)(1) of the Income Tax Regulations provides rules concerning the time for, and manner of, making this election.

Section 1274A(d)(2) provides that, for any debt instrument arising out of a sale or exchange during any calendar year after 1989, the dollar amounts stated in § 1274A(b) and § 1274A(c)(2)(A) are increased by the inflation adjustment for the calendar year. Any increase due to the inflation adjustment is rounded to the nearest multiple of $100 (or, if the increase is a multiple of $50 and not of $100, the increase is increased to the nearest multiple of $100). The inflation adjustment for any calendar year is the percentage (if any) by which the CPI for the preceding calendar year exceeds the CPI for calendar year 1988. Section 1274A(d)(2)(B)

Rev. Rul. 99–50 Table 1

Calendar Year of Sale or Exchange	Inflation-Adjusted Amounts Under § 1274A 1274A(b) Amount (qualified debt instrument)	1274A(c)(2)(A) Amount (cash method debt instrument)
1990	$2,933,200	$2,095,100
1991	$3,079,600	$2,199,700
1992	$3,234,900	$2,310,600
1993	$3,332,400	$2,380,300
1994	$3,433,500	$2,452,500
1995	$3,523,600	$2,516,900
1996	$3,622,500	$2,587,500
1997	$3,723,800	$2,659,900
1998	$3,823,100	$2,730,800
1999	$3,885,500	$2,775,400
2000	$3,960,100	$2,828,700

Note: These inflation adjustments were computed using the All-Urban, Consumer Price Index, 1982-1984 base, published by the Bureau of Labor Statistics.

defines the CPI for any calendar year as the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of that calendar year.

INFLATION-ADJUSTED AMOUNTS

For debt instruments arising out of sales or exchanges after December 31, 1989, the inflation-adjusted amounts under § 1274A are shown in Table 1.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 98–58, 1998–52 I.R.B. 6 is supplemented and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Courtney Shepardson the Office of the Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact Ms. Shepardson on (202) 622-3930 (not a toll-free call).

Section 6621.— Determination of Interest Rate

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 2000, will be 8 percent for overpayments (7 percent in the case of a corporation), 8 percent for underpayments, and 10 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 is 5.5 percent.

Rev. Rul. 99–53

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under § 6621(a)(1), the overpayment rate beginning January 1, 2000, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See § 6621(c) and § 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) provides that in determining the addition to tax under § 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate that applies during the third month following such taxable year also applies during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of ½ of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of October 1999 is 5 percent. Accordingly, an overpayment rate of 8 percent (7 percent in the case of a corporation) and an underpayment rate of 8 percent are established for the calendar quarter beginning January 1, 2000. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 2000, is 5.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2000, is 10 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 8 percent rate also applies to estimated tax underpayments for the first calendar quarter in 2000 and for the first 15 days in April 2000.

Interest factors for daily compound interest for annual rates of 5.5 percent, 7 percent, 8 percent, and 10 percent are published in Tables 64, 67, 69, and 73 of Rev. Proc. 95–17, 1995–1 C.B. 556, 618, 621, 623, and 627.

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Bailey on (202) 622-6226 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 – PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25 pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B. RATE TABLE PG			1995–1 C.B. RATE TABLE PG	
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573

TABLE OF INTEREST RATES—Continued

FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

		1995–1 C.B	
	RATE	TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 - PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000
FROM JANUARY 1, 1995 – PRESENT

	RATE	1995–1 C.B TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1. 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618

Section 7701.—Definitions

26 CFR 301.7701–3: Classification of certain business entities.

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

T.D. 8844

Treatment of Changes in Elective Entity Classification

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations describing how elective changes in classification will be treated for federal tax purposes. The final regulations affect business entities and their members. The final regulations provide guidance to taxpayers who elect to change an entity's classification for federal tax purposes.

DATES: *Effective Date:* These regulations are effective November 29, 1999.

Applicability Dates: These regulations apply on or after November 29, 1999. However, taxpayers may choose to apply certain provisions in these regulations before November 29, 1999 as specified in §301.7701–2(e) and §301.7701–3(g)(4).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Dan Carmody, (202) 622-3080 (not a toll-free number); concerning international issues, Mark Harris, (202) 622-3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On October 28, 1997, proposed amendments to the regulations (REG–105162–97, 1997–2 C.B. 649) under §§301.6109–1, 301.7701–2, and 301.7701–3 were published in the **Federal Register** (62 F.R. 55768). A number of comments were received on the proposed regulations. The public hearing scheduled for February 24, 1998, was canceled because no one requested to speak. After considering the submitted comments, the IRS and Treasury adopt the proposed amendments to the regulations under §§301.6109–1, 301.7701–2, and 301.7701–3 as revised by this Treasury decision.

Explanation of Provisions

I. *Characterization of Elective Changes in Classification*

There are four possible changes in classification of an eligible entity by election under §301.7701–3: (i) a partnership elects to be an association taxable as a

corporation (association); (ii) an association elects to be a partnership; (iii) an association elects to be disregarded as an entity separate from its owner (disregarded entity); and (iv) a disregarded entity elects to be an association. The proposed regulations provide a form that each elective conversion would be treated as having for federal tax purposes. Under the proposed regulations, there is only one form for each elective conversion, and taxpayers could not elect to have a different form apply to the elective conversion.

A. Elective Conversions Treated as Having One Form

Commentators recommended that taxpayers be allowed to choose which form to apply to an elective conversion. This would allow taxpayers to avoid having to take the actual steps of a conversion to produce the most favorable tax results. A commentator suggested that the lack of choice in the proposed regulations is inconsistent with the intent of the check-the-box regulations, which adopted an elective regime for classifying eligible entities.

Because elective conversions are transactions without actual form, the IRS and Treasury believe that it is appropriate to provide that only one transaction form will be applied to each type of elective conversion. Furthermore, while the check-the-box regulations provide an elective regime for classifying eligible entities, the elective regime was not intended to substitute for actual transactions in all situations. Instead, the purpose of implementing the regime was to simplify an area of the law where legal distinctions previously drawn in determining an entity's classification were no longer meaningful. While the factors considered under prior law did not meaningfully distinguish between business organizations, taxpayers still were required to expend considerable resources to ensure that they obtained the classification they desired. Small business organizations often lacked the resources and expertise to achieve their desired tax classification. This was viewed as unfair. The IRS was also expending considerable resources providing guidance on these classification issues. These same concerns generally are not present in determining the form of a conversion transaction. Therefore, the final regulations maintain only one form for each type of elective conversion.

B. Form of Conversion From Association to Partnership

The proposed regulations provide that an elective conversion of an association to a partnership is deemed to have the following form: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.

A commentator suggested that the proposed form for an elective conversion of an association to a partnership may not minimize the tax consequences of such a conversion under certain circumstances. The commentator suggested that the proposed form should be available as an election, but that the default form should be a deemed transfer of assets and liabilities from the electing corporation to a newly formed partnership for interests in the partnership followed immediately by a liquidation of the electing corporation.

The IRS and Treasury believe that under current law a voluntary formless change from an association to a partnership should be treated as a liquidation of the corporation followed by a contribution of assets to the partnership. See Rev. Rul. 63–107 (1963–2 C.B. 71). Moreover, if the assets were deemed contributed by the electing corporation to the partnership for partnership interests followed by a liquidation of the corporation, the application of section 704(c) (contribution of appreciated property), section 708 (partnership termination), and section 754 (elective adjustments to the basis of partnership assets) could be somewhat complex and difficult for taxpayers and the IRS to administer. Therefore, the proposed form for the elective conversion of an association to a partnership is adopted without change.

C. Timing of Elective Changes in Classification

The proposed regulations provide that a classification election takes effect at the start of the day for which the election is effective. Any transactions that are deemed to occur because of a change in classification are treated as occurring immediately before the close of the day before the effective date of the election. The owners of the entity when the election is effective may be different from the owners of the entity when the conversion transactions are deemed to occur. To ensure that the taxpayers who recognize the tax consequences of a conversion election approve of the election, the proposed regulations require that the election be signed by every owner on the date of the deemed conversion transactions.

A commentator indicated that purchasers who wish to make a classification election effective as of their first day of ownership may endure a burden in obtaining the consents of previous owners. The commentator recommended that the deemed conversion transactions be treated as occurring at the start of the day for which the election is effective, eliminating the need to obtain the consent of prior owners. Under this suggestion, purchasers of an association who wish to elect partnership treatment effective as of the first day of ownership would be treated as owning both stock and partnership interests on that first day of ownership. This would result in the purchasers being responsible for a corporate return for their transitory period of corporate ownership. See §1.6012–2.

The IRS and Treasury intended that the proposed timing rule generally would be beneficial for taxpayers. The IRS and Treasury believe that any burden imposed by this rule is outweighed by the transactional flexibility that this rule provides. Accordingly, the suggested change to the timing rule is not adopted.

Another commentator noted a conflict between the proposed timing rule and the deemed transactions under section 338. Section 338 allows a purchasing corporation to treat its stock purchase of another corporation as an asset purchase. Under section 338, a purchasing corporation may elect to treat the target corporation as (1) selling its assets at fair market value on the acquisition date, and (2) a new corporation that purchased all of the assets at the beginning of the day after the acquisition date. If the purchaser also makes a classification election for the target effective for the purchaser's first day of ownership, the timing of the deemed liquidation under §301.7701–3(g)(1) would conflict

with the timing of the deemed transactions required by section 338.

To address the issue, the final regulations specify that if section 338 applies, an election to convert the target corporation's classification cannot be effective before the day after the acquisition date of the target corporation. Additionally, the deemed liquidation and conversion under §301.7701–3(g)(1) will occur immediately after the completion of the section 338 transactions. These rules follow the approach of §1.338–2(c)(1)(i), which provides that when a target corporation liquidates on the acquisition date, the liquidation is treated as occurring on the following day and immediately after the deemed purchase of assets. If a taxpayer makes an election under section 338 (without a section 338(h)(10) election) regarding a target corporation that is subsequently deemed liquidated under these final regulations, the target corporation must file a final or deemed sale return as a C corporation reflecting the deemed sale. See §1.338–1(e).

Commentators also expressed concern over the effect the proposed timing rule would have on a sequence of elections when a number of corporations are owned through a single ownership chain. If the elections are all effective for the same date, the effect of the interaction of the timing rule with section 332 is unclear. For example, P corporation owns 100 percent of the interest of an eligible entity classified as an association (S1), which owns directly 100 percent of the interest of an eligible entity classified as an association (S2). P wants to convert S1 and S2 to disregarded entities on the same day; however, if both deemed liquidations are treated as occurring simultaneously, it is not clear that section 332 nonrecognition treatment would be available for both liquidations. The final regulations clarify that in such a situation, unless another order is specified for the elections, S1 will be treated as liquidating into P immediately before S2 liquidates into P.

Commentators suggested that this situation could be addressed by allowing taxpayers to make elections effective by the hour, instead of only at the start of the day. The IRS and Treasury believe that the clarification in the final regulations appropriately addresses the treatment of successive elections. Therefore, the final regulations maintain the rule that conversion elections take effect at the start of the day on which the election is effective.

II. *Taxpayer Identifying Numbers and Disregarded Entities*

The proposed regulations provide clarification of the rules regarding taxpayer identifying numbers (TINs). The proposed regulations restate the rule that when an entity's classification changes under §301.7701–3, it retains its employer identification number (EIN). The proposed regulations also clarified the rule that a disregarded entity must use its owner's TIN for federal tax purposes. Furthermore, when a disregarded entity becomes respected as a separate entity, it must use its own EIN and not the TIN of the single owner.

One commentator asked for clarification regarding the use of TINs and EINs in the proposed regulations. TINs include EINs, social security numbers (SSNs), and IRS individual taxpayer identification numbers (ITINs). The regulations require that a disregarded entity report under the owner's TIN. The regulations refer to a taxpayer's TIN because the term TIN encompasses not only an EIN, but also an SSN and an ITIN.

Another commentator suggested that the proposed regulations were too restrictive and prohibited a disregarded entity from applying for and receiving its own TIN. The regulations do not prevent a single member disregarded entity from applying for and receiving its own TIN. The regulations merely provide that, except as otherwise provided in regulations or other guidance, the single owner disregarded entity must use the owner's TIN for federal tax purposes and not the EIN of the disregarded entity. Notice 99–6 (1999–3 I.R.B. 1) provides guidance on the limited circumstances under which a disregarded entity may use its own EIN.

III. *Rules for Foreign Entities*

These final regulations also contain rules relating to certain foreign entities.

A. Foreign Per Se Entities

The final check-the-box regulations provided a list of the names of certain foreign business entities that are treated as corporations for federal tax purposes. In response to comments from taxpayers, the proposed regulations clarified those provisions. Specifically, clarifications were made with respect to certain business entities formed in Finland, Malaysia, Malta, Mexico, and Norway. These final regulations adopt the proposed regulation's clarifications.

These final regulations also clarify the treatment of an entity formed in Trinidad and Tobago that is specified in the final check-the-box regulations. Prior to April 1997, Trinidad and Tobago's Companies Act distinguished between public and private limited companies. Effective April 1997, Trinidad and Tobago's Companies Act was amended and now only provides for limited companies (and no longer provides for private limited companies). Accordingly, these final regulations have been modified to take into account that change. The effective date of these final regulations with regard to an entity formed in Trinidad and Tobago has been modified so as not to disadvantage taxpayers who relied on the final check-the-box regulations. These final regulations provide that the rule with regard to an entity formed in Trinidad and Tobago will be effective on or after November 29, 1999. Accordingly, this rule only affects those entities which were formed (or made affirmative elections) on or after November 29, 1999.

These regulations also clarify the exception to per se corporate treatment for Canadian companies and corporations. When the final check-the-box regulations were promulgated, the only company or corporation that could be formed where the liability of all of its members was unlimited pursuant to any federal or provincial statute (as opposed to through side agreements of the members), was a Nova Scotia Unlimited Liability Company (NSULC). However, in order to avoid changing the regulations if any other province, or the federal government, subsequently allowed for the formation of unlimited liability companies by statute, these regulations did not specifically list the NSULC. In response to questions from taxpayers, the regulation is clarified, with effect from January 1, 1997, by specifically naming the NSULC, while still providing for any other unlimited liability company that might subsequently be allowed by any other federal or provincial statute.

B. Foreign Eligible Entities

Proposed regulations that provide a special rule for certain foreign eligible entities are published in REG–110385–99 on page 000. In addition, the IRS and Treasury are still studying what, if any, consequences occur when a foreign eligible entity that is not relevant for federal tax purposes files an entity classification election. The IRS and Treasury continue to request comments on this topic.

IV. *Changes in Number of Members of an Entity*

The proposed regulations provide that an entity's classification may change as a result of a change in the number of its members. Specifically, an eligible entity classified as a partnership will become a disregarded entity when the entity's membership is reduced to one member, and a disregarded entity will be classified as a partnership when the entity has more than one member. The final regulations adopt these provisions without substantive change. Guidance on the federal tax consequences of such changes has been provided in Rev. Rul. 99–5 (1999–6 I.R.B. 8) and Rev. Rul. 99–6 (1999–6 I.R.B. 6).

Effective Date

These regulations are applicable on or after November 29, 1999. In response to comments, however, the final regulations include a provision allowing taxpayers to apply the regulations retroactively for elective entity conversions that occurred before November 29, 1999. Taxpayers may apply the final regulations retroactively only if all taxpayers involved in the transaction follow the regulations. The rules contained in §301.6109–1(h) are applicable as of January 1, 1997. Certain changes to §301.7701–2(b)(8) may be applied before the effective date as specified in §301.7701–2(e).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Dan Carmody and Jeff Erickson, Office of Chief Counsel (Passthroughs and Special Industries) and Mark Harris and Philip Tretiak, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6109-1 is amended as follows:

1. Paragraph (d)(2)(ii) is removed and reserved.

2. Paragraph (h) is redesignated as paragraph (i) and the first sentence of newly designated paragraph (i)(1) is amended by removing the language "paragraph (h)" and adding "paragraph (i)" in its place.

3. A new paragraph (h) is added.

The addition reads as follows:

§301.6109–1 Identifying numbers.

* * * * *

(h) *Special rules for certain entities under §301.7701-3*—(1) *General rule.* Any entity that has an employer identification number (EIN) will retain that EIN if its federal tax classification changes under §301.7701–3.

(2) *Special rules for entities that are disregarded as entities separate from their owners*—(i) *When an entity becomes disregarded as an entity separate from its owner.* Except as otherwise provided in regulations or other guidance, a single owner entity that is disregarded as an entity separate from its owner under §301.7701–3, must use its owner's taxpayer identifying number (TIN) for federal tax purposes.

(ii) *When an entity that was disregarded as an entity separate from its owner becomes recognized as a separate entity.* If a single owner entity's classification changes so that it is recognized as a separate entity for federal tax purposes, and that entity had an EIN, then the entity must use that EIN and not the TIN of the single owner. If the entity did not already have its own EIN, then the entity must acquire an EIN and not use the TIN of the single owner.

(3) *Effective date.* The rules of this paragraph (h) are applicable as of January 1, 1997.

* * * * *

Par. 3. Section 301.7701–2 is amended as follows:

1. Paragraph (b)(8)(i) is amended by revising the entries for Finland, Malta, Norway, and Trinidad and Tobago.

2. Paragraph (b)(8)(ii)(A) is redesignated as paragraph (b)(8)(ii)(A)(1) and is revised.

3. Paragraph (b)(8)(ii)(B) is redesignated as paragraph (b)(8)(ii)(A)(2).

4. Paragraph (b)(8)(ii) heading and introductory text are redesignated as paragraph (b)(8)(ii)(A) heading and introductory text, and a new paragraph heading is added for paragraph (b)(8)(ii).

5. Paragraphs (b)(8)(ii)(A)(3) and (b)(8)(ii)(B) are added.

6. Paragraphs (b)(8)(iii), (b)(8)(iv), and (e) are revised.

The revisions and additions read as follows:

§301.7701–2 Business entities; definitions.

* * * * *

(b) * * *

(8) * * *

(i) * * *

Finland, Julkinen Osakeyhtio/Publikt Aktiebolag

* * * * *

Malta, Public Limited Company

* * * * *

Norway, Allment Aksjeselskap

* * * * *

Trinidad and Tobago, Limited Company

* * * * *

(ii) *Clarification of list of corporations in paragraph (b)(8)(i) of this section*—(A) *Exceptions in certain cases.* * * *

* * * * *

(*1*) With regard to Canada, a Nova Scotia Unlimited Liability Company (or any other company or corporation all of whose owners have unlimited liability pursuant to federal or provincial law).

* * * * *

(*3*) With regard to Malaysia, a Sendirian Berhad.

(B) *Inclusions in certain cases.* With regard to Mexico, the term Sociedad Anonima includes a Sociedad Anonima that chooses to apply the variable capital provision of Mexican corporate law (Sociedad Anonima de Capital Variable).

(iii) *Public companies.* For purposes of paragraph (b)(8)(i) of this section, with regard to Cyprus, Hong Kong, and Jamaica, the term Public Limited Company includes any Limited Company that is not defined as a private company under the corporate laws of those jurisdictions. In all other cases, where the term Public Limited Company is not defined, that term shall include any Limited Company defined as a public company under the corporate laws of the relevant jurisdiction.

(iv) *Limited companies.* For purposes of this paragraph (b)(8), any reference to a Limited Company includes, as the case may be, companies limited by shares and companies limited by guarantee.

* * * * *

(e) *Effective date.* Except as otherwise provided in this paragraph (e), the rules of this section apply as of January 1, 1997. The reference to the Finnish, Maltese, and Norwegian entities in paragraph (b)(8)(i) of this section is applicable on November 29, 1999. The reference to the Trinidadian entity in paragraph (b)(8)(i) of this section applies to entities formed on or after November 29, 1999. Any Maltese or Norwegian entity that becomes an eligible entity as a result of paragraph (b)(8)(i) of this section in effect on November 29, 1999, may elect by February 14, 2000, to be classified for federal tax purposes as an entity other than a corporation retroactive to any period from and including January 1, 1997. Any Finnish entity that becomes an eligible entity as a result of paragraph (b)(8)(i) of this section in effect on November 29, 1999, may elect by February 14, 2000, to be classified for federal tax purposes as an entity other than a corporation retroactive to any period from and including September 1, 1997.

Par. 4. Section 301.7701-3 is amended as follows:

1. A sentence is added at the end of paragraph (c)(1)(iii).

2. A sentence is added at the end of paragraph (c)(1)(iv).

3. Paragraph (c)(2)(iii) is added.

4. A heading is added to paragraph (d)(1).

5. Paragraph (f) is redesignated as paragraph (h) and newly designated paragraph (h)(1) is revised.

6. Paragraphs (f) and (g) are added.

The revision and additions read as follows:

§301.7701-3 Classification of certain business entities.

* * * * *

(c) * * *

(1) * * *

(iii) *Effective date of election.* * * * If a purchasing corporation makes an election under section 338 regarding an acquired subsidiary, an election under paragraph (c)(1)(i) of this section for the acquired subsidiary can be effective no earlier than the day after the acquisition date (within the meaning of section 338(h)(2)).

(iv) *Limitation.* * * * An election by a newly formed eligible entity that is effective on the date of formation is not considered a change for purposes of this paragraph (c)(1)(iv).

* * * * *

(2) * * *

(iii) *Changes in classification.* For paragraph (c)(2)(i) of this section, if an election under paragraph (c)(1)(i) of this section is made to change the classification of an entity, each person who was an owner on the date that any transactions under paragraph (g) of this section are deemed to occur, and who is not an owner at the time the election is filed, must also sign the election. This paragraph (c)(2)(iii) applies to elections filed on or after November 29, 1999.

(d) *Special rules for foreign eligible entities—(1) Definition of relevance.* * * *

* * * * *

(f) *Changes in number of members of an entity*—(1) Associations. The classification of an eligible entity as an association is not affected by any change in the number of members of the entity.

(2) *Partnerships and single member entities.* An eligible entity classified as a partnership becomes disregarded as an entity separate from its owner when the entity's membership is reduced to one member. A single member entity disregarded as an entity separate from its owner is classified as a partnership when the entity has more than one member. If an elective classification change under paragraph (c) of this section is effective at the same time as a membership change described in this paragraph (f)(2), the deemed transactions in paragraph (g) of this section resulting from the elective change preempt the transactions that would result from the change in membership.

(3) *Effect on sixty month limitation.* A change in the number of members of an entity does not result in the creation of a new entity for purposes of the sixty month limitation on elections under paragraph (c)(1)(iv) of this section.

(4) *Examples.* The following examples illustrate the application of this paragraph (f):

Example 1. A, a U.S. person, owns a domestic eligible entity that is disregarded as an entity separate from its owner. On January 1, 1998, *B*, a U.S. person, buys a 50 percent interest in the entity from A. Under this paragraph (f), the entity is classified as a partnership when *B* acquires an interest in the entity. However, *A* and *B* elect to have the entity classified as an association effective on January 1, 1998. Thus, *B* is treated as buying shares of stock on Janu-

ary 1, 1998. (Under paragraph (c)(1)(iv) of this section, this election is treated as a change in classification so that the entity generally cannot change its classification by election again during the sixty months succeeding the effective date of the election.) Under paragraph (g)(1) of this section, *A* is treated as contributing the assets and liabilities of the entity to the newly formed association immediately before the close of December 31, 1997. Because A does not retain control of the association as required by section 351, A's contribution will be a taxable event. Therefore, under section 1012, the association will take a fair market value basis in the assets contributed by *A*, and *A* will have a fair market value basis in the stock received. *A* will have no additional gain upon the sale of stock to *B*, and *B* will have a cost basis in the stock purchased from *A*.

Example 2. (i) On April 1, 1998, *A* and *B*, U.S. persons, form *X*, a foreign eligible entity. *X* is treated as an association under the default provisions of paragraph (b)(2)(i) of this section, and *X* does not make an election to be classified as a partnership. *A* subsequently purchases all of *B*'s interest in *X*.

(ii) Under paragraph (f)(1) of this section, *X* continues to be classified as an association. *X*, however, can subsequently elect to be disregarded as an entity separate from A. The sixty month limitation of paragraph (c)(1)(iv) of this section does not prevent *X* from making an election because *X* has not made a prior election under paragraph (c)(1)(i) of this section.

Example 3. (i) On April 1, 1998, *A* and *B*, U.S. persons, form *X*, a foreign eligible entity. *X* is treated as an association under the default provisions of paragraph (b)(2)(i) of this section, and *X* does not make an election to be classified as a partnership. On January 1, 1999, *X* elects to be classified as a partnership effective on that date. Under the sixty month limitation of paragraph (c)(1)(iv) of this section, *X* cannot elect to be classified as an association until January 1, 2004 (i.e., sixty months after the effective date of the election to be classified as a partnership).

(ii) On June 1, 2000, *A* purchases all of *B*'s interest in *X*. After *A*'s purchase of *B*'s interest, *X* can no longer be classified as a partnership because *X* has only one member. Under paragraph (f)(2) of this section, *X* is disregarded as an entity separate from A when A becomes the only member of *X*. *X*, however, is not treated as a new entity for purposes of paragraph (c)(1)(iv) of this section. As a result, the sixty month limitation of paragraph (c)(1)(iv) of this section continues to apply to *X*, and *X* cannot elect to be classified as an association until January 1, 2004 (i.e., sixty months after January 1, 1999, the effective date of the election by *X* to be classified as a partnership).

(5) *Effective date.* This paragraph (f) applies as of November 29, 1999.

(g) *Elective changes in classification*—(1) *Deemed treatment of elective change*—(i) *Partnership to association.* If an eligible entity classified as a partnership elects under paragraph (c)(1)(i) of this section to be classified as an association, the following is deemed to occur: The partnership contributes all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners.

(ii) *Association to partnership.* If an eligible entity classified as an association elects under paragraph (c)(1)(i) of this section to be classified as a partnership, the following is deemed to occur: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.

(iii) *Association to disregarded entity.* If an eligible entity classified as an association elects under paragraph (c)(1)(i) of this section to be disregarded as an entity separate from its owner, the following is deemed to occur: The association distributes all of its assets and liabilities to its single owner in liquidation of the association.

(iv) *Disregarded entity to an association.* If an eligible entity that is disregarded as an entity separate from its owner elects under paragraph (c)(1)(i) of this section to be classified as an association, the following is deemed to occur: The owner of the eligible entity contributes all of the assets and liabilities of the entity to the association in exchange for stock of the association.

(2) *Effect of elective changes.* The tax treatment of a change in the classification of an entity for federal tax purposes by election under paragraph (c)(1)(i) of this section is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law, including the step transaction doctrine.

(3) *Timing of election*—(i) *In general.* An election under paragraph (c)(1)(i) of this section that changes the classification of an eligible entity for federal tax purposes is treated as occurring at the start of the day for which the election is effective. Any transactions that are deemed to occur under this paragraph (g) as a result of a change in classification are treated as occurring immediately before the close of the day before the election is effective. For example, if an election is made to change the classification of an entity from an association to a partnership effective on January 1, the deemed transactions specified in paragraph (g)(1)(ii) of this section (including the liquidation of the association) are treated as occurring immediately before the close of December 31 and must be reported by the owners of the entity on December 31. Thus, the last day of the association's taxable year will be December 31 and the first day of the partnership's taxable year will be January 1.

(ii) *Coordination with section 338 election.* A purchasing corporation that makes a qualified stock purchase of an eligible entity taxed as a corporation may make an election under section 338 regarding the acquisition if it satisfies the requirements for the election, and may also make an election to change the classification of the target corporation. If a taxpayer makes an election under section 338 regarding its acquisition of another entity taxable as a corporation and makes an election under paragraph (c) of this section for the acquired corporation (effective at the earliest possible date as provided by paragraph (c)(1)(iii) of this section), the transactions under paragraph (g) of this section are deemed to occur immediately after the deemed asset purchase by the new target corporation under section 338.

(iii) *Application to successive elections in tiered situations.* When elections under paragraph (c)(1)(i) of this section for a series of tiered entities are effective on the same date, the eligible entities may specify the order of the elections on Form 8832. If no order is specified for the elections, any transactions that are deemed to occur in this paragraph (g) as a result of the classification change will be treated as occurring first for the highest tier entity's classification change, then for the next highest tier entity's classification change, and so forth down the chain of entities until all the transactions under this paragraph (g) have occurred. For example, Parent, a corporation, wholly owns all of the interest of an eligible entity classified as an association (S1), which wholly owns another eligible entity classified as an association (S2), which wholly owns another eligible entity classified as an association (S3). Elections under paragraph (c)(1)(i) of this section are filed to classify S1, S2, and S3 each as disregarded as an entity separate from its owner effective on the same day. If no order is specified for the elections, the following transactions are deemed to occur under this paragraph

(g) as a result of the elections, with each successive transaction occurring on the same day immediately after the preceding transaction: S1 is treated as liquidating into Parent, then S2 is treated as liquidating into Parent, and finally S3 is treated as liquidating into Parent.

(4) *Effective date.* This paragraph (g) applies to elections that are filed on or after November 29, 1999. Taxpayers may apply this paragraph (g) retroactively to elections filed before November 29, 1999 if all taxpayers affected by the deemed transactions file consistently with this paragraph (g).

(h) *Effective date*—(1) *In general.* Except as otherwise provided in this section, the rules of this section are applicable as of January 1, 1997.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved November 2, 1999.

Jonathan Talisman,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 26, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 29, 1999, 64 F.R. 66580)

Section 7872.—Treatment of Loans with Below-Market Interest Rates

CPI adjustments for below-market loans for 2000. The amount that section 7872(g) of the Code permits a taxpayer to lend to a qualified continuing care facility without incurring imputed interest is adjusted for years 1987-2000. Rev. Rul. 98-59 supplemented and superseded.

Rev. Rul. 99–49

This revenue ruling publishes the amount that § 7872(g) of the Internal Revenue Code permits a taxpayer to lend to a qualifying continuing care facility without incurring imputed interest. The amount is adjusted for inflation for the years after 1986.

Section 7872 generally treats loans bearing a below-market interest rate as if they bore interest at the market rate.

Section 7872(g)(1) provides that, in general, § 7872 does not apply for any calendar year to any below-market loan made by a lender to a qualified continuing care facility pursuant to a continuing care contract if the lender (or the lender's spouse) attains age 65 before the close of the year.

Section 7872(g)(2) provides that, in the case of loans made after October 11, 1985, and before 1987, § 7872(g)(1) applies only to the extent that the aggregate outstanding amount of any loan to which § 7872(g) applies (determined without regard to § 7872(g)(2)), when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender's spouse) and any qualified continuing care facility to which § 7872(g)(1) applies, does not exceed $90,000.

Section 7872(g)(5) provides that, for loans made during any calendar year after 1986 to which § 7872(g)(1) applies, the $90,000 limit specified in § 7872(g)(2) is increased by an inflation adjustment. The inflation adjustment for any calendar year is the percentage (if any) by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for calendar year 1985. Section 7872(g)(5) states that the CPI for any calendar year is the average of the CPI as of the close of the 12-month period ending on September 30 of that calendar year.

Table 1 sets forth the amount specified in § 7872(g)(2) of the Code. The amount is increased by the inflation adjustment for the years 1987-2000.

REV. RUL. 99–49 TABLE 1

Limit under 7872(g)(2)

Year	*Amount*
Before 1987	$ 90,000
1987	$ 92,200
1988	$ 94,800
1989	$ 98,800
1990	$103,500
1991	$108,600
1992	$114,100
1993	$117,500
1994	$121,100
1995	$124,300
1996	$127,800
1997	$131,300
1998	$134,800
1999	$137,000
2000	$139,700

Note: These inflation adjustments were computed using the All-Urban, Consumer Price Index 1982-1984 base, published by the Bureau of Labor Statistics.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 98–59, 1998–52 I.R.B. 8, is supplemented and superseded.

DRAFTING INFORMATION

The author of this revenue ruling is Courtney Shepardson of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. Shepardson on (202) 622-3930 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

Tables for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income

Notice 99-56

1. Table for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income (Forms 668-W, 668-W(c), & 668-W(c)(DO)) 2000

Publication 1494, shown below, provides tables which show the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2000.

(Amounts are for each pay period.)

Filing Status: Single							
	Number of Exemptions Claimed on Statement						
Pay Period	1	2	3	4	5	6	More Than 6
Daily	27.69	38.46	49.23	60.00	70.77	81.54	16.92 plus 10.77 for each exemption
Weekly	138.46	192.31	246.15	300.00	353.85	407.69	84.62 plus 53.85 for each exemption
Biweekly	276.92	384.62	492.31	600.00	707.69	815.38	169.23 plus 107.69 for each exemption
Semi-monthly	300.00	416.67	533.33	650.00	766.67	883.33	183.33 plus 116.67 for each exemption
Monthly	600.00	833.33	1066.67	1300.00	1533.33	1766.67	366.67 plus 233.33 for each exemption

Filing Status: Unmarried Head of Household							
	Number of Exemptions Claimed on Statement						
Pay Period	1	2	3	4	5	6	More Than 6
Daily	35.58	46.35	57.12	67.88	78.65	89.42	24.81 plus 10.77 for each exemption
Weekly	177.88	231.73	285.58	339.42	393.27	447.12	124.04 plus 53.85 for each exemption
Biweekly	355.77	463.46	571.15	678.85	786.54	894.23	248.08 plus 107.69 for each exemption
Semi-monthly	385.42	502.08	618.75	735.42	852.08	968.75	268.75 plus 116.67 for each exemption
Monthly	770.83	1004.17	1237.50	1470.83	1704.17	1937.50	537.50 plus 233.33 for each exemption

Filing Status: Married Filing Joint (and Qualifying Widow(er)s)							
	Number of Exemptions Claimed on Statement						
Pay Period	1	2	3	4	5	6	More Than 6
Daily	39.04	49.81	60.58	71.35	82.12	92.88	28.27 plus 10.77 for each exemption
Weekly	195.19	249.04	302.88	356.73	410.58	464.42	141.35 plus 53.85 for each exemption
Biweekly	390.38	498.08	605.77	713.46	821.15	928.85	282.69 plus 107.69 for each exemption
Semi-monthly	422.92	539.58	656.25	772.92	889.58	1006.25	306.25 plus 116.67 for each exemption
Monthly	845.83	1079.17	1312.50	1545.83	1779.17	2012.50	612.50 plus 233.33 for each exemption

Filing Status: Married Filing Separate							
	Number of Exemptions Claimed on Statement						
Pay Period	1	2	3	4	5	6	More Than 6
Daily	24.90	35.67	46.44	57.21	67.98	78.75	14.13 plus 10.77 for each exemption
Weekly	124.52	178.37	232.21	286.06	339.90	393.75	70.67 plus 53.85 for each exemption
Biweekly	249.04	356.73	464.42	572.12	679.81	787.50	141.35 plus 107.69 for each exemption
Semi-monthly	269.79	386.46	503.13	619.79	736.46	853.13	153.13 plus 116.67 for each exemption
Monthly	539.58	772.92	1006.25	1239.58	1472.92	1706.25	306.25 plus 233.33 for each exemption

2. Table for Figuring Additional Exempt Amount for Taxpayers at Least 65 Years Old and/or Blind

Additional Exempt Amount

Filing Status	*	Daily	Wkly	Bi-Wkly	Semi-Mo	Monthly
Single or Head of Household	1	4.23	21.15	42.31	45.83	91.67
	2	8.46	42.31	84.62	91.67	183.33
Any Other Filing Status	1	3.27	16.35	32.69	35.42	70.83
	2	6.54	32.69	65.38	70.83	141.67
	3	9.81	49.04	98.08	106.25	212.50
	4	13.08	65.38	130.77	141.67	283.33

* ADDITIONAL STANDARD DEDUCTION claimed on Parts 3, 4, & 5 of levy.

Examples

These tables show the amount exempt from a levy on wages, salary, and other income. For example:

1. A single taxpayer who is paid weekly and claims three exemptions (including one for the taxpayer) has $246.15 exempt from levy.

2. If the taxpayer in number 1 is over 65 and writes 1 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy, $267.30 is exempt from this levy ($246.15 plus $21.15).

3. A taxpayer who is married, files jointly, is paid bi-weekly, and claims two exemptions (including one for the taxpayer) has $498.08 exempt from levy.

4. If the taxpayer in number 3 is over 65 and has a spouse who is blind, this taxpayer should write 2 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy. Then, $563.46 is exempt from this levy ($498.08 plus $65.38).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Changes in Entity Classification: Special Rule for Certain Foreign Eligible Entities

REG-110385-99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations addressing certain transactions that occur within a specified period of time before or after a change in entity classification. The proposed regulations prevent, in limited circumstances, the use of changes in entity classification to alter a taxpayer's Federal tax consequences. Under these regulations, a change in classification by a foreign eligible entity that was originally classified as an association taxable as a corporation (and, but for this regulation, would be classified as an entity disregarded as an entity separate from its owner) will be invalidated in certain limited circumstances. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by February 28, 2000. Requests to speak (with outlines of oral comments) at the public hearing scheduled for January 31, 2000, must be submitted by January 10, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-110385-99), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-110385-99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Mark D. Harris, (202) 622-3860 (not a toll-free number); concerning submissions and the hearing, LaNita VanDyke, (202) 622-7180 (not a toll-free number).

Supplementary Information:

Background

This document proposes to amend the current Procedure and Administration Regulations (26 CFR Part 301) relating to the classification of entities for Federal tax purposes. On December 18, 1996, the IRS and the Treasury Department published final regulations (61 FR 66584) relating to the classification of business organizations under section 7701. The regulations (the check-the-box regulations) replaced the increasingly formalistic entity classification rules with a simpler, elective regime. The new rules were designed to ease administrative burdens for taxpayers and the government. They were not, however, intended to change the application of substantive Internal Revenue Code (Code) provisions.

In the preamble to the check-the-box regulations, the IRS and Treasury expressed concern about potential improper uses of the check-the-box regulations involving partnerships:

> [I]n light of the increased flexibility under an elective regime for the creation of organizations classified as partnerships, Treasury and the IRS will continue to monitor carefully the uses of partnerships in the international context and will take appropriate action when partnerships are used to achieve results that are inconsistent with the policies and rules of particular Code provisions or of U.S. tax treaties.

On October 28, 1997, the IRS and Treasury issued a notice of proposed rulemaking (62 FR 55768) under section 7701. These regulations specify the tax consequences resulting from an election to change the Federal tax classification of an eligible entity (the conversion regulations). The conversion regulations also provide that the tax consequences of an elective change in the classification of an entity for Federal tax purposes are determined under all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine. Those final regulations are issued elsewhere in this issue of the Federal Register.

As indicated in the preamble to the check-the-box regulations, the IRS and Treasury have been monitoring the manner in which taxpayers have used the check-the-box regulations since their enactment. The focus has been to determine whether taxpayers use the regulations in a manner inconsistent with the application of any Code provisions, and, if so, what, if any, action is appropriate. The preamble to the check-the-box regulations cited the use of partnerships as a primary concern. However, it has become apparent to the IRS and Treasury that taxpayers may attempt to use entities that are disregarded as entities separate from their owners (disregarded entities), in addition to partnerships, to achieve results, in relation to certain transactions, that are inconsistent with the policies and rules of particular Code sections or tax treaties. These regulations are intended to address inappropriate Federal tax consequences that would otherwise result from certain of these transactions under a number of international provisions of the Code. These provisions include the rules governing source of income under sections 861 through 865, foreign tax credit limitation categories under section 904, the disposition of ownership interests under Subpart F (sections 951 through 964), and outbound transfers under section 367 (in this last case, leading to a different result than that outlined in the example in the preamble to the section 367(a) regulations (63 FR 33550)).

The IRS and Treasury considered several responses to these transactions and determined that a special rule completely revoking the entity's classification as a disregarded entity was the most equitable and administrable approach. Of the responses considered, the IRS and Treasury believe that this approach also gives the greatest certainty to all parties involved in the transactions covered by this rule.

Explanation of Provisions

This special rule is limited in scope. It only applies to "extraordinary transac-

tions" (such as sales of a part or whole interest) that occur within a period commencing one day before and ending 12 months after the date that a foreign eligible entity changed its classification to disregarded entity status, provided that the entity had been classified as an association taxable as a corporation within the 12-month period prior to the extraordinary transaction. The rule also applies to certain "shelf" entities that might be used in an attempt to circumvent the 12-month rule. In these cases, the entity would not be treated as a disregarded entity, and instead would be classified as an association taxable as a corporation for all purposes. The regulations provide rules specifying from what date this classification as an association taxable as a corporation will be applicable. Examples of these provisions are included in the regulations.

This special rule will not apply to an extraordinary transaction if a taxpayer establishes to the satisfaction of the Commissioner that the classification as a disregarded entity does not materially alter the Federal tax consequences of the extraordinary transaction.

The IRS and Treasury do not intend that this regulation will invalidate an entity classification election in the absence of a separate extraordinary transaction, even though the deemed consequences of such election under the conversion regulations may constitute an extraordinary transaction. In the preamble to the conversion regulations, however, the IRS and Treasury requested comments on the appropriate tax consequences of an entity classification election made by a foreign eligible entity that is not relevant for Federal tax purposes (e.g., with respect to the basis of property or earnings and profits of the entity). No comments have been received. The IRS and Treasury continue to study and solicit comments on this important issue and are considering whether, in certain circumstances, the election, combined with another event whereby the entity becomes relevant, should be considered to be inappropriate and, therefore, invalid under these regulations.

If an entity made a classification election pursuant to §301.7701–3(c) to be disregarded, and that election was considered a change in classification, that entity would normally be subject to the 60-month limitation on elections under §301.7701–3(c)(1)(iv). However, if that classification election under §301.7701–3(c) is invalid under this regulation, then the election to be a disregarded entity shall not constitute an election for all Federal tax purposes, including the limitation on elections under §301.7701–3(c)(1)(iv).

These regulations do not prevent the Commissioner from applying all applicable common law doctrines to any extraordinary transaction to which this rule applies, in any administrative or judicial proceeding (and create no inference as to the treatment of such transactions occurring prior to the effective date of these regulations). Conversely, the Commissioner may also provide administrative relief from these regulations by published guidance.

The IRS and Treasury will continue to monitor potentially improper uses of the check-the-box regulations involving partnerships and disregarded entities, and will take appropriate action when such uses achieve results that are inconsistent with the policies and rules of particular Code provisions or of U.S. tax treaties.

This special rule does not apply to the transactions described in the proposed regulations on hybrid branch transactions published in the Federal Register on July 13, 1999 (64 FR 37727), issued pursuant to Notice 98–35 (1998–27 IRB 35). These proposed regulations apply only to dispositions of interests in disregarded entities in extraordinary transactions.

The IRS and Treasury request comments with respect to the special rule contained herein. In particular, the IRS and Treasury request comments on the specific types of transactions which should be excluded from the application of the special rule. When this proposed regulation is finalized, the IRS and Treasury intend to issue guidance that will identify specific transactions that will be excluded from the application of this special rule.

Grandfathered Foreign Per Se Entities

The check-the-box regulations allowed for certain corporations under §301.7701–2(b)(8)(i) to be treated as partnerships if certain conditions enumerated in §301.7701–2(d)(1) were satisfied. However, upon the occurrence of certain events, such an entity's "grandfathered status" could be terminated. See §301.7701–2(d)(3)(i). The IRS and Treasury are concerned that taxpayers have been trafficking in these types of entities. Accordingly, these proposed regulations would add a new provision to §301.7701–2(d)(3)(i) which terminates an entity's "grandfather status" when one or more persons, who were not owners of the entity as of November 29, 1999, become owners of 50 percent or more of the interests in the entity.

Relevance

The check-the-box regulations provide a special rule when the Federal tax classification of a foreign eligible entity is no longer relevant. The rule states that if the classification of a foreign eligible entity which was previously relevant for Federal tax purposes ceases to be relevant for sixty consecutive months, the entity's classification will initially be determined under the default classification when the classification of the foreign eligible entity again becomes relevant (hereinafter 60-month rule). Several practitioners have requested guidance on whether the act of filing an entity classification election (Form 8832, Entity Classification Election) causes an entity to be relevant for purposes of the 60-month rule. Practitioners also have requested clarification regarding whether a newly formed foreign eligible entity, that has never been relevant, is subject to the 60-month rule.

These proposed regulations provide that if a foreign eligible entity files an entity classification election, it is considered relevant on the effective date of the election for purposes of the 60-month rule. However, if the foreign eligible entity is otherwise not relevant within the meaning of §301.7701–3(d)(1)(i), then for purposes of applying the 60-month rule the entity will be considered to be not relevant on the day after the date the entity classification election was effective.

The preamble to the conversion regulations stated that a foreign eligible entity that is not relevant has a Federal tax classification. The proposed regulations clarify that such an entity is subject to the 60-month rule. However, the proposed regulations provide an exception for a foreign eligible entity that was never relevant (within the meaning of §301.7701–3(d)(1)) during its existence.

Such entity's classification will initially be determined pursuant to the provisions of §301.7701–3(b)(2) when the entity first becomes relevant.

Proposed Effective Date

Except as otherwise specified, these regulations are proposed to apply as of the date final regulations are published in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed regulation and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 31, 2000, beginning at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit timely written comments and an outline of the topics to be discussed and the time to be devoted to each topic by (preferably a signed original and eight (8) copies) January 10, 2000. However, comments not to be presented at the hearing must be submitted by February 28, 2000.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Mark D. Harris, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301--PROCEDURE AND ADMINISTRATION

Par. 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7701–2 is amended by:

1. Removing the language "or" at the end of paragraph (d)(3)(i)(B).

2. Removing the period at the end of paragraph (d)(3)(i)(C) and adding "; or" in its place.

3. Adding paragraph (d)(3)(i)(D).

4. Adding a sentence at the end of paragraph (e).

The additions read as follows:

§301.7701–2 Business entities; definitions.

* * * * *

(d) * * *

(3) * * *

(i) * * *

(D) The date any person or persons, who were not owners of the entity as of November 29, 1999, own in the aggregate a 50 percent or greater interest in the entity.

* * * * *

(e) *Effective date.* * * * However, paragraph (d)(3)(i)(D) of this section applies on or after the date final regulations are published in the Federal Register.

Par. 3. Section 301.7701–3 is amended as follows:

1. The text of paragraph (d)(1) following the paragraph heading is redesignated as paragraph (d)(1)(i), and a paragraph heading is added for paragraph (d)(1)(i).

2. Paragraph (d)(1)(ii) is added.

3. Paragraph (d)(2) is revised.

4. Paragraphs (d)(3) and (d)(4) are added.

5. Paragraph (h) is redesignated as paragraph (i).

6. A new paragraph (h) is added.

The revision and addition reads as follows:

§301.7701–3 Classification of certain business entities.

* * * * *

(d) *Special rules for foreign eligible entities*—(1) *Definition of relevance*—(i) *General rule.* * * *

(ii) *Deemed relevance*—(A) *General rule.* For purposes of this section, except as provided in paragraph (d)(1)(ii)(B) of this section, a foreign eligible entity that files Form 8832 (Entity Classification Election) shall be deemed to be relevant only on the date the entity classification election is effective.

(B) *Exception.* If a foreign eligible entity is relevant within the meaning of paragraph (d)(1)(i) of this section, then the rule in paragraph (d)(1)(ii)(A) of this section shall not apply.

(2) *Entities that were never relevant.* If a foreign eligible entity's Federal tax classification has never been relevant (as defined in paragraph (d)(1) of this section), then the entity's classification will initially be determined pursuant to the provisions of paragraph (b)(2) of this section when the entity first becomes relevant (as defined in paragraph (d)(1)(i) of this section).

(3) *Special rule when classification is no longer relevant.* If the classification of a foreign eligible entity is not relevant for sixty consecutive months, the entity's classification will initially be determined under the default classification when the classification of the foreign eligible entity becomes relevant. The date that the classification of a foreign entity is not relevant is the date an event occurs that causes the classification to no longer be relevant, or, if no event occurs in a tax-

able year that causes the classification to be relevant, then the date is the first day of that taxable year.

(4) *Effective date.* Paragraphs (d)(1)(ii), (d)(2), and (d)(3) of this section apply on or after the date final regulations are published in the Federal Register.

* * * * *

(h) *Special rule when foreign entities that are disregarded as entities separate from their owner are used in an extraordinary transaction*—(1) *General rule*—(i) *When an eligible entity becomes disregarded as an entity separate from its owner.* Notwithstanding any other provision of this section, a foreign eligible entity classified as an entity that is disregarded as an entity separate from its owner, will instead be classified as an association taxable as a corporation, if—

(A) A 10-percent or greater interest in the foreign eligible entity is sold, exchanged, transferred or otherwise disposed of in one or more transactions (collectively, extraordinary transactions) that occur (or are treated as occurring) in the period commencing one day before and ending 12 months after the effective date of that foreign eligible entity's change in classification to an entity that is disregarded as an entity separate from its owner; and

(B) The foreign eligible entity was previously classified as an association taxable as a corporation at any time within the 12-month period prior to the date of the commencement of the extraordinary transaction.

(ii) *Period of reclassification.* If paragraph (h)(1)(i) of this section applies, the foreign eligible entity shall be treated as an association taxable as a corporation (and no intervening Federal tax classification will be valid) from and including the date that the foreign eligible entity ceased to be classified as an association taxable as a corporation.

(2) *Shelf entities*—(i) *Acquisition of assets from another entity.* A foreign eligible entity, classified as an entity that is disregarded as an entity separate from its owner, will instead be classified as an association taxable as a corporation, if—

(A) It acquires the assets of one or more foreign business entities (which were classified as associations taxable as corporations at any time within the 12-month period prior to the date of the commencement of the extraordinary transaction) in a transaction or series of related transactions in which gain or loss is not recognized (for Federal tax purposes), in whole or in part (acquisition transaction);

(B) After the acquisition transaction (or transactions), the acquired assets comprise more than 80 percent of the value of the assets of the entity that is disregarded as an entity separate from its owner; and

(C) Such entity is subsequently involved in an extraordinary transaction within 12 months of the date on which the acquisition transaction (or the last of such transactions) is completed.

(ii) *Calculation of value of entities.* For purposes of calculating the ratio of assets under paragraph (h)(2)(i)(B) of this section, cash and marketable securities of an entity shall not be included to the extent that the cash and marketable securities exceed the reasonable needs of that entity's business.

(iii) *Period of reclassification.* If paragraph (h)(2)(i) of this section applies, the foreign eligible entity shall be treated as an association taxable as a corporation from and including the date of the acquisition transaction, or, if the acquisition transaction involves a series of related transactions, the date of the last of such transactions.

(3) *Exception.* The rules in paragraphs (h)(1) and (2) of this section will not apply to an extraordinary transaction if a taxpayer establishes to the satisfaction of the Commissioner that the classification as an entity that is disregarded as an entity separate from its owner does not materially alter the Federal tax consequences of the extraordinary transaction. The Commissioner may also provide exceptions to paragraphs (h)(1) and (2) of this section by published guidance (see §601.601(d)(2) of this chapter).

(4) *Examples.* The following examples illustrate the rules of this paragraph (h). These examples assume that all foreign entities (FC) are eligible entities that are classified as associations taxable as corporations, and all U.S. entities (P) are corporations, unless otherwise specified. The examples are as follows:

Example 1. (i) *Facts.* P owns 100 percent of FC1. P plans to sell FC1. An entity classification election under paragraph (c) of this section is made for FC1 such that FC1 is now classified as an entity disregarded as an entity separate from its owner (P). P sells FC1 to an unrelated third party within 12 months of the effective date of the entity classification election.

(ii) *Result.* The sale of FC1, an entity that is disregarded as an entity separate from its owner which was previously classified as an association taxable as a corporation, is an extraordinary transaction, and because it occurred within 12 months of the effective date of the entity classification election, it is subject to the rule of paragraph (h)(1) of this section. Under paragraph (h)(1) of this section, the entity classification election to treat FC1 as an entity that is disregarded as an entity separate from its owner is invalid, and FC1 remains classified as an association taxable as a corporation as if there had been no election to be disregarded as an entity separate from its owner. Therefore, P is taxed as if it sold the stock of FC1, and not the assets of FC1.

Example 2. (i) *Facts.* The facts are the same as *Example 1,* except that an entity classification election is not made for FC1. P wishes to avoid the result in *Example 1,* and not be subject to paragraph (h)(1) of this section. P had formed FC2 two years before the date of the extraordinary transaction. At that time, P had elected for FC2 to be treated as an entity that is disregarded as an entity separate from P. Since that time, FC2 has conducted no business activities and has held no assets. P causes FC1 to merge into FC2 (under foreign law), with FC2 surviving, in a transaction in which gain or loss is not recognized for Federal tax purposes. On the same day, P sells FC2 to an unrelated third party.

(ii) *Result.* The sale of FC2 is an extraordinary transaction. Furthermore, despite the fact that FC2 was formed two years before the date of the extraordinary transaction, paragraph (h)(2) of this section treats FC2 as an association taxable as a corporation. This is because more than 80 percent of FC2's post-merger assets were acquired from FC1. Thus, the extraordinary transaction is subject to the rule of paragraph (h)(2) of this section, and has the same result as *Example 1.*

(5) *Effective date.* This paragraph (h) applies on or after the date final regulations are published in the Federal Register.

* * * * *

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 26, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 29, 1999, 64 F.R. 66591)

Special Basis Rules for Transfer of Property by a Partnership to a Corporation

Announcement 99-113

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of proposed

regulations.

SUMMARY: This document partially withdraws certain proposed regulations relating to special basis adjustments under section 743. The withdrawal is in response to the publication of subsequent proposed regulations (REG–209682–94) addressing the same subject matter.

FOR FURTHER INFORMATION CONTACT: Daniel Carmody at (202) 622-3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On October 28, 1997, the IRS published in the Federal Register (62 FR 55768) proposed regulations under section 743 of the Internal Revenue Code (the proposed regulations). Section 1.743–2 of the proposed regulations addresses the effect of the special basis adjustment under section 743 for partnerships that participate in section 351 exchanges. This issue is addressed in the proposed regulations published in the Federal Register on January 29, 1998 (63 FR 4408), which contain general guidance on basis adjustments under section 743. Therefore, this document withdraws §1.743–2 of the proposed regulations published in the Federal Register on October 28, 1997 (62 FR 55768).

Withdrawal of Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, proposed amendments to 26 CFR part 1 relating to §1.743–2 are withdrawn.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 26, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 29, 1999, 64 F.R. 66591)

Announcement 99–114

Publication 3386, relating to veterans' organizations that are recognized as tax exempt under section 501(c) of the Internal Revenue Code or that are considering applying for recognition of tax exemption, is now available.

Publication 3386, Tax Guide for Veterans' Organizations, provides general information regarding tax exemption under section 501(a) of the Code for unrelated business income, contributions to veterans' organizations, recordkeeping, filing requirements, and group rulings.

You may obtain Publication 3386 by calling the IRS at 1-800-829-3676 or through the Internet at www/irs/gov/bus-info/eo.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period October through December 1999. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 1999.

Rev. Rul. 99–54

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) for dispositions of qualified low-income buildings or interests therein during the period October through December 1999, and includes bond factor amounts previously published for dispositions occurring during the period January through September 1999.

Table 1
Rev. Rul. 99–54

Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year												
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Jan '99	44.10	57.48	70.98	72.56	74.67	77.09	79.54	81.87	84.18	86.70	89.33	92.33	92.81
Feb '99	44.10	57.48	70.98	72.35	74.45	76.85	79.29	81.60	83.90	86.40	89.00	91.92	92.81
Mar '99	44.10	57.48	70.98	72.14	74.24	76.62	79.05	81.35	83.63	86.11	88.69	91.56	92.81
Apr '99	45.71	60.18	75.06	76.82	79.83	83.22	86.70	90.11	93.55	97.27	101.15	105.33	107.43
May '99	45.71	60.18	75.06	76.60	79.60	82.97	86.44	89.83	93.26	96.96	100.81	104.97	107.43
Jun '99	45.71	60.18	75.06	76.39	79.38	82.73	86.18	89.56	92.97	96.66	100.51	104.65	107.43
Jul '99	45.71	60.18	75.06	76.18	79.16	82.50	85.93	89.30	92.70	96.38	100.22	104.36	107.43
Aug '99	45.71	60.18	75.06	75.97	78.94	82.27	85.69	89.04	92.44	96.11	99.95	104.10	107.43
Sep '99	45.71	60.18	75.06	75.77	78.73	82.05	85.45	88.80	92.19	95.85	99.69	103.86	107.43
Oct '99	45.71	60.18	75.06	75.57	78.52	81.83	85.22	88.56	91.94	95.60	99.45	103.65	107.43
Nov '99	45.71	60.18	75.06	75.37	78.32	81.61	85.00	88.32	91.71	95.37	99.23	103.46	107.43
Dec '99	45.71	60.18	75.06	75.18	78.12	81.40	84.78	88.10	91.48	95.14	99.01	103.28	107.43

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul.98–3, 1998–2 I.R.B. 4, for dispositions occurring during the calendar years 1996 and 1997; Rev. Rul. 98–13, 1998–11 I.R.B. 4, for dispositions occurring during the period January through March 1998; Rev. Rul. 98–31, 1998–25 I.R.B. 4, for dispositions occurring during the period April through June 1998; Rev. Rul. 98–45, 1998–38 I.R.B. 4, for dispositions occurring during the period July through September 1998; and Rev. Rul. 99–1, 1999–2 I.R.B. 4, for dispositions occurring during the period October through December 1998.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran on (202) 622-3040 (not a toll-free call).

Section 165.—Losses

26 CFR 1.165–7: Casualty losses.

If a taxpayer suffers a timber casualty loss, what is the single, identifiable property that the taxpayer will use to compute the amount of the casualty loss? See Rev. Rul. 99–56, page 676.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The October 1999 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, October 31, 1999.

Rev. Rul. 99–55

The following Department Store Inventory Price Indexes for October 1999 were issued by the Bureau of Labor Statistics.

The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, 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, October 31, 1999.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	Oct. 1998	Oct. 1999	Percent Change from Oct. 1998 to Oct. 1999[1]
1. Piece Goods	548.9	545.8	-0.6
2. Domestics and Draperies	637.5	625.6	-1.9
3. Women's and Children's Shoes	679.2	653.3	-3.8
4. Men's Shoes	921.6	881.2	-4.4
5. Infants' Wear	640.2	645.2	0.8
6. Women's Underwear	572.6	571.7	-0.2
7. Women's Hosiery	308.9	328.9	6.5
8. Women's and Girls' Accessories	551.6	536.7	-2.7
9. Women's Outerwear and Girls' Wear	423.5	416.9	-1.6
10. Men's Clothing	620.1	627.5	1.2
11. Men's Furnishings	607.8	631.1	3.8
12. Boys' Clothing and Furnishings	521.0	508.8	-2.3
13. Jewelry	982.7	969.2	-1.4
14. Notions	757.6	771.7	1.9
15. Toilet Articles and Drugs	946.4	985.6	4.1
16. Furniture and Bedding	673.7	692.3	2.8
17. Floor Coverings	601.0	603.3	0.4
18. Housewares	817.1	792.9	-3.0
19. Major Appliances	238.3	234.8	-1.5
20. Radio and Television	70.6	64.2	-9.1
21. Recreation and Education[2]	102.8	96.5	-6.1
22. Home Improvements[2]	129.5	128.8	-0.5
23. Auto Accessories[2]	107.9	106.8	-1.0
Groups 1 - 15: Soft Goods	612.7	612.3	-0.1
Groups 16 - 20: Durable Goods	460.5	448.6	-2.6
Groups 21 - 23: Misc. Goods[2]	107.3	102.7	-4.3
Store Total[3]	556.9	550.9	-1.1

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Alan J. Tomsic of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic on (202) 622-4970 (not a toll-free call).

Section 611.—Allowance of Deduction for Depletion

26 CFR 1.611–3: Rules applicable to timber. (Also, section 165; 1.165–7.)

Timber casualty losses. The decisions in *Westvaco Corp. v. United States* and *Weyerhaueser v. United States* pertain to single, identifiable property (SIP) in relation to casualty losses. Rev. Ruls. 66–9 and 73–51 revoked.

Rev. Rul. 99–56

ISSUE

The Internal Revenue Service has reconsidered Rev. Rul. 66–9, 1966–1 C.B. 39, and Rev. Rul. 73–51, 1973–1 C.B. 75,

in light of the decisions in *Westvaco Corp. v. United States*, 639 F.2d 700 (Ct. Cl. 1980), and *Weyerhaeuser v. United States*, 92 F.3d 1148 (1996), *rev'g in part and aff'g in part*, 32 Fed. Cl. 80 (1994), *cert. denied*, 519 U.S. 1091 (1997).

LAW AND ANALYSIS

Section 1.165–7(b)(2) of the Income Tax Regulations provides that a casualty loss must be determined by reference to a single, identifiable property (SIP) damaged or destroyed by casualty. Rev. Rul. 66–9 holds that, in the case of a casualty loss to timber, the SIP damaged or destroyed by casualty is the quantity of timber—the units (board feet, log scale, cords, or other units) of wood in standing trees that are available and suitable for exploitation and use by forest industries—rendered unfit for use by casualty (in that case, a hurricane). Rev. Rul. 66–9 articulates two interrelated concepts. One is the definition of SIP; the other is the sufficiency of damage giving rise to a casualty loss. It defines SIP to be the quantity of timber destroyed by the casualty. It regards only total destruction of the timber to be legally sufficient to trigger a casualty loss. The revenue ruling holds that the loss from the sale or other disposition of the timber that was not destroyed by the hurricane should be determined at the time of sale or other disposition by subtracting the adjusted basis of the quantity of timber disposed of from the amount received for that timber.

Rev. Rul. 73–51, in considering the allowance of a section 165 casualty loss on account of an ice storm, repeats the SIP definition of Rev. Rul. 66–9 and holds that the physical damage (in that case, broken crowns or root damage that stunted tree growth) to the merchantable trees did not result in any of the existing timber being rendered unfit for use.

The Court of Claims, in *Westvaco*, decided that the SIP damaged or destroyed by storms and fires included all of the taxpayer's standing timber in the district (block) directly affected by each casualty and not just the units of timber contained in the trees suffering mortal injury. The court enunciated the standard that the appropriate SIP is any unit of property that has an identifiable adjusted basis and that is reasonable and logical and identifiable in relation to the area affected by the casualty. The court also held that the allowable loss for casualty is not limited to merchantable units of timber totally destroyed.

In Weyerhaeuser, the United States Court of Appeals for the Federal Circuit held that the SIP damaged or destroyed by several forest fires and a volcanic eruption affecting taxpayer's timber property was the block, that subdivision of a taxpayer's forest holdings selected by the taxpayer as a means of tracking the adjusted basis in the timber pursuant to section 1.611–(3)(d)(1). Consistent with *Westvaco*, a casualty loss was allowed for trees that were damaged but not rendered worthless.

HOLDING

In light of the court decisions in *Westvaco* and *Weyerhaeuser* the Service is revoking Rev. Rul. 66–9 and Rev. Rul. 73–51.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 66–9, 1966–1 C.B. 39, and Rev. Rul. 73–51, 1973–1 C.B. 75, are revoked.

DRAFTING INFORMATION

The principal author of this revenue ruling is Richard T. Probst of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Richard T. Probst on (202) 622-3120 (not a toll-free call).

Section 701.—Partners, not Partnership, Subject to Tax

26 CFR 1.701–2: Anti-abuse rule.

Is the partnership viewed as an entity or as an aggregate of its partners when determining whether a corporate partner must recognize any gain or loss that the partnership allocates to it upon the sale or exchange in a taxable transaction of the partner's stock contributed by the partner to the partnership? See Rev. Rul. 99–57, page 678.

Section 704.—Partner's Distributive Share

26 CFR 1.704.3: Contributed property.

What is a partner's correct amount of gain or loss from a partnership's sale or exchange in a taxable transaction of stock in the partner contributed to the partnership by the partner? See Rev. Rul. 99–57, page 678.

Section 705.—Determination of Basis of Partner's Interest

What basis adjustment should be made to reflect that amount of gain or loss allocated to a partner that contributes its own stock to a partnership upon the partnership's sale or exchange in a taxable transaction of that stock when the partner may not recognize that gain or loss under § 1032 of the Internal Revenue Code? See Rev. Rul. 99–57, page 678.

Section 721.—Nonrecognition of Gain or Loss on Contribution

Does a partner that contributes shares of its own stock to a partnership in exchange for a partnership interest recognize gain or loss on that contribution? See Rev. Rul. 99–57, page 678.

Section 722.—Basis of Contributing Partner's Interest

What basis does a partner that contributes shares of its own stock to a partnership in exchange for a partnership interest have in its partnership interest? See Rev. Rul. 99–57, page 678.

Section 723.—Basis of Property Contributed to Partnership

What basis does a partnership have in the stock of one of its partners contributed by that partner in exchange for a partnership interest? See Rev. Rul. 99–57, page 678.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

What is a partnership's amount of gain or loss on the sale or exchange in a taxable transaction of stock of one of its partners contributed to the partnership by that partner? See Rev. Rul. 99–57, on this page.

Section 1011.—Adjusted Basis for Determining Loss

What is a partnership's basis in the stock of one of its partners contributed to the partnership by that partner when computing the amount of gain or loss on the sale or exchange in taxable transaction of that stock? See Rev. Rul. 99–57, on this page .

Section 1032.—Exchange of Stock For Property

26 CFR 1.1032–1: Disposition by a corporation of its own capital stock. (Also, sections 701, 704, 705, 721, 722, 723, 1001, 1011; 1.701–2(e), 1.704–3.)

Applying section 1032 to partnership transaction. This ruling explains the tax consequences to a partnership and a corporate partner where the corporate partner contributes its own stock to the partnership, and the partnership later exchanges the stock with a third party in a taxable transaction.

Rev. Rul. 99–57

ISSUE

What are the tax consequences to a partnership and a corporate partner where the corporate partner contributes its own stock to the partnership, and the partnership later exchanges the stock with a third party in a taxable transaction?

FACTS

A, a corporation taxed under subchapter C of the Internal Revenue Code, and B, an individual, form AB partnership for bona fide business purposes. A contributes 100 shares of its own stock, valued at $100x, with a basis of zero, to AB in exchange for a 50 percent partnership interest. B contributes a parcel of real property with a value and adjusted basis equal to $100x in exchange for a 50 percent partnership interest. Under the partnership agreement, A and B each will be allocated a 50 percent share of all partnership items. One year later, after the value of the stock has increased to $120x, AB purchases property valued at $60x from C in exchange for 50 shares of A stock and transfers 50 shares of A stock to D in exchange for services valued at $60x.

LAW

Section 701 states that the partners in a partnership, and not the partnership, are liable for the income tax imposed by Chapter 1.

Sections 702(a)(1) and 702(a)(2) provide that in determining the partners' income tax, each partner shall take into account separately the partner's distributive share of partnership gains or losses from sales or exchanges of capital assets.

Section 704(b) provides that a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if (1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Section 704(c)(1)(A) provides that income, gain, loss, and deduction with respect to property contributed to a partnership by a partner is shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution (the built-in gain or loss).

Section 1.704–3(a)(3) of the Income Tax Regulations defines § 704(c) property as property contributed to a partnership if, at the time of contribution, its book value differs from the contributing partner's adjusted tax basis. Book value is equal to the fair market value of the property at the time of contribution.

Section 705(a)(1) provides that the adjusted basis of a partner's interest in a partnership shall be increased by the sum of the partner's distributive share for the taxable year and prior taxable years of: (A) taxable income of the partnership as determined under § 703(a), (B) income of the partnership exempt from income tax, and (C) the excess of the deductions for depletion over the basis of the property subject to depletion.

Section 721(a) provides a general nonrecognition rule for a partner's contributions of property to a partnership in exchange for a partnership interest. The rule is subject to a limited exception in § 721(b).

Section 722 provides 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 the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at the time.

Section 723 states that the basis of property contributed to a partnership is the adjusted basis of the property to the partner at the time of contribution increased by the amount (if any) of gain recognized by the contributing partner under § 721(b).

Section 1001 provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011. The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received.

Section 1011 provides that the adjusted basis for determining gain or loss from the sale or other disposition of property by a partnership, whenever acquired, shall be the basis determined under § 1012 and other applicable sections of subchapters O and K.

Section 1032(a) states that a corporation does not recognize gain or loss on the receipt of money or other property in exchange for the corporation's stock. Prior to the enactment of § 1032, a corporation potentially could recognize gain or loss by purchasing and reselling its own shares, even though it would not have recognized gain or loss on the disposition of newly issued shares. This disparity, which gave rise to tax avoidance opportu-

nities through selective loss recognition, was eliminated by Congress with the enactment of § 1032. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A268 (1954).

Section 1.1032–1(a) provides that a transfer by a corporation of shares of its own stock as compensation for services is considered, for purposes of § 1032(a), as a disposition by the corporation of the shares for money or other property.

Rev. Rul. 74–503, 1974–2 C.B. 117, considers the tax consequences of a parent corporation's transfer to its subsidiary of its own treasury stock in a transaction to which § 351 applies. The ruling holds that, under certain circumstances, the basis of the parent corporation's treasury stock in the hands of the parent corporation is zero. Accordingly, under the transferred basis rule of § 362(a), the subsidiary corporation's basis of the treasury stock of the parent corporation is also zero.

Partnership taxation is a mixture of provisions that treat the partnership as an aggregate of its members or as a separate entity. Under the aggregate approach, each partner is treated as the owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is treated as a separate entity in which partners have no direct interest in partnership assets and operations. In enacting subchapter K, Congress indicated that aggregate, rather than entity, concepts should be applied if the concepts are more appropriate in applying other provisions of the Code. S.Rep. No. 1622, 83d Cong., 2d Sess. 89 (1954) and H.R. Conf. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954); *See also* Treas. Reg. § 1.701–2(e) (1994).

ANALYSIS

When *A* contributes its own stock to *AB*, no gain or loss is recognized to *A* or *AB* under § 721(a). *AB*'s basis in the stock is zero under § 723, and *A*'s basis in its partnership interest in *AB* is zero under § 722. *Cf.* Rev. Rul. 74–503, 1974–2 C.B. 117. When *AB* subsequently purchases property from *C* in exchange for *A* stock and pays *A* stock to *D* in exchange for services, there is a realization of gain by *AB* measured by the difference between the basis of the stock and the value of the property and services received. *AB* realizes $120x of gain ($60x on the exchange of stock for property and $60x on the payment of stock for services). *AB* allocates $100x of gain to *A* under § 704(c), and allocates the remaining $20x pursuant to the partnership agreement, $10x each to *A* and *B*.

If *A*'s share of the gain from the use of its stock in these transactions was not subject to § 1032, *A* would recognize $110x of gain. Section 1032 is intended to prevent a corporation from recognizing gain or loss when dealing in its own stock. Under § 704(b) and 704(c), a corporate partner contributing its own stock generally will be allocated an amount of gain attributable to its stock that corresponds to its economic interest in the stock held by the partnership. Accordingly, use of the aggregate theory of partnerships is appropriate in determining the application of § 1032 with respect to gain allocated to a corporate partner. Under § 1032, *A*'s share of the gain resulting from *AB*'s exchange of *A* stock will not be subject to tax. In addition, *A* increases its basis in its partnership interest in *AB* under § 705 by $110x, the amount equal to *A*'s share of the gain resulting from *AB*'s exchange of *A* stock, thereby preserving the nonrecognition result of the transaction in accordance with the policy underlying § 1032.

Furthermore, in keeping with the nonrecognition policy underlying § 1032, an analysis similar to that described above would apply to a transaction in which a corporate partner is allocated a loss from a transaction involving the disposition of stock of the corporate partner held by the partnership.

HOLDING

If a corporate partner contributes its own stock to a partnership in exchange for a partnership interest, and the partnership later exchanges the stock in a taxable transaction, then the partnership will realize gain that will be allocated to the partners under § 704. Under § 1032, however, the corporate partner will not recognize the gain allocated to it with respect to the sale or exchange of the stock. Furthermore, under § 705, the corporate partner increases its basis in its partnership interest by an amount equal to its share of the gain resulting from the partnership's sale or exchange of the stock.

DRAFTING INFORMATION

The principal author of this revenue ruling is Robert Honigman of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue ruling contact Robert Honigman at (202) 622-3050 (not a toll-free call).

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(b)–4: Marital deduction; valuation of interest passing to surviving spouse.

T.D. 8846

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 20

Deductions for Transfers for Public, Charitable, and Religious Uses; In General

Marital Deduction; Valuation of Interest Passing to Surviving Spouse

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the effect of certain administration expenses on the valuation of property that qualifies for either the estate tax marital deduction under section 2056 of the Internal Revenue Code or the estate tax charitable deduction under section 2055. The regulations distinguish between estate transmission expenses, which reduce the value of property for marital and charitable deduction purposes, and estate management expenses, which generally do not reduce the value of property for these purposes.

EFFECTIVE DATES: These regulations are effective on December 3, 1999.

FOR FURTHER INFORMATION CONTACT: Deborah Ryan, (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 16, 1998, the Treasury Department and the IRS published in the **Federal Register** (63 FR 69248) a notice of proposed rulemaking (REG–114663–97, 1999-6 I.R.B. 15) relating to the effect of certain administration expenses on the valuation of property which qualifies for the estate tax marital or charitable deduction. The proposed regulations were issued in response to the decision of the Supreme Court of the United States in *Commissioner v. Estate of Hubert*, 520 U.S. 93 (1997) (1997–2 C.B. 231). Written comments responding to the notice of proposed rulemaking were received, and a public hearing was held on April 21, 1999, at which time oral testimony was presented. This Treasury decision adopts final regulations with respect to the notice of proposed rulemaking. A summary of the principal comments received and revisions made in response to those comments is provided below.

The proposed regulations set forth the substantive provisions as applied to the estate tax marital deduction in §20.2056(b)–4(a). For the estate tax charitable deduction, the proposed regulations (under §20.2055–1(d)(6)) merely cross-reference the rules for the marital deduction.

Several commentators suggested that the regulations under section 2055 should contain specific rules relating to the charitable deduction, rather than just a cross-reference. The Treasury and the IRS agree with this suggestion. The final regulations contain rules under §20.2055–3 specifically addressing the effect of administration expenses on the valuation of property when all or a portion of the interests in property qualify for the estate tax charitable deduction.

Several commentators stated that the distinction between estate transmission expenses and estate management expenses was not clearly made in the proposed regulations and requested more concrete definitions of each type of expense. In response to these comments, the final regulations characterize estate transmission expenses as those expenses that would not have been incurred except for the decedent's death. Although the amount of these expenses cannot be calculated with any degree of certainty on the date of the decedent's death, they are expenses that are incurred because of the decedent's death. Estate management expenses, on the other hand, are characterized in the final regulations as expenses that would be incurred with respect to the property even if the decedent had not died; that is, expenses incurred in investing, maintaining, and preserving the property. These are expenses that typically would have been incurred with respect to the property by the decedent before death or by the beneficiaries had they received the property on the date of death without any intervening period of administration. In order to be certain that all expenses are classified as either transmission expenses or management expenses, transmission expenses are defined to include all expenses that are not management expenses.

Three commentators stated that the different treatment accorded to estate transmission expenses and estate management expenses under the proposed regulations creates a new federal standard for allocating expenses that may be contrary to the manner in which the expenses must be charged under state law. However, the Treasury and the IRS believe that the allocation of administration expenses based on the distinction between transmission and management expenses provides the most accurate measure of the value of the property which passes to the surviving spouse or to the charity at the moment of the decedent's death for federal estate tax marital and charitable deduction purposes. Transmission expenses that are charged to the property passing to the surviving spouse or to the charity reduce the amount of that property as of the date of the decedent's death because the expenses, as well as the transfer to the surviving spouse or to charity, are a consequence of, and arise as a result of, the decedent's death. In contrast, management expenses do not generally reduce the amount of the property passing from the decedent as of the date of the decedent's death because these expenses are incurred in producing income and preserving and maintaining the property between the date of the decedent's death and the date of distribution. These expenses are the ongoing, year-to-year expenses incurred in the investment, preservation, and maintenance of property by property owners.

In response to other comments, the final regulations illustrate the application of these rules to pecuniary bequests to the surviving spouse. If, under the terms of the governing instrument or applicable local law, the recipient of a pecuniary bequest is not entitled to income earned until distribution, the income is not included in the definition of the marital or charitable share. Thus, the amount of the property passing to the surviving spouse or charity for which a marital or charitable deduction is allowable will not be reduced even if estate transmission or estate management expenses are paid out of the income earned by assets that will be used to satisfy the pecuniary bequest.

Two commentators requested guidance in applying the regulations to estates that are intended to be nontaxable. Accordingly, the final regulations add two examples, one involving a formula designed to produce zero estate taxes and the other involving a pecuniary bequest designed to utilize the applicable exclusion amount under section 2010.

Many of the comments concerned the special rule of §20.2056(b)–4(e)(2)(ii) of the proposed regulations. Under the special rule, the value of the deductible property interest is not increased as a result of the decrease in the federal estate tax liability that is attributable to the deduction of estate management expenses as expenses ofadministration under section 2053 on the federal estate tax return. A similar rule would have applied for purposes of the estate tax charitable deduction.

Several of these commentators argued that the special rule is inconsistent with sections 2056(a) and 2055(c), because the value of the property passing to the surviving spouse or charity should be reduced only by the estate taxes actually paid. Thus, an estate should be permitted the full benefit of deducting management expenses on the federal estate tax return, including an increase to the marital or charitable deduction based on the resultant decrease in tax payable from the marital or charitable share.

Conversely, other commentators asserted that the special rule does not conform with section 2056(b)(9). Section 2056(b)(9) provides that nothing in section 2056 or any other estate tax provision shall allow the value of any interest in property to be deducted for federal estate tax purposes more than once with respect to the same decedent. These commentators pointed out that if estate management expenses paid from the marital or charitable share are deducted on the federal estate tax return, and no reduction is made to the allowable amount of the marital or charitable deduction, then the same property interest is deducted twice in violation of section 2056(b)(9).

After considering these comments, the Treasury and the IRS have eliminated the special rule of the proposed regulations. The final regulations provide that estate management expenses attributable to, and payable from, the property interest passing to the surviving spouse or charity do not reduce the value of the property interest. However, pursuant to section 2056(b)(9), the allowable amount of the marital or charitable deduction is reduced by the amount of these management expenses if they are deducted on the Federal estate tax return.

The Treasury and the IRS believe that the principles which apply for determining the value of the marital and charitable deductions should also apply for determining the value of property that passes from one decedent to another when calculating the amount of the credit for tax on prior transfers under section 2013. Therefore, the final regulations amend §20.2013–4(b) by adding a cross reference to §20.2056(b)–4(d).

Effective Dates

The regulations under sections 2055 and 2056 are applicable to estates of decedents dying on or after December 3, 1999. The regulations under section 2013 are applicable to transfers from estates of decedents dying on or after December 3, 1999.

Effect on Other Documents

The following publications are obsolete as of December 3, 1999:
Rev. Rul. 66–233 (1996–2 C.B. 428)
Rev. Rul. 73–98 (1973–1 C.B. 407)
Rev. Rul. 80–159 (1980–1 C.B. 206)
Rev. Rul. 93–48 (1993–2 C.B. 270)

Special Analyses

This rule is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Deborah Ryan, Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 20 is amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2013–4 is amended by:

1. Removing "and" at the end of paragraph (b)(2).

2. Redesignating paragraph (b)(3) as paragraph (b)(4).

3. Adding a new paragraph (b)(3).

The addition reads as follows:

§20.2013–4 Valuation of property transferred.

* * * * *

(b) * * *

(3)(i) By the amount of administration expenses in accordance with the principles of §20.2056(b)–4(d).

(ii) This paragraph (b)(3) applies to transfers from estates of decedents dying on or after December 3, 1999; and

* * * * *

Par. 3. Section 20.2055–3 is amended by:

1. Revising the section heading.

2. Adding a paragraph heading for paragraph (a).

3. Redesignating the text of paragraph (a) following the heading and paragraphs (b) and (c) as paragraph (a)(1), and paragraphs (a)(2) and (a)(3), respectively.

4. Adding a new paragraph (b).

The revision and additions read as follows:

§20.2055–3 Effect of death taxes and administration expenses.

(a) *Death taxes.* * * *

(b) *Administration expenses*—(1) *Definitions*—(i) *Management expenses.* Estate management expenses are expenses that are incurred in connection with the investment of estate assets or with their preservation or maintenance during a reasonable period of administration. Examples of these expenses could include investment advisory fees, stock brokerage commissions, custodial fees, and interest.

(ii) *Transmission expenses.* Estate transmission expenses are expenses that would not have been incurred but for the decedent's death and the consequent necessity of collecting the decedent's assets, paying the decedent's debts and death taxes, and distributing the decedent's property to those who are entitled to receive it. Estate transmission expenses include any administration expense that is not a management expense. Examples of these expenses could include executor commissions and attorney fees (except to the extent of commissions or fees specifically related to investment, preservation, and maintenance of the assets), probate fees, expenses incurred in construction proceedings and defending against will contests, and appraisal fees.

(iii) *Charitable share.* The charitable share is the property or interest in property that passed from the decedent for which a deduction is allowable under section 2055(a) with respect to all or part of the property interest. The charitable share includes, for example, bequests to charitable organizations and bequests to a charitable lead unitrust or annuity trust, a charitable remainder unitrust or annuity trust,

and a pooled income fund, described in section 2055(e)(2). The charitable share also includes the income produced by the property or interest in property during the period of administration if the income, under the terms of the governing instrument or applicable local law, is payable to the charitable organization or is to be added to the principal of the property interest passing in whole or in part to the charitable organization.

(2) *Effect of transmission expenses.* For purposes of determining the charitable deduction, the value of the charitable share shall be reduced by the amount of the estate transmission expenses paid from the charitable share.

(3) *Effect of management expenses attributable to the charitable share.* For purposes of determining the charitable deduction, the value of the charitable share shall not be reduced by the amount of the estate management expenses attributable to and paid from the charitable share. Pursuant to section 2056(b)(9), however, the amount of the allowable charitable deduction shall be reduced by the amount of any such management expenses that are deducted under section 2053 on the decedent's federal estate tax return.

(4) *Effect of management expenses not attributable to the charitable share.* For purposes of determining the charitable deduction, the value of the charitable share shall be reduced by the amount of the estate management expenses paid from the charitable share but attributable to a property interest not included in the charitable share.

(5) *Example.* The following example illustrates the application of this paragraph (b):

Example. The decedent, who dies in 2000, leaves his residuary estate, after the payment of debts, expenses, and estate taxes, to a charitable remainder unitrust that satisfies the requirements of section 664(d). During the period of administration, the estate incurs estate transmission expenses of $400,000. The residue of the estate (the charitable share) must be reduced by the $400,000 of transmission expenses and by the Federal and State estate taxes before the present value of the remainder interest passing to charity can be determined in accordance with the provisions of §1.664–4 of this chapter. Because the estate taxes are payable out of the residue, the computation of the estate taxes and the allowable charitable deduction are interrelated. See paragraph (a)(2) of this section.

(6) *Cross reference.* See §20.2056(b)–4(d) for additional examples applicable to the treatment of administration expenses under this paragraph (b).

(7) *Effective date.* The provisions of this paragraph (b) apply to estates of decedents dying on or after December 3, 1999.

Par. 4. Section 20.2056(b)–4 is amended by:

1. Removing the last two sentences of paragraph (a).

2. Redesignating paragraph (d) as paragraph (e).

3. Adding a new paragraph (d).

The addition reads as follows:

§20.2056(b)–4 Marital deduction; valuation of interest passing to surviving spouse.

* * * * *

(d) *Effect of administration expenses*—(1) *Definitions*—(i) *Management expenses.* Estate management expenses are expenses that are incurred in connection with the investment of estate assets or with their preservation or maintenance during a reasonable period of administration. Examples of these expenses could include investment advisory fees, stock brokerage commissions, custodial fees, and interest.

(ii) *Transmission expenses.* Estate transmission expenses are expenses that would not have been incurred but for the decedent's death and the consequent necessity of collecting the decedent's assets, paying the decedent's debts and death taxes, and distributing the decedent's property to those who are entitled to receive it. Estate transmission expenses include any administration expense that is not a management expense. Examples of these expenses could include executor commissions and attorney fees (except to the extent of commissions or fees specifically related to investment, preservation, and maintenance of the assets), probate fees, expenses incurred in construction proceedings and defending against will contests, and appraisal fees.

(iii) *Marital share.* The marital share is the property or interest in property that passed from the decedent for which a deduction is allowable under section 2056(a). The marital share includes the income produced by the property or interest in property during the period of administration if the income, under the terms of the governing instrument or applicable local law, is payable to the surviving spouse or is to be added to the principal of the property interest passing to, or for the benefit of, the surviving spouse.

(2) *Effect of transmission expenses.* For purposes of determining the marital deduction, the value of the marital share shall be reduced by the amount of the estate transmission expenses paid from the marital share.

(3) *Effect of management expenses attributable to the marital share.* For purposes of determining the marital deduction, the value of the marital share shall not be reduced by the amount of the estate management expenses attributable to and paid from the marital share. Pursuant to section 2056(b)(9), however, the amount of the allowable marital deduction shall be reduced by the amount of any such management expenses that are deducted under section 2053 on the decedent's Federal estate tax return.

(4) *Effect of management expenses not attributable to the marital share.* For purposes of determining the marital deduction, the value of the marital share shall be reduced by the amount of the estate management expenses paid from the marital share but attributable to a property interest not included in the marital share.

(5) *Examples.* The following examples illustrate the application of this paragraph (d):

Example 1. The decedent dies after 2006 having made no lifetime gifts. The decedent makes a bequest of shares of ABC Corporation stock to the decedent's child. The bequest provides that the child is to receive the income from the shares from the date of the decedent's death. The value of the bequeathed shares on the decedent's date of death is $3,000,000. The residue of the estate is bequeathed to a trust for which the executor properly makes an election under section 2056(b)(7) to treat as qualified terminable interest property. The value of the residue on the decedent's date of death, before the payment of administration expenses and Federal and State estate taxes, is $6,000,000. Under applicable local law, the executor has the discretion to pay administration expenses from the income or principal of the residuary estate. All estate taxes are to be paid from the residue. The State estate tax equals the State death tax credit available under section 2011. During the period of administration, the estate incurs estate transmission expenses of $400,000, which the executor charges to the residue. For purposes of determining the marital deduction, the value of the

residue is reduced by the Federal and State estate taxes and by the estate transmission expenses. If the transmission expenses are deducted on the Federal estate tax return, the marital deduction is $3,500,000 ($6,000,000 minus $400,000 transmission expenses and minus $2,100,000 Federal and State estate taxes). If the transmission expenses are deducted on the estate's Federal income tax return rather than on the estate tax return, the marital deduction is $3,011,111 ($6,000,000 minus $400,000 transmission expenses and minus $2,588,889 Federal and State estate taxes).

Example 2. The facts are the same as in *Example 1*, except that, instead of incurring estate transmission expenses, the estate incurs estate management expenses of $400,000 in connection with the residue property passing for the benefit of the spouse. The executor charges these management expenses to the residue. In determining the value of the residue passing to the spouse for marital deduction purposes, a reduction is made for Federal and State estate taxes payable from the residue but no reduction is made for the estate management expenses. If the management expenses are deducted on the estate's income tax return, the net value of the property passing to the spouse is $3,900,000 ($6,000,000 minus $2,100,000 Federal and State estate taxes). A marital deduction is claimed for that amount, and the taxable estate is $5,100,000.

Example 3. The facts are the same as in *Example 1*, except that the estate management expenses of $400,000 are incurred in connection with the bequest of ABC Corporation stock to the decedent's child. The executor charges these management expenses to the residue. For purposes of determining the marital deduction, the value of the residue is reduced by the Federal and State estate taxes and by the management expenses. The management expenses reduce the value of the residue because they are charged to the property passing to the spouse even though they were incurred with respect to stock passing to the child. If the management expenses are deducted on the estate's Federal income tax return, the marital deduction is $3,011,111 ($6,000,000 minus $400,000 management expenses and minus $2,588,889 Federal and State estate taxes). If the management expenses are deducted on the estate's Federal estate tax return, rather than on the estate's Federal income tax return, the marital deduction is $3,500,000 ($6,000,000 minus $400,000 management expenses and minus $2,100,000 in Federal and State estate taxes).

Example 4. The decedent, who dies in 2000, has a gross estate of $3,000,000.

Included in the gross estate are proceeds of $150,000 from a policy insuring the decedent's life and payable to the decedent's child as beneficiary. The applicable credit amount against the tax was fully consumed by the decedent's lifetime gifts. Applicable State law requires the child to pay any estate taxes attributable to the life insurance policy. Pursuant to the decedent's will, the rest of the decedent's estate passes outright to the surviving spouse. During the period of administration, the estate incurs estate management expenses of $150,000 in connection with the property passing to the spouse. The value of the property passing to the spouse is $2,850,000 ($3,000,000 less the insurance proceeds of $150,000 passing to the child). For purposes of determining the marital deduction, if the management expenses are deducted on the estate's income tax return, the marital deduction is $2,850,000 ($3,000,000 less $150,000) and there is a resulting taxable estate of $150,000 ($3,000,000 less a marital deduction of $2,850,000). Suppose, instead, the management expenses of $150,000 are deducted on the estate's estate tax return under section 2053 as expenses of administration. In such a situation, claiming a marital deduction of $2,850,000 would be taking a deduction for the same $150,000 in property under both sections 2053 and 2056 and would shield from estate taxes the $150,000 in insurance proceeds passing to the decedent's child. Therefore, in accordance with section 2056(b)(9), the marital deduction is limited to $2,700,000, and the resulting taxable estate is $150,000.

Example 5. The decedent dies after 2006 having made no lifetime gifts. The value of the decedent's residuary estate on the decedent's date of death is $3,000,000, before the payment of administration expenses and Federal and State estate taxes. The decedent's will provides a formula for dividing the decedent's residuary estate between two trusts to reduce the estate's Federal estate taxes to zero. Under the formula, one trust, for the benefit of the decedent's child, is to be funded with that amount of property equal in value to so much of the applicable exclusion amount under section 2010 that would reduce the estate's Federal estate tax to zero. The other trust, for the benefit of the surviving spouse, satisfies the requirements of section 2056(b)(7) and is to be funded with the remaining property in the estate. The State estate tax equals the State death tax credit available under section 2011. During the period of administration, the estate incurs transmission expenses of $200,000. The transmission expenses of $200,000 reduce the value of the residue to $2,800,000. If the transmission expenses are deducted on the Federal estate tax return, then the formula divides the residue so that the value of the property passing to the child's trust is $1,000,000 and the value of the property passing to the marital trust is $1,800,000. The allowable marital deduction is $1,800,000. The applicable exclusion amount shields from Federal estate tax the entire $1,000,000 passing to the child's trust so that the amount of Federal and State estate taxes is zero. Alternatively, if the transmission expenses are deducted on the estate's Federal income tax return, the formula divides the residue so that the value of the property passing to the child's trust is $800,000 and the value of the property passing to the marital trust is $2,000,000. The allowable marital deduction remains $1,800,000. The applicable exclusion amount shields from Federal estate tax the entire $800,000 passing to the child's trust and $200,000 of the $2,000,000 passing to the marital trust so that the amount of Federal and State estate taxes remains zero.

Example 6. The facts are the same as in *Example 5*, except that the decedent's will provides that the child's trust is to be funded with that amount of property equal in value to the applicable exclusion amount under section 2010 allowable to the decedent's estate. The residue of the estate, after the payment of any debts, expenses, and Federal and State estate taxes, is to pass to the marital trust. The applicable exclusion amount in this case is $1,000,000, so the value of the property passing to the child's trust is $1,000,000. After deducting the $200,000 of transmission expenses, the residue of the estate is $1,800,000 less any estate taxes. If the transmission expenses are deducted on the Federal estate tax return, the allowable marital deduction is $1,800,000, the taxable estate is zero, and the Federal and State estate taxes are zero. Alternatively, if the transmission expenses are deducted on the estate's Federal income tax return, the net value of the property passing to the spouse is $1,657,874 ($1,800,000 minus $142,106 estate taxes). A marital deduction is claimed for that amount, the taxable estate is $1,342,106, and the Federal and State estate taxes total $142,106.

Example 7. The decedent, who dies in 2000, makes an outright pecuniary bequest of $3,000,000 to the decedent's surviving spouse, and the residue of the estate, after the payment of all debts, expenses, and Federal and State estate taxes, passes to the decedent's child. Under the terms of the applicable local law, a beneficiary of a pecuniary bequest is not entitled to any income on the bequest. During the period of administration, the estate pays estate transmission expenses from the income earned by the property that will be distributed to the surviving spouse in satisfaction of the pecuniary bequest. The income earned on this property is not part of the marital share. Therefore, the allowable marital deduction is $3,000,000, unreduced by the amount of the estate transmission expenses.

(6) *Effective date.* The provisions of this paragraph (d) apply to estates of decedents dying on or after December 3, 1999.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved November 22, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 2, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 3, 1999, 64 F.R. 67763)

Section 6501.—Limitations on Assessment and Collection

26 CFR 301.6501(c)–1: Exceptions to general period of limitations on assessment and collection.

T.D. 8845

DEPARTMENT OF THE TREASURY
Internal Revenue Service

26 CFR Part 20

Adequate Disclosure of Gifts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to changes made to Internal Revenue Code sections 2001, 2504, and 6501 by the Taxpayer Relief Act of 1997 and the Internal Revenue Service Restructuring and Reform Act of 1998 regarding the valuation of prior gifts in determining estate and gift tax liability, and the period of limitations for assessing and collecting gift tax. These regulations are necessary because section 6501(c)(9) now requires that a gift must be adequately disclosed on a gift tax return in order to commence the running of the period of limitations on assessment with respect to the gift. Once the period of limitations expires, the amount of that gift as reported on the return may not be adjusted for purposes of determining future gift and estate tax liability. The regulations provide guidance on what constitutes adequate disclosure for purposes of the statute.

DATES: These regulations are effective December 3, 1999.

FOR FURTHER INFORMATION CONTACT: William L. Blodgett, (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1637. Responses to this collection of information are mandatory.

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

The reporting burden contained in §301.6501(c)–1(f) is reflected in the burden for Form 709, "U.S. Gift (and Generation-Skipping Transfer) Tax Return."

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may be material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On December 22, 1998, the IRS published in the **Federal Register** (63 FR 70701) a notice of proposed rulemaking (REG–106177–98, 1998–2 C.B. 344) under sections 2001 and 2504 relating to the value of prior gifts for purposes of computing the estate and gift tax, and under section 6501 relating to the period for assessment and collection of gift tax. Written comments responding to the notice of proposed rulemaking were received and a hearing was held on April 28, 1999, at which time oral testimony was presented. This document adopts final regulations with respect to this notice of proposed rulemaking. A summary of the principal comments received and the revisions made in response to those comments is provided below.

1. *Requirements for Adequate Disclosure*

Under section 6501(c)(9), the period of limitations on the assessment of gift tax with respect to a gift will commence to run only if the gift is adequately disclosed on the gift tax return. The proposed regulations provide a list of information required to satisfy the adequate disclosure standard.

In general, the comments objected to the quantity, detail, and nature of the information required under the proposed regulations. In some cases, information required in the proposed regulations is not required in the final regulations. However, Treasury and the IRS continue to believe that the adequate disclosure rule was intended to afford the IRS a viable means to identify the returns that should be examined, with a minimum expenditure of resources. Further, the more complete and comprehensive the information filed with the return is, the more readily the IRS will be able to identify the returns that should not be examined, thus saving taxpayers needless expenditures of time and money.

Several commentators suggested that the language in §301.6501–1(f)(2) of the proposed regulations imposed two requirements for adequate disclosure. That is, the taxpayer had to provide information adequate to apprise the IRS of the nature of the gift, etc. and in addition, the taxpayer had to provide the information listed in the regulation. In response to these comments, the final regulations clarify that the adequate disclosure requirement is satisfied if the information listed in the regulation is provided.

Some commentators argued that Congress intended that the new adequate disclosure requirements be the same as the existing disclosure requirements under prior section 6501(c)(9) for pre-August 5, 1997 gifts of property subject to the special valuation rules of sections 2701 and 2702. Therefore, the commentators suggested that the IRS adopt the disclosure requirements under §301.6501(c)–1(e)(2) for transfers of those interests. This suggestion was not adopted. The IRS and Treasury believe it is necessary to expand on those disclosure requirements to address the broader range of transfers covered by the new legislation, as well as transactions and entities that may not have been prevalent when the prior regulations were promulgated.

Under the proposed regulations, if property is transferred in trust, taxpayers are required to provide a brief description of the terms of the trust. In response to comments, the final regulations provide that taxpayers may submit a complete copy of the trust document in lieu of a description of the trust terms.

The proposed regulations require the submission of a detailed description of the method used in determining the fair market value of the property, including "any relevant financial data." Commentators contended that "any relevant financial data" is a subjective concept that lacks specificity. Rather, the regulations should specify exactly what financial data must

be submitted, such as balance sheets, net earnings statements, etc. In response to these comments, the final regulations require that any financial data that was used in valuing the interest must be submitted. This ensures that the information requested is available and was deemed relevant by the person valuing the interest.

Several commentators expressed concern over the requirement in the proposed regulations that, if a less-than-100-percent interest in a non-actively traded entity is transferred, the taxpayer must submit a statement regarding the fair market value of 100 percent of the entity determined without regard to any discounts. It was contended that a less-than-100-percent interest in an operating company may not be valued based on a pro rata portion of the value of 100 percent of the entity; rather the appraiser often will determine the value based on indicia other than the value of the entire entity, such as the price/earnings ratio of stock in comparable publicly-traded entities. Because the entire entity is not valued in these situations, valuing 100 percent of the entity would not be relevant. One comment stated that this requirement would be reasonable in valuing an interest in nonactively-traded entities, such as entities holding securities or real estate, since in those cases the value of an interest in the entity would be determined based on a pro rata portion of the value of 100 percent of the entity. In response to these comments, the final regulations do not require a statement of the fair market value of 100 percent of the entity (without regard to any discounts), if the value of the interest in the entity is properly determined without using the net asset value of the entire entity. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity.

The proposed regulations also require valuation information for each entity (and its assets) that is owned or controlled by the entity subject to the transfer. Comments indicated that this requirement would be difficult to satisfy, because in some cases the information would not be within the control of the taxpayer and the entity subject to the transfer would not normally be required to maintain the financial records with respect to lower-tiered entities. The comments suggested that information on the lower-tiered entities should be required only to the extent such information is essential to a reasonable appraisal of the interest transferred and is in the personal control of the taxpayer. Many commentators suggested that the regulations require the submission of only that information that a qualified and competent appraiser would use in valuing the interest. In response to these comments, the final regulations provide that the information on the lower-tiered entities must be submitted if the information is relevant and material in determining the value of the interest in the entity.

Finally, comments suggested that a properly completed appraisal would contain all the information that is material and relevant to the valuation of the transferred property and, therefore, should be sufficient to satisfy any disclosure requirement. Accordingly, under the final regulations, an appraisal satisfying specific requirements may be submitted in lieu of a detailed description of the method used to determine the fair market value and in lieu of information regarding tiered entities.

The proposed regulations require a statement of relevant facts that would apprise the IRS of the nature of any potential gift tax controversy concerning the transfer, or instead of that statement, a concise description of the legal issue presented by the facts. This requirement is similar to the disclosure required to avoid the accuracy-related penalty under section 6662. It was intended to enable the IRS to easily identify issues presented so that the IRS could evaluate whether an examination is warranted during the initial review of the gift tax return. Commentators indicated that the requirement was too subjective and open-ended, since it would be difficult for a practitioner to identify or anticipate "any" potential controversy. In response to these comments, that requirement has been eliminated from the final regulations. The proposed regulations also require that the taxpayer submit a statement describing any position taken that is contrary to any temporary or final regulations or any revenue ruling. Commentators were concerned that this requirement could be interpreted as including both regulations and revenue rulings that are published after the gift tax return is filed that interpret earlier IRS positions. In response to these comments, the final regulations limit the required statement to positions taken that are contrary to any proposed, temporary or final regulation, and any revenue ruling published at the time the transfer occurred.

Commentators also noted that, under the proposed regulations, if a taxpayer failed to provide, for example, one item of information, the adequate disclosure requirement would not be satisfied, regardless of the significance of the item. The comments suggested that "substantial compliance" with the requirements of the regulations or a good-faith effort to comply should be deemed actual compliance. This suggestion was not adopted in view of the difficulty in defining and illustrating what would constitute substantial compliance. However, it is not intended that the absence of any particular item or items would necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall adequacy of the information provided.

In response to comments, a rule was added regarding the application of the adequate disclosure rules in the case of "split gifts" under section 2513. Under this rule, gifts attributed to the non-donor spouse are deemed to be adequately disclosed if the gifts are adequately disclosed on the return filed by the donor spouse.

2. *Finality with Respect to Adequately Disclosed Gifts*

Under the proposed regulations, if a transfer is adequately disclosed on the gift tax return, and the period for assessment of gift tax has expired, then the IRS is foreclosed from adjusting the value of the gift under section 2504(c) (for purposes of determining the current gift tax liability) and under section 2001(f) (for purposes of determining the estate tax liability). However, the IRS is not precluded from making adjustments involving legal issues, even if the gift was adequately disclosed. This position was based on longstanding regulations applying section 2504(c) and relevant case law.

Comments suggested that this rule is contrary to Congressional intent in enacting section 2001(f) and amending section 2504(c) to provide a greater degree of fi-

nality with respect to the gift and estate tax statutory scheme. In response to these comments, the final regulations preclude adjustments with respect to all issues related to a gift once the gift tax statute of limitations expires with respect to that gift.

3. *Non-gift Transactions*

Under the proposed regulations, a completed transfer that did not constitute a gift would be considered adequately disclosed if the taxpayer submitted the information required for adequate disclosure and an explanation describing why the transfer was not subject to the gift tax. One commentator suggested that the adequate disclosure requirement should be waived if the taxpayer reasonably, in good faith, believes the transfer is not a gift (for example, a salary payment made to a child employed in a family business). Another commentator noted that the standard for adequate disclosure is higher for a "non-gift" than it is for a gift transaction since, in the non-gift situation, the donor must provide all the information required by the regulation and a statement why the transaction is not a gift. Another comment requested more guidance for reporting non-gift business transactions. In response to the comments, the final regulations limit the information required in a non-gift situation. In addition, the final regulations provide that completed transfers to members of the transferor's family (as defined in section 2032A(e)(2)) in the ordinary course of operating a business are deemed to be adequately disclosed, even if not reported on a gift tax return, if the item is properly reported by all parties for income tax purposes. For example, in the case of a salary payment made to a child of the donor employed in the donor's business, the transaction will be treated as adequately disclosed for gift tax purposes if the salary payment is properly reported by the business and the child on their income tax returns. This exception only applies to transactions conducted in the ordinary course of operating a business. It does not apply, for example, in the case of a sale of property (including a business) by a parent to a child.

4. *Effective Date Provisions*

Several comments were received regarding clarification of the statutory effective date rules.

One comment requested clarification of the effective date of section 6501(c)(9), as amended. The Taxpayer Relief Act of 1997 provides that the amendments to section 6501(c)(9) (commencing the running of the period of limitations only if the gift is adequately disclosed) apply to gifts made in calendar years ending after August 5, 1997 (that is, all gifts made in calendar year 1997 and thereafter). However, the underlying legislative history indicates that the amendment to section 6501(c)(9) applies "to gifts made in calendar years after the date of enactment [August 5, 1997]". H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 408 (1997). Notwithstanding this statement in the legislative history, the statutory language is clear that the section as amended applies to all gifts made during the 1997 calendar year, and thereafter. In the final regulations, the statutory effective date language is restated in a manner that makes it clear that section 6501(c)(9) as amended applies to all gifts made after December 31, 1996.

Another comment suggested clarification of the application of the adequate disclosure rules and the interaction between sections 2504(c) and 6501(c)(9) with respect to gifts made between January 1, 1997, and August 6, 1997, since section 2504(c) as amended applies only to gifts made after August 5, 1997, but section 6501(c)(9) as amended applies to all gifts made in 1997. In response to this comment, an example has been added under §25.2504–2(c) involving a situation where a gift is made prior to August 6, 1997, that is not adequately disclosed on the return filed for 1997. The example clarifies that the period for assessment with respect to the pre-August 6, 1997 gift does not commence to run because the gift is not adequately disclosed. Accordingly, a gift tax may be assessed with respect to the gift at any time, and notwithstanding the effective date for section 2504(c), that 1997 gift can be adjusted as a part of prior taxable gifts in determining subsequent gift tax liability. Further, the 1997 gift can be adjusted as part of taxable gifts under section 2001 in determining estate tax liability.

Finally, in response to another comment, an example has been added illustrating the application of the effective date rules in a similar fact pattern, where the gifts are made in a calendar year prior to 1997. The example illustrates that the IRS may not revalue the gifts, for purposes of determining prior taxable gifts for gift tax purposes, if a gift tax was paid and assessed with respect to the calendar year, and the period for assessment has expired. Since the gifts were made prior to 1997, the rules of section 2504(c) and section 6501 prior to amendment apply. However, the IRS may adjust the gifts for purposes of determining adjusted taxable gifts for estate tax purposes.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is William L. Blodgett, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 20, 25, 301 and 602 are amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2001–1 is revised to read as follows:

§20.2001–1 Valuation of adjusted taxable gifts and section 2701(d) taxable events.

(a) *Adjusted taxable gifts made prior to August 6, 1997.* For purposes of determining the value of adjusted taxable gifts as defined in section 2001(b), if the gift was made prior to August 6, 1997, the value of the gift may be adjusted at any time, even if the time within which a gift tax may be assessed has expired under section 6501. This paragraph (a) also applies to adjustments involving issues other than valuation for gifts made prior to August 6, 1997.

(b) *Adjusted taxable gifts and section 2701(d) taxable events occurring after August 5, 1997.* For purposes of determining the amount of adjusted taxable gifts as defined in section 2001(b), if, under section 6501, the time has expired within which a gift tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) with respect to a gift made after August 5, 1997, or with respect to an increase in taxable gifts required under section 2701(d) and §25.2701–4 of this chapter, then the amount of the taxable gift will be the amount as finally determined for gift tax purposes under chapter 12 of the Internal Revenue Code and the amount of the taxable gift may not thereafter be adjusted. The rule of this paragraph (b) applies to adjustments involving all issues relating to the gift, including valuation issues and legal issues involving the interpretation of the gift tax law.

(c) *Finally determined.* For purposes of paragraph (b) of this section, the amount of a taxable gift as finally determined for gift tax purposes is—

(1) The amount of the taxable gift as shown on a gift tax return, or on a statement attached to the return, if the Internal Revenue Service does not contest such amount before the time has expired under section 6501 within which gift taxes may be assessed;

(2) The amount as specified by the Internal Revenue Service before the time has expired under section 6501 within which gift taxes may be assessed on the gift, if such specified amount is not timely contested by the taxpayer;

(3) The amount as finally determined by a court of competent jurisdiction; or

(4) The amount as determined pursuant to a settlement agreement entered into between the taxpayer and the Internal Revenue Service.

(d) *Definitions.* For purposes of paragraph (b) of this section, the amount is finally determined by a court of competent jurisdiction when the court enters a final decision, judgment, decree or other order with respect to the amount of the taxable gift that is not subject to appeal. See, for example, section 7481 regarding the finality of a decision by the U.S. Tax Court. Also, for purposes of paragraph (b) of this section, a settlement agreement means any agreement entered into by the Internal Revenue Service and the taxpayer that is binding on both. The term includes a closing agreement under section 7121, a compromise under section 7122, and an agreement entered into in settlement of litigation involving the amount of the taxable gift.

(e) *Expiration of period of assessment.* For purposes of determining if the time has expired within which a tax may be assessed under chapter 12 of the Internal Revenue Code, see §301.6501(c)–1(e) and (f) of this chapter.

(f) *Effective dates.* Paragraph (a) of this section applies to transfers of property by gift made prior to August 6, 1997, if the estate tax return for the donor/decedent's estate is filed after December 3, 1999. Paragraphs (b) through (e) of this section apply to transfers of property by gift made after August 5, 1997, if the gift tax return for the calendar period in which the gift is made is filed after December 3, 1999.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 3. The authority citation for part 25 continues to read in part as follows:

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

Par. 4. In §25.2504–1, a sentence is added at the end of paragraph (d) to read as follows:

§25.2504–1 Taxable gifts for preceding calendar periods.

* * * * *

(d) * * * However, see §25.2504–2(b) regarding certain gifts made after August 5, 1997.

Par. 5. Section 25.2504–2 is revised to read as follows:

§25.2504–2 Determination of gifts for preceding calendar periods.

(a) *Gifts made before August 6, 1997.* If the time has expired within which a tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period, as defined in §25.2502–1(c)(2), the gift was made prior to August 6, 1997, and a tax has been assessed or paid for such prior calendar period, the value of the gift, for purposes of arriving at the correct amount of the taxable gifts for the preceding calendar periods (as defined under §25.2504–1(a)), is the value used in computing the tax for the last preceding calendar period for which a tax was assessed or paid under chapter 12 of the Internal Revenue Code or the corresponding provisions of prior laws. However, this rule does not apply where no tax was paid or assessed for the prior calendar period. Furthermore, this rule does not apply to adjustments involving issues other than valuation. See §25.2504–1(d).

(b) *Gifts made or section 2701(d) taxable events occurring after August 5, 1997.* If the time has expired under section 6501 within which a gift tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period, as defined in §25.2502–1(c)(2), or with respect to an increase in taxable gifts required under section 2701(d) and §25.2701–4, and the gift was made, or the section 2701(d) taxable event occurred, after August 5, 1997, the amount of the taxable gift or the amount of the increase in taxable gifts, for purposes of determining the correct amount of taxable gifts for the preceding calendar periods (as defined in §25.2504–1(a)), is the amount that is finally determined for gift tax purposes (within the meaning of §20.2001–1(c) of this chapter) and such amount may not be thereafter adjusted. The rule of this paragraph (b) applies to adjustments involving all issues relating to the gift including valuation issues and legal issues involving the interpretation of the gift tax law. For purposes of determining if the time has

expired within which a gift tax may be assessed, see §301.6501(c)–1(e) and (f) of this chapter.

(c) *Examples.* The following examples illustrate the rules of paragraphs (a) and (b) of this section:

Example 1. (i) *Facts.* In 1996, A transferred closely-held stock in trust for the benefit of B, A's child. A timely filed a Federal gift tax return reporting the 1996 transfer to B. No gift tax was assessed or paid as a result of the gift tax annual exclusion and the application of A's available unified credit. In 2001, A transferred additional closely-held stock to the trust. A's Federal gift tax return reporting the 2001 transfer was timely filed and the transfer was adequately disclosed under §301.6501(c)–1(f)(2) of this chapter. In computing the amount of taxable gifts, A claimed annual exclusions with respect to the transfers in 1996 and 2001. In 2003, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts.* Under section 2504(c), in determining A's 2003 gift tax liability, the amount of A's 1996 gift can be adjusted for purposes of computing prior taxable gifts, since that gift was made prior to August 6, 1997, and therefore, the provisions of paragraph (a) of this section apply. Adjustments can be made with respect to the valuation of the gift and legal issues presented (for example, the availability of the annual exclusion with respect to the gift). However, A's 2001 transfer was adequately disclosed on a timely filed gift tax return and, thus, under paragraph (b) of this section, the amount of the 2001 taxable gift by A may not be adjusted (either with respect to the valuation of the gift or any legal issue) for purposes of computing prior taxable gifts in determining A's 2003 gift tax liability.

Example 2. (i) *Facts.* In 1996, A transferred closely-held stock to B, A's child. A timely filed a Federal gift tax return reporting the 1996 transfer to B and paid gift tax on the value of the gift reported on the return. On August 1, 1997, A transferred additional closely-held stock to B in exchange for a promissory note signed by B. Also, on September 10, 1997, A transferred closely-held stock to C, A's other child. On April 15, 1998, A timely filed a gift tax return for 1997 reporting the September 10, 1997, transfer to C and, under §301.6501(c)–1(f)(2) of this chapter, adequately disclosed that transfer and paid gift tax with respect to the transfer. However, A believed that the transfer to B on August 1, 1997, was for full and adequate consideration and A did not report the transfer to B on the 1997 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts.* Under section 2504(c), in determining A's 2002 gift tax liability, the value of A's 1996 gift cannot be adjusted for purposes of computing the value of prior taxable gifts, since that gift was made prior to August 6, 1997, and a timely filed Federal gift tax return was filed on which a gift tax was assessed and paid. However, A's prior taxable gifts can be adjusted to reflect the August 1, 1997, transfer because, although a gift tax return for 1997 was timely filed and gift tax was paid, under §301.6501(c)–1(f) of this chapter the period for assessing gift tax with respect to the August 1, 1997, transfer did not commence to run since that transfer was not adequately disclosed on the 1997 gift tax return. Accordingly, a gift tax may be assessed with respect to the August 1, 1997, transfer and the amount of the gift would be reflected in prior taxable gifts for purposes of computing A's gift tax liability for 2002. A's September 10, 1997, transfer to C was adequately disclosed on a timely filed gift tax return and, thus, under paragraph (b) of this section, the amount of the September 10, 1997, taxable gift by A may not be adjusted for purposes of computing prior taxable gifts in determining A's 2002 gift tax liability.

Example 3. (i) *Facts.* In 1994, A transferred closely-held stock to B and C, A's children. A timely filed a Federal gift tax return reporting the 1994 transfers to B and C and paid gift tax on the value of the gifts reported on the return. Also in 1994, A transferred closely-held stock to B in exchange for a bona fide promissory note signed by B. A believed that the transfer to B in exchange for the promissory note was for full and adequate consideration and A did not report that transfer to B on the 1994 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts.* Under section 2504(c), in determining A's 2002 gift tax liability, the value of A's 1994 gifts cannot be adjusted for purposes of computing prior taxable gifts because those gifts were made prior to August 6, 1997, and a timely filed Federal gift tax return was filed with respect to which a gift tax was assessed and paid, and the period of limitations on assessment has expired. The provisions of paragraph (a) of this section apply to the 1994 transfers. However, for purposes of determining A's adjusted taxable gifts in computing A's estate tax liability, the gifts may be adjusted. See §20.2001–1(a) of this chapter.

(d) *Effective dates.* Paragraph (a) of this section applies to transfers of property by gift made prior to August 6, 1997. Paragraphs (b) and (c) of this section apply to transfers of property by gift made after August 5, 1997, if the gift tax return for the calendar period in which the transfer is reported is filed after December 3, 1999.

Par. 6. In §25.2511–2, paragraph (j) is revised to read as follows:

§25.2511–2 Cessation of donor's dominion and control.

* * * * *

(j) If the donor contends that a power is of such nature as to render the gift incomplete, and hence not subject to the tax as of the calendar period (as defined in §25.2502–1(c)(1)) of the initial transfer, see §301.6501(c)–1(f)(5) of this chapter.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 7. The authority citation for part 301 continues to read in part as follows:

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

Par. 8. Section 301.6501(c)–1 is amended by:

1. Revising the heading to paragraph (e).

2. Adding paragraph (f).

The revision and addition reads as follows:

§301.6501(c)–1 Exceptions to general period of limitations on assessment and collection.

* * * * *

(e) *Gifts subject to chapter 14 of the In-*

ternal Revenue Code not adequately disclosed on the return. * * *

(f) *Gifts made after December 31, 1996, not adequately disclosed on the return*— (1) *In general.* If a transfer of property, other than a transfer described in paragraph (e) of this section, is not adequately disclosed on a gift tax return (Form 709, "United States Gift (and Generation-Skipping Transfer) Tax Return"), or in a statement attached to the return, filed for the calendar period in which the transfer occurs, then any gift tax imposed by chapter 12 of subtitle B of the Internal Revenue Code on the transfer may be assessed, or a proceeding in court for the collection of the appropriate tax may be begun without assessment, at any time.

2) *Adequate disclosure of transfers of property reported as gifts.* A transfer will be adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed under this paragraph (f)(2) if the return (or a statement attached to the return) provides the following information—

(i) A description of the transferred property and any consideration received by the transferor;

(ii) The identity of, and relationship between, the transferor and each transferee;

(iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument;

(iv) Except as provided in §301.6501–1(f)(3), a detailed description of the method used to determine the fair market value of property transferred, including any financial data (for example, balance sheets, etc. with explanations of any adjustments) that were utilized in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property. In the case of a transfer of an interest that is actively traded on an established exchange, such as the New York Stock Exchange, the American Stock Exchange, the NASDAQ National Market, or a regional exchange in which quotations are published on a daily basis, including recognized foreign exchanges, recitation of the exchange where the interest is listed, the CUSIP number of the security, and the mean between the highest and lowest quoted selling prices on the applicable valuation date will satisfy all of the requirements of this paragraph (f)(2)(iv). In the case of the transfer of an interest in an entity (for example, a corporation or partnership) that is not actively traded, a description must be provided of any discount claimed in valuing the interests in the entity or any assets owned by such entity. In addition, if the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity, a statement must be provided regarding the fair market value of 100 percent of the entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity), the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred interest as reported on the return. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity. If the entity that is the subject of the transfer owns an interest in another non-actively traded entity (either directly or through ownership of an entity), the information required in this paragraph (f)(2)(iv) must be provided for each entity if the information is relevant and material in determining the value of the interest; and

(v) A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer (see §601.601(d)(2) of this chapter).

(3) *Submission of appraisals in lieu of the information required under paragraph (f)(2)(iv) of this section.* The requirements of paragraph (f)(2)(iv) of this section will be satisfied if the donor submits an appraisal of the transferred property that meets the following requirements—

(i) The appraisal is prepared by an appraiser who satisfies all of the following requirements:

(A) The appraiser is an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.

(B) Because of the appraiser's qualifications, as described in the appraisal that details the appraiser's background, experience, education, and membership, if any, in professional appraisal associations, the appraiser is qualified to make appraisals of the type of property being valued.

(C) The appraiser is not the donor or the donee of the property or a member of the family of the donor or donee, as defined in section 2032A(e)(2), or any person employed by the donor, the donee, or a member of the family of either; and

(ii) The appraisal contains all of the following:

(A) The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal.

(B) A description of the property.

(C) A description of the appraisal process employed.

(D) A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the analyses, opinions, and conclusions.

(E) The information considered in determining the appraised value, including in the case of an ownership interest in a business, all financial data that was used in determining the value of the interest that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value.

(F) The appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions.

(G) The valuation method utilized, the rationale for the valuation method, and the procedure used in determining the fair market value of the asset transferred.

(H) The specific basis for the valuation, such as specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisition transactions, etc.

(4) *Adequate disclosure of non-gift completed transfers or transactions.*

Completed transfers to members of the transferor's family, as defined in section 2032A(e)(2), that are made in the ordinary course of operating a business are deemed to be adequately disclosed under paragraph (f)(2) of this section, even if the transfer is not reported on a gift tax return, provided the transfer is properly reported by all parties for income tax purposes. For example, in the case of salary paid to a family member employed in a family owned business, the transfer will be treated as adequately disclosed for gift tax purposes if the item is properly reported by the business and the family member on their income tax returns. For purposes of this paragraph (f)(4), any other completed transfer that is reported, in its entirety, as not constituting a transfer by gift will be considered adequately disclosed under paragraph (f)(2) of this section only if the following information is provided on, or attached to, the return—

(i) The information required for adequate disclosure under paragraphs (f)(2)(i), (ii), (iii) and (v) of this section; and

(ii) An explanation as to why the transfer is not a transfer by gift under chapter 12 of the Internal Revenue Code.

(5) *Adequate disclosure of incomplete transfers.* Adequate disclosure of a transfer that is reported as a completed gift on the gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer, even if the transfer is ultimately determined to be an incomplete gift for purposes of §25.2511–2 of this chapter. For example, if an incomplete gift is reported as a completed gift on the gift tax return and is adequately disclosed, the period for assessment of the gift tax will begin to run when the return is filed, as determined under section 6501(b). Further, once the period of assessment for gift tax expires, the transfer will not be subject to inclusion in the donor's gross estate for estate tax purposes. On the other hand, if the transfer is reported as an incomplete gift whether or not adequately disclosed, the period for assessing a gift tax with respect to the transfer will not commence to run even if the transfer is ultimately determined to be a completed gift. In that situation, the gift tax with respect to the transfer may be assessed at any time, up until three years after the donor files a return reporting the transfer as a completed gift with adequate disclosure.

(6) *Treatment of split gifts.* If a husband and wife elect under section 2513 to treat a gift made to a third party as made one-half by each spouse, the requirements of this paragraph (f) will be satisfied with respect to the gift deemed made by the consenting spouse if the return filed by the donor spouse (the spouse that transferred the property) satisfies the requirements of this paragraph (f) with respect to that gift.

(7) *Examples.* The following examples illustrate the rules of this paragraph (f):

Example 1. (i) *Facts.* In 2001, A transfers 100 shares of common stock of XYZ Corporation to A's child. The common stock of XYZ Corporation is actively traded on a major stock exchange. For gift tax purposes, the fair market value of one share of XYZ common stock on the date of the transfer, determined in accordance with §25.2512–2(b) of this chapter (based on the mean between the highest and lowest quoted selling prices), is $150.00. On A's Federal gift tax return, Form 709, for the 2001 calendar year, A reports the gift to A's child of 100 shares of common stock of XYZ Corporation with a value for gift tax purposes of $15,000. A specifies the date of the transfer, recites that the stock is publicly traded, identifies the stock exchange on which the stock is traded, lists the stock's CUSIP number, and lists the mean between the highest and lowest quoted selling prices for the date of transfer.

(ii) *Application of the adequate disclosure standard.* A has adequately disclosed the transfer. Therefore, the period of assessment for the transfer under section 6501 will run from the time the return is filed (as determined under section 6501(b)).

Example 2. (i) *Facts.* On December 30, 2001, A transfers closely-held stock to B, A's child. A determined that the value of the transferred stock, on December 30, 2001, was $9,000. A made no other transfers to B, or any other donee, during 2001. On A's Federal gift tax return, Form 709, for the 2001 calendar year, A provides the information required under paragraph (f)(2) of this section such that the transfer is adequately disclosed. A claims an annual exclusion under section 2503(b) for the transfer.

(ii) *Application of the adequate disclosure standard.* Because the transfer is adequately disclosed under paragraph (f)(2) of this section, the period of assessment for the transfer will expire as prescribed by section 6501(b), notwithstanding that if A's valuation of the closely-held stock was correct, A was not required to file a gift tax return reporting the transfer under section 6019. After the period of assessment has expired on the transfer, the Internal Revenue Service is precluded from redetermining the amount of the gift for purposes of assessing gift tax or for purposes of determining the estate tax liability. Therefore, the amount of the gift as reported on A's 2001 Federal gift tax return may not be redetermined for purposes of determining A's prior taxable gifts (for gift tax purposes) or A's adjusted taxable gifts (for estate tax purposes).

Example 3. (i) *Facts.* A owns 100 percent of the common stock of X, a closely- held corporation. X does not hold an interest in any other entity that is not actively traded. In 2001, A transfers 20 percent of the X stock to B and C, A's children, in a transfer that is not subject to the special valuation rules of section 2701. The transfer is made outright with no restrictions on ownership rights, including voting rights and the right to transfer the stock. Based on generally applicable valuation principles, the value of X would be determined based on the net value of the assets owned by X. The reported value of the transferred stock incorporates the use of minority discounts and lack of marketability discounts. No other discounts were used in arriving at the fair market value of the transferred stock or any assets owned by X. On A's Federal gift tax return, Form 709, for the 2001 calendar year, A provides the information required under paragraph (f)(2) of this section including a statement reporting the fair market value of 100 percent of X (before taking into account any discounts), the pro rata portion of X subject to the transfer, and the reported value of the transfer. A also attaches a statement regarding the determination of value that includes a discussion of the discounts claimed and how the discounts were determined.

(ii) *Application of the adequate disclosure standard.* A has provided sufficient information such that the transfer will be considered adequately disclosed and the period of assessment for the transfer under section 6501 will run from the time the return is filed (as determined under section 6501(b)).

Example 4. (i) *Facts.* A owns a 70 percent limited partnership interest in PS. PS owns 40 percent of the stock in X, a closely-held corporation. The assets of X include a 50 percent general partnership interest in PB. PB owns an interest in commercial real property. None of the entities (PS, X, or PB) is actively traded and, based on generally applicable valuation principles, the value of each entity would be determined based on the net value of the assets owned by each entity. In 2001, A transfers a 25 percent limited partnership interest in PS to B, A's child. On the Federal gift tax return, Form 709, for the 2001 calendar year, A reports the transfer of the 25 percent limited partnership interest in PS and that the fair market value of 100 percent of PS is $y and that the value of 25 percent of PS is $z, reflecting marketability and minority discounts with respect to the 25 percent interest. However, A does not disclose that PS owns 40 percent of X, and that X owns 50 percent of PB and that, in arriving at the $y fair market value of 100 percent of PS, discounts were claimed in valuing PS's interest in X, X's interest in PB, and PB's interest in the commercial real property.

(ii) *Application of the adequate disclosure standard.* The information on the lower tiered entities is relevant and material in determining the value of the transferred interest in PS. Accordingly, because A has failed to comply with requirements of paragraph (f)(2)(iv) of this section regarding PS's interest in X, X's interest in PB, and PB's interest in the commercial real property, the transfer will not be considered adequately disclosed and the period of assessment for the transfer under section 6501 will remain open indefinitely.

Example 5. The facts are the same as in *Example 4* except that A submits, with the Federal tax return, an appraisal of the 25 percent limited partnership in-

terest in PS that satisfies the requirements of paragraph (f)(3) of this section in lieu of the information required in paragraph (f)(2)(iv) of this section. Assuming the other requirements of paragraph (f)(2) of this section are satisfied, the transfer is considered adequately disclosed and the period for assessment for the transfer under section 6501 will run from the time the return is filed (as determined under section 6501(b) of this chapter).

Example 6. A owns 100 percent of the stock of X Corporation, a company actively engaged in a manufacturing business. B, A's child, is an employee of X and receives an annual salary paid in the ordinary course of operating X Corporation. B reports the annual salary as income on B's income tax returns. In 2001, A transfers property to family members and files a Federal gift tax return reporting the transfers. However, A does not disclose the 2001 salary payments made to B. Because the salary payments were reported as income on B's income tax return, the salary payments are deemed to be adequately disclosed. The transfer of property to family members, other than the salary payments to B, reported on the gift tax return must satisfy the adequate disclosure requirements under paragraph (f)(2) of this section in order for the period of assessment under section 6501 to commence to run with respect to those transfers.

(8) *Effective date.* This paragraph (f) is applicable to gifts made after December 31, 1996, for which the gift tax return for such calendar year is filed after December 3, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 9. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 10. In §602.101, paragraph (b) is amended in the table by revising the entry for 301.6501(c)–1 to read as follows:

§602.101 OMB Control numbers.

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
301.6501(c)–1	1545–1241 1545–1637
* * * * *	

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved November 18, 1999

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 2, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 3, 1999, 64 F.R. 67767)

Part III. Administrative, Procedural, and Miscellaneous

Section 705 Special Basis Rules

Notice 99–57

The Internal Revenue Service intends to promulgate regulations under § 705 of the Internal Revenue Code to address certain situations where gain or loss may be improperly created by adjusting the basis of a partnership interest for partnership income that is not subject to tax, or for partnership losses or deductions that are permanently denied, with respect to a partner.

BACKGROUND

Section 705(a) provides that the adjusted basis of a partner's interest in a partnership generally shall be increased by the partner's distributive share of (i) taxable income of the partnership as determined under § 703(a), (ii) income of the partnership exempt from tax, and (iii) the excess of the deduction for depletion over the basis of the property subject to depletion. Conversely, the adjusted basis of a partner's interest in a partnership generally shall be decreased by the partner's distributive share of (i) losses of the partnership, (ii) nondeductible expenditures not properly chargeable to capital account, and (iii) in certain cases, deductions for depletion.

The legislative history describing § 705(a) states that adjusting the basis of a partner's interest is necessary to prevent unintended benefit or detriment to the partners. Thus, a partner should add to the basis of the partner's partnership interest the partner's distributive share of nontaxable income so that the partner does not lose the benefit of that type of tax-exempt income. Otherwise, the partner could eventually incur a capital gain with respect to such amounts. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A225 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 384 (1954).

Rev. Rul. 96–11, 1996–1 C.B. 140, provides an example of how § 705 has been interpreted to carry out the purposes of this legislative history. There, a partnership made a charitable contribution of property with a basis of $60x and fair market value of $100x in a transaction that qualified under § 170(c). The ruling states that "[i]n determining whether a transaction results in exempt income within the meaning of § 705(a)(1)(B), or a nondeductible, noncapital expenditure within the meaning of § 705(a)(2)(B), the proper inquiry is whether the transaction has a permanent effect on the partnership's basis in its assets, without a corresponding current or future effect on its taxable income." The ruling explains that the partners' bases in their partnership interests should be reduced only by their respective shares of the permanent decrease in the partnership's asset basis. This preserves the deduction for the fair market value of appreciated property without the recognition of the appreciation. Reducing the partners' bases in their partnership interests by the fair market value of the property contributed to the charity would subsequently cause the partners to recognize gain (or a reduced loss) upon a disposition of their interests in the partnership attributable to the unrecognized appreciation in the property at the time of the contribution. See also Rev. Rul. 96–10, 1996–1 C.B. 138, which discusses adjustments to basis in partnership interests where loss on sale of partnership property is denied under § 707(b)(1) and subsequent gain is not recognized under §§ 267(d) and 707(b)(1).

Section 743(a) provides that the basis of partnership property shall not be adjusted as the result of the transfer of a partnership interest by sale or exchange or on the death of a partner unless an election under § 754 is in effect with respect to the partnership.

Section 743(b) provides that, in the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which an election under § 754 is in effect shall (i) increase the basis of the partnership property by the excess of the basis to the transferee partner of the transferee partner's interest in the partnership over the transferee partner's proportionate share of the adjusted basis of the partnership property, or (ii) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of the transferee partner's interest in the partnership.

The partnership rules generally attempt to preserve equality between a partner's basis in the partnership interest and the partner's share of inside basis in the assets of the partnership. In order to promote administrative convenience, however, § 743(a) departs from this general rule, allowing a partner's basis in its partnership interest to diverge from the partner's share of basis in partnership assets in situations where the partnership has not made an election under § 754.

The failure to make a § 754 election generally will result in a timing benefit or detriment to the partner or partners with divergent inside and outside bases. For instance, consider the situation where a person (*A*) purchases a 50 percent interest in a partnership for $100x. The partnership owns one asset with a basis of $100x and a value of $200x. If the partnership had made a § 754 election, *A* would have a $50x special basis adjustment in the property, so that when the partnership disposed of the property for $200x, *A*'s special basis adjustment would exactly offset *A*'s allocated share of the gain. *A*'s basis in the partnership interest would remain at $100x after the sale. Accordingly, *A* would not recognize any gain upon the sale of the partnership interest immediately thereafter.

If the partnership had not made a § 754 election, *A* would have no special basis adjustment, so that when the partnership disposed of the property for $200x, *A* would be allocated $50x of gain. *A*'s basis in the partnership interest would increase to $150x under § 705(a)(1)(A), so that *A* would recognize an offsetting $50x loss (or reduced gain) upon a subsequent sale of the partnership interest. Thus, without the § 754 election, there may be a timing detriment to *A*, but the correct amount of cumulative income or loss (albeit possibly of a different character) is ultimately reported by *A*.

The correct amount of cumulative income may not be reported, however, in certain situations in which *A* is not subject to tax on the gain that results from the failure to make the § 754 election. For instance, in the example discussed immediately above, if *A* was a corporation and the property held by the partnership was *A* stock, under § 1032, the gain allocated to

A (assuming that no § 754 election had been made) would not be subject to tax. See Rev. Rul. 99–57, published in this issue of the Internal Revenue Bulletin. In this situation, it would be inconsistent with the intent of § 705 to increase the basis of *A*'s partnership interest for the non-recognized gain. To do so would create a recognizable loss in a situation where no offsetting gain had previously been recognized.

DESCRIPTION OF REGULATIONS

The regulations will apply specifically to situations where a corporation acquires an interest in a partnership that holds stock in that corporation, and a § 754 election is not in effect with respect to the partnership for the taxable year of the acquisition. In those situations, a corporate partner may increase its basis in its partnership interest under § 705 only by the amount of its share of § 1032 gain that the partner would have realized had a § 754 election been made. Rules regarding tiered-entity structures also will apply.

It is intended that the regulations also will apply to other situations where the price paid for a partnership interest reflects built-in gain or accrued income items that will not be subject to income tax, or built-in loss or accrued deductions that will be permanently denied, when allocated to the transferee partner, and the partnership has not made an election under § 754. Comments are requested as to the appropriate scope of the regulations in this regard.

EFFECTIVE DATES

In situations where a corporate partner is allocated gain that is subject to § 1032, and the basis of the stock was not adjusted upon the purchase of the partnership interest by the corporate partner under § 743(b), the regulations shall apply to gain or loss allocated with respect to sales of partner stock occurring after December 6, 1999. In other situations, the regulations will apply to gain or loss realized or income or deductions taken into account after the date of publication of proposed regulations. Moreover, the Service may challenge any transaction within the scope of this Notice under the anti-abuse provisions of § 1.701–2 of the Income Tax Regulations, as appropriate.

The principal author of this notice is Robert Honigman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice contact Robert Honigman at (202) 622-3050 (not a toll-free call).

Opportunity to Obtain a Debt Indicator in a Pilot Program for Tax Year 1999 Form 1040 IRS *e-file* and On-Line Returns

Notice 99–58

SUMMARY: Authorized IRS *e-file* Providers, Form 1040 On-Line Transmitters and financial institutions may apply to obtain a Debt Indicator for their customer/client taxpayers in exchange for actively screening individual income tax returns and return information for potential fraud and abuse and to reporting the findings to the IRS in accordance with a proposal accepted by the IRS.

ADDRESSES: Questions or concerns should be directed to Lisa Johnson at the IRS, Electronic Tax Administration, Electronic Program Operations Office, OP:ETA:O:C, New Carrollton Federal Building, ATTN: Lisa Johnson, 5000 Ellin Road C4–187, Lanham, MD 20706 or via E-mail at LJJOHN00@m1.irs.gov or faxed to (202) 283-4786, ATTN: Lisa Johnson.

SUPPLEMENTARY INFORMATION

Background

The Debt Indicator is useful to taxpayers who wish to use their anticipated individual income tax return refunds to apply for bank products, for example, refund anticipation loans. The Debt Indicator tells a taxpayer whether or not there are any scheduled offsets against the refund by IRS, for example, for back taxes, or by the Financial Management Service (FMS), for example, for outstanding child support or federal debts, such as student loans. These bank products are offered by financial institutions in conjunction with tax practitioners that file returns electronically. An indicator called the Direct Deposit Indicator or DDI was available to taxpayers seeking bank products prior to 1994. The DDI was discontinued because it was thought to be a contributing factor to fraudulent claims for the Earned Income Tax Credit. The new Debt Indicator seeks to address this issue through a joint fraud detection program. Authorized IRS *e-file* Providers, Form 1040 On-Line Filers, and financial institutions will sign agreements with the IRS to actively screen returns and return information for potential fraud and abuse and report findings to the IRS. Parties to the agreements are eligible to obtain the Debt Indicator for their taxpayers who apply for bank products and sign consents to disclose the Debt Indicator to Authorized IRS *e-file* Providers, Form 1040 On-Line Filers, and financial institutions. The application and instructions for applying to obtain an agreement follow.

APPROVED

Terence H. Lutes,
National Director,
Electronic Program Operations Office,
Electronic Tax Administration.

(Filed by the Office of the Federal Register on December 1, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 2, 1999, 64 F.R. 67621)

Application for Memorandum of Agreement
Debt Indicator

Name:
DBA Name:
Address:
Authorized Representative: **Phone Number:** **Fax Number:**
ETIN(s):
EFIN(s) Covered **By This Proposal:** **(attach separate sheet if necessary)**

IRS Authorized Representative: Lisa Johnson **Phone Number: (202) 283-0980** **Fax Number: (202) 283-4786** **E-mail: LJJOHN00@m1.irs.gov**
Address: IRS **Attn: Lisa Johnson, OP:ETA:O:C** **5000 Ellin Road** **Lanham, MD 20706**

1. INTRODUCTION

(A) The Internal Revenue Service (IRS) faces the challenge of eliminating barriers by providing incentives and using competitive market forces to make progress towards its goal to electronically transact 80% of IRS business by the year 2007 and the interim goal that, to the extent practicable, all returns prepared electronically should be filed electronically by the year 2002. One of these incentives was the issuance of the Debt Indicator Pilot Request For Agreement (RFA) that was issued on June 22, 1999. This RFA provided the opportunity for electronic return originators (EROs), transmitters and On-line service providers to obtain a Debt Indicator in exchange for screening the returns they transmit for potential abuse. Authorized *e-file* providers and financial institutions that did not submit proposals under this RFA or are not covered under one of the announced agreements may still apply to obtain the DI for the upcoming filing season through this Memorandum of Agreement (MOA).(B) The Electronic Tax Administration (ETA) MOA between the Internal Revenue Service (IRS) and the Participant sets forth the complete agreement of the parties with regard to participation in the Debt Indicator Pilot for electronically filed individual (1040 series) federal income tax returns during the 2000 filing season which covers the 1999 tax year. The parties agree that, except as provided below, the participant will be treated as an ERO, On-line service provider, transmitter, software developer or financial institution for the 2000 IRS *e-file* program as those terms are defined in Revenue Procedures 98-50 and 98-51. Also, except as provided below, the parties agree to comply with all relevant statutory, regulatory, and administrative requirements relating to the electronic filing program.

(C) The IRS is looking for creative and innovative abuse and fraud detection beyond what is required in Revenue Procedures 98-50 and 98-51 in addition to creative and innovative ways to perform the due diligence required by these Revenue Procedures. Partnered proposals offer

greater opportunities for more comprehensive screening of returns and return information and have a greater chance of being accepted by the IRS.

2. AUTHORITY

This Agreement is entered into pursuant to (1) the authority vested in the Commissioner of the IRS by Treasury Order 150-10 to administer and enforce the internal revenue laws and revenue procedures for electronic filing and (2) the authority vested in the Secretary of the Treasury by the IRS Restructuring and Reform Act of 1998, implemented in Section 6011 of the Internal Revenue Code, to promote the benefits of and encourage the use of ETA programs.

3. BACKGROUND AND PURPOSE

In exchange for providing the screening procedures in the accepted proposal, the IRS will provide to the taxpayer through the selected Participant, a debt indicator for taxpayers who have entered into an agreement with a financial institution. This indicator may show the reason that the refund changed was because of a debt owed to either the IRS or Financial Management Service (FMS) or both.

The return software must also be modified to include a voluntary consent to disclose when the RAL indicator field is significant. This authorizes the Service to provide the debt indicator when financial agreements have been made with the taxpayer.

4. DEFINITIONS

(A) "Days" as used herein means calendar days unless otherwise stated.

(B) A "fraudulent return" is a return in which the individual is attempting to file using someone else's name or SSN on the return or where the taxpayer is presenting documents or information that have no basis in fact. NOTE: Fraudulent returns should not be filed with the Service.

(C) A "potentially abusive return" is a return (1) that is not a fraudulent return; (2) that the taxpayer is required to file; (3) but that may contain inaccurate or unsubstantiated information (including, but not limited to, the information subject to reporting) that may lead to an understatement of a liability or an overstatement of a credit, and production of a refund to which the taxpayer may not be entitled. NOTE: The decision not to provide a RAL or other bank product does not necessarily make it an abusive return.

(D) Refund offset is the reduction of the taxpayer's claimed refund in whole or in part for unpaid IRS tax debt or past-due debts submitted to FMS' Treasury Offset Program for child support arrearages, Federal agency non-tax debt, or state income tax.

(E) Refund delay is the suspension of the refund process resulting from systemic reviews.

(F) Sub-Participant is an ERO, On-line service provider, Transmitter, or Financial Institution other than the Participant who has entered into an Agreement with the Participant to perform some of the duties and responsibilities of the Participant.

5. DUTIES AND RESPONSIBILITIES OF THE PARTICIPANT

(A) The Participant will perform all the screening activities included in the checklist submitted with, and incorporated by reference into, this Agreement.

(B) The Participant must agree to track and report (by SSN) to the IRS on a weekly basis, the potentially abusive federal individual income tax returns electronically filed and the reason(s) the return may be abusive. The format is as follows and should be delivered via electronic mail to HQ-ORF@ci.irs.gov.

Field Name	Field Length	Format
Filer EFIN	6	Alpha/Numeric
Primary SSN	9	Alpha/Numeric
W2	1	Alpha (Y or blank)
Dependents	1	Alpha (Y or blank)
Schedule C	1	Alpha (Y or blank)
Filing Status Change	1	Alpha (Y or blank)
Telephone # Invalid	1	Alpha (Y or blank)
Duplicate SSN	1	Alpha (Y or blank)
Invalid SSN	1	Alpha (Y or blank)
Duplicate Address	1	Alpha (Y or blank)
Other	1	Alpha (Y or blank)
Return Filed	1	Alpha (Y or blank)
Explanation of Other	250	Alpha

Filer EFIN — Electronic Filer Identification Number of the ERO processing the return.

Primary SSN — Primary SSN on the return, which is suspected of abuse/fraud.

W2 — the W2 was the reason for suspecting abuse/fraud.

Dependents — questions about the dependents was the reason for suspecting fraud (i.e. last name of dependent is different from taxpayer).

Schedule C — no substantiation for the Schedule C.

Filing Status Change — questions about the filing status changes was the reason for suspecting abuse/fraud.

Telephone # Invalid — telephone numbers given by the taxpayer were found to be either invalid, disconnected, or that the taxpayer was not known by the person answering the telephone.

Duplicate SSN — a duplicate primary, secondary, dependent or EIC qualifying SSN is found within the ERO's own universe of returns.

Invalid SSN — the ERO determines that the primary, secondary, dependent or EIC qualifying SSN is invalid.

Duplicate Address — multiple returns filed for the same address for seemingly

unrelated taxpayers found within the ERO's own universe of returns.

Other — any reason, not conforming to those previously listed, for which a return could be considered fraudulent.

Return Filed — the "Y" will indicate that the return was filed and blank will mean that the return was not filed.

If you have additional information, provide it in a flat file format, comma delimited (e.g., SSN information on returns that were not processed).

(C) The Participant will provide the Service with a Final Pilot Finding report. This report will be sent to the Authorized IRS Representative via email no later than May 31, 2000. The report shall include information on each of the following items:

- Number of RALs applied for and 1999 vs. 2000 comparison
- Average amount of RAL and 1999 vs. 2000 comparison
- Distribution of RAL applicants with respect to adjusted gross income (AGI)
- Range of fees charged for RALs
- Comparison of fees prior to DI pilot
- Breakdown of e-filers between RAL applicants and non-RAL applicants and 1999 vs. 2000 comparison

6. LIABILITY

The IRS shall not be liable for any injury to the Participant's personnel or damage to the Participant's property unless such injury or damage is due to negligence on the part of the Government and is recoverable under the Federal Tort Claims Act [28 U.S.C. 1346(b)], or pursuant to other statutory authority.

7. THIRD PARTY RIGHTS

This Agreement does not alter, change, or eliminate any rights or responsibilities that taxpayers have under the Internal Revenue Code.

8. PERIOD OF PERFORMANCE AND TERMINATION

(A) This Agreement shall be in effect from the date of IRS' signature for the 2000 filing season with an option to extend for the 2001 filing season subject to a modification of the agreement.

(B) This Agreement may be terminated by either party upon 30 days after receipt of written notice signed by either of the signatories to this Agreement or by their successors or designees. The Participant understands that in the event the IRS terminates this Agreement, the Participant has no right to any claim against the Government, including a claim for termination costs.

9. MODIFICATION

This Agreement may be modified by the IRS, and the Participant may submit requests for modifications to the IRS Authorized Representative. All modifications must be in writing and signed by both of the signatories to this Agreement or by their successors or designees.

10. INSPECTION

(A) The IRS has the right to inspect the work performed by the Participant or any Sub-Participant as stated below. If the duties and responsibilities of the Participant or any Sub-Participant are not being met, then the IRS may terminate this Agreement for default, and the Participant and any Sub-Participant may be suspended from the IRS *e-file* program.

(B) The IRS may inspect the work performed by the Participant upon reasonable notice to the Participant's Authorized Representative and in a manner that will not interfere with the Participant's performance of this Agreement. The Participant shall provide access for this purpose to the IRS' Authorized Representative(s) to the location where the work is being performed. The IRS shall also have the right to inspect the Participant's Report(s) of the work performed as a result of this Agreement. The IRS's Authorized Representative shall provide the results of any inspections to the Participant's Authorized Representative for any necessary resolution.

11. RELEASE OF INFORMATION

The Participant shall provide written notice to the IRS and obtain consent in advance of releasing any national press releases for the purposes of performing the work described in this Agreement or publicizing this partnership with the IRS. The text and purpose of the intended release shall be provided to the IRS's Authorized Representative for this Agreement. The Service may monitor advertising standards as authorized in Section 12 of Revenue Procedure 98-50.

12. REMEDIES

There are no remedies other than the termination rights described in 11(B) and (C) of this Agreement unless provided in a modification to this Agreement. The Contract Disputes Act does not apply.

13. ORDER OF PRECEDENCE

In the event the terms of this Agreement are inconsistent with the terms of the checklist, the Agreement shall take precedence.

14. GOVERNING LAW

This Agreement is subject to and governed by the laws of the United States of America, that is, by Federal law, and not by the laws of any State. The terms of this Agreement are not intended to alter, modify, or rescind any current Agreement or provision of Federal law now in effect. Any provision of this Agreement that conflicts with Federal law will be null and void.

SIGNATURES

_____

Participant

_____

Terence H. Lutes
National Director, ETA

INSTRUCTIONS

The IRS is encouraging the formation of partnerships among EROs, transmitters, software developers and financial institutions to meet the requirements of this agreement more efficiently and to cover more participants. These partnerships may apply as a group and the privileges obtained through successful applications will be extended to all member partners.

Software developers, transmitters and financial institutions are encouraged to initiate these partnership applications on behalf of their customers — EROs, direct transmitters, small banks — to ensure that their entire customer bases have access to the Debt Indicator. Partnered proposals offer greater opportunities for more com-

prehensive screening of returns and return information and have a greater chance of being accepted by the IRS.

Individual EROs that apply will need to negotiate changes with their software company before they can participate.

In order to receive this indicator for you and/or your clients, use the application and sample checklist (Attachment 1) as resources to formulate your submission. Include all screening procedures currently employed by all members of the partnership. This could include cross-checks of all data received from EROs that could identify improbable information; software checks that can identify abusive scenarios within ERO practices and fraudulent or abusive situations; transmitter databases that can identify duplicated information as well as facilitating the reporting process; and fraud screening services and other checks.

Attachment 1

SAMPLE CHECKLIST

	Current Check	Willing to Do for 2000
ERO		
-Identification		
Require two forms of valid identification (one must be a photo ID)	☐	☐
Verify telephone numbers	☐	☐
Verify residence	☐	☐
-Social Security Card		
Require a valid SSN card for all SSNs on return	☐	☐
-Maintain Previous Client Database		
Document change in filing status	☐	☐
Document change in number or names of dependents	☐	☐
Document multiple returns to same address in prior year	☐	☐
INCOME VERIFICATION		
- Questionable W–2s		
Verification of W–2s when one of the following exist: • Typed, handwritten or altered forms • W–2's with all copies attached • Unknown companies (out of area) • W–2s that differ from other forms issued from the same company	☐	☐
- Schedule C or Other Income Reporting Forms		
Documentation of income	☐	☐
Validation and recording of expenses	☐	☐
- EITC and Filing Status Verification		
Complete Due Diligence worksheet	☐	☐
Document lack of child care expenses where potential exists	☐	☐
Utilize tax package and requirements to ensure: • A child can be claimed as a dependent	☐	☐
• The taxpayer can qualify as Head of Household	☐	☐
• A child can be considered as a qualifying child for EITC purposes	☐	☐

	Current Check	Willing to Do for 2000
- Return Verification		
Document Schedule A deductions	☐	☐
Software Developer		
Validate SSNs are within valid ranges	☐	☐
Check for Duplicate SSNs	☐	☐
Check for Multiple Head of Household Returns at the same address	☐	☐
Check for improbable Federal withholding amounts	☐	☐
Check for incorrect Social Security or Medicare Withholding	☐	☐
Verify math computations are correct	☐	☐
Verify format is correct	☐	☐
Transmitter		
Verify ERO suitability	☐	☐
Maintain databases for the following:		
Duplicate SSNs	☐	☐
Addresses and phone numbers for jails, drug treatment centers, health/welfare agencies, hotels, etc.	☐	☐
SSNs of deceased persons	☐	☐
Credit card fraud	☐	☐
Bank		
Contract with a fraud screening service for bank products connected to tax returns	☐	☐
Request Credit Reports for loan customers	☐	☐

Other

Feel free to add any additional screens you currently employ. Attach additional pages as necessary.

Use this space to further describe any of the above screens. Attach additional pages as necessary.

Part IV. Items of General Interest

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organizations listed below have recently filed timely declaratory judgment suits under section 7428 of the Code, challenging revocation of their status as eligible donees under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Sta-Home Home Health Agency, Inc.
Jackson, MS

Sta-Home Home Health Agency, Inc.
of Forest, Mississippi
Jackson, MS

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1(e): Continuity of interest.

Continuity of interest on repurchase of issuer's shares. This ruling holds that an open market repurchase of shares through a broker has no effect on continuity of interest in a potential reorganization.

Rev. Rul. 99-58

ISSUE

What is the effect on continuity of interest when a potential reorganization is followed by an open market reacquisition of P's stock?

FACTS

T merges into P, a corporation whose stock is widely held, and is publicly and actively traded. P has one class of common stock authorized and outstanding. In the merger, T shareholders receive 50 percent common stock of P and 50 percent cash. Viewed in isolation, the exchange would satisfy the continuity of interest requirement of § 1.368-1(e) of the Income Tax Regulations. However, in an effort to prevent dilution resulting from the issuance of P shares in the merger, P's preexisting stock repurchase program is modified to enable P to reacquire a number of its shares equal to the number issued in the acquisition of T. The number of shares repurchased will not exceed the total number of P shares issued and outstanding prior to the merger. The repurchases are made following the merger, on the open market, through a broker for the prevailing market price. P's intention to repurchase shares was announced prior to the T merger, but the repurchase program was not a matter negotiated with T or the T shareholders. There was not an understanding between the T shareholders and P that the T shareholders' ownership of P stock would be transitory. Because of the mechanics of an open market purchase, P does not know the identity of a seller of P stock, nor does a former T shareholder who receives P stock in the merger and subsequently sells it know whether P is the buyer. Without regard to the repurchase program, a market exists for the newly-issued P stock held by the former T shareholders. During the time P undertakes its repurchase program, there are sales of P stock on the open market, which may include sales of P shares by former T shareholders.

LAW AND ANALYSIS

Requisite to a reorganization under the Internal Revenue Code is a continuity of interest as described in § 1.368–1(e). Section 1.368–1(b). The general purpose of the continuity of interest requirement is "to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations." Section 1.368–1(e)(1)(i). To achieve this purpose, the regulation provides that a proprietary interest in the target corporation is not preserved to the extent that, "in connection with the potential reorganization, . . . stock of the issuing corporation furnished in exchange for a proprietary interest in the target corporation in the potential reorganization is redeemed." Id. However, for purposes of the continuity requirement, "a mere disposition of stock of the issuing corporation received in the potential reorganization to persons not related . . . to the issuing corporation is disregarded." Id. The regulation provides that all facts and circumstances will be considered in determining whether, in substance, a proprietary interest in the target corporation is preserved.

Under the facts set forth above, continuity of interest is satisfied. There was not an understanding between the T shareholders and P that the T shareholders' ownership of the P shares would be transitory. Further, because of the mechanics of an open market repurchase, the repurchase program does not favor participation by the former T shareholders. Therefore, even if it could be established that P has repurchased P shares from former T shareholders in the repurchase program, any such purchase would be coincidental. The merger and the stock repurchase together in substance would not resemble a sale of T stock to P by the former T shareholders and, thus, the repurchase would not be treated as "in connection with" the merger. Under the facts presented, a sale of P stock on the open market by a former T shareholder during the repurchase program will have the same effect on continuity of interest as a mere disposition to persons not related to P.

HOLDING

Under the facts presented, the open market repurchase of shares through a broker has no effect on continuity of interest in the potential reorganization.

DRAFTING INFORMATION

The principal author of this revenue ruling is Marie C. Milnes-Vasquez of the Office of Assistant Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Ms. Milnes-Vasquez on (202) 622-7770 (not a toll-free call).

Section 743.—Optional Adjustment to Basis of Partnership Property

26 CFR 1.743-1: Optional adjustment to basis of partnership property.

T.D. 8847

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Adjustments Following Sales of Partnership Interests

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document finalizes regulations relating to the optional adjustments to the basis of partnership property following certain transfers of partnership interests under section 743, the calculation of gain or loss under section 751(a) following the sale or exchange of a partnership interest, the allocation of basis adjustments among partnership assets under section 755, the allocation of a partner's basis in its partnership interest to proper-

ties distributed to the partner by the partnership under section 732(c), and the computation of a partner's proportionate share of the adjusted basis of depreciable property (or depreciable real property) under section 1017. The changes will affect partnerships and partners where there are transfers of partnership interests, distributions of property, or elections under sections 108(b)(5) or (c). In addition, the final regulations under section 732(c) reflect changes to the law made by the Taxpayer Relief Act of 1997.

DATES: *Effective Dates*: These regulations are effective December 15, 1999.

Applicability Date: These regulations apply to transfers of partnership interests and distributions occurring on or after December 15, 1999.

FOR FURTHER INFORMATION CONTACT: Matthew Lay, (202) 622-3050.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information in these final regulations have been reviewed and approved by the **Office of Management and Budget** in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1588. Responses to these collections of information are mandatory for partnerships that have made an election under section 754 and for which a section 743 transfer has been made, and for partnerships which distribute property in a transaction subject to section 732(d).

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

The estimated annual burden per respondent varies from 1 hour to 300 hours, depending on the individual circumstances, with an estimated average of 4 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to these collections of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document (a) revises §§1.743-1 and 1.755-1 of the Income Tax Regulations (26 CFR part 1), and (b) amends §§1.732-1, 1.732-2, 1.734-1, 1.751-1, 1.754-1, and §1.1017-1 of the Income Tax Regulations.

On January 29, 1998, proposed regulations (REG 209682-94) were published in the **Federal Register** (63 FR 4408). Written comments were received in response to the notice of proposed rulemaking. One speaker provided testimony at a public hearing held on September 10, 1998.

After consideration of all the comments, the proposed regulations under sections 732, 734, 743, 751, 755, and 1017 are adopted, as revised by this Treasury Decision.

Explanation of Revisions and Summary of Contents

1. *Basis in Distributed Property*

(a) Mandatory application of section 732(d). Section 1.732-1(d)(4) of the current regulations requires transferees to apply the special basis rule in certain cases. In the preamble to the proposed regulations, the IRS and the Treasury Department requested comments on the proper scope of section 732(d), and specifically, under what circumstances, if any, the Secretary should continue to exercise his authority to mandate the application of section 732(d) to a transferee. Several commentators suggested that the mandatory application of section 732(d) no longer should be required, because the changes made to section 732(c) by the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788, 945-46 (1997), make the distortions targeted by the regulations less likely to occur. However, other commentators noted that distortions caused by section 732(c) still may occur. Accordingly, the rule contained in §1.732-1(d)(4), which requires the mandatory application of section 732(d) in certain cases, remains in effect.

(b) Statement required by partnership. Because partners, rather than partnerships, are required to report basis adjustments under section 732(d), the final regulations require partnerships to provide transferees with such information as is necessary for the transferees properly to compute basis adjustments made under section 732(d). This information must be provided if a transferee notifies a partnership that it plans to make the election under section 732(d) or if a partnership makes a distribution subject to the mandatory application of section 732(d).

(c) Effective date. One commentator asked for clarification regarding the application of the final regulations to section 732(d) adjustments. If section 732(d) applies to a distribution, it is necessary to calculate the basis adjustments which would have been required under section 743(b) if a section 754 election were in effect for the partnership in the taxable year in which the partnership interest was transferred to the partner. In calculating these basis adjustments, the partnership should apply the final regulations under section 743 and 755 if the distribution to which section 732(d) applies occurs after December 15, 1999.

2. *Basis Adjustments Under Section 743(b)*

(a) Coordination with section 704(c). Where a partnership adopts the remedial allocation method, the proposed regulations provide that the section 704(c) built-in gain portion of a basis adjustment under section 743(b) shall be recovered over the remaining cost recovery period for the section 704(c) built-in gain. Some commentators suggested that the final regulations should provide this treatment for the section 704(c) built-in gain portion of the adjustment regardless of the method elected by the partnership for allocating section 704(c) built-in gain and loss. The IRS and the Treasury Department continue to believe that, except for partnerships which adopt the remedial allocation method, it is appropriate for sec-

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tions 704(c) and 743(b) to operate independently. Accordingly, this change has not been adopted.

In the preamble to the proposed regulations, comments were requested concerning the application of the remedial allocation method to contributed property where there are no distortions caused by the ceiling rule at the time the property was contributed to the partnership. Even if it is not clear that the ceiling rule will apply at the time the property is contributed because the adjusted basis of the contributed property is sufficient so that the non-contributing partners will be allocated their appropriate share of depreciation or amortization attributable to the property, the partnership's adoption of the remedial method still may be relevant due to allocations resulting from a subsequent disposition of the property. For instance, suppose that partners A and B form a partnership and agree that each partner will be allocated a 50 percent share of all partnership items, and that the partnership will make allocations under section 704(c) using the traditional method. A contributes depreciable property with an adjusted tax basis of $40 and a book value of $50, and B contributes $50 in cash. At the time of the contribution, it is not readily apparent that the ceiling rule will have any application. However, if, before any federal income tax depreciation accrues with respect to the contributed property, the property's value declines to $40, and the property is sold for that amount, there will be no tax gain or loss. The book loss of $10 would be shared equally between A and B. In this situation, the ceiling rule would prevent B from being allocated the $5 tax loss to which it otherwise would be entitled. However, if the partnership elected to use the remedial method with respect to the contributed property, B would be allocated a $5 tax loss, and A would be allocated a corresponding $5 tax gain. In addition, if a contributing partner transfers its interest in a partnership during a period when a section 754 election is in effect, the section 704(c) method adopted by the partnership will determine the recovery period for the built-in gain portion of the transferee's section 743(b) adjustment. The IRS and the Treasury Department believe that under the current regulations under section 704(c), a partnership may use the remedial method under §1.704-3, even where it is not readily apparent at the time the property is contributed that the ceiling rule will be applicable.

(b) Previously taxed capital. One commentator suggested that the second sentence in proposed §1.743-1(d)(2), relating to the correlation between a partner's interest in previously taxed capital and the partnership's capital accounts, is redundant and should be deleted. This suggestion has been adopted; however, no substantive change is intended by the deletion.

(c) Common basis election. Some commentators suggested that the provision in the proposed regulations that permitted the partners to elect to apply negative basis adjustments under section 743(b) to the partnership's common basis should be deleted. The commentators argued that the provision was contrary to the purpose of section 743(b), because it permitted basis adjustments under section 743(b) to affect nontransferring partners. The commentators also argued that the provision would be used by a small number of partnerships and would add unnecessary complexity to the regulations. In response to these suggestions, the provision that permitted the partners to elect to apply negative basis adjustments under section 743(b) to the partnership's common basis has been deleted.

(d) Statements by partners. Some commentators suggested modifying the statements which partners are required to provide to the partnership in the case of transfers which result in basis adjustments under section 743(b). Many of these suggestions have been adopted. For example, the regulations specify that the transferee of a partnership interest is required to provide the name, address, and taxpayer identification number of the transferor only if that information is ascertainable by the transferee. The regulations also specify that if a partnership interest is transferred to a nominee which is required to furnish the statement under §1.6031(c)-1T to the partnership, the nominee may satisfy the notice requirements of both the section 743 and 6031 regulations by providing a single statement with respect to that transfer, but only if the statement satisfies all requirements of both regulations.

The regulations require the transferee to sign the statement under penalties of perjury, and require the transferee to provide the amount of any liabilities assumed or taken subject to by the transferee, and any other information necessary for the partnership to compute the transferee's basis in the partnership interest. In order to assist the partnership in properly calculating depreciation and amortization deductions which may be subject to anti-churning provisions, the regulations require the transferee to describe its relationship, if any, to the transferor. Finally, the statement required by a transferee that acquires an interest by death must include the date of the decedent's death.

One commentator suggested that the statement required by a transferee that acquires a partnership interest by sale or exchange should be provided within 30 days of the sale or exchange, regardless of whether or not the transfer occurs at the end of the calendar year. This change has been adopted.

One commentator suggested that references to the tax matters partner in §1.743-1(k) of the proposed regulations (regarding the partnership's obligations where a partner's statement is clearly erroneous, or a partner fails to notify the partnership that an interest has been transferred and the partnership has actual knowledge of the transfer) should be changed. This commentator emphasized that while the tax matters partner has a specialized role with respect to consolidated administrative and judicial proceedings to determine the tax treatment of partnership items at the partnership level, the tax matters partner does not have any special responsibilities with respect to federal income tax reporting. The final regulations adopt this comment. Section 1.743-1(k) now refers to partners who are responsible for federal income tax reporting by the partnership.

(e) Oil and gas. One commentator suggested that the example described in §1.743-1(j)(6) should be changed to describe a non- oil and gas property. This change has been made. The commentator also suggested that in the case of domestic oil and gas properties that are depleted at the partner level, the transferee partner (rather than the partnership) should be required to make and allocate basis adjustments among such properties. The final regulations adopt this comment.

The same commentator suggested that the regulations should specify a method

for adjusting the basis of section 613A(c)(7)(D) properties in order to account for percentage depletion made by a partner with respect to such properties. Under the principles of §1.743-1(j), percentage depletion should reduce first any carryover basis under §1.613A-3(e)(6)(iv). After the carryover basis has been recovered, any further percentage depletion should reduce the section 743 adjustment for the property.

3. *Sales of Partnership Interests*

One commentator suggested that references to fair market value should specify whether fair market value is determined taking into account section 7701(g), which generally provides that fair market value shall be treated as being not less than the amount of any nonrecourse indebtedness to which the property is subject. The regulations specify that for purposes of the hypothetical sale employed to determine the income or loss realized by a partner upon the sale or exchange of its interest in section 751 property, fair market value is determined taking into account section 7701(g). Basis adjustments under section 743(b) also are allocated by reference to a hypothetical transaction. The IRS and the Treasury Department intend to issue guidance in the near future which will provide rules for determining the fair market value of partnership assets in certain situations, including for purposes of allocating section 743(b) basis adjustments upon the transfer of a partnership interest. The IRS and the Treasury Department anticipate that the guidance will provide that section 7701(g) will apply in determining the fair market value of partnership assets for purposes of allocating section 743(b) basis adjustments.

One commentator suggested that where a partnership interest is sold or exchanged, the transferor and the transferee of a partnership interest should be permitted jointly to assign values to partnership assets in a written agreement. Because this approach is inconsistent with the hypothetical sale approach of the regulations, this suggestion has not been adopted.

4. *Elections Under Section 754*

One commentator requested that partnerships be granted a one-time right to revoke section 754 elections in effect for such partnerships. Given the significant changes to the rules made by these final regulations as compared to the regulations that were in effect at the time that section 754 elections previously were made, the IRS and Treasury believe that it is appropriate to provide for a one-time revocation of such elections. Accordingly, a partnership having an election in effect under section 754 for its taxable year that includes December 15, 1999 may revoke such election by attaching a statement to the partnership's return for that year. The return must be filed on or before the due date (including extensions) for the return for that year.

5. *Allocation of Basis Adjustments Among Partnership Assets*

(a) Income in respect of a decedent. One commentator requested that the final regulations illustrate the allocation of basis adjustments among partnership assets where one or more of such assets represents income in respect of a decedent. Where a partnership interest is transferred as a result of the death of a partner, under section 1014(c) the transferee's basis in its partnership interest is not adjusted for that portion of the interest, if any, which is attributable to items representing income in respect of a decedent under section 691. Because the transferee's basis in its partnership interest does not include the value of assets which represent income in respect of a decedent, the section 743(b) adjustment likewise does not reflect the value of such assets. *George Edward Quick's Trust*, 54 TC 1336 (1970) (acq.), *aff'd per curiam*, 444 F.2d 90 (8th Cir. 1971); *Chrissie H. Woodhall*, 28 T.C.M. 1438 (1969), *aff'd*, 454 F.2d 226 (9th Cir. 1972); Rev. Rul. 66-325, 1966-2 C.B. 249. Where a partnership holds assets that represent income in respect of a decedent, the section 743(b) adjustment should be allocated solely to other assets. Accordingly, the final regulations provide that if a partnership interest is transferred as a result of the death of a partner, and the partnership holds assets representing income in respect of a decedent, no part of the basis adjustment under section 743(b) is allocated to these assets.

(b) Transferred basis transactions. One commentator called for a revised system for allocating basis adjustments under section 743(b) which are triggered by exchanges in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest. In many such cases, the net section 743(b) adjustment will be zero. However, a positive or negative section 743(b) adjustment may result, because the transferee's basis in the interest may not be equal to the transferee's share of the partnership's bases in its assets.

The IRS and the Treasury Department believe that, although these transferred basis transactions involve transfers which are subject to section 743(b), the new, comprehensive basis allocation rules in the proposed regulations should not be available. For example, where a partnership interest is contributed to a corporation in a transaction to which section 351 applies, or to a partnership in a transaction to which section 721(a) applies, the transferor merely has changed the form of its investment. If the allocation rules which apply to other section 743(b) transfers were applied to these exchanges, then partners could use these exchanges to shift basis from capital gain assets to ordinary income assets, or vice versa.

Therefore, the final regulations contain special basis allocation rules for transferred basis exchanges. The special rules generally are modeled on the rules for allocating basis adjustments under section 734(b). The final regulations do not contain a specific anti-abuse rule regarding the special basis allocation rules which are applicable to such transfers. However, there may be situations where taxpayers will attempt to undertake abusive transactions using these special rules. For instance, a partner could acquire a partnership interest during a year in which no section 754 election is in effect, and then (in a related transaction) contribute the property to a wholly-owned corporation in order to take advantage of the basis allocation rules applicable to transferred basis exchanges. In appropriate situations, the IRS may attack such abusive transactions under a variety of judicial doctrines, including substance over form or step transaction, or under §1.701-2 of the regulations.

(c) Unrealized receivables under section 751(c). One commentator requested that the final regulations illustrate the effect of depreciation recapture on the allocation of basis adjustments among partnership assets under section 755. For purposes of this section, the final regula-

tions treat depreciation recapture, and any other properties or potential gain treated as unrealized receivables under section 751(c) and the regulations thereunder, as separate assets that are ordinary income property.

(d) Special rules for securities partnerships and tiered partnerships. One commentator suggested that the regulations permit securities partnerships to allocate basis adjustments among partnership assets using an aggregation method. Another commentator requested that the regulations clarify how the regulations would apply to tiered partnerships. The IRS and the Treasury Department believe that a method for allocating basis adjustments among partnership assets on an aggregate basis is not consistent with the hypothetical sale of individual assets, which is required by the regulations. In addition, the IRS and Treasury Department believe that special rules for tiered partnerships would make the regulations more complex. Therefore, these changes have not been adopted.

6. *Other Comments*

One commentator suggested that for purposes of allocating basis adjustments among partnership assets, the values of all partnership assets should be determined by reference to the basis of the transferee or distributee partner in its partnership interest. This suggestion is being considered in connection with a separate project currently under review by the IRS and the Treasury Department.

One commentator suggested that the language of section 743 does not authorize regulations that permit both positive and negative adjustments as part of the same transaction. The IRS and the Treasury Department continue to believe that this aspect of the regulations is within the IRS's authority to administer sections 743 and 755.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that a final regulatory flexibility analysis is required for the collection of information in this Treasury decision under 5 U.S.C. 604. This analysis is set forth below under the heading "Final Regulatory Flexibility Act Analysis." Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. No comments were received regarding the impact of the regulations on small business.

Final Regulatory Flexibility Act Analysis

This analysis is required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). In general, the regulations require a transferee that acquires an interest in a partnership with an election under section 754 in effect to notify the partnership of the transfer. This notification must include the name and taxpayer identification number of the transferee and the transferee's basis in the acquired partnership interest. The partnership is required to include a statement with its Form 1065, U.S. Partnership Return of Income, for the taxable year in which the partnership acquires knowledge of the transfer. This statement must identify the name and taxpayer identification number of the transferee, the computation of the basis adjustment, and the allocation of that adjustment to partnership properties. These requirements will ensure that the partnership has notice that a transfer has occurred and that the proper basis adjustments are computed. The legal basis for these requirements is contained in sections 743(b), 6001, and 7805(a).

If an interest is transferred in a partnership holding domestic oil and gas properties that are depleted at the partner level under 613A(c)(7)(D), the regulations require the transferee partner (rather than the partnership) to make and allocate basis adjustments under section 743(b) among such properties.

There were approximately 1,494,000 partnerships in 1994. However, these regulations apply only to partnerships that have made an election under section 754. The election under section 754 is generally not made unless there has been a transfer of a partnership interest or a distribution by the partnership. Moreover, the effects of the election attach to specific items of partnership property and may provide only temporary benefits for the partners. Except for the one-time revocation which is allowed in connection with the promulgation of these final regulations, the election cannot be revoked without the consent of the Secretary. The IRS and the Treasury Department believe that most partnerships do not make the election under section 754. Therefore, most partnerships will not be affected by the regulations in any given year.

After a partner conveys information to the partnership concerning a transfer of a partnership interest, the partnership must adjust the partner's interest in the basis of partnership property. Because these basis adjustments will affect the partner's share of depreciation or amortization deductions and amounts of gain or loss on the disposition of certain items of partnership property, the partnership must prepare and maintain special entries on its books. However, in many cases, partnership returns are prepared using computer software that can prepare and maintain these special entries after the initial year.

The IRS and the Treasury Department are not aware of any federal rules that may duplicate, overlap, or conflict with the rule.

As an alternative to the disclosure described above, the IRS and the Treasury Department considered, but rejected, a rule that would have required the partners, and not the partnerships, to make the basis adjustments and to determine the effects of the basis adjustments on the partners' distributive shares. This alternative was rejected because the IRS and the Treasury Department believe that partnerships generally have better access to the information necessary to report section 743 basis adjustments properly. To require the partners rather than the partnerships to bear the burden of reporting would require the partnerships to provide the partners with significant amounts of information not otherwise needed by the partners. There are no known alternative rules that are less burdensome to the partnerships and their partners but that accomplish the purpose of the statute.

Finally, because partners, rather than partnerships, are required to report basis adjustments under section 732(d), the final regulations require partnerships to provide transferees with such information

as is necessary for the transferees properly to compute basis adjustments made under section 732(d). This information must be provided if a transferee notifies a partnership that it plans to make the election under section 732(d) or if a partnership makes a distribution subject to the mandatory application of section 732(d). The IRS and the Treasury Department believe that this requirement will apply under limited circumstances to a small percentage of partnerships.

Drafting Information

The principal author of these regulations is Matthew Lay of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are ammended as follows:

PART 1—INCOME TAXES

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

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

Section 1.732-1 also issued under 26 U.S.C. 732.

Section 1.732-2 also issued under 26 U.S.C. 732.

Section 1.734-1 also issued under 26 U.S.C. 734.

Section 1.743-1 also issued under 26 U.S.C. 743.

Section 1.751-1 also issued under 26 U.S.C. 751.

Section 1.755-1 also issued under 26 U.S.C. 755. * * *

Section 1.1017-1 also issued under 26 U.S.C. 1017. * * *

Par. 2. Section 1.732-1 is amended as follows:

1. Revise paragraph (c).

2. Revise paragraph (d)(1)(ii).

3. Revise the last sentence of paragraph (d)(1)(v).

4. Revise paragraph (d)(1)(vi).

5. Revise paragraph (d)(4)(iii).

6. Remove the flush text and *Examples 1* and *2* following paragraph (d)(4)(iii).

7. Add paragraph (d)(5).

The additions and revisions read as follows:

§1.732-1 Basis of distributed property other than money.

* * * * *

(c) *Allocation of basis among properties distributed to a partner*—(1) *General rule*—(i) *Unrealized receivables and inventory items.* The basis to be allocated to properties distributed to a partner under section 732(a)(2) or (b) is allocated first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)(2)) in an amount equal to the adjusted basis of each such property to the partnership immediately before the distribution. If the basis to be allocated is less than the sum of the adjusted bases to the partnership of the distributed unrealized receivables and inventory items, the adjusted basis of the distributed property must be decreased in the manner provided in paragraph (c)(2)(i) of this section.

(ii) *Other distributed property.* Any basis not allocated to unrealized receivables or inventory items under paragraph (c)(1)(i) of this section is allocated to any other property distributed to the partner in the same transaction by assigning to each distributed property an amount equal to the adjusted basis of the property to the partnership immediately before the distribution. However, if the sum of the adjusted bases to the partnership of such other distributed property does not equal the basis to be allocated among the distributed property, any increase or decrease required to make the amounts equal is allocated among the distributed property as provided in paragraph (c)(2) of this section.

(2) *Adjustment to basis allocation*—(i) *Decrease in basis.* Any decrease to the basis of distributed property required under paragraph (c)(1) of this section is allocated first to distributed property with unrealized depreciation in proportion to each property's respective amount of unrealized depreciation before any decrease (but only to the extent of each property's unrealized depreciation). If the required decrease exceeds the amount of unrealized depreciation in the distributed property, the excess is allocated to the distributed property in proportion to the adjusted bases of the distributed property, as adjusted pursuant to the immediately preceding sentence.

(ii) *Increase in basis.* Any increase to the basis of distributed property required under paragraph (c)(1)(ii) of this section is allocated first to distributed property (other than unrealized receivables and inventory items) with unrealized appreciation in proportion to each property's respective amount of unrealized appreciation before any increase (but only to the extent of each property's unrealized appreciation). If the required increase exceeds the amount of unrealized appreciation in the distributed property, the excess is allocated to the distributed property (other than unrealized receivables or inventory items) in proportion to the fair market value of the distributed property.

(3) *Unrealized receivables and inventory items.* If the basis to be allocated upon a distribution in liquidation of the partner's entire interest in the partnership is greater than the adjusted basis to the partnership of the unrealized receivables and inventory items distributed to the partner, and if there is no other property distributed to which the excess can be allocated, the distributee partner sustains a capital loss under section 731(a)(2) to the extent of the unallocated basis of the partnership interest.

(4) *Examples.* The provisions of this paragraph (c) are illustrated by the following examples:

Example 1. A is a one-fourth partner in partnership PRS and has an adjusted basis in its partnership interest of $650. PRS distributes inventory items and Assets X and Y to A in liquidation of A's entire partnership interest. The distributed inventory items have a basis to the partnership of $100 and a fair market value of $200. Asset X has an adjusted basis to the partnership of $50 and a fair market value of $400. Asset Y has an adjusted basis to the partnership and a fair market value of $100. Neither Asset X nor Asset Y consists of inventory items or unrealized receivables. Under this paragraph (c), A's basis in its partnership interest is allocated first to the inventory items in an amount equal to their adjusted basis to the partnership. A, therefore, has an adjusted basis in the inventory items of $100. The remaining basis, $550, is allocated to the distributed

property first in an amount equal to the property's adjusted basis to the partnership. Thus, Asset X is allocated $50 and Asset Y is allocated $100. Asset X is then allocated $350, the amount of unrealized appreciation in Asset X. Finally, the remaining basis, $50, is allocated to Assets X and Y in proportion to their fair market values: $40 to Asset X (400/500 x $50), and $10 to Asset Y (100/500 x $50). Therefore, after the distribution, A has an adjusted basis of $440 in Asset X and $110 in Asset Y.

Example 2. B is a one-fourth partner in partnership PRS and has an adjusted basis in its partnership interest of $200. PRS distributes Asset X and Asset Y to B in liquidation of its entire partnership interest. Asset X has an adjusted basis to the partnership and fair market value of $150. Asset Y has an adjusted basis to the partnership of $150 and a fair market value of $50. Neither of the assets consists of inventory items or unrealized receivables. Under this paragraph (c), B's basis is first assigned to the distributed property to the extent of the partnership's basis in each distributed property. Thus, Asset X and Asset Y are each assigned $150. Because the aggregate adjusted basis of the distributed property, $300, exceeds the basis to be allocated, $200, a decrease of $100 in the basis of the distributed property is required. Assets X and Y have unrealized depreciation of zero and $100, respectively. Thus, the entire decrease is allocated to Asset Y. After the distribution, B has an adjusted basis of $150 in Asset X and $50 in Asset Y.

Example 3. C, a partner in partnership PRS, receives a distribution in liquidation of its entire partnership interest of $6,000 cash, inventory items having an adjusted basis to the partnership of $6,000, and real property having an adjusted basis to the partnership of $4,000. C's basis in its partnership interest is $9,000. The cash distribution reduces C's basis to $3,000, which is allocated entirely to the inventory items. The real property has a zero basis in C's hands. The partnership bases not carried over to C for the distributed properties are lost unless an election under section 754 is in effect requiring the partnership to adjust the bases of remaining partnership properties under section 734(b).

Example 4. Assume the same facts as in *Example 3* of this paragraph except C receives a distribution in liquidation of its entire partnership interest of $1,000 cash and inventory items having a basis to the partnership of $6,000. The cash distribution reduces C's basis to $8,000, which can be allocated only to the extent of $6,000 to the inventory items. The remaining $2,000 basis, not allocable to the distributed property, constitutes a capital loss to partner C under section 731(a)(2). If the election under section 754 is in effect, see section 734(b) for adjustment of the basis of undistributed partnership property.

(5) *Effective date.* This paragraph (c) applies to distributions of property from a partnership that occur on or after December 15, 1999.

(d) * * * (1) * * *

(ii) Where an election under section 754 is in effect, see section 743(b) and §§1.743-1 and 1.732-2.

* * * * *

(v) * * * (For a shift of transferee's basis adjustment under section 743(b) to like property, see §1.743-1(g).)

(vi) The provisions of this paragraph (d)(1) may be illustrated by the following example:

Example. (i) Transferee partner, T, purchased a one-fourth interest in partnership PRS for $17,000. At the time T purchased the partnership interest, the election under section 754 was not in effect and the partnership inventory had a basis to the partnership of $14,000 and a fair market value of $16,000. T's purchase price reflected $500 of this difference. Thus, $4,000 of the $17,000 paid by T for the partnership interest was attributable to T's share of partnership inventory with a basis of $3,500. Within 2 years after T acquired the partnership interest, T retired from the partnership and received in liquidation of its entire partnership interest the following property:

	Assets	
	Adjusted Basis to PRS	Fair Market Value
Cash	$1,500	$1,500
Inventory	$3,500	$4,000
Asset X	$2,000	$4,000
Asset Y	$4,000	$5,000

(ii) The fair market value of the inventory received by T was one-fourth of the fair market value of all partnership inventory and was T's share of such property. It is immaterial whether the inventory T received was on hand when T acquired the interest. In accordance with T's election under section 732(d), the amount of T's share of partnership basis that is attributable to partnership inventory is increased by $500 (one-fourth of the $2,000 difference between the fair market value of the property, $16,000, and its $14,000 basis to the partnership at the time T purchased its interest). This adjustment under section 732(d) applies only for purposes of distributions to T, and not for purposes of partnership depreciation, depletion, or gain or loss on disposition. Thus, the amount to be allocated among the properties received by T in the liquidating distribution is $15,500 ($17,000, T's basis for the partnership interest, reduced by the amount of cash received, $1,500). This amount is allocated as follows: The basis of the inventory items received is $4,000, consisting of the $3,500 common partnership basis, plus the basis adjustment of $500 which T would have had under section 743(b). The remaining basis of $11,500 ($15,500 minus $4,000) is allocated among the remaining property distributed to T by assigning to each property the adjusted basis to the partnership of such property and adjusting that basis by any required increase or decrease. Thus, the adjusted basis to T of Asset X is $5,111 ($2,000, the adjusted basis of Asset X to the partnership, plus $2,000, the amount of unrealized appreciation in Asset X, plus $1,111 ($4,000/$9,000 multiplied by $2,500)). Similarly, the adjusted basis of Asset Y to T is $6,389 ($4,000, the adjusted basis of Asset Y to the partnership, plus $1,000, the amount of unrealized appreciation in Asset Y,

plus, $1,389 ($5,000/$9,000 multiplied by $2,500)).

* * * * *

(4) * * *

(iii) A basis adjustment under section 743(b) would change the basis to the transferee partner of the property actually distributed.

(5) *Required statements.* If a transferee partner notifies a partnership that it plans to make the election under section 732(d) under paragraph (d)(3) of this section, or if a partnership makes a distribution to which paragraph (d)(4) of this section applies, the partnership must provide the transferee with such information as is necessary for the transferee properly to compute the transferee's basis adjustments under section 732(d).

* * * * *

Par. 3. Section 1.732-2 is amended by revising the sentence at the end of the *Example* in paragraph (b) to read as follows:

§1.732-2 Special partnership basis of distributed property.

* * * * *

(b) * * *

Example. * * * See §1.743-1(g).

* * * * *

Par. 4. In §1.734-1, paragraph (e) is added to read as follows:

§1.734-1 Optional adjustment to basis of undistributed partnership property.

* * * * *

(e) *Recovery of adjustments to basis of partnership property*—(1) *Increases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is increased as a result of the distribution of property to a partner, then the increased portion of the basis must be taken into account as if it were newly-purchased recovery property placed in service when the distribution occurs. Consequently, any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. However, no change is made for purposes of determining the recovery allowance under section 168 for the portion of the basis for which there is no increase.

(2) *Decreases in basis.* For purposes of section 168, if the basis of a partnership's recovery property is decreased as a result of the distribution of property to a partner, then the decrease in basis must be accounted for over the remaining recovery period of the property beginning with the recovery period in which the basis is decreased.

(3) *Effective date.* This paragraph (e) applies to distributions of property from a partnership that occur on or after December 15, 1999.

Par. 5. Section 1.743-1 is revised to read as follows:

§1.743-1 Optional adjustment to basis of partnership property.

(a) *Generally.* The basis of partnership property is adjusted as a result of the transfer of an interest in a partnership by sale or exchange or on the death of a partner only if the election provided by section 754 (relating to optional adjustments to the basis of partnership property) is in effect with respect to the partnership. Whether or not the election provided in section 754 is in effect, the basis of partnership property is not adjusted as the result of a contribution of property, including money, to the partnership.

(b) *Determination of adjustment.* In the case of the transfer of an interest in a partnership, either by sale or exchange or as a result of the death of a partner, a partnership that has an election under section 754 in effect—

(1) Increases the adjusted basis of partnership property by the excess of the transferee's basis for the transferred partnership interest over the transferee's share of the adjusted basis to the partnership of the partnership's property; or

(2) Decreases the adjusted basis of partnership property by the excess of the transferee's share of the adjusted basis to the partnership of the partnership's property over the transferee's basis for the transferred partnership interest.

(c) *Determination of transferee's basis in the transferred partnership interest.* In the case of the transfer of a partnership interest by sale or exchange or as a result of the death of a partner, the transferee's basis in the transferred partnership interest is determined under section 742 and §1.742-1. See also section 752 and §§1.752-1 through 1.752-5.

(d) *Determination of transferee's share of the adjusted basis to the partnership of the partnership's property*—(1) *Generally.* A transferee's share of the adjusted basis to the partnership of partnership property is equal to the sum of the transferee's interest as a partner in the partnership's previously taxed capital, plus the transferee's share of partnership liabilities. Generally, a transferee's interest as a partner in the partnership's previously taxed capital is equal to—

(i) The amount of cash that the transferee would receive on a liquidation of the partnership following the hypothetical transaction, as defined in paragraph (d)(2) of this section (to the extent attributable to the acquired partnership interest); increased by

(ii) The amount of tax loss (including any remedial allocations under §1.704-3(d)), that would be allocated to the transferee from the hypothetical transaction (to the extent attributable to the acquired partnership interest); and decreased by

(iii) The amount of tax gain (including any remedial allocations under §1.704-3(d)), that would be allocated to the transferee from the hypothetical transaction (to the extent attributable to the acquired partnership interest).

(2) *Hypothetical transaction defined.* For purposes of paragraph (d)(1) of this section, the hypothetical transaction means the disposition by the partnership of all of the partnership's assets, immediately after the transfer of the partnership interest, in a fully taxable transaction for cash equal to the fair market value of the assets.

(3) *Examples.* The provisions of this paragraph (d) are illustrated by the following examples:

Example 1. (i) A is a member of partnership PRS in which the partners have equal interests in capital and profits. The partnership has made an election under section 754, relating to the optional adjustment to the basis of partnership property. A sells its interest to T for $22,000. The balance sheet of the partnership at the date of sale shows the following:

Assets		
	Adjusted Basis	Fair Market Value
Cash	$5,000	$5,000
Accounts receivable	10,000	10,000
Inventory	20,000	21,000
Depreciable assets	20,000	40,000
Total	$55,000	$76,000

Liabilities and Capital		
	Adjusted Per Books	Fair Market Value
Liabilities	$10,000	$10,000
Capital:		
A	15,000	22,000
B	15,000	22,000
C	15,000	22,000
Total	$55,000	$76,000

(ii) The amount of the basis adjustment under section 743(b) is the difference between the basis of T's interest in the partnership and T's share of the adjusted basis to the partnership of the partnership's property. Under section 742, the basis of T's interest is $25,333 (the cash paid for A's interest, $22,000, plus $3,333, T's share of partnership liabilities). T's interest in the partnership's previously taxed capital is $15,000 ($22,000, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, decreased by $7,000, the amount of tax gain allocated to T from the hypothetical transaction). T's share of the adjusted basis to the partnership of the partnership's property is $18,333 ($15,000 share of previously taxed capital, plus $3,333 share of the partnership's liabilities). The amount of the basis adjustment under section 743(b) to partnership property therefore, is $7,000, the difference between $25,333 and $18,333.

Example 2. A, B, and C form partnership PRS, to which A contributes land (Asset 1) with a fair market value of $1,000 and an adjusted basis to A of $400, and B and C each contribute $1,000 cash. Each partner has $1,000 credited to it on the books of the partnership as its capital contribution. The partners share in profits equally. During the partnership's first taxable year, Asset 1 appreciates in value to $1,300. A sells its one-third interest in the partnership to T for $1,100, when an election under section 754 is in effect. The amount of tax gain that would be allocated to T from the hypothetical transaction is $700 ($600 section 704(c) built-in gain, plus one-third of the additional gain). Thus, T's interest in the partnership's previously taxed capital is $400 ($1,100, the amount of cash T would receive if PRS liquidated immediately after the hypothetical transaction, decreased by $700, T's share of gain from the hypothetical transaction). The amount of T's basis adjustment under section 743(b) to partnership property is $700 (the excess of $1,100, T's cost basis for its interest, over $400, T's share of the adjusted basis to the partnership of partnership property).

(e) *Allocation of basis adjustment.* For the allocation of the basis adjustment under this section among the individual items of partnership property, see section 755 and the regulations thereunder.

(f) *Subsequent transfers.* Where there has been more than one transfer of a partnership interest, a transferee's basis adjustment is determined without regard to any prior transferee's basis adjustment. In the case of a gift of an interest in a partnership, the donor is treated as transferring, and the donee as receiving, that portion of the basis adjustment attributable to the gifted partnership interest. The provisions of this paragraph (f) are illustrated by the following example:

Example. (i) A, B, and C form partnership PRS. A and B each contribute $1,000 cash, and C contributes land with a basis and fair market value of $1,000. When the land has appreciated in value to $1,300, A sells its interest to T1 for $1,100 (one-third of $3,300, the fair market value of the partnership property). An election under section 754 is in effect; therefore, T1 has a basis adjustment under section 743(b) of $100.

(ii) After the land has further appreciated in value to $1,600, T1 sells its interest to T2 for $1,200 (one-third of $3,600, the fair market value of the partnership property). T2 has a basis adjustment under section 743(b) of $200. This amount is determined without regard to any basis adjustment under section 743(b) that T1 may have had in the partnership assets.

(iii) During the following year, T2 makes a gift to T3 of fifty percent of T2's interest in PRS. At the time of the transfer, T2 has a $200 basis adjustment under section 743(b). T2 is treated as transferring $100 of the basis adjustment to T3 with the gift of the partnership interest.

(g) *Distributions—(1) Distribution of adjusted property to the transferee—(i) Coordination with section 732.* If a partnership distributes property to a transferee and the transferee has a basis adjustment for the property, the basis adjustment is taken into account under section 732. See §1.732-2(b).

(ii) *Coordination with section 734.* For certain adjustments to the common basis of remaining partnership property after the distribution of adjusted property to a transferee, see §1.734-2(b).

(2) *Distribution of adjusted property to another partner— (i) Coordination with section 732.* If a partner receives a distribution of property with respect to which another partner has a basis adjustment, the distributee does not take the basis adjustment into account under section 732.

(ii) *Reallocation of basis.* A transferee with a basis adjustment in property that is distributed to another partner reallocates the basis adjustment among the remaining items of partnership property under §1.755-1(c).

(3) *Distributions in complete liquidation of a partner's interest.* If a transferee receives a distribution of property (whether or not the transferee has a basis adjustment in such property) in liquidation of its interest in the partnership, the adjusted basis to the partnership of the distributed property immediately before the distribution includes the transferee's basis adjustment for the property in which the transferee relinquished an interest (either because it remained in the partnership or was distributed to another partner). Any basis adjustment for property in which the transferee is deemed to relinquish its interest is reallocated among the properties distributed to the transferee under §1.755-1(c).

(4) *Coordination with other provisions.* The rules of sections 704(c)(1)(B), 731, 737, and 751 apply before the rules of this paragraph (g).

(5) *Example.* The provisions of this paragraph (g) are illustrated by the following example:

Example. (i) A, B, and C are equal partners in partnership PRS. Each partner originally contributed $10,000 in cash, and PRS used the contributions to purchase five nondepreciable capital assets. PRS has no liabilities. After five years, PRS's balance sheet appears as follows:

	Assets	
	Adjusted Basis	Fair Market Value
Asset 1	$10,000	$10,000
Asset 2	4,000	6,000
Asset 3	6,000	6,000
Asset 4	7,000	4,000
Asset 5	3,000	13,000
Total	$30,000	$39,000

	Capital	
	Adjusted Per Books	Fair Market Value
Partner A	$10,000	$13,000
Partner B	10,000	13,000
Partner C	10,000	13,000
Total	$30,000	$39,000

(ii) A sells its interest to T for $13,000 when PRS has an election in effect under section 754. T receives a basis adjustment under section 743(b) in the partnership property that is equal to $3,000 (the excess of T's basis in the partnership interest, $13,000, over T's share of the adjusted basis to the partnership of partnership property, $10,000). The basis adjustment is allocated under section 755, and the partnership's balance sheet appears as follows:

	Assets		
	Adjusted Basis	Fair Market Value	Basis Adjustment
Asset 1	$10,000	$10,000	$ 0.00
Asset 2	4,000	6,000	666.67
Asset 3	6,000	6,000	0.00
Asset 4	7,000	4,000	(1,000.00)
Asset 5	3,000	13,000	3,333.33
Total	$30,000	$39,000	$3,000.00

	Adjusted Per Books	Capital Fair Market Value	Special Basis
Partner T	$10,000	$13,000	$3,000
Partner B	10,000	13,000	0
Partner C	10,000	13,000	0
Total	$30,000	$39,000	$3,000

(iii) Assume that PRS distributes Asset 2 to T in partial liquidation of T's interest in the partnership. T has a basis adjustment under section 743(b) of $666.67 in Asset 2. Under paragraph (g)(1)(i) of this section, T takes the basis adjustment into account under section 732. Therefore, T will have a basis in Asset 2 of $4,666.67 following the distribution.

(iv) Assume instead that PRS distributes Asset 5 to C in complete liquidation of C's interest in PRS. T has a basis adjustment under section 743(b) of $3,333.33 in Asset 5. Under paragraph (g)(2)(i) of this section, C does not take T's basis adjustment into account under section 732. Therefore, the partnership's basis for purposes of sections 732 and 734 is $3,000. Under paragraph (g)(2)(ii) of this section, T's $3,333.33 basis adjustment is reallocated among the remaining partnership assets under §1.755-1(c).

(v) Assume instead that PRS distributes Asset 5 to T in complete liquidation of its interest in PRS. Under paragraph (g)(3) of this section, immediately prior to the distribution of Asset 5 to T, PRS must adjust the basis of Asset 5. Therefore, immediately prior to the distribution, PRS's basis in Asset 5 is equal to $6,000, which is the sum of (A) $3,000, PRS's common basis in Asset 5, plus (B) $3,333.33, T's basis adjustment to Asset 5, plus (C) ($333.33), the sum of T's basis adjustments in Assets 2 and 4. For purposes of sections 732 and 734, therefore, PRS will be treated as having a basis in Asset 5 equal to $6,000.

(h) *Contributions of adjusted property—(1) Section 721(a) transactions.* If, in a transaction described in section 721(a), a partnership (the upper tier) contributes to another partnership (the lower tier) property with respect to which a basis adjustment has been made, the basis adjustment is treated as contributed to the lower-tier partnership, regardless of whether the lower-tier partnership makes a section 754 election. The lower tier's basis in the contributed assets and the upper tier's basis in the partnership interest received in the transaction are determined with reference to the basis adjustment. However, that portion of the basis of the upper tier's interest in the lower tier attributable to the basis adjustment must be segregated and allocated solely to the transferee partner for whom the basis adjustment was made. Similarly, that portion of the lower tier's basis in its assets attributable to the basis adjustment must be segregated and allocated solely to the upper tier and the transferee. A partner with a basis adjustment in property held by a partnership that terminates under section 708(b)(1)(B) will continue to have the same basis adjustment with respect to property deemed contributed by the terminated partnership to the new partnership under §1.708-1(b)(1)(iv), regardless of whether the new partnership makes a section 754 election.

(2) *Section 351 transactions—(i) Basis in transferred property.* A corporation's adjusted tax basis in property transferred to the corporation by a partnership in a transaction described in section 351 is determined with reference to any basis adjustments to the property under section 743(b) (other than any basis adjustment that reduces a partner's gain under paragraph (h)(2)(ii) of this section).

(ii) *Partnership gain.* The amount of gain, if any, recognized by the partnership on a transfer of property by the partnership to a corporation in a transfer described in section 351 is determined without reference to any basis adjustment to the transferred property under section 743(b). The amount of gain, if any, recognized by the partnership on the transfer that is allocated to a partner with a basis adjustment in the transferred property is adjusted to reflect the partner's basis adjustment in the transferred property.

(iii) *Basis in stock.* The partnership's adjusted tax basis in stock received from a corporation in a transfer described in section 351 is determined without reference to the basis adjustment in property transferred to the corporation in the section 351 exchange. A partner with a basis adjustment in property transferred to the corporation, however, has a basis adjustment in the stock received by the partnership in the section 351 exchange in an amount equal to the partner's basis adjustment in the transferred property, reduced by any basis adjustment that reduced the partner's gain under paragraph (h)(2)(ii) of this section.

(iv) *Example.* The following example illustrates the principles of this paragraph (h):

Example. (i) A, B, and C are equal partners in partnership PRS. The partnership's only asset, Asset 1, has an adjusted tax basis of $60 and a fair market value of $120. Asset 1 is a nondepreciable capital asset and is not section 704(c) property. A has a basis in its partnership interest of $40, and a positive section 743(b) adjustment of $20 in Asset 1. In a transaction to which section 351 applies, PRS contributes Asset 1 to X, a corporation, in exchange for $15 in cash and X stock with a fair market value of $105.

(ii) Under paragraph (h)(2)(ii) of this section, PRS realizes $60 of gain on the transfer of Asset 1 to X ($120, its amount realized, minus $60, its adjusted basis), but recognizes only $15 of that gain under section 351(b)(1). Of this amount, $5 is allocated to each partner. A must use $5 of its basis adjustment in Asset 1 to offset A's share of PRS's gain. Under paragraph (h)(2)(iii) of this section, PRS's basis in the stock received from X is $60. However, A has a basis adjustment in the stock received by PRS equal to $15 (its basis adjustment in Asset 1, $20, reduced by the portion of the adjustment which reduced A's gain, $5). Under paragraph (h)(2)(i) of this section, X's basis in Asset 1 equals $75 (PRS's common basis in the asset, $60, plus A's basis adjustment under section 743(b), $20, less the portion of the adjustment which reduced A's gain, $5).

(i) [Reserved].

(j) *Effect of basis adjustment*—(1) *In general.* The basis adjustment constitutes

an adjustment to the basis of partnership property with respect to the transferee only. No adjustment is made to the common basis of partnership property. Thus, for purposes of calculating income, deduction, gain, and loss, the transferee will have a special basis for those partnership properties the bases of which are adjusted under section 743(b) and this section. The adjustment to the basis of partnership property under section 743(b) has no effect on the partnership's computation of any item under section 703.

(2) *Computation of partner's distributive share of partnership items.* The partnership first computes its items of income, deduction, gain, or loss at the partnership level under section 703. The partnership then allocates the partnership items among the partners, including the transferee, in accordance with section 704, and adjusts the partners' capital accounts accordingly. The partnership then adjusts the transferee's distributive share of the items of partnership income, deduction, gain, or loss, in accordance with paragraphs (j)(3) and (4) of this section, to reflect the effects of the transferee's basis adjustment under section 743(b). These adjustments to the transferee's distributive shares must be reflected on Schedules K and K-1 of the partnership's return (Form 1065). These adjustments to the transferee's distributive shares do not affect the transferee's capital account.

(3) *Effect of basis adjustment in determining items of income, gain, or loss*—(i) *In general.* The amount of a transferee's income, gain, or loss from the sale or exchange of a partnership asset in which the transferee has a basis adjustment is equal to the transferee's share of the partnership's gain or loss from the sale of the asset (including any remedial allocations under §1.704-3(d)), minus the amount of the transferee's positive basis adjustment for the partnership asset (determined by taking into account the recovery of the basis adjustment under paragraph (j)(4)(i)(B) of this section) or plus the amount of the transferee's negative basis adjustment for the partnership asset (determined by taking into the account the recovery of the basis adjustment under paragraph (j)(4)(ii)(B) of this section).

(ii) *Examples.* The following examples illustrate the principles of this paragraph (j)(3):

Example 1. A and B form equal partnership PRS. A contributes nondepreciable property with a fair market value of $50 and an adjusted tax basis of $100. PRS will use the traditional allocation method under §1.704-3(b). B contributes $50 cash. A sells its interest to T for $50. PRS has an election in effect to adjust the basis of partnership property under section 754. T receives a negative $50 basis adjustment under section 743(b) that, under section 755, is allocated to the nondepreciable property. PRS then sells the property for $60. PRS recognizes a book gain of $10 (allocated equally between T and B) and a tax loss of $40. T will receive an allocation of $40 of tax loss under the principles of section 704(c). However, because T has a negative $50 basis adjustment in the nondepreciable property, T recognizes a $10 gain from the partnership's sale of the property.

Example 2. A and B form equal partnership PRS. A contributes nondepreciable property with a fair market value of $100 and an adjusted tax basis of $50. B contributes $100 cash. PRS will use the traditional allocation method under §1.704-3(b). A sells its interest to T for $100. PRS has an election in effect to adjust the basis of partnership property under section 754. Therefore, T receives a $50 basis adjustment under section 743(b) that, under section 755, is allocated to the nondepreciable property. PRS then sells the nondepreciable property for $90. PRS recognizes a book loss of $10 (allocated equally between T and B) and a tax gain of $40. T will receive an allocation of the entire $40 of tax gain under the principles of section 704(c). However, because T has a $50 basis adjustment in the property, T recognizes a $10 loss from the partnership's sale of the property.

Example 3. A and B form equal partnership PRS. PRS will make allocations under section 704(c) using the remedial allocation method described in §1.704-3(d). A contributes nondepreciable property with a fair market value of $100 and an adjusted tax basis of $150. B contributes $100 cash. A sells its partnership interest to T for $100. PRS has an election in effect to adjust the basis of partnership property under section 754. T receives a negative $50 basis adjustment under section 743(b) that, under section 755, is allocated to the property. The partnership then sells the property for $120. The partnership recognizes a $20 book gain and a $30 tax loss. The book gain will be allocated equally between the partners. The entire $30 tax loss will be allocated to T under the principles of section 704(c). To match its $10 share of book gain, B will be allocated $10 of remedial gain, and T will be allocated an offsetting $10 of remedial loss. T was allocated a total of $40 of tax loss with respect to the property. However, because T has a negative $50 basis adjustment to the property, T recognizes a $10 gain from the partnership's sale of the property.

(4) *Effect of basis adjustment in determining items of deduction*—(i) *Increases*—(A) *Additional deduction.* The amount of any positive basis adjustment that is recovered by the transferee in any year is added to the transferee's distributive share of the partnership's depreciation or amortization deductions for the year. The basis adjustment is adjusted under section 1016(a)(2) to reflect the recovery of the basis adjustment.

(B) *Recovery period*—(1) *In general.* Except as provided in paragraph (j)(4)(i)(B)(2) of this section, for purposes of section 168, if the basis of a partnership's recovery property is increased as a result of the transfer of a partnership interest, then the increased portion of the basis is taken into account as if it were newly-purchased recovery property placed in service when the transfer occurs. Consequently, any applicable recovery period and method may be used to determine the recovery allowance with respect to the increased portion of the basis. However, no change is made for purposes of determining the recovery allowance under section 168 for the portion of the basis for which there is no increase.

(2) *Remedial allocation method.* If a partnership elects to use the remedial allocation method described in §1.704-3(d) with respect to an item of the partnership's recovery property, then the portion of any increase in the basis of the item of the partnership's recovery property under section 743(b) that is attributable to section 704(c) built-in gain is recovered over the remaining recovery period for the partnership's excess book basis in the property as determined in the final sentence of §1.704-3(d)(2). Any remaining portion of the basis increase is recovered under paragraph (j)(4)(i)(B)(1) of this section.

(C) *Examples.* The provisions of this paragraph (j)(4)(i) are illustrated by the following examples:

Example 1. (i) A, B, and C are equal partners in partnership PRS, which owns Asset 1, an item of depreciable property that has a fair market value in excess of its adjusted tax basis. C sells its interest in PRS to T while PRS has an election in effect under section 754. PRS, therefore, increases the basis of Asset 1 with respect to T.

(ii) Assume that in the year following the transfer

of the partnership interest to T, T's distributive share of the partnership's common basis depreciation deductions from Asset 1 is $1,000. Also assume that, under paragraph (j)(4)(i)(B) of this section, the amount of the basis adjustment under section 743(b) that T recovers during the year is $500. The total amount of depreciation deductions from Asset 1 reported by T is equal to $1,500.

Example 2. (i) A and B form equal partnership PRS. A contributes property with an adjusted basis of $100,000 and a fair market value of $500,000. B contributes $500,000 cash. When PRS is formed, the property has five years remaining in its recovery period. The partnership's adjusted basis of $100,000 will, therefore, be recovered over the five years remaining in the property's recovery period. PRS elects to use the remedial allocation method under §1.704-3(d) with respect to the property. If PRS had purchased the property at the time of the partnership's formation, the basis of the property would have been recovered over a 10-year period. The $400,000 of section 704(c) built-in gain will, therefore, be amortized under §1.704-3(d) over a 10-year period beginning at the time of the partnership's formation.

(ii)(A)Except for the depreciation deductions, PRS's expenses equal its income in each year of the first two years commencing with the year the partnership is formed. After two years, A's share of the adjusted basis of partnership property is $120,000, while B's is $440,000:

Capital Accounts

	A		B	
	Book	Tax	Book	Tax
Initial Contribution	$500,000	$100,000	$500,000	$500,000
Depreciation Year 1	(30,000)		(30,000)	(20,000)
Remedial		10,000		(10,000)
	470,000	110,000	470,000	470,000
Depreciation Year 2	(30,000)		(30,000)	(20,000)
Remedial		10,000		(10,000)
	$440,000	$120,000	$440,000	$440,000

(B) A sells its interest in PRS to T for its fair market value of $440,000. A valid election under section 754 is in effect with respect to the sale of the partnership interest. Accordingly, PRS makes an adjustment, pursuant to section 743(b), to increase the basis of partnership property. Under section 743(b), the amount of the basis adjustment is equal to $320,000. Under section 755, the entire basis adjustment is allocated to the property.

(iii) At the time of the transfer, $320,000 of section 704(c) built-in gain from the property was still reflected on the partnership's books, and all of the basis adjustment is attributable to section 704(c) built-in gain. Therefore, the basis adjustment will be recovered over the remaining recovery period for the section 704(c) built-in gain under §1.704-3(d).

(ii) *Decreases*—(A) *Reduced deduction.* The amount of any negative basis adjustment allocated to an item of depreciable or amortizable property that is recovered in any year first decreases the transferee's distributive share of the partnership's depreciation or amortization deductions from that item of property for the year. If the amount of the basis adjustment recovered in any year exceeds the transferee's distributive share of the partnership's depreciation or amortization deductions from the item of property, then the transferee's distributive share of the partnership's depreciation or amortization deductions from other items of partnership property is decreased. The transferee then recognizes ordinary income to the extent of the excess, if any, of the amount of the basis adjustment recovered in any year over the transferee's distributive share of the partnership's depreciation or amortization deductions from all items of property.

(B) *Recovery period.* For purposes of section 168, if the basis of an item of a partnership's recovery property is decreased as the result of the transfer of an interest in the partnership, then the decrease is recovered over the remaining useful life of the item of the partnership's recovery property. The portion of the decrease that is recovered in any year during the recovery period is equal to the product of—

(1) The amount of the decrease to the item's adjusted basis (determined as of the date of the transfer); multiplied by

(2) A fraction, the numerator of which is the portion of the adjusted basis of the item recovered by the partnership in that year, and the denominator of which is the adjusted basis of the item on the date of the transfer (determined prior to any basis adjustments).

(C) *Examples.* The provisions of this paragraph (j)(4)(ii) are illustrated by the following examples:

Example 1. (i) A, B, and C are equal partners in partnership PRS, which owns Asset 2, an item of depreciable property that has a fair market value that is less than its adjusted tax basis. C sells its interest in PRS to T while PRS has an election in effect under section 754. PRS, therefore, decreases the basis of Asset 2 with respect to T.

(ii) Assume that in the year following the transfer of the partnership interest to T, T's distributive share of the partnership's common basis depreciation deductions from Asset 2 is $1,000. Also assume that, under paragraph (j)(4)(ii)(B) of this section, the amount of the basis adjustment under section 743(b) that T recovers during the year is $500. The total amount of depreciation deductions from Asset 2 reported by T is equal to $500.

Example 2. (i) A and B form equal partnership PRS. A contributes property with an adjusted basis of $100,000 and a fair market value of $50,000. B contributes $50,000 cash. When PRS is formed, the property has five years remaining in its recovery period. The partnership's adjusted basis of $100,000 will, therefore, be recovered over the five years remaining in the property's recovery period. PRS uses the traditional allocation method under §1.704-3(b) with respect to the property. As a result, B will re-

ceive $5,000 of depreciation deductions from the property in each of years 1-5, and A, as the contributing partner, will receive $15,000 of depreciation deductions in each of these years.

(ii) Except for the depreciation deductions, PRS's expenses equal its income in each of the first two years commencing with the year the partnership is formed. After two years, A's share of the adjusted basis of partnership property is $70,000, while B's is $40,000. A sells its interest in PRS to T for its fair market value of $40,000. A valid election under section 754 is in effect with respect to the sale of the partnership interest. Accordingly, PRS makes an adjustment, pursuant to section 743(b), to decrease the basis of partnership property. Under section 743(b), the amount of the adjustment is equal to ($30,000). Under section 755, the entire adjustment is allocated to the property.

(iii) The basis of the property at the time of the transfer of the partnership interest was $60,000. In each of years 3 through 5, the partnership will realize depreciation deductions of $20,000 from the property. Thus, one third of the negative basis adjustment ($10,000) will be recovered in each of years 3 through 5. Consequently, T will be allocated, for tax purposes, depreciation of $15,000 each year from the partnership and will recover $10,000 of its negative basis adjustment. Thus, T's net depreciation deduction from the partnership in each year is $5,000.

Example 3. (i) A, B, and C are equal partners in partnership PRS, which owns Asset 2, an item of depreciable property that has a fair market value that is less than its adjusted tax basis. C sells its interest in PRS to T while PRS has an election in effect under section 754. PRS, therefore, decreases the basis of Asset 2 with respect to T.

(ii) Assume that in the year following the transfer of the partnership interest to T, T's distributive share of the partnership's common basis depreciation deductions from Asset 2 is $500. PRS allocates no other depreciation to T. Also assume that, under paragraph (j)(4)(ii)(B) of this section, the amount of the negative basis adjustment that T recovers during the year is $1,000. T will report $500 of ordinary income because the amount of the negative basis adjustment recovered during the year exceeds T's distributive share of the partnership's common basis depreciation deductions from Asset 2.

(5) *Depletion.* Where an adjustment is made under section 743(b) to the basis of partnership property subject to depletion, any depletion allowance is determined separately for each partner, including the transferee partner, based on the partner's interest in such property. See §1.702-1(a)(8). For partnerships that hold oil and gas properties that are depleted at the partner level under section 613A(c)(7)(D), the transferee partner (and not the partnership) must make the basis adjustments, if any, required under section 743(b) with respect to such properties. See §1.613A-3(e)(6)(iv).

(6) *Example.* The provisions of paragraph (j)(5) of this section are illustrated by the following example:

Example. A, B, and C each contributes $5,000 cash to form partnership PRS, which purchases a coal property for $15,000. A, B, and C have equal interests in capital and profits. C subsequently sells its partnership interest to T for $100,000 when the election under section 754 is in effect. T has a basis adjustment under section 743(b) for the coal property of $95,000 (the difference between T's basis, $100,000, and its share of the basis of partnership property, $5,000). Assume that the depletion allowance computed under the percentage method would be $21,000 for the taxable year so that each partner would be entitled to $7,000 as its share of the deduction for depletion. However, under the cost depletion method, at an assumed rate of 10 percent, the allowance with respect to T's one-third interest which has a basis to him of $100,000 ($5,000, plus its basis adjustment of $95,000) is $10,000, although the cost depletion allowance with respect to the one-third interest of A and B in the coal property, each of which has a basis of $5,000, is only $500. For partners A and B, the percentage depletion is greater than cost depletion and each will deduct $7,000 based on the percentage depletion method. However, as to T, the transferee partner, the cost depletion method results in a greater allowance and T will, therefore, deduct $10,000 based on cost depletion. See section 613(a).

(k) *Returns*—(1) *Statement of adjustments*—(i) *In general.* A partnership that must adjust the bases of partnership properties under section 743(b) must attach a statement to the partnership return for the year of the transfer setting forth the name and taxpayer identification number of the transferee as well as the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

(ii) *Special rule.* Where an interest is transferred in a partnership which holds oil and gas properties that are depleted at the partner level under section 613A(c)(7)(D), the transferee must attach a statement to the transferee's return for the year of the transfer, setting forth the computation of the basis adjustment under section 743(b) which is allocable to such properties and the specific properties to which the adjustment has been allocated.

(iii) *Example.* The provisions of paragraph (k)(1)(ii) of this section are illustrated by the following example:

Example. (i) Partnership XYZ owns a single section 613A(c)(7)(D) domestic oil and gas property (Property) and other non-depletable assets. A, a partner in XYZ with an adjusted tax basis in Property of $100 (excluding any prior adjustments under section 743(b)), sells its partnership interest to B for $800 cash. Under §1.613A-3(e)(6)(iv), A's adjusted basis of $100 in Property carries over to B.

(ii) Under section 755, XYZ determines that Property accounts for 50% of the fair market value of all partnership assets. The remaining 50% of B's purchase price ($400) is attributable to non-depletable property. XYZ must provide a statement to B containing the portion of B's adjusted basis attributable to non-depletable property ($400). Under this paragraph (k)(1), XYZ must report basis adjustments under section 743(b) to non-depletable property. B must report basis adjustments under section 743(b) to Property.

(2) *Requirement that transferee notify partnership*—(i) *Sale or exchange.* A transferee that acquires, by sale or exchange, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within 30 days of the sale or exchange. The written notice to the partnership must be signed under penalties of perjury and must include the names and addresses of the transferee and (if ascertainable) of the transferor, the taxpayer identification numbers of the transferee and (if ascertainable) of the transferor, the relationship (if any) between the transferee and the transferor, the date of the transfer, the amount of any liabilities assumed or taken subject to by the transferee, and the amount of any money, the fair market value of any other property delivered or to be delivered for the transferred interest in the partnership, and any other information necessary for the partnership to compute the transferee's basis.

(ii) *Transfer on death.* A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within one year of the death of the deceased partner. The written notice to the partnership must be signed under penalties of perjury and must in-

clude the names and addresses of the deceased partner and the transferee, the taxpayer identification numbers of the deceased partner and the transferee, the relationship (if any) between the transferee and the transferor, the deceased partner's date of death, the date on which the transferee became the owner of the partnership interest, the fair market value of the partnership interest on the applicable date of valuation set forth in section 1014, and the manner in which the fair market value of the partnership interest was determined.

(iii) *Nominee reporting.* If a partnership interest is transferred to a nominee which is required to furnish the statement under section 6031(c)(1) to the partnership, the nominee may satisfy the notice requirement contained in this paragraph (k)(2) by providing the statement required under §1.6031(c)-1T, provided that the statement satisfies all requirements of §1.6031(c)-1T and this paragraph (k)(2).

(3) *Reliance.* In making the adjustments under section 743(b) and any statement or return relating to such adjustments under this section, a partnership may rely on the written notice provided by a transferee pursuant to paragraph (k)(2) of this section to determine the transferee's basis in a partnership interest. The previous sentence shall not apply if any partner who has responsibility for federal income tax reporting by the partnership has knowledge of facts indicating that the statement is clearly erroneous.

(4) *Partnership not required to make or report adjustments under section 743(b) until it has notice of the transfer.* A partnership is not required to make the adjustments under section 743(b) (or any statement or return relating to those adjustments) with respect to any transfer until it has been notified of the transfer. For purposes of this section, a partnership is notified of a transfer when either—

(i) The partnership receives the written notice from the transferee required under paragraph (k)(2) of this section; or

(ii) Any partner who has responsibility for federal income tax reporting by the partnership has knowledge that there has been a transfer of a partnership interest.

(5) *Effect on partnership of the failure of the transferee to comply.* If the transferee fails to provide the partnership with the written notice required by paragraph (k)(2) of this section, the partnership must attach a statement to its return in the year that the partnership is otherwise notified of the transfer. This statement must set forth the name and taxpayer identification number (if ascertainable) of the transferee. In addition, the following statement must be prominently displayed in capital letters on the first page of the partnership's return for such year, and on the first page of any schedule or information statement relating to such transferee's share of income, credits, deductions, etc.: "RETURN FILED PURSUANT TO §1.743-1(k)(5)." The partnership will then be entitled to report the transferee's share of partnership items without adjustment to reflect the transferee's basis adjustment in partnership property. If, following the filing of a return pursuant to this paragraph (k)(5), the transferee provides the applicable written notice to the partnership, the partnership must make such adjustments as are necessary to adjust the basis of partnership property (as of the date of the transfer) in any amended return otherwise to be filed by the partnership or in the next annual partnership return of income to be regularly filed by the partnership. At such time, the partnership must also provide the transferee with such information as is necessary for the transferee to amend its prior returns to properly reflect the adjustment under section 743(b).

(l) *Effective date.* This section applies to transfers of partnership interests that occur on or after December 15, 1999.

Par. 6. Section 1.751-1 is amended by:

1. Revising paragraphs (a)(2) and (a)(3).
2. Revising paragraph (c)(3).
3. Removing paragraph (c)(4)(x).
4. Adding a sentence at the end of paragraph (f).
5. Revising *Example 1* of paragraph (g).

The addition and revisions read as follows:

§1.751-1 Unrealized receivables and inventory items.

* * * * *

(a) * * *

(2) *Determination of gain or loss.* The income or loss realized by a partner upon the sale or exchange of its interest in section 751 property is the amount of income or loss from section 751 property (including any remedial allocations under §1.704-3(d)) that would have been allocated to the partner (to the extent attributable to the partnership interest sold or exchanged) if the partnership had sold all of its property in a fully taxable transaction for cash in an amount equal to the fair market value of such property (taking into account section 7701(g)) immediately prior to the partner's transfer of the interest in the partnership. Any gain or loss recognized that is attributable to section 751 property will be ordinary gain or loss. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 and the amount of ordinary income or loss determined under this paragraph (a)(2) is the transferor's capital gain or loss on the sale of its partnership interest.

(3) *Statement required.* A partner selling or exchanging any part of an interest in a partnership that has any section 751 property at the time of sale or exchange must submit with its income tax return for the taxable year in which the sale or exchange occurs a statement setting forth separately the following information—

(i) The date of the sale or exchange;

(ii) The amount of any gain or loss attributable to the section 751 property; and

(iii) The amount of any gain or loss attributable to capital gain or loss on the sale of the partnership interest.

* * * * *

(c) *Unrealized receivables.* * * *

(3) In determining the amount of the sale price attributable to such unrealized receivables, or their value in a distribution treated as a sale or exchange, full account shall be taken not only of the estimated cost of completing performance of the contract or agreement, but also of the time between the sale or distribution and the time of payment.

* * * * *

(f) * * * The rules contained in paragraphs (a)(2) and (a)(3) of this section apply to transfers of partnership interests that occur on or after December 15, 1999.

(g) * * *

Example 1. (i)(A) A and B are equal partners in personal service partnership PRS. B transfers its interest in PRS to T for $15,000 when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	Assets	
	Adjusted Basis	Fair Market Value
Cash	$ 3,000	$ 3,000
Loans Receivable	10,000	10,000
Capital Assets	7,000	5,000
Unrealized Receivables	0	14,000
Total	20,000	32,000

	Liabilities and Capital	
	Adjusted Per Books	Fair Market Value
Liabilities	$ 2,000	$ 2,000
Capital:		
A	9,000	15,000
B	9,000	15,000
Total	20,000	32,000

(B) None of the assets owned by PRS is section 704(c) property, and the capital assets are nondepreciable. The total amount realized by B is $16,000, consisting of the cash received, $15,000, plus $1,000, B's share of the partnership liabilities assumed by T. See section 752. B's undivided half-interest in the partnership property includes a half-interest in the partnership's unrealized receivables items. B's basis for its partnership interest is $10,000 ($9,000, plus $1,000, B's share of partnership liabilities). If section 751(a) did not apply to the sale, B would recognize $6,000 of capital gain from the sale of the interest in PRS. However, section 751(a) does apply to the sale.

(ii) If PRS sold all of its section 751 property in a fully taxable transaction immediately prior to the transfer of B's partnership interest to T, B would have been allocated $7,000 of ordinary income from the sale of PRS's unrealized receivables. Therefore, B will recognize $7,000 of ordinary income with respect to the unrealized receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 ($6,000) and the amount of ordinary income or loss determined under paragraph (a)(2) of this section ($7,000) is the transferor's capital gain or loss on the sale of its partnership interest. In this case, B will recognize a $1,000 capital loss.

* * * * *

Par. 7. Section 1.754-1 is amended as follows:

1. Designate the text following the heading of paragraph (c) as paragraph (c)(1).

2. Add a heading to newly designated paragraph (c)(1).

3. Add paragraph (c)(2).

The additions read as follows:

§1.754-1 Time and manner of making election to adjust basis of partnership property.

* * * * *

(c) *Revocation of election*—(1) *In general.* * * *

(2) *Revocations made for first taxable year ending after December 15, 1999.* Notwithstanding paragraph (c)(1) of this section, any partnership having an election in effect under this section for its taxable year that includes December 15, 1999 may revoke such election by attaching a statement to the partnership's return for such year. For the revocation to be valid, the statement must be filed not later than the time prescribed by §1.6031(a)-1(e) (including extensions thereof) for filing the return for such taxable year, and must set forth the name and address of the partnership revoking the election, be signed by any one of the partners who is authorized to sign the partnership's federal income tax return, and contain a declaration that the partnership revokes its election under section 754 to apply the provisions of section 734(b) and 743(b). In addition, the following statement must be prominently displayed in capital letters on the first page of the partnership's return for such year: "RETURN FILED PURSUANT TO §1.754-1(c)(2)."

Par. 8. Section 1.755-1 is revised to read as follows:

§1.755-1 Rules for allocation of basis.

(a) *Generally.* A partnership that has an election in effect under section 754 must adjust the basis of partnership property under the provisions of section 734(b) and section 743(b) pursuant to the provisions of this section. The basis adjustment is first allocated between the two classes of property described in section 755(b). These classes of property consist of capital assets and section 1231(b) property (capital gain property), and any other property of the partnership (ordinary income property). For purposes of this section, properties and potential gain treated as unrealized receivables under section 751(c) and the regulations thereunder shall be treated as separate assets that are ordinary income property. The portion of the basis adjustment allocated to each class is then allocated among the items within the class. Adjustments under section 743(b) are allocated under paragraph (b) of this section. Adjustments under section 734(b) are allocated under paragraph (c) of this section.

(b) *Adjustments under section 743(b)*—(1) *Generally.* (i) For ex-

changes in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest, paragraph (b)(5) of this section shall apply. For all other transfers which result in a basis adjustment under section 743(b), paragraphs (b)(2) through (b)(4) of this section shall apply. Except as provided in paragraph (b)(5) of this section, the portion of the basis adjustment allocated to one class of property may be an increase while the portion allocated to the other class is a decrease. This would be the case even though the total amount of the basis adjustment is zero. Except as provided in paragraph (b)(5) of this section, the portion of the basis adjustment allocated to one item of property within a class may be an increase while the portion allocated to another is a decrease. This would be the case even though the basis adjustment allocated to the class is zero.

(ii) *Hypothetical transaction.* For purposes of paragraphs (b)(2) through (b)(4) of this section, the allocation of the basis adjustment under section 743(b) between the classes of property and among the items of property within each class are made based on the allocations of income, gain, or loss (including remedial allocations under §1.704-3(d)) that the transferee partner would receive (to the extent attributable to the acquired partnership interest) if, immediately after the transfer of the partnership interest, all of the partnership's property were disposed of in a fully taxable transaction for cash in an amount equal to the fair market value of such property (the hypothetical transaction).

(2) *Allocations between classes of property*—(i) *In general.* The amount of the basis adjustment allocated to the class of ordinary income property is equal to the total amount of income, gain, or loss (including any remedial allocations under §1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the sale of all ordinary income property in the hypothetical transaction. The amount of the basis adjustment to capital gain property is equal to—

(A) The total amount of the basis adjustment under section 743(b); less

(B) The amount of the basis adjustment allocated to ordinary income property under the preceding sentence; provided, however, that in no event may the amount of any decrease in basis allocated to capital gain property exceed the partnership's basis (or in the case of property subject to the remedial allocation method, the transferee's share of any remedial loss under §1.704-3(d) from the hypothetical transaction) in capital gain property. In the event that a decrease in basis allocated to capital gain property would otherwise exceed the partnership's basis in capital gain property, the excess must be applied to reduce the basis of ordinary income property.

(ii) *Examples.* The provisions of this paragraph (b)(2) are illustrated by the following examples:

Example 1. (i) A and B form equal partnership PRS. A contributes $50,000 and Asset 1, a nondepreciable capital asset with a fair market value of $50,000 and an adjusted tax basis of $25,000. B contributes $100,000. PRS uses the cash to purchase Assets 2, 3, and 4. After a year, A sells its interest in PRS to T for $120,000. At the time of the transfer, A's share of the partnership's basis in partnership assets is $75,000. Therefore, T receives a $45,000 basis adjustment.

(ii) Immediately after the transfer of the partnership interest to T, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted Basis	Fair Market Value
Capital Gain Property:		
Asset 1	$ 25,000	$ 75,000
Asset 2	100,000	117,500
Ordinary Income Property:		
Asset 3	$ 40,000	$ 45,000
Asset 4	10,000	2,500
Total	$175,000	$240,000

(iii) If PRS sold all of its assets in a fully taxable transaction at fair market value immediately after the transfer of the partnership interest to T, the total amount of capital gain that would be allocated to T is equal to $46,250 ($25,000 section 704(c) built-in gain from Asset 1, plus fifty percent of the $42,500 appreciation in capital gain property). T would also be allocated a $1,250 ordinary loss from the sale of the ordinary income property.

(iv) The amount of the basis adjustment that is allocated to ordinary income property is equal to ($1,250) (the amount of the loss allocated to T from the hypothetical sale of the ordinary income property).

(v) The amount of the basis adjustment that is allocated to capital gain property is equal to $46,250 (the amount of the basis adjustment, $45,000, less ($1,250), the amount of loss allocated to T from the hypothetical sale of the ordinary income property).

Example 2. (i) A and B form equal partnership PRS. A and B each contribute $1,000 cash which the partnership uses to purchase Assets 1, 2, 3, and 4. After a year, A sells its partnership interest to T for $1,000. T's basis adjustment under section 743(b) is zero.

(ii) Immediately after the transfer of the partnership interest to T, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted Basis	Fair Market Value
Capital Gain Property:		
Asset 1	$ 500	$ 750
Asset 2	500	500
Ordinary Income Property:		
Asset 3	$ 500	$ 250
Asset 4	500	500
Total	$2,000	$2,000

(iii) If, immediately after the transfer of the partnership interest to T, PRS sold all of its assets in a fully taxable transaction at fair market value, T would be allocated a loss of $125 from the sale of the ordinary income property. Thus, the amount of the basis adjustment to ordinary income property is ($125). The amount of the basis adjustment to capital gain property is $125 (zero, the amount of the basis adjustment under section 743(b), less ($125), amount of the basis adjustment allocated to ordinary income property).

(3) *Allocation within the class*—(i) *Ordinary income property.* The amount of the basis adjustment to each item of property within the class of ordinary income property is equal to—

(A) The amount of income, gain, or loss (including any remedial allocations under §1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of the item; reduced by

(B) The product of—

(1) Any decrease to the amount of the basis adjustment to ordinary income property required pursuant to the last sentence of paragraph (b)(2)(i) of this section; multiplied by

(2) A fraction, the numerator of which is the fair market value of the item of property to the partnership and the denominator of which is the total fair market value of all of the partnership's items of ordinary income property.

(ii) *Capital gain property.* The amount of the basis adjustment to each item of property within the class of capital gain property is equal to—

(A) The amount of income, gain, or loss (including any remedial allocations under §1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of the item; minus

(B) The product of—

(*1*) The total amount of gain or loss (including any remedial allocations under §1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all items of capital gain property, minus the amount of the positive basis adjustment to all items of capital gain property or plus the amount of the negative basis adjustment to capital gain property; multiplied by

(*2*) A fraction, the numerator of which is the fair market value of the item of property to the partnership, and the denominator of which is the fair market value of all of the partnership's items of capital gain property.

(iii) *Examples.* The provisions of this paragraph (b)(3) are illustrated by the following examples:

Example 1. (i) Assume the same facts as Example 1 in paragraph (b)(2)(ii) of this section. Of the $45,000 basis adjustment, $46,250 was allocated to capital gain property. The amount allocated to ordinary income property was ($1,250).

(ii) Asset 1 is a capital gain asset, and T would be allocated $37,500 from the sale of Asset 1 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 1 is $37,500.

(iii) Asset 2 is a capital gain asset, and T would be allocated $8,750 from the sale of Asset 2 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 2 is $8,750.

(iv) Asset 3 is ordinary income property, and T would be allocated $2,500 from the sale of Asset 3 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 3 is $2,500.

(v) Asset 4 is ordinary income property, and T would be allocated ($3,750) from the sale of Asset 4 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 4 is ($3,750).

Example 2. (i) Assume the same facts as Example 1 in paragraph (b)(2)(ii) of this section, except that A sold its interest in PRS to T for $110,000 rather than $120,000. T, therefore, receives a basis adjustment under section 743(b) of $35,000. Of the $35,000 basis adjustment, ($1,250) is allocated to ordinary income property, and $36,250 is allocated to capital gain property.

(ii) Asset 3 is ordinary income property, and T would be allocated $2,500 from the sale of Asset 3 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 3 is $2,500.

(iii) Asset 4 is ordinary income property, and T would be allocated ($3,750) from the sale of Asset 4 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 4 is ($3,750).

(iv) Asset 1 is a capital gain asset, and T would be allocated $37,500 from the sale of Asset 1 in the hypothetical transaction. Asset 2 is a capital gain asset, and T would be allocated $8,750 from the sale of Asset 2 in the hypothetical transaction. The total amount of gain that would be allocated to T from the sale of the capital gain assets in the hypothetical transaction is $46,250, which exceeds the amount of the basis adjustment allocated to capital gain property by $10,000. The amount of the adjustment to Asset 1 is $33,604 ($37,500 minus $3,896 ($10,000 x $75,000/192,500)). The amount of the basis adjustment to Asset 2 is $2,646 ($8,750 minus $6,104 ($10,000 x $117,500/192,500)).

(4) *Income in respect of a decedent*—(i) *In general.* Where a partnership interest is transferred as a result of the death of a partner, under section 1014(c) the transferee's basis in its partnership interest is not adjusted for that portion of the interest, if any, which is attributable to items representing income in respect of a decedent under section 691. See §1.742-1. Accordingly, if a partnership interest is transferred as a result of the death of a partner, and the partnership holds assets representing income in respect of a decedent, no part of the

basis adjustment under section 743(b) is allocated to these assets. See §1.743-1(b).

(ii) The provisions of this paragraph (b)(4) are illustrated by the following example:

Example. (i) A and B are equal partners in personal service partnership PRS. As a result of B's death, B's partnership interest is transferred to T when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	Assets	
	Adjusted Basis	Fair Market Value
Capital Asset	$ 2,000	$ 5,000
Unrealized Receivables	0	15,000
Total	2,000	20,000

	Liabilities and Capital	
	Adjusted Per Books	Fair Market Value
Capital:		
A	1,000	10,000
B	1,000	10,000
Total	2,000	20,000

(ii) None of the assets owned by PRS is section 704(c) property, and the capital asset is nondepreciable. The fair market value of T's partnership interest on the applicable date of valuation set forth in section 1014 is $10,000. Of this amount, $2,500 is attributable to T's share of the partnership's capital asset, and $7,500 is attributable to T's 50% share of the partnership's unrealized receivables. The partnership's unrealized receivables represent income in respect of a decedent. Accordingly, under section 1014(c), T's basis in its partnership interest is not adjusted for that portion of the interest which is attributable to the unrealized receivables. Therefore, T's basis in its partnership interest is $2,500.

(iii) At the time of the transfer, B's share of the partnership's basis in partnership assets is $1,000. Accordingly, T receives a $1,500 basis adjustment under section 743(b). Under this paragraph (b)(4), the entire basis adjustment is allocated to the partnership's capital asset.

(5) *Transferred basis exchanges*—(i) *In general.* This paragraph (b)(5) applies to basis adjustments under section 743(b) which result from exchanges in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest. For example, this paragraph applies if a partnership interest is contributed to a corporation in a transaction to which section 351 applies or to a partnership in a transaction to which section 721(a) applies.

(ii) *Allocations between classes of property.* If the total amount of the basis adjustment under section 743(b) is zero, then no adjustment to the basis of partnership property will be made under this paragraph (b)(5). If there is an increase in basis to be allocated to partnership assets, such increase must be allocated to capital gain property or ordinary income property, respectively, only if the total amount of gain or loss (including any remedial allocations under §1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all such property would result in a net gain or net income, as the case may be, to the transferee. Where, under the preceding sentence, an increase in basis may be allocated to both capital gain assets and ordinary income assets, the increase shall be allocated to each class in proportion to the net gain or net income, respectively, which would be allocated to the transferee from the sale of all assets in each class. If there is a decrease in basis to be allocated to partnership assets, such decrease must be allocated to capital gain property or ordinary income property, respectively, only if the total amount of gain or loss (including any remedial allocations under §1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all such property would result in a net loss to the transferee. Where, under the preceding sentence, a decrease in basis may be allocated to both capital gain assets and ordinary income assets, the decrease shall be allocated to each class in proportion to the net loss which would be allocated to the transferee from the sale of all assets in each class.

(iii) *Allocations within the classes*—(A) *Increases.* If there is an increase in basis to be allocated within a class, the increase must be allocated first to properties with unrealized appreciation in proportion to the transferee's share of the respective amounts of unrealized appreciation before such increase (but only to the extent of the transferee's share of each property's unrealized appreciation). Any remaining increase must be allocated among the properties within the class in proportion to the transferee's share of the amount that would be realized by the partnership upon the hypothetical sale of each asset in the class.

(B) *Decreases.* If there is a decrease

in basis to be allocated within a class, the decrease must be allocated first to properties with unrealized depreciation in proportion to the transferee's shares of the respective amounts of unrealized depreciation before such decrease (but only to the extent of the transferee's share of each property's unrealized depreciation). Any remaining decrease must be allocated among the properties within the class in proportion to the transferee's shares of their adjusted bases (as adjusted under the preceding sentence).

(C) *Limitation in decrease of basis.* Where, as the result of a transaction to which this paragraph (b)(5) applies, a decrease in basis must be allocated to capital gain assets, ordinary income assets, or both, and the amount of the decrease otherwise allocable to a particular class exceeds the transferee's share of the adjusted basis to the partnership of all depreciated assets in that class, the transferee's negative basis adjustment is limited to the transferee's share of the partnership's adjusted basis in all depreciated assets in that class.

(D) *Carryover adjustment.* Where a transferee's negative basis adjustment under section 743(b) cannot be allocated to any asset, because the adjustment exceeds the transferee's share of the adjusted basis to the partnership of all depreciated assets in a particular class, the adjustment is made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

(iv) *Examples.* The provisions of this paragraph (b)(5) are illustrated by the following examples:

Example 1. A is a member of partnership LTP, which has made an election under section 754. The three partners in LTP have equal interests in capital and profits. Solely in exchange for a partnership interest in UTP, A contributes its interest in LTP to UTP in a transaction described in section 721. At the time of the transfer, A's basis in its partnership interest ($5,000) equals its share of inside basis (also $5,000). Under section 723, UTP's basis in its interest in LTP is $5,000. LTP's only two assets on the date of contribution are inventory with a basis of $5,000 and a fair market value of $7,500, and a nondepreciable capital asset with a basis of $10,000 and a fair market value of $7,500. The amount of the basis adjustment under section 743(b) to partnership property is $0 ($5,000, UTP's basis in its interest in LTP, minus $5,000, UTP's share of LTP's basis in partnership assets). Because UTP acquired its interest in LTP in a transferred basis exchange, and the total amount of the basis adjustment under section 743(b) is zero, UTP receives no special basis adjustments under section 743(b) with respect to the partnership property of LTP.

Example 2. (i) A purchases a partnership interest in LTP at a time when an election under section 754 is not in effect. The three partners in LTP have equal interests in capital and profits. During a later year for which LTP has an election under section 754 in effect, and in a transaction that is unrelated to A's purchase of the LTP interest, A contributes its interest in LTP to UTP in a transaction described in section 721 (solely in exchange for a partnership interest in UTP). At the time of the transfer, A's adjusted basis in its interest in LTP is $20,433. Under section 721, A recognizes no gain or loss as a result of the contribution of its partnership interest to UTP. Under section 723, UTP's basis in its partnership interest in LTP is $20,433. The balance sheet of LTP on the date of the contribution shows the following:

Assets	Adjusted Basis	Fair Market Value
Cash	$ 5,000	$5,000
Accounts receivable	10,000	10,000
Inventory	20,000	21,000
Nondepreciable capital asset	20,000	40,000
Total	$55,000	$76,000

Liabilities and Capital	Adjusted Per Books	Fair Market Value
Liabilities	$10,000	$10,000
Capital:		
A	15,000	22,000
B	15,000	22,000
C	15,000	22,000
Total	$55,000	$76,000

(ii) The amount of the basis adjustment under section 743(b) is the difference between the basis of UTP's interest in LTP and UTP's share of the adjusted basis to LTP of partnership property. UTP's interest in the previously taxed capital of LTP is $15,000 ($22,000, the amount of cash UTP would receive if LTP liquidated immediately after the hypothetical transaction, decreased by $7,000, the amount of tax gain allocated to UTP from the hypothetical transaction). UTP's share of the adjusted basis to LTP of partnership property is $18,333 ($15,000 share of previously taxed capital, plus

$3,333 share of LTP's liabilities). The amount of the basis adjustment under section 743(b) to partnership property therefore, is $2,100 ($20,433 minus $18,333).

(iii) The total amount of gain that would be allocated to UTP from the hypothetical sale of capital gain property is $6,666.67 (one-third of the excess of the fair market value of LTP's nondepreciable capital asset, $40,000, over its basis, $20,000). The total amount of gain that would be allocated to UTP from the hypothetical sale of ordinary income property is $333.33 (one-third of the excess of the fair market value of LTP's inventory, $21,000, over its basis, $20,000). Under paragraph (b)(5), LTP must allocate $2,000 ($6,666.67 divided by $7,000 times $2,100) of UTP's basis adjustment to the nondepreciable capital asset. LTP must allocate $100 ($333.33 divided by $7,000 times $2,100) of UTP's basis adjustment to the inventory.

(c) *Adjustments under section 734(b)*—(1) *Allocations between classes of property*—(i) *General rule.* Where there is a distribution of partnership property resulting in an adjustment to the basis of undistributed partnership property under section 734(b)(1)(B) or (b)(2)(B), the adjustment must be allocated to remaining partnership property of a character similar to that of the distributed property with respect to which the adjustment arose. Thus, when the partnership's adjusted basis of distributed capital gain property immediately prior to distribution exceeds the basis of the property to the distributee partner (as determined under section 732), the basis of the undistributed capital gain property remaining in the partnership is increased by an amount equal to the excess. Conversely, when the basis to the distributee partner (as determined under section 732) of distributed capital gain property exceeds the partnership's adjusted basis of such property immediately prior to the distribution, the basis of the undistributed capital gain property remaining in the partnership is decreased by an amount equal to such excess. Similarly, where there is a distribution of ordinary income property, and the basis of the property to the distributee partner (as determined under section 732) is not the same as the partnership's adjusted basis of the property immediately prior to distribution, the adjustment is made only to undistributed property of the same class remaining in the partnership.

(ii) *Special rule.* Where there is a distribution resulting in an adjustment under section 734(b)(1)(A) or (b)(2)(A) to the basis of undistributed partnership property, the adjustment is allocated only to capital gain property.

(2) Allocations within the classes—(i) *Increases.* If there is an increase in basis to be allocated within a class, the increase must be allocated first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation). Any remaining increase must be allocated among the properties within the class in proportion to their fair market values.

(ii) *Decreases.* If there is a decrease in basis to be allocated within a class, the decrease must be allocated first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation). Any remaining decrease must be allocated among the properties within the class in proportion to their adjusted bases (as adjusted under the preceding sentence).

(3) *Limitation in decrease of basis.* Where a decrease in the basis of partnership assets is required under section 734(b)(2) and the amount of the decrease exceeds the adjusted basis to the partnership of property of the required character, the basis of such property is reduced to zero (but not below zero).

(4) *Carryover adjustment.* Where, in the case of a distribution, an increase or a decrease in the basis of undistributed property cannot be made because the partnership owns no property of the character required to be adjusted, or because the basis of all the property of a like character has been reduced to zero, the adjustment is made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

(5) *Example.* The following example illustrates this paragraph (c):

Example. (i) A, B, and C form equal partnership PRS. A contributes $50,000 and Asset 1, capital gain property with a fair market value of $50,000 and an adjusted tax basis of $25,000. B and C each contributes $100,000. PRS uses the cash to purchase Assets 2, 3, 4, 5, and 6. Assets 4, 5, and 6 are the only assets held by the partnership which are subject to section 751. The partnership has an election in effect under section 754. After seven years, the adjusted basis and fair market value of PRS's assets are as follows:

Assets	Adjusted Basis	Fair Market Value
Capital Gain Property:		
Asset 1	$ 25,000	$ 75,000
Asset 2	100,000	117,500
Asset 3	50,000	60,000
Ordinary Income Property:		
Asset 4	$ 40,000	$ 45,000
Asset 5	50,000	60,000
Asset 6	10,000	2,500
Total	$275,000	$360,000

(ii) *Allocation between classes.* Assume that PRS distributes Assets 3 and 5 to A in complete liquidation of A's interest in the partnership. A's basis in the partnership interest was $75,000. The partnership's basis in Assets 3 and 5 was $50,000 each. A's $75,000 basis in its partnership interest is allocated between Assets 3 and 5 under sections 732(b) and (c). A will, therefore, have a basis of $25,000 in Asset 3 (capital gain property), and a basis of $50,000 in Asset 5 (section 751 property). The distribution results in a $25,000 increase in the basis of capital gain property. There is no change in the basis of ordinary income property.

(iii) *Allocation within class.* The amount of the basis increase to capital gain property is $25,000 and must be allocated among the remaining capital gain assets in proportion to the difference between the fair market value and basis of each. The fair market value of Asset 1 exceeds its basis by $50,000. The fair market value of Asset 2 exceeds its basis by $17,500. Therefore, the basis of Asset 1 will be increased by $18,519 ($25,000, multiplied by $50,000, divided by $67,500), and the basis of Asset 2 will be increased by $6,481 ($25,000 multiplied by $17,500, divided by $67,500).

(d) *Effective date.* This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after December 15, 1999.

Par. 9. Section 1.1017-1 is amended by:

1. Revising paragraph (g)(2)(iv).

2. Adding paragraph (g)(2)(v).

The addition and revision read as follows:

§1.1017-1 Basis reductions following a discharge of indebtedness.

* * * * *

(g) * * *

(2) * * *

(iv) *Partner's share of partnership basis*—(A) *In general.* For purposes of this paragraph (g), a partner's proportionate share of the partnership's basis in depreciable property (or depreciable real property) is equal to the sum of—

(1) The partner's section 743(b) basis adjustments to items of partnership depreciable property (or depreciable real property); and

(2) The common basis depreciation deductions (but not including remedial allocations of depreciation deductions under §1.704-3(d)) that, under the terms of the partnership agreement effective for the taxable year in which the discharge of indebtedness occurs, are reasonably expected to be allocated to the partner over the property's remaining useful life. The assumptions made by a partnership in determining the reasonably expected allocation of depreciation deductions must be consistent for each partner. For example, a partnership may not treat the same depreciation deductions as being reasonably expected by more than one partner.

(B) *Effective date.* This paragraph (g)(2)(iv) applies to elections made under sections 108(b)(5) and 108(c) on or after December 15, 1999.

(v) *Treatment of basis reduction*—(A) *Basis adjustment.* The amount of the reduction to the basis of depreciable partnership property constitutes an adjustment to the basis of partnership property with respect to the partner only. No adjustment is made to the common basis of partnership property. Thus, for purposes of income, deduction, gain, loss, and distribution, the partner will have a special basis for those partnership properties the bases of which are adjusted under section 1017 and this section.

(B) *Recovery of adjustments to basis of partnership property.* Adjustments to the basis of partnership property under this section are recovered in the manner described in §1.743-1.

(C) *Effect of basis reduction.* Adjustments to the basis of partnership property under this section are treated in the same manner and have the same effect as an adjustment to the basis of partnership property under section 743(b). The following example illustrates this paragraph (g)(2)(v):

(b) * * *

Example. (i) A, B, and C are equal partners in partnership PRS, which owns (among other things) Asset 1, an item of depreciable property with a basis of $30,000. A's basis in its partnership interest is $20,000. Under the terms of the partnership agreement, A's share of the depreciation deductions from Asset 1 over its remaining useful life will be $10,000. Under section 1017, A requests, and PRS agrees, to decrease the basis of Asset 1 with respect to A by $10,000.

(ii) In the year following the reduction of basis under section 1017, PRS amends its partnership agreement to provide that items of depreciation and loss from Asset 1 will be allocated equally between B and C. In that year, A's distributive share of the partnership's common basis depreciation deductions from Asset 1 is now $0. Under §1.743-1(j)(4)(ii)(B), the amount of the section 1017 basis adjustment that A recovers during the year is $1,000. A will report $1,000 of ordinary income because A's distributive share of the partnership's common basis depreciation deductions from Asset 1 ($0) is insufficient to offset the amount of the section 1017 basis adjustment recovered by A during the year ($1,000).

(iii) In the following year, PRS sells Asset 1 for $15,000 and recognizes a $12,000 loss. This loss is allocated equally between B and C, and A's share of the loss is $0. Upon the sale of Asset 1, A recovers its entire remaining section 1017 basis adjustment ($9,000). A will report $9,000 of ordinary income.

(D) *Effective date.* This paragraph (g)(2)(v) applies to elections made under sections 108(b)(5) and 108(c) on or after December 15, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 10. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 11. In §602.101, paragraph (b) is amended by

revising the entries for 1.732-1 and 1.743-1 in the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.732-1	1545–0099 1545–1588
* * * * *	
1.732-1	1545–0074 1545–1588
* * * *	

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

Approved November 29, 1999

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 14, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 15, 1999, 64 F.R. 69903)

Section 1361.—S Corporation Defined

26 CFR 1.1361–1: S corporation defined.

If a state law limited partnership elects under § 301.7701–3 to be classified as an association taxable as a corporation, does the entity have more than one class of stock for purposes of § 1361(b)(1)(D)? See Rev. Proc. 99–51, page 760.

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26 CFR 601.901: Missing children shown on penalty mail.

T.D. 8848

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 601

Use of Penalty Mail in the Location and Recovery of Missing Children

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Procedural rules.

SUMMARY: This rule establishes the procedures under which the IRS may use penalty mail to aid in the location and recovery of missing children. The IRS can participate in this cause as a result of the Juvenile Justice and Delinquency Prevention Act of 1974. Printing pictures and biographical data of missing children on blank pages of annual tax forms and instructions, taxpayer information publications, and other IRS products will assist the National Center for Missing and Exploited Children (National Center).

DATES: Effective Date: These regulations are effective December 13, 1999

Applicability Date: For dates of applicability of these regulations, see §601.901 (e).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Randall Hall, (202) 283-7900. Concerning the IRS' forms and publications program, Sandy Kopta, (202) 622-3726 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On August 9, 1985, Congress enacted Public Law 99–87, 99 Stat. 290, which added a new section 3220 to title 39, United States Code. That provision authorized Federal agencies to place photographs and biographical data of missing children on penalty mail in accordance with guidelines promulgated by the Department of Justice. On December 1, 1997, Congress amended the statute to provide that the use of missing children photographs and biographical data on penalty mail would be continued until December 31, 2002.

The Office of Juvenile Justice and Delinquency Prevention (OJJDP) within the Department of Justice is directed by 39 U.S.C. 3220 (a) (1), after consultation with appropriate public and private agencies, to prescribe general guidelines under which penalty mail may be used to assist in the location and recovery of missing children. These guidelines were published on November 8, 1985 (50 FR 46622). In addition, each executive department of the Government of the United States is required by 39 U.S.C. 3220 (a) (2) to promulgate or authorize subunits to promulgate regulations under which penalty mail sent by such departments may be used in conformance with the OJJDP guidelines.

This rule is being promulgated in compliance with 39 U.S.C. 3220 (a)(2) and is in conformance with the OJJDP guidelines. The rule sets forth information on U.S. Postal Service restrictions on the placement of information, "shelf-life" restrictions on the use of missing children information, and other applicable administrative factors.

The IRS will receive photographic and biographical information on missing children through the National Center. The IRS will then give priority to the use of missing children information in mail addressed to members of the public.

Findings and Other Matters

The Commissioner has determined that notice and prior public procedure are not required for this regulation because the subject matter of the regulation pertains only to the IRS's use of penalty mail in the location and recovery of missing children. The regulation does not directly affect the rights and interests of the general public. For these reasons, the rule is to be effective on the date of publication in the Federal Register.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553 (b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply. Pursuant to section 7805 (f) of the Internal Revenue Code, this statement of procedural rule will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this statement of procedural rule is Randall Hall, Office of Chief Counsel (General Legal Services). However, other personnel from the IRS participated in its development.

* * * * *

Adoption of Amendments to the Statement of Procedural Rules

Accordingly, 26 CFR part 601 is amended as follows:

PART 601–STATEMENT OF PROCEDURAL RULES

Paragraph 1. The authority citation for part 601 is revised to read as follows:

Authority: 5 U.S.C. 301 and 552, unless otherwise noted.

Subpart I also issued under 39 U.S.C.

3220.

Par. 2. Subpart I, consisting of §601.901, is added to read as follows:

Subpart I–Use of Penalty Mail in the Location and Recovery of Missing Children

§601.901 Missing children shown on penalty mail.

(a) *Purpose.* To support the national effort to locate and recover missing children, the Internal Revenue Service (IRS) joins other executive departments and agencies of the Government of the United States in using official mail to disseminate photographs and biographical information on hundreds of missing children.

(b) *Procedures for obtaining and disseminating data.* (1) The IRS shall publish pictures and biographical data related to missing children in domestic penalty mail containing annual tax forms and instructions, taxpayer information publications, and other IRS products directed to members of the public in the United States and its territories and possessions.

(2) Missing children information shall not be placed on the "Penalty Indicia," "OCR Read Area," "Bar Code Read Area," and "Return Address" areas of letter-size envelopes.

(3) The IRS shall accept photographic and biographical materials solely from the National Center for Missing and Exploited Children (National Center). Photographs that were reasonably current as of the time of the child's disappearance, or those which have been updated to reflect a missing child's current age through computer enhancement technique, shall be the only acceptable form of visual media or pictorial likeness used in penalty mail.

(c) *Withdrawal of data.* The shelf life of printed penalty mail is limited to 3 months for missing child cases. The IRS shall follow those guidelines whenever practicable. For products with an extended shelf life, such as those related to filing and paying taxes, the IRS will not print any pictures or biographical data relating to missing children without obtaining from the National Center a waiver of the 3-month shelf-life guideline.

(d) *Reports and contact official.* IRS shall compile and submit to OJJDP reports on its experience in implementing Public Law 99–87, 99 Stat. 290, as required by that office. The IRS contact person is: Chief, Business Publications Section (or successor office), Tax Forms and Publications Division, Technical Publications Branch, OP:FS:FP:P:3, Room 5613, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, DC 20224.

(e) *Period of applicability.* This section is applicable December 13, 1999 through December 31, 2002.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 10, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 13, 1999, 64 F.R. 69398)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 56, 162, 165, 166, 167, 168, 171, 174, 197, 263, 263A, 404, 446, 451, 454, 455, 461, 471, 472, 475, 481, 585, 1272, 1273, 1278, 1281, 1363; 1.165–2, 1.167(a)–11, 1.167(e)–1, 1.171–4, 1.174–1, 1.174–3, 1.174–4, 1.263(a)–2, 1.263A–1, 1.263A–3, 1.446–1, 1.446–2, 1.451–1, 1.454–1, 1.455–6, 1.461–4, 1.461–5, 1.471–1, 1.471–2, 1.471–3, 1.472–6, 1.472–8, 1.481–1, 1.481–4, 1.1272–1, 1.1273–1, 1.1273–2.)

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SECTION 1. PURPOSE

This revenue procedure provides the procedures by which a taxpayer may obtain automatic consent to change the methods of accounting described in the APPENDIX of this revenue procedure. This revenue procedure clarifies, modifies, amplifies, and supersedes Rev. Proc. 98–60, 1998–51 I.R.B. 16. It also consolidates automatic consent procedures for changes in several methods of accounting that were published subsequent to the publication of Rev. Proc. 98–60, and provides new automatic consent procedures for changes in several other methods of accounting. A taxpayer complying with all the applicable provisions of this revenue procedure has obtained the consent of the Commissioner of Internal Revenue to change its method of accounting under § 446(e) of the Internal Revenue Code and the Income Tax Regulations thereunder.

SECTION 2. BACKGROUND AND CHANGES

.01 *Change in method of accounting defined.*

(1) Section 1.446–1(e)(2)(ii)(a) of the Income Tax Regulations provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions, or a change in the treatment of any material item. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. In determining whether a taxpayer's accounting practice for an item involves timing, generally the relevant question is whether the practice permanently changes the amount of the taxpayer's lifetime income. If the practice does not permanently affect the taxpayer's lifetime income, but does or could change the taxable year in which income is reported, it involves timing and is therefore a method of accounting. *See* Rev. Proc. 91–31, 1991–1 C.B. 566.

(2) Although a method of accounting may exist under this definition without a pattern of consistent treatment of an item, a method of accounting is not adopted in most instances without consistent treatment. The treatment of a material item in the same way in determining the gross income or deductions in two or more consecutively filed tax returns (without regard to any change in status of the method as permissible or impermissible) represents consistent treatment of that item for purposes of § 1.446–1(e)(2)(ii)(a). If a taxpayer treats an item properly in the first return that reflects the item, however, it is not necessary for the taxpayer to treat the item consistently in two or more consecutive tax returns to have adopted a method of accounting. If a taxpayer has adopted a method of accounting under these rules, the taxpayer may not change the method by amending its prior income tax return(s). *See* Rev. Rul. 90–38, 1990–1 C.B. 57.

(3) A change in the characterization of an item may also constitute a change in method of accounting if the change has the effect of shifting income from one period to another. For example, a change from treating an item as income to treating the item as a deposit is a change in method of accounting. *See* Rev. Proc. 91–31.

(4) A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit). *See* § 1.446–1(e)(2)(ii)(b).

.02 *Securing permission to make a method change.* Sections 446(e) and 1.446–1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(i) requires that, in order to obtain the Commissioner's consent to a method change, a taxpayer must file a Form 3115, Application for Change in Accounting Method, during the taxable year in which the taxpayer wants to make the proposed change.

.03 *Terms and conditions of a method 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 change a method of accounting in accordance with § 446(e). The terms and conditions the Commissioner may prescribe include the year of change, whether the change is to be made with a § 481(a) adjustment or on a cut-off basis, and the § 481(a) adjustment period.

.04 *No retroactive method change.* Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting, regardless of whether the change is from a permissible or an impermissible method. *See generally* Rev. Rul. 90–38.

.05 *Method change with a § 481(a) adjustment.*

(1) *Need for adjustment.* Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to 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. When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following taxable years must be determined under the new method of accounting as if the new method had always been used.

Example. A taxpayer that is not required to use inventories uses the overall cash receipts and disbursements method and changes to an overall accrual method. The taxpayer has $120,000 of income earned but not yet received (accounts receivable) and $100,000 of expenses incurred but not yet paid (accounts payable) as of the end of the taxable year preceding the year of change. A positive § 481(a) adjustment of $20,000 ($120,000 accounts receivable less $100,000 accounts payable) is required as a result of the change.

(2) *Adjustment period.* Section 481(c) and §§ 1.446–1(e)(3)(ii) and 1.481–4 provide that the adjustment required by § 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. Generally, in the absence of such an agreement, the § 481(a) adjustment is taken into account completely in the year of change, subject to § 481(b) which limits the amount of tax where the § 481(a) adjustment is substantial. However, under the Commissioner's authority in § 1.446–1(e)(3)(ii) to prescribe terms and conditions for changes in methods of accounting, this revenue procedure provides specific adjustment periods that are intended to achieve an appropriate balance between the goals of mitigating distortions of income that result from accounting method changes and providing appropriate incentives for voluntary compliance.

.06 *Method change using a cut-off method.* The Commissioner may determine that certain changes in methods of accounting will be made without a § 481(a) adjustment, using a "cut-off method." Under a cut-off method, only the items arising on or after the beginning of the year of change (or other operative date) are accounted for under the new method of accounting. Any items arising before the year of change (or other operative date) continue to be accounted for under the taxpayer's former method of accounting. See, for example, § 263A (which generally applies to costs incurred after December 31, 1986, for noninventory property), § 461(h) (which generally applies to amounts incurred on or after July 18, 1984), and § 1.446–3 (which applies to notional principal contracts entered into on or after December 13, 1993). Because no items are duplicated or omitted from income when a cut-off method is used to effect a change in accounting method, no § 481(a) adjustment is necessary.

.07 *Consistency and clear reflection of income.* Methods of accounting should clearly reflect income on a continuing basis, and the Internal Revenue Service exercises its discretion under §§ 446(e) and 481(c) in a manner that generally minimizes distortions of income across taxable years and on an annual basis.

.08 *Separate trades or businesses.*

(1) Sections 1.446–1(d)(1) and (2) provide that when a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business provided the method of accounting used for each trade or business clearly reflects the overall income of the taxpayer as well as that of each particular trade or business. No trade or business is separate and distinct unless a complete and separable set of books and records is kept for that trade or business.

(2) Section 1.446–1(d)(3) provides that if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer are not separate and distinct.

.09 *Penalties.* Any otherwise applicable penalty for the failure of a taxpayer to change its method of accounting (for example, the accuracy-related penalty under § 6662 or the fraud penalty under § 6663) may be imposed if the taxpayer does not timely file a request to change a method of accounting. *See* § 446(f). Additionally, the taxpayer's return preparer may also be subject to the preparer penalty under § 6694. However, penalties will not be imposed when a taxpayer changes from an impermissible method of accounting to a permissible one by complying with all applicable provisions of this revenue procedure.

.10 *Change made as part of an examination.* Sections 446(b) and 1.446–1(b)(1) provide that if a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the computation of taxable income must be made in a manner that, in the opinion of the Commissioner, does clearly reflect income. If a taxpayer under examination is not eligible to change a method of accounting under this revenue procedure, the change may be made by the district director. A change resulting in a positive § 481(a) adjustment will ordinarily be made in the earliest taxable year under examination with a one-year § 481(a) adjustment period.

.11 *Significant changes.* Significant changes to Rev. Proc. 98–60 include:

(1) The term "district director" is now defined in new section 3.11 to include the district director or other appropriate examining office or official. This change was made to accommodate anticipated future changes in the organizational structure of the Internal Revenue Service.

(2) Section 4.02 is modified by the addition of section 4.02(8), which provides that this revenue procedure does not apply if the taxpayer would be required to accelerate the § 481(a) adjustment in the year of change. This scope limitation does not apply to changes of accounting method under sections 2.01 and 2.02 of the APPENDIX of this revenue procedure.

(3) The additional statement required by section 6.02(5) of Rev. Proc. 98–60 has been discontinued. Elimination of this statement does not otherwise change the responsibility of a taxpayer seeking automatic consent to comply with all the applicable provisions of this revenue procedure. See sections 5.01, 6.01, 6.06 and 10.04(1) of this revenue procedure.

(4) Section 6.03(4) clarifies that the office conducting the examination gives consent to the filing of the application, rather than to the change itself. This is consistent with the current authority of such office, upon examination, to deny the change if the taxpayer fails to comply with all the applicable provisions of this revenue procedure. *See* section 6.06 of this revenue procedure.

(5) Sections 2.01 and 2.02 of the APPENDIX are modified to include certain changes in method of accounting for depreciation or amortization for purposes of computing alternative minimum taxable income and adjusted current earnings under § 56.

(6) Section 5.01 of the APPENDIX is modified to permit a taxpayer required to use an inventory method of accounting to change to an overall accrual method, provided the taxpayer uses a proper inventory method and either is a small reseller or is eligible to use the simplified resale method;

(7) Section 5.01 of the APPENDIX is modified to provide that the change does not apply to a taxpayer with two or more trades or businesses, unless the taxpayer uses or adopts the same overall accrual method for each such trade or business.

(8) Section 8.04 of the APPENDIX is modified to include changes in the method of accounting for state unemployment taxes and railroad retirement taxes.

(9) The following changes in methods of accounting have been added to the

APPENDIX of this revenue procedure:

(a) Section 1A.01 of the APPENDIX regarding the revocation of a § 171(c) election;

(b) Section 4A.01 of the APPENDIX regarding deferred compensation;

(c) Section 5A.01 of the APPENDIX regarding accrual of interest on nonperforming loans;

(d) Sections 8A.01, 8A.02, and 8A.03 of the APPENDIX regarding § 467 rental agreements;

(e) Section 10A.02 regarding elections to use the mark-to-market method of accounting under § 475(e) or (f).

(f) Section 12A.01 of the APPENDIX regarding the revocation of a § 1278(b) election.

SECTION 3. DEFINITIONS

.01 *Application.* The term "application" includes a Form 3115, or any statement that is authorized under the APPENDIX of this revenue procedure to be filed in lieu of a Form 3115, and any attachments.

.02 *Taxpayer.*

(1) *In general.* The term "taxpayer" has the same meaning as the term "person" defined in § 7701(a)(1) (rather than the meaning of the term "taxpayer" defined in § 7701(a)(14)).

(2) *Consolidated group.* For purposes of (a) sections 3.08(1), 3.09(1), and 4.02(1) of this revenue procedure (taxpayer under examination), (b) sections 3.09(2) and 4.02(2) of this revenue procedure (taxpayer before an appeals office), or (c) sections 3.09(3) and 4.02(3) of this revenue procedure (taxpayer before a federal court), the term "taxpayer" includes a consolidated group.

.03 *Filed.* Any form (including an application), statement, or other document required to be filed under this revenue procedure is filed on the date it is mailed to the proper address (or an address similar enough to complete delivery). If the form, statement, or other document is not mailed (or the date it is mailed cannot be reasonably determined), it is filed on the date it is delivered to the Service.

.04 *Mailed.* The date of mailing will be determined under the rules of § 7502. For example, the date of mailing is the date of the U.S. postmark or the applicable date recorded or marked by a designated private delivery service. *See* Notice 99–41, 1999–35 I.R.B. 325.

.05 *Timely performance of acts.* The rules of § 7503 apply when the last day for the taxpayer's timely performance of any act (for example, filing an application or submitting additional information) falls on a Saturday, Sunday, or legal holiday. The performance of any act is timely if the act is performed on the next succeeding day that is not a Saturday, Sunday, or legal holiday.

.06 *Year of change.* The year of change is the taxable year for which a change in method of accounting is effective, that is, the first taxable year the new method is to be used, even if no affected items are taken into account for that year.

.07 *Section 481(a) adjustment period.* The § 481(a) adjustment period is the applicable number of taxable years for taking into account the § 481(a) adjustment required as a result of the change in method of accounting. The year of change is the first taxable year in the adjustment period and the § 481(a) adjustment is taken into account ratably over the number of taxable years in the adjustment period. The applicable adjustment periods are set forth in section 5.04 of this revenue procedure.

.08 *Under examination.*

(1) *In general.*

(a) Except as provided in section 3.08(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891 or 987) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by Appeals that the case has been referred by the examining agent(s) to Appeals, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to Appeals under the provisions of Rev. Proc. 96–9, 1996–1 C.B. 575.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by Appeals (or otherwise) that the case has been referred to the examining agent(s) for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA.* For an entity (including a limited liability company), treated as a partnership or an S corporation for federal income tax purposes, that is subject to the TEFRA unified audit and litigation provisions for partnerships and S corporations, an examination begins on the date of the notice of the beginning of an administrative proceeding sent to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in a case in which the Service accepts the partnership or S corporation return as filed, on the date of the "no adjustments" letter or the "no change" notice of final administrative adjustment sent to the TMP;

(b) in a fully agreed case, when all the partners, members, or shareholders execute a Form 870–P, 870-L, or 870-S; or

(c) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by Appeals that the case has been referred by the examining agent(s) to Appeals, the date the TMP (or a partner, member, or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires. But see section 4.02(5) of this revenue procedure for certain rules that preclude an entity from requesting a change in accounting method. Also note that S corporations are not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996. *See* Small Business Job Protection Act of 1996, Pub. L. No. 104–188, § 1317(a), 110 Stat. 1755, 1787 (1996).

.09 *Issue under consideration.*

(1) *Under examination.* A taxpayer's

method of accounting for an item is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the item as an issue under consideration. For example, a taxpayer's method of pooling under the dollar-value, last-in, first-out (LIFO) inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined, but it is not an issue under consideration as a result of an examination plan that merely identifies LIFO inventories as a matter to be examined. Similarly, a taxpayer's method of determining inventoriable costs under § 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs, but it is not an issue under consideration as a result of an IDR that requests documentation supporting the amount of cost of goods sold reported on the return. The question of whether a method of accounting is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 99–2, 1999–1 I.R.B. 73 (or any successor).

(2) *Before an appeals office.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years before an appeals office if the treatment of the item is included as an item of adjustment in the examination report referred to Appeals or is specifically identified in writing to the taxpayer by Appeals.

(3) *Before a federal court.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years before a federal court if the treatment of the item is included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the counsel for the government.

.10 *Change within the LIFO inventory method.* A change within the LIFO inventory method is a change from one LIFO inventory method or sub-method to another LIFO inventory method or sub-method. A change within the LIFO inventory method does not include a change in method of accounting that could be made by a taxpayer that does not use the LIFO inventory method (for example, a method governed by § 471 or 263A).

.11 *District director.* The term "district director" includes the district director or other appropriate examining office or official.

SECTION 4. SCOPE

.01 *Applicability.* This revenue procedure applies to a taxpayer requesting the Commissioner's consent to change to a method of accounting described in the APPENDIX of this revenue procedure. This revenue procedure is the exclusive procedure for a taxpayer within its scope to obtain the Commissioner's consent.

.02 *Inapplicability.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 4A.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), this revenue procedure does not apply in the following situations:

(1) *Under examination.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is under examination (as provided in section 3.08 of this revenue procedure), except as provided in sections 6.03(2) (90-day window), 6.03(3) (120-day window), and 6.03(4) (examination officials consent) of this revenue procedure;

(2) *Before an appeals office.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is before an appeals office with respect to any income tax issue and the method of accounting to be changed is an issue under consideration by the appeals office (as provided in section 3.09(2) of this revenue procedure);

(3) *Before a federal court.* If, on the date the taxpayer would otherwise file a copy of the application with the national office, the taxpayer is before a federal court with respect to any income tax issue and the method of accounting to be changed is an issue under consideration by the federal court (as provided in section 3.09(3) of this revenue procedure);

(4) *Consolidated group member.* A corporation that is (or was formerly) a member of a consolidated group is under examination, before an appeals office, or before a federal court (for purposes of sections 4.02(1), (2), and (3) of this revenue procedure) if the consolidated group is under examination, before an appeals office, or before a federal court for a taxable year(s) that the corporation was a member of the group;

(5) *Partnerships and S corporations.* For an entity (including a limited liability company) treated as a partnership or an S corporation for federal income tax purposes, if, on the date the entity would otherwise file a copy of the application with the national office, the entity's accounting method to be changed is an issue under consideration in an examination of a partner, member, or shareholder's federal income tax return or an issue under consideration by an appeals office or by a federal court with respect to a partner, member, or shareholder's federal income tax return;

(6) *Prior change.* If the taxpayer, within the last five taxable years (including the year of change), (a) has made a change in the same method of accounting (with or without obtaining the Commissioner's consent), or (b) has applied to change the same method of accounting without effecting the change (whether, for example, the application to change was withdrawn, not perfected, not granted, or denied);

(7) *Section 381(a) transaction.* If the taxpayer engages in a transaction to which § 381(a) applies within the proposed taxable year of change (determined without regard to any potential closing of the year under § 381(b)(1)); or

(8) *Final year of trade or business.* If the taxpayer would be required by section 5.04(3)(c) of this revenue procedure to take the entire amount of the § 481(a) adjustment into account in computing taxable income for the year of change.

.03 *Nonautomatic changes.* If a taxpayer is precluded by other than sections 4.02(1) through 4.02(5) of this revenue procedure from using this revenue procedure to make a change in method of accounting, the taxpayer requesting such a

change must file a Form 3115 with the Commissioner in accordance with the requirements of § 1.446–1(e)(3)(i) and Rev. Proc. 97–27, 1997–1 C.B. 680 (or any other applicable Code, regulation, or administrative provision).

SECTION 5. TERMS AND CONDITIONS OF CHANGE

.01 *In general.* An accounting method change filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Year of change.* The year of change is the taxable year designated on the application and for which the application is timely filed under section 6.02(2).

.03 *Section 481(a) adjustment.* Unless otherwise provided in this revenue procedure, a taxpayer making a change in method of accounting under this revenue procedure must take into account a § 481(a) adjustment in the manner provided in section 5.04 of this revenue procedure.

.04 *Section 481(a) adjustment period.*

(1) *In general.* Except as otherwise provided in section 5.04(3) or the APPENDIX of this revenue procedure, the § 481(a) adjustment period for positive and negative § 481(a) adjustments is four taxable years.

(2) *Short period as a separate taxable year.* If the year of change, or any taxable year during the § 481(a) adjustment period, is a short taxable year, the § 481(a) adjustment must be included in income as if that short taxable year were a full 12-month taxable year. *See* Rev. Rul. 78–165, 1978–1 C.B. 276.

Example 1. A calendar year taxpayer received permission to change an accounting method beginning with the 1999 calendar year. The § 481(a) adjustment is $30,000 and the adjustment period is four taxable years. The taxpayer subsequently receives permission to change its annual accounting period to September 30, effective for the taxable year ending September 30, 2000. The taxpayer must include $7,500 of the § 481(a) adjustment in gross income for the short period from January 1, 2000, through September 30, 2000.

Example 2. Corporation *X*, a calendar year taxpayer, received permission to change an accounting method beginning with the 1999 calendar year. The § 481(a) adjustment is $30,000 and the adjustment period is four taxable years. On July 1, 2001, Corporation *Z* acquires Corporation *X* in a transaction to which § 381(a) applies. Corporation *Z* is a calendar year taxpayer that uses the same method of accounting to which Corporation *X* changed in 1999. Corporation *X* must include $7,500 of the § 481(a) adjustment in gross income for its short period income tax return for January 1, 2001, through June 30, 2001. In addition, Corporation *Z* must include $7,500 of the § 481(a) adjustment in gross income in its income tax return for calendar year 2001.

(3) *Shortened or accelerated adjustment periods.* The § 481(a) adjustment period provided in section 5.04(1) or the APPENDIX of this revenue procedure will be shortened or accelerated in the following situations.

(a) *De minimis rule.* A taxpayer may elect to use a one-year adjustment period in lieu of the § 481(a) adjustment period otherwise provided by this revenue procedure if the entire § 481(a) adjustment is less than $25,000 (either positive or negative). A taxpayer makes an election under this *de minimis* rule by so indicating on the application. For example, for a taxpayer filing a Form 3115, the taxpayer must complete the appropriate line on the Form 3115 to elect this *de minimis* rule.

(b) *Cooperatives.* A cooperative within the meaning of § 1381(a) generally must take the entire amount of a § 481(a) adjustment into account in computing taxable income for the year of change. *See* Rev. Rul. 79–45, 1979–1 C.B. 284.

(c) *Ceasing to engage in the trade or business.*

(i) *In general.* A taxpayer that ceases to engage in a trade or business or terminates its existence must take the remaining balance of any § 481(a) adjustment relating to the trade or business into account in computing taxable income in the taxable year of the cessation or termination. Except as provided in sections 5.04(3)(c)(iv) and (v) of this revenue procedure, a taxpayer is treated as ceasing to engage in a trade or business if the operations of the trade or business cease or substantially all the assets of the trade or business are transferred to another taxpayer. For this purpose, "substantially all" has the same meaning as in section 3.01 of Rev. Proc. 77–37, 1977–2 C.B. 568.

(ii) *Examples of transactions that are treated as the cessation of a trade or business.* The following is a nonexclusive list of transactions that are treated as the cessation of a trade or business for purposes of accelerating the § 481(a) adjustment under section 5.04(3)(c) of this revenue procedure:

(A) the trade or business to which the § 481(a) adjustment relates is incorporated;

(B) the trade or business to which the § 481(a) adjustment relates is purchased by another taxpayer in a transaction to which § 1060 applies;

(C) the trade or business to which the § 481(a) adjustment relates is terminated or transferred pursuant to a taxable liquidation;

(D) a division of a corporation ceases to operate the trade or business to which the § 481(a) adjustment relates; or

(E) the assets of a trade or business to which the § 481(a) adjustment relates are contributed to a partnership.

(iii) *Conversion to or from S corporation status.* Except as provided in section 10.01 of the APPENDIX of this revenue procedure, no acceleration of a § 481(a) adjustment is required under section 5.04(3)(c) of this revenue procedure when a C corporation elects to be treated as an S corporation or an S corporation terminates its S election and is then treated as a C corporation.

(iv) *Certain transfers to which § 381(a) applies.* No acceleration of the § 481(a) adjustment is required under section 5.04(3)(c) of this revenue procedure when a taxpayer transfers substantially all the assets of the trade or business that gave rise to the § 481(a) adjustment to another taxpayer in a transfer to which § 381(a) applies and the accounting method (the change to which gave rise to the § 481(a) adjustment) is a tax attribute that is carried over and used by the acquiring corporation immediately after the transfer pursuant to § 381(c). The acquiring corporation is subject to any terms and conditions imposed on the transferor (or any predecessor of the transferor) as a result of its change in method of accounting.

(v) *Certain transfers pursuant to § 351 within a consolidated group.*

(A) *In general.* No acceleration of the § 481(a) adjustment is required under section 5.04(3)(c) of this revenue procedure when one member of an affiliated group filing a consolidated return transfers substantially all the assets of the trade or business that gave rise to the § 481(a) adjustment to another member of the same consolidated group in an exchange quali-

fying under § 351 and the transferee member adopts and uses the same method of accounting (the change to which gave rise to the § 481(a) adjustment) used by the transferor member. The transferor member must continue to take the § 481(a) adjustment into account pursuant to the terms and conditions set forth in this revenue procedure. The transferor member must take into account activities of the transferee member (or any successor) in determining whether acceleration of the § 481(a) adjustment is required. For example, except as provided in the following sentence, the transferor member must take any remaining § 481(a) adjustment into account in computing taxable income in the taxable year in which the transferee member ceases to engage in the trade or business to which the § 481(a) adjustment relates. The § 481(a) adjustment is not accelerated when the transferee member engages in a transaction described in section 5.04(3)(c)(iv) or 5.04(3)(c)(v)(A) of this revenue procedure.

(B) *Exception.* The provisions of section 5.04(3)(c)(v)(A) of this revenue procedure cease to apply and the transferor member must take any remaining balance of the § 481(a) adjustment into account in the taxable year immediately preceding any of the following: (1) the taxable year the transferor member ceases to be a member of the group; (2) the taxable year any transferee member owning substantially all the assets of the trade or business which gave rise to the § 481(a) adjustment ceases to be a member of the group; or (3) a separate return year of the common parent of the group. In applying the preceding sentence, the rules of paragraphs (j)(2), (j)(5), and (j)(6) of § 1.1502–13 apply, but only if the method of accounting to which the transferor member changed and to which the § 481(a) adjustment relates is adopted, carried over, or used by any transferee member acquiring the assets of the trade or business that gave rise to the § 481(a) adjustment immediately after acquisition of such assets. For example, the transferor member is not required to accelerate the § 481(a) adjustment if a transferee member ceases to be a member of a consolidated group by reason of an acquisition to which § 381(a) applies and the acquiring corporation (1) is a member of the same group as the transferor member, and (2) continues, under § 381(c)(4) and the regulations thereunder, to use the same method of accounting as that used by the transferor member with respect to the assets of the trade or business to which the § 481(a) adjustment relates.

.05 *NOL carryback limitation for taxpayer subject to criminal investigation.* Generally, no portion of any net operating loss that is attributable to a negative § 481(a) adjustment may be carried back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation or proceeding concerning (1) directly or indirectly, any issue relating to the taxpayer's federal tax liability, or (2) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability.

.06 *Change treated as initiated by the taxpayer.* For purposes of § 481, a change in method of accounting made under this revenue procedure is a change in method of accounting initiated by the taxpayer.

SECTION 6. GENERAL APPLICATION PROCEDURES

.01 *Consent.* Pursuant to § 1.446–1(e)(2)(i), the consent of the Commissioner is hereby granted to any taxpayer within the scope of this revenue procedure to change a method of accounting, provided the taxpayer complies with all the applicable provisions of this revenue procedure.

.02 *Filing requirements.*

(1) *Waiver of taxable year filing requirement.* The requirement under § 1.446–1(e)(3)(i) to file a Form 3115 within the taxable year for which the change is requested is waived for any application for a change in method of accounting filed pursuant to this revenue procedure. *See* § 1.446–1(e)(3)(ii).

(2) *Timely duplicate filing requirement.*

(a) *In general.* A taxpayer changing a method of accounting pursuant to this revenue procedure must complete and file an application in duplicate. The original must be attached to the taxpayer's timely filed (including extensions) original federal income tax return for the year of change, and a copy (with signature) of the application must be filed with the national office (see section 6.02(6) of this revenue procedure for the address) no earlier than the first day of the year of change and no later than when the original is filed with the federal income tax return for the year of change.

(b) *Limited relief for late application.*

(i) *Automatic extension.* An automatic extension of 6 months from the due date of the return for the year of change (excluding extensions) is granted to file an application, provided the taxpayer (A) timely filed (including extensions) its federal income tax return for the year of change, (B) files an amended return within the 6-month extension period in a manner that is consistent with the new method of accounting, (C) attaches the original application to the amended return, (D) files a copy of the application with the national office no later than when the original is filed with the amended return, and (E) writes at the top of the application "FILED PURSUANT TO § 301.9100–2."

(ii) *Other extensions.* A taxpayer that fails to file the application for the year of change as provided in section 6.02(2)(a) or 6.02(2)(b)(i) of this revenue procedure will not be granted an extension of time to file under § 301.9100 of the Procedure and Administration Regulations, except in unusual and compelling circumstances. *See* § 301.9100–3(c)(2).

(3) *Label.*

(a) In order to assist in processing an application under this revenue procedure, the section of the APPENDIX of this revenue procedure describing the specific change in method of accounting should be included in the application. For example, a phrase such as "Section 1.01 of the APPENDIX of Rev. Proc. 99–49" should be included on the appropriate line on the Form 3115.

(b) If a taxpayer is authorized under the APPENDIX of this revenue procedure to file a statement in lieu of a Form 3115, the taxpayer must include the taxpayer's name and employer identification number (or social security number in the case of an individual) at the top of the first page of the statement underneath any other required label.

(4) *Signature requirements.* The application must be signed by, or on behalf of, the taxpayer requesting the change by an individual with authority to bind the taxpayer in such matters. For example, an

officer must sign on behalf of a corporation, a general partner on behalf of a state law partnership, a member-manager on behalf of a limited liability company, a trustee on behalf of a trust, or an individual taxpayer on behalf of a sole proprietorship. If the taxpayer is a member of a consolidated group, an application submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See the signature requirements set forth in the General Instructions attached to a current Form 3115 regarding those who are to sign. If an agent is authorized to represent the taxpayer before the Service, receive the original or a copy of the correspondence concerning the application, or perform any other act(s) regarding the application filed on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. A taxpayer's representative without a power of attorney to represent the taxpayer as indicated in this section will not be given any information regarding the application.

(5) *Where to file copy.*

(a) For a taxpayer other than an exempt organization, the copy of the application must be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), P.O. Box 7604, Benjamin Franklin Station, Washington, D.C. 20044 (or, in the case of a designated private delivery service: Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), 1111 Constitution Avenue, NW, Washington, D.C. 20224).

(b) For an exempt organization, the copy of the application must be addressed to the Commissioner, Tax Exempt and Government Entities, Attention: TEGE:EO, P.O. Box 120, Benjamin Franklin Station, Washington, D.C. 20044 (or, in the case of a designated private delivery service: Commissioner, Tax Exempt and Government Entities, Attention: TEGE:EO, 1111 Constitution Avenue, NW, Washington, D.C. 20224).

(c) The copy of the application may also be hand delivered:

(i) To the drop box at the 12th Street entrance of 1111 Constitution Avenue, NW, Washington, D.C. No receipt will be given at the drop box. For a taxpayer other than an exempt organization, the copy of the application must be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), 1111 Constitution Avenue, NW, Washington, D.C. 20224. For an exempt organization, the copy of the application must be addressed to the Commissioner, Tax Exempt and Government Entities, Attention: TEGE:EO, 1111 Constitution Avenue, NW, Washington, D.C. 20224; or

(ii) Between the hours of 8:15 a.m. and 5:00 p.m., to the courier's desk at the main entrance of 1111 Constitution Avenue, NW, Washington, D.C. A receipt will be given at the courier's desk. For a taxpayer other than an exempt organization, the copy of the application must be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A (Automatic Rulings Branch), 1111 Constitution Avenue, NW, Washington, D.C. 20224. For an exempt organization, the copy of the application must be addressed to the Commissioner, Tax Exempt and Government Entities, Attention: TEGE:EO, 1111 Constitution Avenue, NW, Washington, D.C. 20224

(6) *No user fee.* A user fee is not required for an application filed under this revenue procedure, and, except as provided in section 6.02(6)(c)(ii) of this revenue procedure, the receipt of an application filed under this revenue procedure will not be acknowledged.

(7) *Single application for certain consolidated groups.* A parent corporation may file a single application to change an identical method of accounting on behalf of more than one member of a consolidated group. To qualify, the taxpayers in the consolidated group must be members of the same affiliated group under § 1504(a) that join in the filing of a consolidated tax return, and they must be changing from the identical present method of accounting to the identical proposed method of accounting. All aspects of the change in method of accounting, including the present and proposed methods, the underlying facts, and the authority for the change, must be identical, except for the § 481(a) adjustment. *See* section 15.07(3) of Rev. Proc. 99– 1, 1999–1 I.R.B. 6, 53 (or any successor), for the information required to be submitted with the application.

.03 *Taxpayer under examination.*

(1) *In general.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 4A.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), a taxpayer that is under examination may file an application to change a method of accounting under section 6 of this revenue procedure only if the taxpayer is within the provisions of section 6.03(2) (90-day window), 6.03(3) (120-day window), or 6.03(4) (district director consent) of this revenue procedure. A taxpayer that files an application beyond the time periods provided in the 90-day and 120-day windows is not eligible for the automatic extension of time and will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances.

(2) *90-day window period.*

(a) A taxpayer may file a copy of the application with the national office to change a method of accounting under this revenue procedure during the first 90-days of any taxable year (the "90-day window") if the taxpayer has been under examination for at least 12 consecutive months as of the first day of the taxable year. This 90-day window is not available if the method of accounting the taxpayer is changing is an issue under consideration at the time the copy of the application is filed or an issue the examining agent(s) has placed in suspense at the time the copy of the application is filed.

(b) A taxpayer changing a method of accounting under this 90-day window must provide a copy of the application to the examining agent(s) at the same time it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s). The taxpayer must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration or an issue placed in suspense by the examining agent(s).

(3) *120-day window period.*

(a) A taxpayer may file a copy of the application with the national office to change a method of accounting under this revenue procedure during the 120-day pe-

riod following the date an examination ends (the "120-day window"), regardless of whether a subsequent examination has commenced. This 120-day window is not available if the method of accounting the taxpayer is changing is an issue under consideration at the time a copy of the application is filed or an issue the examining agent(s) has placed in suspense at the time the copy of the application is filed.

(b) A taxpayer changing a method of accounting under this 120-day window must provide a copy of the application to the examining agent(s) for any examination that is in process at the same time it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s). The taxpayer must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration or an issue placed in suspense by the examining agent(s).

(4) *Consent of district director.*

(a) A taxpayer under examination may change its method of accounting under this revenue procedure if the district director consents to the filing of the application. The district director will consent to the filing of the application unless, in the opinion of the district director, the method of accounting to be changed would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the district director will consent to the filing of an application to change from a clearly permissible method of accounting, or from an impermissible method of accounting where the impermissible method was adopted subsequent to the years under examination. The question of whether the method of accounting from which the taxpayer is changing is permissible or was adopted subsequent to the years under examination may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 99–2 (or any successor).

(b) A taxpayer changing a method of accounting under this revenue procedure with the consent of the district director must attach to the application a statement from the district director consenting to the filing of the application. The taxpayer must provide a copy of the application to the district director at the same time it files a copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s).

.04 *Taxpayer before an appeals office.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 4A.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), a taxpayer that is before an appeals office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the appeals office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files a copy of the application with the national office. The application must contain the name and telephone number of the appeals officer.

.05 *Taxpayer before a federal court.* Except as otherwise provided in the APPENDIX of this revenue procedure (see, for example, sections 4.01, 4A.01, 5.04, 8.05, 9.02, 10A.01, 12.01, and 12.02 of the APPENDIX of this revenue procedure), a taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the counsel for the government at the same time it files a copy of the application with the national office. The application must contain the name and telephone number of the counsel for the government.

.06 *Compliance with provisions.* If a taxpayer to which this revenue procedure applies changes to a method of accounting without complying with all the applicable provisions of this revenue procedure (for example, the taxpayer changes to a method of accounting that varies from the applicable accounting method described in this revenue procedure or the taxpayer is outside the scope of this revenue procedure), the taxpayer has initiated a change in method of accounting without obtaining the consent of the Commissioner as required by § 446(e). Upon examination, a taxpayer that has initiated an unauthorized change in method of accounting may be denied the change. Alternatively, such a taxpayer may be required to effect the change in an earlier or later taxable year and may be denied the benefit of spreading the § 481(a) adjustment over the number of taxable years otherwise prescribed by this revenue procedure.

SECTION 7. AUDIT PROTECTION FOR TAXABLE YEARS PRIOR TO YEAR OF CHANGE

.01 *In general.* Except as provided in section 7.02 or the APPENDIX of this revenue procedure, when a taxpayer timely files a copy of the application with the national office in compliance with all the applicable provisions of this revenue procedure, the Service will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change.

.02 *Exceptions.*

(1) *Change not made or made improperly.* The Service may change a taxpayer's method of accounting for prior taxable years if (a) the taxpayer fails to implement the change, (b) the taxpayer implements the change but does not comply with all the applicable provisions of this revenue procedure, or (c) the method of accounting is changed or modified because there has been a misstatement or omission of material facts (*see* section 8.02(2) of this revenue procedure).

(2) *Change in sub-method.* The Service may change a taxpayer's method of accounting for prior taxable years if the taxpayer is changing a sub-method of accounting within the method. For example, an examining agent may propose to terminate the taxpayer's use of the LIFO inventory method during a prior taxable year even though the taxpayer changes its method of valuing increments in the current year.

(3) *Prior year Service-initiated change.* The Service may make adjustments to the taxpayer's returns for the same item for taxable years prior to the requested year of change to reflect a prior year Service-initiated change.

(4) *Criminal investigation.* The Service may change a taxpayer's method of accounting for the same item for taxable years prior to the year of change if there is

any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability for any taxable year prior to the year of change, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability for any taxable year prior to the year of change.

SECTION 8. EFFECT OF CONSENT

.01 *In general.* A taxpayer that changes to a method of accounting pursuant to this revenue procedure may be required to change or modify that method of accounting for the following reasons:

(1) the enactment of legislation;

(2) a decision of the United States Supreme Court;

(3) the issuance of temporary or final regulations;

(4) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;

(5) the issuance of written notice to the taxpayer that the change in method of accounting was not in compliance with all the applicable provisions of this revenue procedure or is not in accord with the current views of the Service; or

(6) a change in the material facts on which the consent was based.

.02 *Retroactive change or modification.* Except in rare or unusual circumstances, if a taxpayer that changes its method of accounting under this revenue procedure is subsequently required under section 8.01 of this revenue procedure to change or modify that method of accounting, the required change or modification will not be applied retroactively, provided that:

(1) the taxpayer complied with all the applicable provisions of this revenue procedure;

(2) there has been no misstatement or omission of material facts;

(3) there has been no change in the material facts on which the consent was based;

(4) there has been no change in the applicable law; and

(5) the taxpayer to whom consent was granted acted in good faith in relying on the consent, and applying the change or modification retroactively would be to the taxpayer's detriment.

SECTION 9. REVIEW BY DISTRICT DIRECTOR

.01 *In general.* The district director must apply a change in method of accounting made in compliance with all the applicable provisions of this revenue procedure in determining the taxpayer's liability, unless the district director recommends that the change in method of accounting should be modified or revoked. (See section 6.06 of this revenue procedure if a change in method of accounting is made without complying with all the applicable provisions of this revenue procedure.) The district director will ascertain if the change in method of accounting was made in compliance with all the applicable provisions of this revenue procedure, including whether:

(1) the representations on which the change was based reflect an accurate statement of the material facts;

(2) the amount of the § 481(a) adjustment was properly determined;

(3) the change in method of accounting was implemented in compliance with all the applicable provisions of this revenue procedure.

The district director will also ascertain whether:

(4) there has been any change in the material facts on which the change was based during the period the method of accounting was used; and

(5) there has been any change in the applicable law during the period the method of accounting was used.

.02 *National office consideration.* If the district director recommends that a change in method of accounting (other than the § 481(a) adjustment) made in compliance with all the applicable provisions of this revenue procedure should be modified or revoked, the district director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 99–2 (or any successor) will be followed.

SECTION 10. REVIEW BY NATIONAL OFFICE

.01 *In general.* Any application filed under this revenue procedure may be reviewed by the national office. If the application is reviewed by the national office, the procedures in sections 10.02 through 10.04 of this revenue procedure apply.

.02 *Incomplete application — 30 day rule.* If the Service reviews an application and determines that the application is not properly completed in accordance with the instructions of the Form 3115 or the provisions of this revenue procedure, or if supplemental information is needed, the Service will notify the taxpayer. The notification will specify the information that needs to be provided, and the taxpayer will be permitted 30 days from the date of the notification to furnish the necessary information. The Service reserves the right to impose shorter reply periods if subsequent requests for additional information are made. An extension of the 30-day period to furnish information, not to exceed 30 days, may be granted to a taxpayer. A request for an extension of the 30-day period must be made in writing and submitted within the initial 30-day period. If the extension request is denied, there is no right of appeal. Ordinarily, if the taxpayer fails to provide the additional information on a timely basis, the application does not qualify for the automatic consent procedures of this revenue procedure.

.03 *Conference in the national office.* If the national office tentatively determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure (for example, the taxpayer changed to a method of accounting that varies from the applicable accounting method described in this revenue procedure or the taxpayer is outside the scope of this revenue procedure), the national office will notify the taxpayer of its tentative adverse determination and will offer the taxpayer a conference of right, if the taxpayer has requested a conference. For conference procedures for taxpayers other than exempt organizations, see section 11 of Rev. Proc. 99–1 (or any successor). For conference procedures for exempt organizations, see section 12 of Rev. Proc. 99–4, 1999–1 I.R.B. 115 (or any successor).

.04 *National office determination.*

(1) *Consent not granted.* Except as provided in section 10.04(2) of this revenue procedure, if the national office determines that a taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure, the national office will notify the taxpayer that consent to make the change in method of accounting is not granted. See section 6.06 of this revenue procedure.

(2) *Application changed.* If the national office determines that a taxpayer has changed its method of accounting without complying with all the applicable provisions of this revenue procedure, the national office, in its discretion, may allow the taxpayer (a) to make appropriate adjustments to conform its change in method of accounting to the applicable provisions of this revenue procedure, and (b) to make conforming amendments to any federal income tax returns filed for the year of change and subsequent taxable years. Any application changed under section 10.04(2) of this revenue procedure is subject to review by the district director as provided in section 9 of this revenue procedure.

SECTION 11. APPLICABILITY OF REV. PROCS. 99–1 AND 99–4

Rev. Procs. 99–1 and 99–4 (or any successors) are applicable to applications filed under this revenue procedure, unless specifically excluded or overridden by other published guidance (including the special procedures in this document).

SECTION 12. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, D.C. 20224.

SECTION 13. EFFECTIVE DATE

.01 *In general.* Except as provided in sections 13.02 and 13.03 of this revenue procedure, this revenue procedure is effective for taxable years ending on or after December 27, 1999. The Service will return any application that is filed on or after December 27, 1999 if the application is filed with the national office pursuant to the Code, regulations, or administrative guidance other than this revenue procedure and the change in method of accounting is within the scope of this revenue procedure.

.02 *Transition rules.* If a taxpayer filed an application or ruling request with the national office to make a change in method of accounting authorized by this revenue procedure, and the application or ruling request is pending with the national office on December 27, 1999, the taxpayer may make the change under this revenue procedure. However, the national office will process the application or ruling request in accordance with the authority under which it was filed, unless prior to the later of February 1, 2000, or the issuance of the letter ruling granting or denying consent to the change, the taxpayer notifies the national office that it wants to make the change under this revenue procedure. If the taxpayer timely notifies the national office that it wants to make the method change under this revenue procedure, the national office will require the taxpayer to make appropriate modifications to the application or ruling request to comply with the applicable provisions of this revenue procedure. In addition, any user fee that was submitted with the application or ruling request will be returned to the taxpayer.

.03 *Special rules.*

(1) *Change in method of accounting to comply with § 404(a)(11).* For a change in method of accounting described in section 4A.01 of the APPENDIX of this revenue procedure, this revenue procedure is effective for the taxpayer's first taxable year ending after July 22, 1998.

(2) *Changes in methods of accounting for § 467 rental agreements.* For changes in methods of accounting described in sections 8A.01, 8A.02, and 8A.03 of the APPENDIX of this revenue procedure, this revenue procedure is effective for applications filed after December 27, 1999 for the taxpayer's first taxable year ending after May 18, 1999.

(3) *Change in method of accounting to discontinue the mark-to-market method of accounting.* For a change in method of accounting described in section 10A.01 of the APPENDIX of this revenue procedure, this revenue procedure is effective for the taxpayer's first taxable year ending after July 22, 1998.

(4) *Change in method of accounting for a pool of debt instruments.* For a change in method of accounting described in section 12.02 of the APPENDIX of this revenue procedure, this revenue procedure is effective for the taxpayer's first taxable year beginning after August 5, 1997.

SECTION 14. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 98–60, is clarified, modified, amplified, and superseded.

.02 Section 7 of Rev. Proc. 92–67, 1992–2 C.B. 429, is modified and, as modified, is superseded. The remainder of Rev. Proc. 92–67 remains in effect as originally published.

.03 Section 6 of Rev. Proc. 99–17, 1999–7 I.R.B. 52, is superseded. The remainder of Rev. Proc. 99–17 remains in effect as originally published.

SECTION 15. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551.

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

The collections of information in this revenue procedure are in sections 6, 10, and sections 1A, 2, 3, 5, 6, 7, 10, 10A, 12, and 12A of the APPENDIX. This information is necessary and will be used to determine whether the taxpayer properly changed to a permitted method of accounting. The collections of information are required for the taxpayer to obtain consent to change its method of accounting. The likely respondents are the following: individuals, farms, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

The estimated total annual reporting and/or recordkeeping burden is 15,739 hours.

The estimated annual burden per respondent/recordkeeper varies from $^{1}/_{6}$

hour to $8^1/_2$ hours, depending on individual circumstances, with an estimated average of $1^1/_2$ hours. The estimated number of respondents is 13,650. The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Grant D. Anderson of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Anderson on (202) 622-4970 (not a toll-free call). For further information regarding the APPENDIX of this revenue procedure contact the following individuals: (1) for changes in methods of accounting under sections 1A.01 and 12A.01 of the APPENDIX of this revenue procedure, Christina Morrison of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3960 (not a toll-free call); (2) for changes in methods of accounting under sections 2.01 and 2.02 of the APPENDIX of this revenue procedure, Peter Friedman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) on (202) 622-3110 (not a toll-free call); (3) for changes in methods of accounting under section 2A.01 of the APPENDIX of this revenue procedure, Leslie H. Finlow of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) on (202) 622-3120 (not a toll free call);(4)for changes in methods of accounting under section 4A.01 of the APPENDIX of this revenue procedure, Norm Paul of the Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations); (5) for changes in methods of accounting under sections 5.04, 6, 12, and 13 of the APPENDIX of this revenue procedure, William Blanchard of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3950 (not a toll-free call); (6) for changes in methods of accounting under section 5A.01 of the APPENDIX of this revenue procedure, Timothy Sebastian of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3920 (not a toll-free call); (7) for changes in methods of accounting under section 10A.01 of the APPENDIX of this revenue procedure, Pamela Lew of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3950 (not a toll-free call); (8) for changes in methods of accounting under section 10A.02 of the APPENDIX of this revenue procedure, JoLynn Ricks of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3920 (not a toll-free call); (9) for changes in methods of accounting under section 11 of the APPENDIX of this revenue procedure, Craig R. Wojay of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622-3920 (not a toll-free call); and (10) for all other sections, Mr. Anderson on (202) 622-4970 (not a toll-free call).

APPENDIX
CHANGES IN METHODS OF ACCOUNTING TO WHICH THIS REVENUE PROCEDURE APPLIES

SECTION 1. TRADE OR BUSINESS EXPENSES (§ 162)

.01 *Advances made by a lawyer on behalf of clients — Description of change and scope.* This change applies to a lawyer handling cases on a contingent fee basis that advances money to pay for costs of litigation or for other expenses on behalf of clients and that wants to change the method of accounting for such advances from treating them as deductible business expenses to treating them as loans. *See Boccardo v. United States*, 12 Cl. Ct. 184 (1987); *Canelo v. Commissioner*, 53 T.C. 217 (1969), *aff'd per curiam*, 447 F.2d 484 (9th Cir. 1971).

.02 *Year 2000 costs — Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for Year 2000 costs (as defined in Rev. Proc. 97–50, 1997–2 C.B. 525) to conform to the method described in section 3 of Rev. Proc. 97–50. Section 3 of Rev. Proc. 97–50 provides that Year 2000 costs fall within the purview of Rev. Proc. 69–21, 1969–2 C.B. 303, and that the Service will not disturb a taxpayer's treatment of its Year 2000 costs as deductible expenses or capital expenditures if the taxpayer treats these costs in accordance with Rev. Proc. 69–21.

SECTION 1A. AMORTIZABLE BOND PREMIUM (§ 171)

.01 *Revocation of § 171(c) election.*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for amortizable bond premium by revoking its § 171(c) election. Under § 171(c), a taxpayer that holds certain taxable bonds may elect to amortize any bond premium on the bonds in accordance with regulations prescribed by the Secretary. Sections 1.171–1 through 1.171–5 provide rules relating to the amortization of bond premium by a taxpayer. Section 1.171–4 provides the procedures to make a § 171(c) election to amortize bond premium.

(2) *Revocation of election.* The revocation of a § 171(c) election applies to all taxable bonds that are held by the taxpayer on the first day of the first taxable year for which the revocation is effective (year of change), and to all taxable bonds that are subsequently acquired by the taxpayer.

(3) *Manner of making the change.* This change is made using a cut-off method and applies only to taxable bonds held during or after the year of change. Consequently, for taxable bonds held at the beginning of the year of change, the taxpayer may not amortize any remaining bond premium on the bonds. Because cut-off treatment is prescribed for this change, the basis of any bond, adjusted for amounts previously amortized during the period of the election, is not affected by the revocation.

(4) *Additional requirements.* On a statement attached to the application, the taxpayer must provide:

(a) the reason(s) for revoking the election; and

(b) a description of the method by which, and the date on which, the taxpayer made the § 171(c) election that is proposed to be revoked.

(5) *Audit protection.* A taxpayer receives audit protection under section 7 of

this revenue procedure in connection with this change. However, the audit protection applicable to this change does not preclude the Commissioner from examining the method used by the taxpayer to determine the amount of amortizable bond premium under § 171(b) for a taxable year prior to the year of change.

.02 *Reserved.*

SECTION 2. DEPRECIATION OR AMORTIZATION (§ 56(a)(1), 56(g)(4)(A), 167, 168, OR 197, OR FORMER § 168)

.01 *Impermissible to permissible method of accounting for depreciation or amortization.*

(1) *Description of change.*

(a) This change applies to a taxpayer that wants to change from an impermissible method of accounting for depreciation or amortization (depreciation) under which the taxpayer did not claim the depreciation allowable, to a permissible method of accounting for depreciation under which the taxpayer will claim the depreciation allowable.

(b) A change from a taxpayer's impermissible method of accounting for depreciation under which the taxpayer did not claim the depreciation allowable to a permissible method of accounting for depreciation under which the taxpayer will claim the depreciation allowable is a change in method of accounting for which the consent of the Commissioner is required. Sections 1.167(e)–1(a) and 1.446–1(e)(2)(ii)(b). This method change, however, does not include any correction of mathematical or posting errors. Section 1.446–1(e)(2)(ii)(b).

(2) *Scope.*

(a) *Applicability.* This change applies to any taxpayer that has used an impermissible method of accounting for depreciation in at least the two taxable years immediately preceding the year of change, and is changing that accounting method to a permissible method of accounting for depreciation, for any item of property:

(i) for which, under the taxpayer's impermissible method of accounting, the taxpayer has not taken into account any depreciation allowance or has taken into account some depreciation but less than or more than the depreciation allowable (claimed less than or more than the depreciation allowable);

(ii) for which depreciation is determined under-§ 56(a)(1), 56(g)(4)(A), 167, 168, 197, or 168 prior to its amendment in 1986 (former § 168); and

(iii) that is owned by the taxpayer at the beginning of the year of change.

(b) *Certain scope limitations inapplicable.* The scope limitations in section 4.02(8) of this revenue procedure are not applicable to this change.

(c) *Inapplicability.* This change does not apply to:

(i) any property to which § 1016(a)(3) (regarding property held by a tax-exempt organization) applies;

(ii) any taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 2.01 of this APPENDIX, if the taxpayer is not capitalizing the costs as required;

(iii) any intangible property subject to § 56(g)(4)(A) or 167, except for property subject to § 167(f) (regarding certain property excluded from § 197);

(iv) any property subject to § 167(g) (regarding property depreciated under the income forecast method);

(v) any § 1250 property that a taxpayer is reclassifying to an asset class of Rev. Proc. 87–56, 1987–2 C.B. 674, or Rev. Proc. 83–35, 1983–1 C.B. 745, as appropriate, that does not explicitly include § 1250 property (for example, asset class 57.0, Distributive Trades and Services);

(vi) any property for which a taxpayer is revoking a timely valid election, or making a late election, under § 167, 168, former § 168, or § 13261(g)(2) or (3) of the Revenue Reconciliation Act of 1993 (1993 Act), 1993–3 C.B. 1, 128 (relating to amortizable § 197 intangibles). A taxpayer may request consent to revoke or make the election by submitting a request for a letter ruling under Rev. Proc. 99–1, 1999–1 I.R.B. 6 (or any successor);

(vii) any property subject to § 56(g)(4)(A) or 167 (other than § 167(f), regarding certain property excluded from § 197), for which a taxpayer is changing only the estimated useful life of the property. A change in the estimated useful life of property for which depreciation is determined under § 56(g)(4)(A) or 167 (other than § 167(f)) must be made prospectively (*see*, for example, § 1.167(b)–2(c)). (In contrast, section 2.01 of this APPENDIX generally applies to a change in the recovery period of property for which depreciation is determined under § 56(a)(1), 56(g)(4)(A), 168 or former § 168);

(viii) any depreciable property that changes use but continues to be owned by the same taxpayer (*see*, for example, § 168(i)(5));

(ix) any property for which depreciation is determined in accordance with § 1.167(a)–11 (regarding the Class Life Asset Depreciation Range System (ADR));

(x) any change in method of accounting involving a change from deducting the cost or other basis of any property as an expense to capitalizing and depreciating the cost or other basis;

(xi) any change in method of accounting involving a change from one permissible method of accounting for the property to another permissible method of accounting for the property. For example:

(A) a change from the straight-line method of depreciation to the income forecast method of depreciation for videocassettes. *See* Rev. Rul. 89–62, 1989–1 C.B. 78; or

(B) a change from charging the depreciation reserve with costs of removal and crediting the depreciation reserve with salvage proceeds to deducting costs of removal as an expense (provided the costs of removal are not required to be capitalized under any provision of the Code, such as, § 263(a)) and including salvage proceeds in taxable income (see section 2.02 of this APPENDIX for making this change for property for which depreciation is determined under § 167);

(xii) any change in method of accounting involving both a change from treating the cost or other basis of the property as nondepreciable property to treating the cost or other basis of the property as depreciable property and the adoption of a method of accounting for depreciation requiring an election under § 167, 168, former § 168, or § 13261(g)(2) or (3) of the 1993 Act (for example, a change in the treatment of the space consumed in landfills placed in service in 1990 from

nondepreciable to depreciable property (assuming section 2.01(2)(c)(xiii) of the APPENDIX does not apply) and the making of an election under § 168(f)(1) to depreciate this property under the unit-of-production method of depreciation under § 167);

(xiii) any change in method of accounting for an item of income or deduction other than depreciation, even if a taxpayer's present method of accounting may have resulted in the taxpayer claiming less than or more than the depreciation allowable. For example, a change in method of accounting involving:

(A) a change in inventory costs (for example, when property is reclassified from inventory property to depreciable property, or vice versa) (but see section 3.02 of this APPENDIX for making a change from inventory property to depreciable property for unrecoverable line pack gas or unrecoverable cushion gas); or

(B) a change in the character of a transaction from sale to lease, or vice versa (but see section 2.03 of this APPENDIX for making this change); or

(xiv) a change from determining depreciation under § 168 to determining depreciation under former § 168 for any property subject to the transition rules in § 203(b) or 204(a) of the Tax Reform Act of 1986, 1986–3 (Vol. 1) C.B. 1, 60–80.

(3) *Additional requirements.* A taxpayer also must comply with the following:

(a) *Permissible depreciation method.* A taxpayer must change to a permissible method of accounting for depreciation for the item of property. This method is the same method that determines the depreciation allowable for the item of property (as provided in section 2.01(6) of this APPENDIX).

(b) *Statements required.* A taxpayer must provide the following statements, if applicable, and attach them to the completed application:

(i) a detailed description of the former and new methods of accounting. A general description of these methods of accounting is unacceptable (for example, MACRS to MACRS or erroneous method to proper method);

(ii) to the extent not provided elsewhere on the application, a statement describing the taxpayer's business or income-producing activities. Also, if the taxpayer has more than one business or income-producing activity, a statement describing the taxpayer's business or income-producing activity in which the item of property at issue is primarily used by the taxpayer;

(iii) to the extent not provided elsewhere on the application, a statement of the facts and law supporting the new method of accounting, new classification of the item of property, and new asset class in, as appropriate, Rev. Proc. 87–56 or Rev. Proc. 83–35. If the taxpayer is the owner and lessor of the item of property at issue, the statement of the facts and law supporting the new asset class also must describe the business or income-producing activity in which that item of property is primarily used by the lessee;

(iv) to the extent not provided elsewhere on the application, a statement identifying the year in which the item of property was placed in service;

(v) if the item of property is depreciated under former § 168, a statement identifying the asset class in Rev. Proc. 83–35 that applies under the taxpayer's former and new methods of accounting (if none, state and explain);

(vi) if any item of property is public utility property within the meaning of § 168(i)(10) or former § 167(l)(3)(A), as applicable, a statement providing that the taxpayer agrees to the following additional terms and conditions:

(A) a normalization method of accounting (within the meaning of former § 167(l)(3)(G), former § 168(e)(3)(B), or § 168(i)(9), as applicable) will be used for the public utility property subject to the application;

(B) as of the beginning of the year of change, the taxpayer will adjust its deferred tax reserve account or similar reserve account in the taxpayer's regulatory books of account by the amount of the deferral of federal income tax liability associated with the § 481(a) adjustment applicable to the public utility property subject to the application; and

(C) within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application;

(vii) if the taxpayer is changing the classification of an item of § 1250 property placed in service after August 19, 1996, to a retail motor fuels outlet under § 168(e)(3)(E)(iii), a statement containing the following representation: "For purposes of § 168(e)(3)(E)(iii) of the Internal Revenue Code, the taxpayer represents that (A) 50 percent or more of the gross revenue generated from the item of § 1250 property is from the sale of petroleum products (not including gross revenue from related services, such as the labor cost of oil changes and gross revenue from the sale of nonpetroleum products such as tires and oil filters), (B) 50 percent or more of the floor space in the item of property is devoted to the sale of petroleum products (not including floor space devoted to related services, such as oil changes and floor space devoted to nonpetroleum products such as tires and oil filters), or (C) the item of § 1250 property is 1,400 square feet or less."; and

(viii) if the taxpayer is changing the classification of an item of property from § 1250 property to § 1245 property under § 168 or former § 168, a statement of the facts and law supporting the new § 1245 property classification, and a statement containing the following representation: "Each item of property that is the subject of the application filed under section 2.01 of the APPENDIX of Rev. Proc. 99–49 for the year of change beginning *[Insert the date]*, and that is reclassified from *[Insert, as appropriate: nonresidential real property, residential rental property, 19-year real property, 18-year real property, or 15-year real property]* to an asset class of *[Insert, as appropriate, either: Rev. Proc. 87–56, 1987–2 C.B. 674, or Rev. Proc. 83–35, 1983–1 C.B. 745]* that does not explicitly include § 1250 property, is § 1245 property for depreciation purposes."

(4) *Section 481(a) adjustment.* Because the adjusted basis of the property is changed as a result of a method change made under section 2.01 of this APPENDIX (*see* section 2.01(5) of this APPENDIX), items are duplicated or omitted. Accordingly, this change is made with a § 481(a) adjustment. This adjustment may result in either a negative § 481(a) adjustment (a decrease in taxable income) or a positive § 481(a) adjustment (an increase

in taxable income) and may be a different amount for regular tax, alternative minimum tax, and adjusted current earnings purposes. This § 481(a) adjustment equals the difference between the total amount of depreciation taken into account in computing taxable income for the property under the taxpayer's former method of accounting, and the total amount of depreciation allowable for the property under the taxpayer's new method of accounting (as determined under section 2.01(6) of this APPENDIX), for open and closed years prior to the year of change. However, the amount of the § 481(a) adjustment must be adjusted to account for the proper amount of the depreciation allowable that is required to be capitalized under any provision of the Code (for example, § 263A) at the beginning of the year of change.

(5) *Basis adjustment.* As of the beginning of the year of change, the basis of depreciable property to which section 2.01 of this APPENDIX applies must reflect the reductions required by § 1016(a)(2) for the depreciation allowable for the property (as determined under section 2.01(6) of this APPENDIX).

(6) *Meaning of depreciation allowable.*

(a) *In general.* Section 2.01(6) of this APPENDIX provides the amount of the depreciation allowable, determined under § 56(a)(1), 56(g)(4)(A), 167, 168, 197, or former § 168. This amount, however, may be limited by other provisions of the Code (for example, § 280F).

(b) *Section 56(a)(1) property.* The depreciation allowable for any taxable year for property for which depreciation is determined under § 56(a)(1) is determined by using the depreciation method, recovery period, and convention provided for under § 56(a)(1) that applies for the property's placed-in-service date.

(c) *Section 56(g)(4)(A) property.* The depreciation allowable for any taxable year for property for which depreciation is determined under § 56(g)(4)(A) is determined by using the depreciation method, recovery period or useful life, as applicable, and convention provided for under § 56(g)(4)(A) that applies for the property's placed-in-service date.

(d) *Section 167 property.* Generally, for any taxable year, the depreciation allowable for property for which depreciation is determined under § 167, is determined either:

(i) under the depreciation method adopted by a taxpayer for the property; or

(ii) if that depreciation method does not result in a reasonable allowance for depreciation or a taxpayer has not adopted a depreciation method for the property, under the straight-line depreciation method.

For determining the estimated useful life and salvage value of the property, see §§ 1.167(a)–1(b) and (c), respectively. The depreciation allowable for any taxable year for property subject to § 167(f) (regarding certain property excluded from § 197) is determined by using the depreciation method and useful life prescribed in § 167(f).

(e) *Section 168 property.* The depreciation allowable for any taxable year for property for which depreciation is determined under § 168, is determined by using either:

(i) the general depreciation system in § 168(a); or

(ii) the alternative depreciation system in § 168(g) if the property is required to be depreciated under the alternative depreciation system pursuant to § 168(g)(1) or other provisions of the Code (for example, property described in § 263A(e)(2)(A) or 280F(b)(1)). Property required to be depreciated under the alternative depreciation system pursuant to § 168(g)(1) includes property in a class (as set out in § 168(e)) for which the taxpayer made a timely election under § 168(g)(7).

(f) *Section 197 property.* The depreciation allowable for any taxable year for an amortizable § 197 intangible (including any property for which a timely election under § 13261(g)(2) of the 1993 Act was made) is determined by using the straight-line method over a 15-year period.

(g) *Former § 168 property.* The depreciation allowable for any taxable year for property subject to former § 168 is determined by using either:

(i) the accelerated method of cost recovery applicable to the property (for example, for 5-year property, the recovery method under former § 168(b)(1)); or

(ii) the straight-line method applicable to the property if the property is required to be depreciated under the straight-line method (for example, property described in former § 168(f)(12) or former § 280F(b)(2)) or if the taxpayer elected to determine the depreciation allowance under the optional straight-line percentage (for example, the straight-line method in former § 168(b)(3)).

.02 *Permissible to permissible method of accounting for depreciation.*

(1) *Description of change.* This change applies to a taxpayer that wants to change from a permissible method of accounting for depreciation under § 56(g)(4)(A)(iv) or 167 to another permissible method of accounting for depreciation under § 56(g)(4)(A)(iv) or 167. Pursuant to §§ 1.167(a)–7(a) and (c), a taxpayer may account for depreciable property either by treating each individual asset as an account or by combining two or more assets in a single account and, for each account, depreciation allowances are computed separately.

(2) *Scope.*

(a) *Applicability.* This change applies to any taxpayer wanting to make a change in method of accounting for depreciation specified in section 2.02(3) of this APPENDIX for the property in an account:

(i) for which the present and proposed methods of accounting for depreciation specified in section 2.02(3) of this APPENDIX are permissible methods for the property under § 56(g)(4)(A) or 167; and

(ii) that is owned by the taxpayer at the beginning of the year of change.

(b) *Certain scope limitations inapplicable.* The scope limitations in section 4.02(8) of this revenue procedure are not applicable to this change.

(c) *Inapplicability.* This change does not apply to:

(i) any taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 2.02 of this APPENDIX, if the taxpayer is not capitalizing the costs as required;

(ii) any property to which § 1016(a)(3) (regarding property held by a tax-exempt organization) applies;

(iii) any intangible property;

(iv) any property described in § 167(f) (regarding certain property excluded from § 197);

(v) any property subject to § 167(g) (regarding property depreciated under the income forecast method);

(vi) any property for which depreciation is determined under § 56(a)(1), 56(g)(4)(A)(i), (ii), (iii), or (v), 168 or § 168 prior to its amendment in 1986 (former § 168);

(vii) any property that the taxpayer elected under § 168(f)(1) or former § 168(e)(2) to exclude from the application of, respectively, § 168 or former § 168;

(viii) any property for which depreciation is determined in accordance with § 1.167(a)–11 (regarding the Class Life Asset Depreciation Range System (ADR)); or

(ix) any depreciable property for which the taxpayer is changing the depreciation method pursuant to § 1.167(e)–1(b) (change from declining-balance method to straight-line method), § 1.167(e)–1(c) (certain changes for § 1245 property), or § 1.167(e)–1(d) (certain changes for § 1250 property). These changes must be made prospectively and are not permitted under the cited regulations for property for which the depreciation is determined under § 168 or former § 168.

(3) *Changes covered.* Section 2.02 of this APPENDIX only applies to the following changes in methods of accounting for depreciation:

(a) a change from the straight-line method to the sum-of-the-years-digits method, the sinking fund method, the unit-of-production method, or the declining-balance method using any proper percentage of the straight-line rate;

(b) a change from the declining-balance method using any percentage of the straight-line rate to the sum-of-the-years-digits method, the sinking fund method, or the declining-balance method using a different proper percentage of the straight-line rate;

(c) a change from the sum-of-the-years-digits method to the sinking fund method, the declining-balance method using any proper percentage of the straight-line rate, or the straight-line method;

(d) a change from the unit-of-production method to the straight-line method;

(e) a change from the sinking fund method to the straight-line method, the unit-of-production method, the sum-of-the-years-digits method, or the declining-balance method using any proper percentage of the straight-line rate;

(f) a change in the interest factor used in connection with a compound interest method or sinking fund method;

(g) a change in averaging convention as set forth in § 1.167(a)–10(b). However, as specifically provided in § 1.167(a)–10(b), in any taxable year in which an averaging convention substantially distorts the depreciation allowance for the taxable year, it may not be used (*see* Rev. Rul. 73–202, 1973–1 C.B. 81);

(h) a change from charging the depreciation reserve with costs of removal and crediting the depreciation reserve with salvage proceeds to deducting costs of removal as an expense and including salvage proceeds in taxable income as set forth in § 1.167(a)–8(e)(2). *See* Rev. Rul. 74–455, 1974–2 C.B. 63. This change, however, may be made under this revenue procedure only if:

(i) the change is applied to all items in the account for which the change is being made; and

(ii) the removal costs are not required to be capitalized under any provision of the Code (for example, § 263(a), 263A, or 280B);

(i) a change from crediting the depreciation reserve with the salvage proceeds realized on normal retirement sales to computing and recognizing gains and losses on such sales (see Rev. Rul. 70–165, 1970–1 C.B. 43);

(j) a change from crediting ordinary income (including the combination method of crediting the lesser of estimated salvage value or actual salvage proceeds to the depreciation reserve, with any excess of salvage proceeds over estimated salvage value credited to ordinary income) with the salvage proceeds realized on normal retirement sales, to computing and recognizing gains and losses on such sales (*see* Rev. Rul. 70–166, 1970–1 C.B. 44); or

(k) a change from item accounting for specific assets to multiple asset accounting for the same assets, or vice versa.

(4) *Additional requirements.* A taxpayer also must comply with the following:

(a) *Basis for depreciation.* At the beginning of the year of change, the basis for depreciation of property to which this change applies is the adjusted basis of the property as provided in § 1011 at the end of the taxable year immediately preceding the year of change (determined under the taxpayer's present method of accounting for depreciation). If applicable under the taxpayer's proposed method of accounting for depreciation, this adjusted basis is reduced by the estimated salvage value of the property (for example, a change to the straight-line method).

(b) *Rate of depreciation.* The rate of depreciation for property changed to:

(i) the straight-line or sum-of-the-years-digits method of depreciation must be based on the remaining useful life of the property as of the beginning of the year of change; or

(ii) the declining-balance method of depreciation must be based on the useful life of the property measured from the placed-in-service date, and not the expected remaining life from the date the change becomes effective.

(c) *Regulatory requirements.* For changes in method of depreciation to the sum-of-the-years-digits or declining-balance method, the property must meet the requirements of § 1.167(b)–0 or 1.167(c)–1, as appropriate.

(d) *Public utility property.* If any item of property is public utility property within the meaning of former § 167(l)(3)(A), the taxpayer must attach to the application a statement providing that the taxpayer agrees to the following additional terms and conditions:

(i) a normalization method of accounting within the meaning of former § 167(l)(3)(G) will be used for the public utility property subject to the application; and

(ii) within 30 calendar days of filing the federal income tax return for the year of change, the taxpayer will provide a copy of the completed application to any regulatory body having jurisdiction over the public utility property subject to the application.

(5) *Section 481(a) adjustment.* Because the adjusted basis of the property is not changed as a result of a method change made under section 2.02 of this APPENDIX, no items are being duplicated or omitted. Accordingly, the §

481(a) adjustment is zero.

.03 *Sale or lease transactions.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change its method of accounting from:

(i) improperly treating property as sold by the taxpayer to properly treating property as leased by the taxpayer;

(ii) improperly treating property as leased by the taxpayer to properly treating property as sold by the taxpayer;

(iii) improperly treating property as purchased by the taxpayer to properly treating property as leased by the taxpayer; and

(iv) improperly treating property as leased by the taxpayer to properly treating property as purchased by the taxpayer.

(b) *Inapplicability.* This change does not apply to:

(i) a rent-to-own dealer that wants to change its method of accounting for rent-to-own contracts described in section 3 of Rev. Proc. 95–38, 1995–2 C.B. 397; or

(ii) a taxpayer that holds assets for sale or lease, if any asset so held is not the subject of a sale or lease transaction as of the beginning of the year of change.

(2) *Manner of making the change.*

(a) The change in method of accounting under section 2.03 of this APPENDIX is made using a cut-off method and applies to transactions entered into on or after the beginning of the year of change. *See* section 2.06 of this revenue procedure.

(b) If a taxpayer wants to change its method of accounting for existing sale or lease transactions, the taxpayer must file an application with the Commissioner in accordance with the requirements of § 1.446–1(e)(3)(i) and Rev. Proc. 97–27. A change involving existing sale or lease transactions will require a § 481(a) adjustment. Consent to change a method of accounting for an existing sale or lease transaction is granted only in unusual and compelling circumstances.

(3) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

SECTION 2A. RESEARCH AND EXPERIMENTAL EXPENDITURES (§ 174)

.01 *Changes to a different method or different amortization period.*

(1) *Description of change.*

(a) This change applies to a taxpayer that wants to change the treatment of expenditures that qualify as research and experimental expenditures under § 174.

(b) Section 174 and the regulations thereunder provide the specific rules for changing a method of accounting under § 174 for research and experimental expenditures. Under § 174, a taxpayer may treat research and experimental expenditures that are paid or incurred by the taxpayer during the taxable year in connection with the taxpayer's trade or business as expenses under § 174(a) or as deferred expenses amortizable ratably over a period of not less than 60 months under § 174(b). Pursuant to § 1.174–1, research and experimental expenditures that are not treated as expenses or deferred expenses under § 174 must be treated as capital expenditures. Further, § 1.174–1 provides that the expenditures to which § 174 applies may relate either to a general research program or to a particular project.

(c) If a taxpayer has not treated research and experimental expenditures as expenses under § 174(a), §§ 174(a)(2)(B) and 1.174–3(b)(2) provide that the taxpayer may, with consent, adopt the expense method at any time.

(d) If a taxpayer has treated research and experimental expenditures as expenses under § 174(a), §§ 174(a)(3) and 1.174–3(b)(3) provide that the taxpayer may, with consent, change to a different method of treating research and experimental expenditures.

(e) If a taxpayer has treated research and experimental expenditures as deferred expenses under § 174(b), §§ 174(b)(2) and 1.174–4(b)(2) provide that the taxpayer may, with consent, change to a different method of treating research or experimental expenditures or to a different period of amortization for deferred expenses.

(2) *Scope.*

(a) *Applicability.* This change applies to any taxpayer that is changing:

(i) from treating research and experimental expenditures for a particular project or projects as expenses under § 174(a) to treating such expenditures as deferred expenses under § 174(b), or vice versa;

(ii) to a different period of amortization for research and experimental expenditures for a particular project or projects that are being treated as deferred expenses under § 174(b); or

(iii) from treating research and experimental expenditures for a particular project or projects as expenses under § 174(a) or deferred expenses under § 174(b) to treating such expenditures as a capital expenditure under § 263(a), or vice versa.

(b) *Scope limitations clarified.* The scope limitation under section 4.02(6) of this revenue procedure is applied on a project by project basis.

(c) *Inapplicability.* This change does not apply to:

(i) a portion of the research and experimental expenditures paid or incurred for a particular project during the year of change or in subsequent taxable years (that is, the change must apply to all of such expenditures; *see* §§ 1.174–3(a) and 1.174–4(a)(5));

(ii) a change in the treatment of computer software costs under Rev. Proc. 69–21, 1969–2 C.B. 303; or

(iii) a change in the treatment of Year 2000 costs under Rev. Proc. 97–50, 1997–2 C.B. 525 (but see section 1.02 of this APPENDIX for making this change).

(3) *Manner of making the change.*

(a) This change is made using a cut-off method and applies to all research and experimental expenditures paid or incurred for a particular project or projects during the year of change and in subsequent taxable years. *See* section 2.06 of this revenue procedure and §§ 174(b)(2), 1.174–3(a), 1.174–3(b)(2), and 1.174–4(a)(5).

(b) The requirement under §§ 1.174–3(b)(2), 1.174–3(b)(3), and 1.174–4(b)(2) to file an application no later than the end of the first taxable year in which the different method or different amortization period is to be used is waived for this change. However, see section 6 of this revenue procedure for filing requirements applicable under this revenue procedure.

(c) The consent granted under this revenue procedure satisfies the consent

required under §§ 174(a)(2)(B), 174(a)(3), 174(b)(2), 1.174–3(b)(2), 1.174–3(b)(3), and 1.174–4(b)(2).

(4) *Additional requirement.* A taxpayer must attach to the application a written statement providing:

(a) the information required in § 1.174–3(b)(2) if the taxpayer is changing to treating research and experimental expenditures as expenses under § 174(a);

(b) the information required in § 1.174–3(b)(3) if the taxpayer is changing from treating research and experimental expenditures as expenses under § 174(a); or

(c) the information required in § 1.174–4(b)(2) if the taxpayer is changing from treating research and experimental expenditures as deferred expenses method under § 174(b) or is changing to a different period of amortization for research and experimental expenditures being treated as deferred expenses under § 174(b).

(5) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

.02 *Reserved.*

SECTION 3. CAPITAL EXPENDITURES (§ 263)

.01 *Package design costs.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change its method of accounting for package design costs that are within the scope of Rev. Proc. 97–35, 1997–2 C.B. 448, to one of the three alternative methods of accounting for package design costs described in section 5 of Rev. Proc. 97–35. The three alternative methods of accounting for package design costs described are: (1) the capitalization method, (2) the design-by-design capitalization and 60-month amortization method, and (3) the pool-of-cost capitalization and 48-month amortization method.

(b) *Inapplicability.* This change does not apply to a taxpayer that wants to change to the capitalization method for costs of developing (or modifying) any package design that has an ascertainable useful life.

(2) *Additional requirements.* If a taxpayer is changing its method of accounting for package design costs to the capitalization method or the design-by-design capitalization and 60-month amortization method, the taxpayer must attach a statement to its timely filed application. The statement must provide a description of each package design, the date on which each was placed in service, and the cost basis of each (as determined under sections 5.01(2) or 5.02(2) of Rev. Proc. 97–35).

.02 *Line pack gas; cushion gas.*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for line pack gas or cushion gas to a method consistent with the holding in Rev. Rul. 97–54, 1997–2 C.B. 23. Rev. Rul. 97–54 holds that the cost of line pack gas or cushion gas is a capital expenditure under § 263, the cost of recoverable line pack gas or recoverable cushion gas is not depreciable, and the cost of unrecoverable line pack gas or unrecoverable cushion gas is depreciable under §§ 167 and 168.

(2) *Additional requirements.* A taxpayer that changes its method of accounting for unrecoverable line pack gas or unrecoverable cushion gas under section 3.02 of this APPENDIX must change to a permissible method of accounting for depreciation for the cost of that gas.

SECTION 4. UNIFORM CAPITALIZATION (§ 263A)

.01 *Certain uniform capitalization (UNICAP) methods used by small resellers, formerly small resellers, and reseller-producers.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to:

(i) a small reseller of personal property changing from a permissible UNICAP method to a permissible non-UNICAP inventory capitalization method in any taxable year that it qualifies as a small reseller;

(ii) a formerly small reseller changing from a permissible non-UNICAP inventory capitalization method to a permissible UNICAP method in the first taxable year that it does not qualify as a small reseller;

(iii) a reseller-producer changing from a permissible UNICAP method for both its production and resale activities to a permissible simplified resale method described in § 1.263A–3(d)(3) in any taxable year that it qualifies to use a simplified resale method for both its production and resale activities under § 1.263A–3(a)(4) (resellers with de minimis production activities); or

(iv) a reseller-producer changing from a permissible simplified resale method described in § 1.263A–3(d)(3) for both its production and resale activities to a permissible UNICAP method for both its production and resale activities in the first taxable year that it does not qualify to use a simplified resale method for both its production and resale activities under § 1.263A–3(a)(4).

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(c) *Inapplicability.* This change does not apply to a taxpayer making a historic absorption ratio election under § 1.263A–2(b)(4) or 1.263A–3(d)(4).

(2) *Definitions.*

(a) "Reseller" means a taxpayer that acquires real or personal property described in § 1221(1) for resale.

(b) "Small reseller" means a reseller whose average annual gross receipts for the three immediately preceding taxable years (or fewer, if the taxpayer has not been in existence during the three preceding taxable years) do not exceed $10,000,000. *See* § 263A(b)(2)(B).

(c) "Formerly small reseller" means a reseller that no longer qualifies as a small reseller.

(d) "Producer" means a taxpayer that produces real or tangible personal property.

(e) "Reseller-producer" means a taxpayer that is both a producer and a reseller.

(f) "Permissible UNICAP

method" means a method of capitalizing costs that is permissible under § 263A.

(g) "Permissible non-UNICAP inventory capitalization method" means a method of capitalizing inventory costs that is permissible under § 471.

(3) *Section 481(a) adjustment.* Beginning with the year of change, a taxpayer changing its method of accounting for costs pursuant to section 4.01 of this APPENDIX generally must take any applicable § 481(a) adjustment into account ratably over the same number of taxable years, not to exceed four, that the taxpayer used its former method of accounting. See section 5.04(3) of this revenue procedure for exceptions to this general rule.

(4) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

(5) *Example.* The following example illustrates the principles of section 4.01 of this APPENDIX for small resellers and formerly small resellers.

Assume X, a corporate reseller of personal property, incorporated January 2, 1991, adopted a taxable year ending December 31. X determines that its average annual gross receipts for the three taxable years (or fewer, if applicable) immediately preceding taxable years 1991 through 2000 are as shown in the table below:

Current Taxable Year	AVERAGE Annual Gross Current Receipts for the Three Taxable Years Immediately Preceding the Year
1991	$ 0
1992	5,000,000
1993	6,000,000
1994	7,000,000
1995	11,000,000
1996	11,000,000
1997	9,000,000
1998	8,000,000
1999	11,000,000
2000	12,000,000

Furthermore, X, which adopted the dollar-value LIFO inventory method, has the following LIFO inventory balances determined without considering the effects of the UNICAP method:

	Beginning	Ending
1995	$1,000,000	$1,100,000
1996	1,100,000	1,200,000
1997	1,200,000	1,300,000
1998	1,300,000	1,400,000
1999	1,400,000	1,500,000
2000	1,500,000	1,600,000

X was required by § 263A to change to the UNICAP method for 1995 because its average annual gross receipts for the three taxable years immediately preceding 1995 were $11,000,000, which exceeded the $10,000,000 ceiling permitted by the small reseller exception. Assume that X was required to capitalize $80,000 of "additional § 263A costs" to the cost of its 1995 beginning inventory because of this change in inventory method. In addition, X was required to include one-fourth of the § 481(a) adjustment when computing taxable income for each of the four taxable years beginning with 1995. Thus, X was required to include a $20,000 positive § 481(a) adjustment in its 1995 taxable income.

X elected to use the simplified resale method without a historic absorption ratio election under § 1.263A–3(d)(3) for determining the amount of additional § 263A costs to be capitalized to each LIFO layer. Assume that X was required to add $10,000 of additional § 263A costs to the cost of its 1995 ending inventory because of the $100,000 increment for 1995.

X's 1995 Ending Inventory:

Beginning Inventory (Without UNICAP costs)	$1,000,000
1995 Increment	100,000
Additional § 263A Costs in Beginning Inventory	80,000
Additional § 263A Costs in 1995 Increment	10,000
Total 1995 Ending Inventory	$1,190,000

X's Unamortized 1995 § 481(a) adjustment:

1995 § 481(a) Adjustment	$80,000
Amount Included in 1995 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/95	$60,000

Because X failed to satisfy the small reseller exception for 1996, X was required to continue using the UNICAP method for its inventory costs. Furthermore, X was required to include $20,000 of the unamortized 1995 positive § 481(a) adjustment in 1996 taxable income. Assume that X was required to add $10,000 of additional § 263A costs to the cost of its 1996 ending inventory because of the $100,000 increment for 1996.

X's 1996 Ending Inventory:

Beginning Inventory (With UNICAP costs)	$1,190,000
1996 Increment	100,000
Additional § 263A Costs in 1996 Increment	10,000
Total 1996 Ending Inventory	$1,300,000

X's Unamortized 1995 § 481(a) Adjustment:

Unamortized 1995 § 481(a) Adjustment—12/31/95	$60,000
Amount Included in 1996 Taxable Income	<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/96	$40,000

Because X satisfies the small reseller exception for 1997, X may change voluntarily from the UNICAP method to a permissible non-UNICAP inventory capitalization method under section 4.01 of this APPENDIX. To reflect the removal of the additional § 263A costs from the cost of its 1997 beginning inventory, X must compute a corresponding § 481(a) adjustment, which is a negative $100,000 ($1,200,000 - $1,300,000). Because X used the UNICAP method for only two years (that is, 1995 and 1996), X must include one-half of the § 481(a) adjustment when computing taxable income for each of the two taxable years beginning with 1997. Thus, X must include a $50,000 negative § 481(a) adjustment in 1997 taxable income. In addition, X must include $20,000 of the unamortized 1995 § 481(a) adjustment in 1997 taxable income.

X's 1997 Ending Inventory:

Beginning Inventory (With UNICAP costs)	$1,300,000
1997 Increment	100,000
1997 § 481(a) Adjustment <Negative>	<100,000>
Total 1997 Ending Inventory	$1,300,000

X's Unamortized 1995 § 481(a) Adjustment:

Unamortized 1995 § 481(a) Adjustment—12/31/96 ..... $40,000
Amount Included in 1997 Taxable Income .....<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/97 .....$20,000

X's Unamortized 1997 § 481(a) Adjustment:

1997 § 481(a) Adjustment <Negative> .....$<100,000>
Amount Included in 1997 Taxable Income 50,000
Unamortized 1997 § 481(a) Adjustment—12/31/97 ...$< 50,000>

X also satisfies the small reseller exception for 1998 and, therefore, is not required to return to the UNICAP method for 1998. X, however, must include $20,000 of the unamortized 1995 positive § 481(a) adjustment and $50,000 of the unamortized 1997 negative § 481(a) adjustment in 1998 taxable income.

X's 1998 Ending Inventory:

Beginning Inventory (Without UNICAP costs) $1,300,000
1998 Increment 100,000
Total 1998 Ending Inventory $1,400,000

X's Unamortized 1995 § 481(a) Adjustment:

Unamortized 1995 § 481(a) Adjustment—12/31/97 ..... $20,000
Amount Included in 1998 Taxable Income .....<20,000>
Unamortized 1995 § 481(a) Adjustment—12/31/98 .....$ 0

X's Unamortized 1997 § 481(a) Adjustment:

Unamortized 1997 § 481(a) Adjustment—12/31/97 .... $<50,000>
Amount Included in 1998 Taxable Income 50,000
Unamortized 1997 § 481(a) Adjustment—12/31/98 .....$ 0

In 1999, X fails to satisfy the small reseller exception and, therefore, must return to the UNICAP method as provided under section 4.01 of this APPENDIX. X changes to the simplified resale method without a historic absorption ratio election under § 1.263A-3(d)(3). Assume that X must capitalize $120,000 of additional § 263A costs to the cost of its 1999 beginning inventory because of this change in inventory method. In addition, X must determine the appropriate adjustment period for the corresponding positive § 481(a) adjustment. Because X used its former inventory method for two taxable years before 1999 (that is, 1997 and 1998), X must include one-half of the § 481(a) adjustment when computing taxable income for each of the two taxable years beginning with 1999. Thus, X must include a $60,000 positive § 481(a) adjustment in its 1999 taxable income. Assume that X must add $10,000 of additional § 263A costs to the cost of its 1999 ending inventory because of the $100,000 increment for 1999.

X's 1999 Ending Inventory:

Beginning Inventory (Without UNICAP costs) $1,400,000
1999 Increment 100,000
Additional § 263A costs in Beginning Inventory 120,000
Additional § 263A costs in 1999 Increment 10,000
Total 1999 Ending Inventory $1,630,000

X's Unamortized 1999 § 481(a) adjustment:

1999 § 481(a) Adjustment .. $120,000
Amount Included in 1999 Taxable Income .....< 60,000>
Unamortized 1999 § 481(a) Adjustment—12/31/99 .....$ 60,000

Because X fails to satisfy the small reseller exception for 2000, X must continue using the UNICAP method for its inventory costs. Furthermore, X is required to include $60,000 of the unamortized 1999 positive § 481(a) adjustment in 2000 taxable income. Assume that X is required to add $10,000 of additional § 263A costs to the cost of its 2000 ending inventory because of the $100,000 increment for 2000.

X's 2000 Ending Inventory:

Beginning Inventory (With UNICAP costs) $1,630,000
2000 Incremen 100,000
Additional § 263A Costs in 2000 Increment 10,000
Total 2000 Ending Inventory $1,740,000

X's Unamortized 1999 § 481(a) Adjustment:

Unamortized 1999 § 481(a) Adjustment—12/31/99 ..... $60,000
Amount Included in 2000 Taxable Income .....<60,000>
Unamortized 1999 § 481(a) Adjustment—12/31/00 .....$ 0

.02 *Reserved.*

SECTION 4A. DEFERRED COMPENSATION (§ 404)

.01 *Change to comply with § 404(a)(11).*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that must change its method of accounting for its first taxable year ending after July 22, 1998, to comply with § 404(a)(11). Section 404(a)(11) provides that, for purposes of determining under § 404 whether compensation of an employee is deferred compensation and when deferred compensation is paid, no amount is treated as received by the employee, or paid, until it is actually received by the employee. Section 404(a)(11) overturns the decision in *Schmidt Baking Co. v. Commissioner*, 107 T.C. 271 (1996), in which the court held that a § 83(a) income inclusion event upon securitization of vacation and severance pay benefits with a letter of credit constitutes receipt of those benefits by employees for purposes of determining whether an employer's deduction for the benefits is subject to § 404. *See* Notice 99-16, 1999-13 I.R.B. 10 (March 29, 1999).

(b) *Scope limitations inapplicable.* A taxpayer that must make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) *Section 481(a) adjustment period.* A taxpayer must take the § 481(a) adjustment into account ratably over three taxable years.

(3) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

.02 *Reserved.*

SECTION 5. METHODS OF ACCOUNTING (§ 446)

.01 *Cash or hybrid method to accrual method.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to:

(i) a taxpayer that wants to change to an overall accrual method, or to an overall accrual method in conjunction with the recurring item exception under § 461(h)(3), from the cash receipts and disbursements method (cash method), or from a hybrid method (the use of a combination of accounting methods under which an item or items of income or expense are reported on the cash method and another item or other items of income or expense are reported on an accrual method); or

(ii) a taxpayer that is required to change to an overall accrual method under § 448, but is ineligible to make the change under § 1.448–1(h)(2) (relating to the "first § 448 year").

(b) *Inapplicability.* This change does not apply to:

(i) a financial institution described in § 581 or 591;

(ii) a farmer;

(iii) a cooperative organization described in § 501(c)(12), 521, or 1381;

(iv) an individual taxpayer, except for activities conducted as a sole proprietorship;

(v) a taxpayer required to use an inventory method of accounting, unless:

(A) the taxpayer is using or adopts a proper inventory method under § 471 and the regulations thereunder, the taxpayer is a small reseller within the meaning of § 1.263A–3(a), and, if the taxpayer has production activities, the taxpayer's production activities qualify under the de minimis presumption of § 1.263A–3(a)(2)(iii); or

(B) the taxpayer is using or adopts a proper inventory method under § 471 and the regulations thereunder, the taxpayer is a reseller eligible to use the simplified resale method under § 1.263A–3(d), and the taxpayer adopts a proper method under that section for the year of change;

(vi) a taxpayer required to use a long-term contract method in accordance with § 460, if the taxpayer is not in compliance with that section and any related administrative guidance;

(vii) a taxpayer required or wanting to use a special method of accounting, unless the taxpayer is permitted to change automatically to the special method under this revenue procedure. A special method of accounting is a method that deviates from the normal tax accounting rules, such as the method of accounting for advance payments pursuant to either Rev. Proc. 71–21, 1971–2 C.B. 549, or § 1.451–5, the installment method of accounting under § 453, or a long-term contract method, such as the percentage of completion method or the completed contract method;

(viii) a taxpayer required to change to an overall accrual method under § 448 and eligible to make the change under § 1.448–1(h)(2). *See* § 1.448–1(h)(2), which provides an automatic consent procedure for a taxpayer changing for the first taxable year that it is subject to § 448. *See also* § 1.448–1(h)(1), which provides that § 1.448–1(h) does not apply to a change required under any Code section (or regulations thereunder) other than § 448 (for example, a taxpayer with inventories); or

(ix) a taxpayer engaged in two or more trades or businesses, unless the taxpayer uses or adopts the same overall accrual method for each such trade or business.

(2) *Section 481(a) adjustment.*

(a) *In general.* The § 481(a) adjustment takes into account the accounts receivable, accounts payable, inventory, and any other item determined to be necessary in order to prevent items from being duplicated or omitted. The § 481(a) adjustment does not include any item of income accrued but not received that was worthless or partially worthless (within the meaning of § 166(a)) on the last day of the year preceding the year of change.

(b) *Recurring item exception.* As part of the change to an overall accrual method, a taxpayer may adopt the recurring item exception for the year of change if the taxpayer is eligible and follows the procedures of § 1.461–5(d). If the taxpayer is eligible and wants to adopt this method as specified in § 461(h)(3), the amount of the § 481(a) adjustment must be modified to account for the amount of any additional deduction.

(3) *Change to a special method of accounting.* If a taxpayer that wants to change to an accrual method in conjunction with a change to a special method of accounting is not permitted to make the change under this revenue procedure, the taxpayer may request to make both changes only by filing one application under the provisions of Rev. Proc. 97–27, 1997–1 C.B. 680. Only one user fee will be required for these changes.

.02 *Multi-year service warranty contracts.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an eligible accrual method manufacturer, wholesaler, or retailer of motor vehicles or other durable consumer goods that wants to change to the service warranty income method described in section 5 of Rev. Proc. 97–38, 1997–2 C.B. 479. Under the service warranty income method, a qualifying taxpayer may, in certain specified and limited circumstances, include a portion of an advance payment related to the sale of a multi-year service warranty contract in gross income generally over the life of the service warranty obligation.

(b) *Inapplicability.* This change does not apply to a taxpayer outside the scope of Rev. Proc. 97–38.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method, under which the taxpayer begins the use of the service warranty income method for all qualified advance payment amounts received in the year of change and thereafter. *See* section 2.06 of this revenue procedure.

(b) In accordance with § 1.446–1(e)(3)(ii), the requirement of § 1.446–1(e)(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: "**CHANGE TO THE SERVICE WARRANTY IN-**

COME METHOD UNDER SECTION 5.02 OF THE APPENDIX OF REV. PROC. 99–49." The statement must set forth the information required under section 6.03 of Rev. Proc. 97–38, except that the statement under section 6.03(2) (that the taxpayer agrees to all of the terms and conditions of the revenue procedure) also should refer to Rev. Proc. 99–49.

(c) A taxpayer changing to the service warranty income method of accounting under section 5.02 of this APPENDIX must satisfy the annual reporting requirement set forth in section 6.04 of Rev. Proc. 97–38.

.03 *Multi-year insurance policies for multi-year service warranty contracts — Description of change and scope.*

(1) *Applicability.* This change applies to a manufacturer, wholesaler, or retailer of motor vehicles or other durable consumer goods that wants to change its method of accounting for insurance costs paid or incurred to insure its risks under multi-year service warranty contracts to the method described in section 5.03(3) of this APPENDIX. Multi-year service warranty contracts to which this change applies include only those separately priced contracts sold by a manufacturer, wholesaler, or retailer also selling the motor vehicles or other durable consumer goods (to the ultimate customer or to an intermediary) underlying the contracts. The classification of goods as "durable consumer goods" for purposes of this change depends on the common usage of the goods, rather than the purchaser's actual intended use of the goods.

(2) *Inapplicability.* This change does not apply to a taxpayer that covers its risks under its multi-year service warranty contracts through arrangements not constituting insurance.

(3) *Description of method.* If a taxpayer purchases a multi-year service warranty insurance policy (in connection with its sale of multi-year service warranty contracts to customers) by paying a lump-sum premium in advance, the taxpayer must capitalize the amount paid or incurred and may only obtain deductions for that amount by prorating (or amortizing) it over the life of the insurance policy (whether the cash method or an accrual method of accounting is used to account for service warranty transactions).

.04 *Interest accruals on short-term consumer loans — Rule of 78s method.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change its method of accounting from the Rule of 78s method to the constant yield method for stated interest (including stated interest that is original issue discount) on short-term consumer loans described in Rev. Proc. 83–40, 1983–1 C.B. 774, which was obsoleted by Rev. Proc. 97–37, 1997–2 C.B. 455.

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change for its first or second taxable year beginning on or after January 1, 1998, is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) *Background.*

(a) A short-term consumer loan is described in Rev. Proc. 83–40, provided:

(i) the loan 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

(ii) 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 78s method.

(b) In general, the Rule of 78s method allocates interest over the term of a loan based, in part, on the sum of the periods' digits for the term of the loan. See Rev. Rul. 83–84, 1983–1 C.B. 97, for a description of the Rule of 78s method.

(c) In general, the constant yield method allocates interest and original issue discount over the term of a loan based on a constant yield. See § 1.1272–1(c) for a description of the constant yield method. The Rule of 78s method generally front-loads interest as compared to the constant yield method.

(d) Rev. Proc. 83–40 was obsoleted because, under §§ 1.446–2 and 1.1272–1 (which were effective for debt instruments issued on or after April 4, 1994), taxpayers generally must account for stated interest and original issue discount on a debt instrument (loan) by using a constant yield method. As a result, the Rule of 78s method is no longer an acceptable method of accounting for federal income tax purposes.

(e) Notwithstanding §§ 1.446–2 and 1.1272–1, as a matter of administrative convenience, the Service will allow a taxpayer to use the Rule of 78s method for stated interest on short-term consumer loans described in Rev. Proc. 83–40 if the loans were issued prior to the first day of the taxpayer's first taxable year that begins on or after January 1, 1999.

(3) *Manner of making the change.*

(a) This change is made using a cut-off method and applies only to loans issued on or after the first day of the year of change. *See* section 2.06 of this revenue procedure.

(b) The taxpayer must maintain books and records sufficient to satisfy the district director that loans issued before the year of change and loans issued on or after the first day of the year of change have been adequately accounted for separately.

SECTION 5A. TAXABLE YEAR OF INCLUSION (§ 451)

.01 *Accrual of interest on nonperforming loans.*

(1) *Description of change and scope.*

(a) This change applies to an accrual method taxpayer that is a bank as defined in § 581 (or whose primary business is making or managing loans) and wants to change its method of accounting to comply with §§ 451 and 1.451–1(a) for qualified stated interest (as defined in § 1.1273–1(c)) on nonperforming loans.

(b) Section 1.451–1(a) requires income to be accrued when all the events have occurred that fix the right to receive the income and the amount thereof can be determined with reasonable accuracy. A taxpayer may not stop accruing qualified stated interest on a nonperforming loan for federal income tax purposes merely because payments on the loan are overdue by a certain length of time, such as 90

days, even if a federal, state, or other regulatory authority having jurisdiction over the taxpayer permits or requires that the overdue interest not be accrued for regulatory purposes.

(c) Under §§ 451 and 1.451–1(a), a taxpayer must continue accruing qualified stated interest on any nonperforming loan until either (i) the loan is worthless under § 166 and charged off as a bad debt, or (ii) the interest is determined to be uncollectible. In order for interest to be determined uncollectible, the taxpayer must substantiate, taking into account all the facts and circumstances, that it has no reasonable expectation of payment of the interest. This substantiation requirement is applied on a loan by loan basis.

(d) A taxpayer that changes its method of accounting under section 5A.01 of this APPENDIX must do so for all of its loans.

(2) *Section 481(a) adjustment.* In general, the § 481(a) adjustment for a method change under section 5A.01 of this APPENDIX represents the amount of qualified stated interest, on the taxpayer's nonperforming loans outstanding as of the beginning of the year of change, that should have been accrued under §§ 451 and 1.451–1(a) and was not accrued. Interest for which the taxpayer, as of the beginning of the year of change, has no reasonable expectation of payment is not taken into account in determining the amount of the § 481(a) adjustment.

.02 *Reserved.*

SECTION 6. OBLIGATIONS ISSUED AT DISCOUNT (§ 454)

.01 *Series E or EE U.S. savings bonds.*

(1) *Description of change and scope.* This change applies to a cash method taxpayer that wants to change its method of accounting for interest income on Series E or EE U.S. savings bonds. However, this change only applies to a taxpayer that has previously made an election under § 454 to report as interest income the increase in redemption price on a bond occurring in a taxable year, and that now wants to report this income in the taxable year in which the bond is redeemed, disposed of, or finally matures, whichever is earliest.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method and is effective for any increase in redemption price occurring after the beginning of the year of change for all Series E and EE U.S. savings bonds held by the taxpayer on or after the beginning of the year of change. *See* section 2.06 of this revenue procedure.

(b) In accordance with § 1.446–1(e)(3)(ii), the requirement of § 1.446–1(e)(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: "**CHANGE IN METHOD OF ACCOUNTING UNDER SECTION 6.01 OF THE APPENDIX OF REV. PROC. 99–49.**" The statement must set forth:

(i) the Series E or EE U.S. savings bonds for which this change in accounting method is requested;

(ii) an agreement to report all interest on any bonds acquired during or after the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest; and

(iii) an agreement to report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of any interest income previously reported in prior taxable years.

.02 *Reserved.*

SECTION 7. PREPAID SUBSCRIPTION INCOME (§ 455)

.01 *Prepaid subscription income.*

(1) *Description of change and scope.* This change applies to an accrual method taxpayer that wants to change its method of accounting for prepaid subscription income to the method described in § 455 and the regulations thereunder, including an eligible taxpayer that wants to make the "within 12 months" election under § 1.455–2.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method and does not apply to any prepaid subscription income received before the first taxable year to which the change applies. Any prepaid subscription income arising prior to the year of change is accounted for under the taxpayer's former method of accounting. *See* section 2.06 of this revenue procedure.

(b) In accordance with § 1.446–1(e)(3)(ii), the requirement of § 1.446–1(e)(3)(i) to file an application on Form 3115 is waived and a statement in lieu of the Form 3115 is authorized for this change. The statement must be identified at the top as follows: "**CHANGE IN METHOD OF ACCOUNTING FOR PREPAID SUBSCRIPTION INCOME UNDER SECTION 7.01 OF THE APPENDIX OF REV. PROC. 99–49.**" The statement must set forth the information required under § 1.455–6(b).

(c) The consent granted under this revenue procedure satisfies the consent required under §§ 455(c)(3) and 1.455–6(b).

.02 *Reserved.*

SECTION 8. TAXABLE YEAR OF DEDUCTION (§ 461)

.01 *Timing of incurring liabilities for employee compensation.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an accrual method taxpayer that wants to change its method of accounting to treat bonuses or self-insured medical benefits as follows:

(i) *Bonuses.* If the obligation to pay a bonus becomes fixed and certain by the end of the taxable year (*see* Rev. Rul. 61–127, 1961–2 C.B. 36), and the bonus is otherwise deductible, but the bonus is paid after the 15th day of the third calendar month after the end of that taxable year, to treat the bonus as deductible in the taxable year of the employer in which or with which ends the taxable year of the employee in which the bonus is includible in the gross income of the employee; or

(ii) *Self-insured medical benefits.* If the obligation to pay an employee's medical expenses is neither insured nor paid from a welfare benefit fund within the meaning of § 419(e), to treat the liability as incurred in the taxable year in which the employee files the claim with the employer. *See United States v. General Dynamics Corp.*, 481 U.S. 239 (1987), 1987–2 C.B. 134.

(b) *Inapplicability.* This change does not apply to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of ac-

counting under section 8.01 of this APPENDIX, if the taxpayer is not capitalizing the costs as required.

(2) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, direct labor costs must be included in inventory costs and may be recovered through cost of goods sold. *See* § 1.263A–1(e)(2)(i)(B). A taxpayer may not rely on the provisions of section 8.01 of this APPENDIX to take a current year deduction.

.02 *Timing of incurring liabilities for real property taxes.*

(1) *Description of change.* An accrual method taxpayer generally incurs a liability in the taxable year that all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. *See* § 1.446–1(c)(1)(ii). Under § 1.461–4(g)(6), if the liability of the taxpayer is to pay a tax, economic performance occurs as the tax is paid to the government authority that imposed the tax.

(2) *Scope.*

(a) *Applicability.* This change applies to an accrual method taxpayer that wants to change its method of accounting to:

(i) treat a liability for real property taxes (for which the all events test of § 461(h)(4) is otherwise met) as incurred in the taxable year in which the taxes are paid, under §§ 461 and 1.461–4(g)(6);

(ii) account for real property taxes under the recurring item exception to the economic performance rules under §§ 461(h)(3) and 1.461–5(b)(1); or

(iii) revoke an election under § 461(c) (ratable accrual election).

(b) *Inapplicability.* This change does not apply to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.02 of this APPENDIX, if the taxpayer is not capitalizing the costs as required.

(3) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, certain real property taxes must be included in inventory costs and may be recovered through cost of goods sold. *See* § 1.263A–1(e)(3)(ii)(L). A taxpayer may not rely on the provisions of section 8.02 of this APPENDIX to take a current year deduction.

.03 *Timing of incurring liabilities under a workers' compensation act, tort, breach of contract, or violation of law.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to an accrual method taxpayer that wants to change its method of accounting for self-insured liabilities (including any amounts not covered by insurance, such as a "deductible" amount under an insurance policy) arising under any workers' compensation act or out of any tort, breach of contract, or violation of law, to treating the liability for the workers' compensation, tort, breach of contract, or violation of law as being incurred in the taxable year in which all the events have occurred which establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and payment is made to the person to which the liability is owed. *See* §§ 461 and 1.461–4(g)(2).

(b) *Inapplicability.* This change does not apply:

(i) to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.03 of this APPENDIX, if the taxpayer is not capitalizing the costs as required;

(ii) if payment is made to a third party rather than to the person to which the liability is owed. *See* § 1.461–4(g)(1); or

(iii) if payment is made by a third party.

(2) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, certain employee benefit costs (including workers' compensation) must be included in inventory costs and may be recovered through costs of goods sold. *See* § 1.263A– 1(e)(3)(ii)(D). A taxpayer may not rely on the provisions of section 8.03 of this APPENDIX to take a current year deduction.

.04 *Timing of incurring liabilities for payroll taxes.*

(1) *Applicability.* This change applies to:

(a) an accrual method employer that wants to change its method of accounting for

(i) FICA and FUTA taxes to a method consistent with the holding in Rev. Rul. 96–51, 1996–2 C.B. 36 (Rev. Rul. 96–51 holds that, under the all events test of § 461, an accrual method employer may deduct in Year 1 its otherwise deductible FICA and FUTA taxes imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, if the requirements of the recurring item exception are met); and

(ii) state unemployment taxes and, in the event the taxpayer is an employer within the meaning of the Railroad Retirement Tax Act (*see* § 3231(a)), railroad retirement taxes to a method under which the taxpayer may deduct in Year 1 its otherwise deductible state unemployment taxes and railroad retirement taxes (if applicable) imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, if the requirements of the recurring item exception are met (including the requirement that, as of the end of the taxable year, all events have occurred that establish the fact of the liability and the amount of the liability can be determined with reasonable accuracy, *see* § 1.461–5(b)); or

(b) an accrual method employer that utilizes a method of accounting for FICA and FUTA taxes that is consistent with the holding in Rev. Rul. 96–51, 1996–2 C.B. 36 and wishes to change its method of accounting for state unemployment taxes and, in the event the employer is an employer within the meaning of the Railroad Retirement Tax Act (*see* § 3231(a)), railroad retirement taxes to a method under which the taxpayer may deduct in Year 1 its otherwise deductible state unemployment taxes and railroad retirement taxes (if applicable)imposed with respect to year-end wages properly accrued in Year 1, but paid in Year 2, if the requirements of the recurring item exception are met (including the requirement that, as of the end of the taxable year, all events have occurred that establish the fact of the lia-

bility and the amount of the liability can be determined with reasonable accuracy, *see* § 1.461–5(b)).

(2) *Inapplicability.* This change does not apply to a taxpayer that is subject to § 263A and that is required to capitalize the costs with respect to which the taxpayer wants to change its method of accounting under section 8.04 of this APPENDIX, if the taxpayer is not capitalizing the costs as required.

(3) *Recurring item exception.* A taxpayer that previously has not changed to or adopted the recurring item exception for FICA, FUTA, state unemployment taxes and railroad retirement taxes (if applicable) must change to the recurring item exception method for FICA, FUTA, state unemployment taxes and railroad retirement taxes (if applicable) as specified in § 461(h)(3) as part of this change.

(4) *Amounts taken into account.* Applicable provisions of the Code, regulations, and other published guidance prescribe the manner in which a liability that has been incurred is taken into account. For example, for a taxpayer with inventories, certain taxes must be included in inventory costs and may be recovered through cost of goods sold. *See* § 1.263A–1(e)(3)(ii)(L). A taxpayer may not rely on the provisions of section 8.04 of this APPENDIX to take a current year deduction.

.05 *Cooperative advertising.*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for cooperative advertising costs to a method consistent with the holding in Rev. Rul. 98–39, 1998–33 I.R.B. 4. Rev. Rul. 98–39 generally provides that, under the all events test of § 461, an accrual method manufacturer's liability to pay a retailer for cooperative advertising services is incurred in the year in which the services are performed, provided the manufacturer is able to reasonably estimate this liability, and even though the retailer does not submit the required claim form until the following year.

(2) *Scope limitations inapplicable.* A taxpayer that wants to make this change for its first or second taxable year ending on or after August 17, 1998, is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

SECTION 8A. CERTAIN PAYMENTS FOR THE USE OF PROPERTY OR SERVICES (§ 467)

.01 *Change to constant rental accrual method.*

(1) *Description of change.* This change applies to a taxpayer that wants to change to the constant rental accrual method, as described in § 1.467–3, for all of its section 467 rental agreements described in § 1.467–8(b). *See* § 1.467–8.

(2) *Requirements.* Taxpayers changing their method of accounting in accordance with this change must do so for all of their section 467 rental agreements described in § 1.467–8(b). This change must be made for the taxpayer's first taxable year ending after May 18, 1999.

(3) *Scope limitations inapplicable.* The scope limitations in section 4.02 of this revenue procedure are not applicable to this change. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

.02 *Change to comply with §§ 1.467–1 through 1.467–7.*

(1) *Description of change.* This change applies to a taxpayer that wants to change its method of accounting for rental agreements described in § 1.467–9(a)(2) to comply with §§ 1.467–1 through 1.467–7. *See* § 1.467–9(e)(1).

(2) *Requirements.* This change must be made for the taxpayer's first taxable year ending after May 18, 1999.

(3) *Scope limitations inapplicable.* The scope limitations in section 4.02 of this revenue procedure are not applicable to this change. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(4) *Manner of making the change.* This change is made using a cut-off method and applies only to rental agreements described in § 1.467–9(a)(2). *See* section 2.06 of this revenue procedure. For purposes of this paragraph (4), a rental agreement is entered into on its agreement date (within the meaning of § 1.467–1(h)(1) and, if applicable, § 1.467–1(f)(1)(i)).

.03 *Change to comply with regulation project IA–292–84.*

(1) *Description of the change.* This change applies to a taxpayer that wants to change its method of accounting for any rental agreement described in § 1.467–9(c) to comply with the provisions of regulation project IA–292–84 (1996–2 C.B. 462).

(2) *Requirements.* This change must be made for the taxpayer's first taxable year ending after May 18, 1999.

(3) *Scope limitations inapplicable.* The scope limitations in section 4.02 of this revenue procedure are not applicable to this change. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

SECTION 9. INVENTORIES (§ 471)

.01 *Cash discounts — Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for cash discounts (discounts granted for timely payment) when they approximate a fair interest rate,

from a method of consistently including the price of the goods before discount in the cost of the goods and including in gross income any discounts taken (the "gross invoice method"), to a method of reducing the cost of the goods by the cash discounts and deducting as an expense any discounts not taken (the "net invoice method"), or vice versa. *See* Rev. Rul. 73–65, 1973–1 C.B. 216.

.02 *Estimating inventory "shrinkage".*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change to a method of accounting for estimating inventory shrinkage in computing ending inventory, using:

(a) the "retail safe harbor method" described in section 4 of Rev. Proc. 98–29, 1998–15 I.R.B. 22; or

(b) a method other than the retail safe harbor method, provided (i) the taxpayer's present method of accounting does not estimate inventory shrinkage, and (ii) the taxpayer's new method of accounting (that estimates inventory shrinkage) clearly reflects income under § 446(b).

(2) *Scope limitations inapplicable.* A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(3) *Additional requirements.* If the taxpayer wants to change to a method of accounting for inventory shrinkage other than the retail safe harbor method, the taxpayer must attach to the application a statement setting forth a detailed description of all aspects of the new method of estimating inventory shrinkage (including, for LIFO taxpayers, the method of determining inventory shrinkage for, or allocating inventory shrinkage to, each LIFO pool).

(4) *Audit protection.* A taxpayer, whose present method of accounting estimates inventory shrinkage, does not receive audit protection under section 7 of this revenue procedure in connection with a change to the retail safe harbor method if, on the date the taxpayer files a copy of the Form 3115 with the national office, the taxpayer's present method of estimating inventory shrinkage is an issue under consideration within the meaning of section 3.09 of this revenue procedure.

(5) *Future change.* A taxpayer that changes to the retail safe harbor method described in this revenue procedure will not be precluded, solely by reason of such change, from changing to another safe harbor method for estimating inventory shrinkage in computing ending inventory in the first year that such other safe harbor method is available.

SECTION 10. LAST-IN, FIRST-OUT (LIFO) INVENTORIES (§ 472)

.01 *Change from the LIFO inventory method.*

(1) *Description of change and scope.*

(a) *In general.* This change applies to any taxpayer that wants to:

(i) change from the LIFO inventory method for all its LIFO inventory; and

(ii) change to the permitted method as determined in section 10.01(1)(b) of this APPENDIX.

(b) *Method to be used.*

(i) *Determining method to be used.* The inventory method to be used by a taxpayer is determined as follows:

(A) If the taxpayer has inventoriable goods not included in its LIFO inventory computations (non-LIFO inventory) and, for all the taxpayer's non-LIFO inventory, the taxpayer uses an inventory method that is a permitted method, then the taxpayer must use that same inventory method for its entire inventory.

(B) If the LIFO inventory method is used by the taxpayer with respect to all its inventoriable goods, then the taxpayer must use the same inventory method it used prior to the adoption of the LIFO inventory method, if that prior method is a permitted method.

(C) If the taxpayer has only LIFO inventory and the method used by the taxpayer prior to the adoption of the LIFO inventory method is not a permitted method, then the taxpayer must use a permitted method.

(D) If the taxpayer did not use an inventory method prior to the adoption of the LIFO inventory method and has no inventoriable goods other than its LIFO inventory, then the taxpayer must use a permitted method.

(ii) *Permitted method defined.* For purposes of section 10.01 of this APPENDIX, a permitted method is a method under which:

(A) the identification method is either the first-in, first-out (FIFO) inventory method or the specific identification inventory method; and

(B) the valuation method is cost; cost or market, whichever is lower; market (but only if the taxpayer is a dealer in securities, as defined in § 1.471–5); the "farm price method" or the "unit-livestock-price method" (but only if the taxpayer is a farmer permitted to use such methods); or the retail method, reduced to either approximate cost or approximate cost or market, whichever is lower (but only if the taxpayer is a retail merchant).

(iii) *Method not to be used.* The average cost method (sometimes also referred to as "the rolling average method") described in Rev. Rul. 71–234, 1971–1 C.B. 148, is not a permitted method.

(iv) *Determining permitted method.* Whether an inventory method is a permitted method is determined by the taxpayer's method of inventory identification and valuation, and not by which types and amounts of costs are capitalized under the taxpayer's method of computing inventory cost. *See* § 263A and the regulations thereunder, which govern the types and amounts of costs required to be included in inventory cost for taxpayers subject to those provisions.

(2) *Limitation on LIFO election.* The taxpayer may not re-elect the LIFO inventory method for a period of at least five taxable years beginning with the year of change, unless based on a showing of unusual and compelling circumstances, consent is specifically granted by the Commissioner to change the method of accounting at an earlier time. A taxpayer that wants to re-elect the LIFO inventory method within a period of five taxable years (beginning with the year of change) must file a Form 3115 in accordance with

Rev. Proc. 97–27, 1997–1 C.B. 680. A taxpayer that wants to re-elect the LIFO inventory method after a period of five taxable years (beginning with the year of change) is not required to file a Form 3115 in accordance with Rev. Proc. 97–27, but must file a Form 970, Application to Use LIFO Inventory Method, in accordance with § 1.472–3.

(3) *Effect of subchapter S election by corporation.*

(a) *S election effective for year of LIFO discontinuance.* If a C corporation elects to be treated as an S corporation for the taxable year in which it discontinues use of the LIFO inventory method, § 1363(d) requires an increase in the taxpayer's gross income for the LIFO recapture amount (as defined in § 1363(d)(3)) for the taxable year preceding the year of change (the taxpayer's last taxable year as a C corporation), and a corresponding adjustment to the basis of the taxpayer's inventory as of the end of the taxable year preceding the year of change. Any increase in income tax as a result of the inclusion of the LIFO recapture amount is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation as provided in § 1363(d)(2). Any corresponding basis adjustment is taken into account in computing the § 481(a) adjustment (if any) that results upon the discontinuance of the LIFO method by the corporation.

(b) *S election effective for a year after LIFO discontinuance.* If a C corporation elects to be treated as an S corporation for a taxable year after the taxable year in which it discontinued use of the LIFO inventory method, the remaining balance of any positive § 481(a) adjustment must be included in its gross income in its last taxable year as a C corporation. If this inclusion results in an increase in tax for its last taxable year as a C corporation, this increase in tax is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation as provided in § 1363(d)(2), unless the taxpayer is required to take the remaining balance of the § 481(a) adjustment into account in the last taxable year as a C corporation under another acceleration provision in section 5.02(3)(c) of this revenue procedure.

(4) *Additional requirements.* The taxpayer must complete the following statements and attach them to the application:

(a) "The new method of identifying inventory goods is the [insert method; that is, specific identification; FIFO; retail; etc.] method."

(b) "The new method of valuing inventory goods is [insert method; that is, cost; cost or market, whichever is lower; etc.]."

(c) "The new method conforms to the requirements of section 10.01(1)(b)(i) [insert either (A), (B), (C), or (D)] of the APPENDIX of Rev. Proc. 99–49 because [explain in detail how the new method conforms to the specific subdivision]."

.02 *Determining the cost of used vehicles purchased or taken as a trade-in.*

(1) *Description of change and scope.* This change applies to a LIFO taxpayer that wants to:

(a) determine the cost of used vehicles acquired by trade-in using the average wholesale price listed by an official used car guide on the date of the trade-in. *See* Rev. Rul. 67–107, 1967–1 C.B. 115. The official used car guide selected must be consistently used;

(b) determine the cost of used vehicles purchased for cash using the actual purchase price of the vehicle; or

(c) reconstruct the beginning-of-the-year cost of used vehicles purchased for cash using values computed by national auto auction companies based on vehicles purchased for cash. The national auto auction company selected must be consistently used.

(2) *Manner of making the change.* This change is made using a cut-off method and applies to used vehicles acquired during the year of change and all subsequent years. *See* section 2.06 of this revenue procedure.

.03 *Alternative LIFO inventory method for retail automobile dealers.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks ("automobile dealer") that wants to change to the "Alternative LIFO Method" described in section 4 of Rev. Proc. 97–36, 1997–2 C.B. 450, for its LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which also are referred to as class 1, 2, or 3 trucks.

(b) *Inapplicability.* This change does not apply to an automobile dealer that uses the inventory price index computation (IPIC) method for goods other than new automobiles, new light-duty trucks, parts and accessories, used automobiles, and used trucks.

(2) *Manner of making the change.*

(a) *Cut-off method.* This change is made using a cut-off method. *See* section 2.06 of this revenue procedure and section 5.03(6) of Rev. Proc. 97–36.

(b) *IPIC method changes.* An automobile dealer that uses the IPIC method also must change from the IPIC method under section 10.03 of this APPENDIX to another acceptable method for its goods other than new automobiles and new light-duty trucks. For parts and accessories, the automobile dealer must change to the dollar-value, index method, with all parts and accessories within each separate trade or business in a separate LIFO pool. For used vehicles, the automobile dealer must change to the dollar-value, link-chain method, with all used automobiles within each separate trade or business in one LIFO pool and all used trucks within each separate trade or business in another separate LIFO pool.

(c) *Additional requirements.* An automobile dealer also must comply with the following:

(i) the conditions in section 5.03 of Rev. Proc. 97–36; and

(ii) for an automobile dealer changing from the IPIC method, the automobile dealer also must attach to the application a schedule setting forth the classes of goods for which the automobile dealer has elected to use the LIFO method and the accounting method changes being made under section 10.03 of this APPENDIX for each class of goods.

.04 *Inventory price index computation (IPIC) method under the LIFO inventory method.*

(1) *Description of change and scope.*

(a) This change applies to an eligible taxpayer that wants to change its LIFO inventory method to use the IPIC method for its entire LIFO inventory in accordance with all the provisions of § 1.472–8(e)(3) and Rev. Proc. 84–57, 1984–2 C. B. 496. The taxpayer must:

(i) in the case of the CPI Detailed Report, select an index from Table 3 (Consumer Price Index for All Urban Consumers (CPI-U): U.S. city average, detailed expenditure categories); and

(ii) in the case of the Producer Price Indexes, select an index from Table 6 (Producer price indexes and percent changes for commodity groupings and individual items).

(b) A taxpayer using the IPIC method must apply the inventory price index to its ending inventory valued at current-year cost, under the taxpayer's method of determining current-year cost. *See* § 1.472–8(e)(2)(ii). Furthermore, there must be a nexus between the taxpayer's method of determining current-year costs and the month to be used in selecting indexes. *See* § 1.472–8(e)(3)(iii)(C) and Rev. Rul. 89–29, 1989–1 C.B. 168. For example, if a taxpayer determines current-year cost by reference to the actual cost of goods purchased or produced during the taxable year in the order of acquisition (earliest acquisitions cost), then the inventory price index must be applied to the earliest acquisitions cost of ending inventory. In computing the inventory price index, such a taxpayer must select indexes from a month toward the beginning of its taxable year.

(c) A taxpayer may not change its method of pooling as part of a change made under section 10.04 of this APPENDIX, except to a method specifically authorized by § 1.472–8(e)(3)(iv) or section 3.04(1)(b) of Rev. Proc. 84–57. These special pooling rules do not apply to goods manufactured by the taxpayer. *See* § 1.472–8(b) for principles for establishing pools of manufacturers and processors.

(d) A taxpayer may change its method of determining current-year cost as part of a change made under section 10.04 of this APPENDIX by also following the provisions of section 10.05 of this APPENDIX. These changes may be made using a single application, provided the application is labeled as being filed under both sections 10.04 and 10.05 of this APPENDIX. *See* section 6.02(3) of this revenue procedure.

(2) *Manner of making the change.* This change is made using a cut-off method. *See* section 2.06 of this revenue procedure.

(3) *Bargain purchase.* If the taxpayer has previously improperly accounted for a bulk bargain purchase, the taxpayer must, as part of this change, first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991), and compute a § 481(a) adjustment for that part of the change. *See* Announcement 91–173, 1991–47 I.R.B. 29. Upon examination, if a taxpayer has properly changed under section 10.04 of this APPENDIX except for complying with section 10.04(3) of this APPENDIX, an examining agent may not deny the taxpayer the change. However, the taxpayer does not receive audit protection under section 7 of this revenue procedure with respect to the improper method of accounting for the bargain purchase. Accordingly, the examining agent may make any necessary adjustments in any open year to effect compliance with *Hamilton Industries, Inc.*

.05 *Determining current-year cost under the LIFO inventory method.*

(1) *Description of change and scope.* This change applies to a LIFO taxpayer that wants to change to a method of determining current year cost:

(a) by reference to the actual cost of the goods most recently purchased or produced;

(b) by reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition; or

(c) by application of an average unit cost equal to the aggregate actual cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced. *See* § 1.472–8(e)(2)(ii).

(2) *Manner of making the change.* This change is made using a cut-off method. *See* section 2.06 of this revenue procedure.

SECTION 10A. MARK-TO-MARKET ACCOUNTING METHOD FOR DEALERS IN SECURITIES (§ 475)

.01 *Discontinuing the mark-to-market method of accounting for nonfinancial customer paper.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to:

(i) a taxpayer that must discontinue the use of the mark-to-market method of accounting for nonfinancial customer paper to comply with § 475(c)(4), enacted by § 7003 of the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 833 (July 22, 1998), provided the change is made for the taxpayer's first taxable year ending after July 22, 1998. The taxpayer must change to a method other than the lower of cost or market method; and

(ii) a taxpayer that was a dealer in securities solely because of its dealings in nonfinancial customer paper, that, in conjunction with the change under section 10A.01(1)(a)(i) of this APPENDIX, wants to discontinue the use of the mark-to-market method of accounting for all securities (including nonfinancial customer paper).

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) *Additional Requirements.*

(a) On a statement attached to the application, the taxpayer must describe all items that were marked to market and that will no longer be marked to market.

(b) When complying with section 6.02(3) of this revenue procedure, the taxpayer should indicate whether the taxpayer is changing under section 10A.01(1)(a)(i) or sections 10A.01(1)(a)(i) and (ii) of this APPENDIX.

(3) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

.02 *Commodities dealers, securities traders, and commodities traders electing to use the mark-to-market method of accounting under § 475(e) or (f).*

(1) *Description of change.* This change applies to certain taxpayers that have elected to use the mark-to-market method of accounting under § 475(e) or (f). Under § 475(e) and (f) and Rev. Proc. 99–17, 1999–7 I.R.B. 52, if a taxpayer makes an election under § 475(e) or (f),

then beginning with the first taxable year for which the election is effective (election year), mark to market is the only permissible method of accounting for securities or commodities subject to the election. Thus, if the electing taxpayer's method of accounting for its taxable year immediately preceding the election year is inconsistent with § 475, the taxpayer is required to change its method of accounting to comply with the election. A taxpayer that makes a § 475(e) or (f) election but fails to change its method of accounting to comply with that election is using an impermissible method. *See* section 4 of Rev. Proc. 99–17.

(2) *Scope*

(a) *Applicability.* This change applies to a taxpayer if all of the following conditions are satisfied:

(i) The taxpayer is a commodities dealer, securities trader, or commodities trader that has made a valid election under § 475(e) or (f) (*see* section 5.02 or 5.03(1) of Rev. Proc. 99–17) and that is required to change its method of accounting to comply with the election;

(ii) The method of accounting to which the taxpayer changes is in accordance with its election under § 475(e) or (f);and

(iii) The year of change is the election year.

(b) *Scope limitations inapplicable.* A taxpayer making this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

SECTION 11. BANK RESERVES FOR BAD DEBTS (§ 585)

.01 *Changing from the § 585 reserve method to the § 166 specific charge-off method.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a bank (as defined in § 581, including a bank for which a qualified subchapter S subsidiary (QSSS) election is filed) that wants to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method.

(b) *Certain scope limitations inapplicable.* A bank that changed from the § 593 reserve method under § 593(g) to the § 585 reserve method will not be prohibited under section 4.02(6) of this revenue procedure from changing its method of accounting for bad debts under section 11.01 of this APPENDIX solely because of the § 593(g) change. A bank for which a QSSS election is filed will not be prohibited under section 4.02(7) of this revenue procedure from changing its method of accounting for bad debts under section 11.01 of this APPENDIX solely because of the deemed liquidation of the bank arising from a QSSS election.

(c) *Inapplicability.* This change does not apply to a large bank as defined in § 585(c)(2).

(2) *Section 481(a) adjustment.* Generally, the amount of the § 481(a) adjustment for a change in method of accounting under section 11.01 of this APPENDIX is the amount of the bank's reserve for bad debts as of the close of the taxable year immediately before the year of change. However, the amount of the § 481(a) adjustment does not include the amount of a bank's pre-1988 reserves (as described in § 593(g)(2)(A)(ii), without taking into account § 593(g)(2)(B)) if the bank changed in a prior year from the § 593 reserve method to the § 585 reserve method and § 593(g) applied to that change. The deemed liquidation of a bank occurring solely because its parent makes a QSSS election does not accelerate the § 481(a) adjustment. In accordance with section 5.04(3)(c) of this revenue procedure, a bank that ceases to be a bank under § 581 must accelerate its § 481(a) adjustment.

(3) *Change from § 585 required when electing S corporation status.* A bank electing S corporation status (or a bank for which a QSSS election is filed) cannot use the § 585 reserve method. The filing by a bank of a Form 2553 (Election by a Small Business Corporation) or the filing by a bank's parent of a QSSS election with respect to the bank will constitute an agreement by the bank to change its method of accounting for bad debts from the § 585 reserve method to the § 166 specific charge-off method effective as of the taxable year for which the S corporation election or QSSS election is effective (year of change) in accordance with all of the applicable provisions of this revenue procedure (including section 6 of this revenue procedure, which requires filing a Form 3115 in duplicate). The § 481(a) adjustment is recognized built-in gain under § 1374. *See* § 1.1374–4(d).

.02 *Reserved.*

SECTION 12. ORIGINAL ISSUE DISCOUNT (§§ 1272; 1273)

.01 *De minimis original issue discount (OID).*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that wants to change to the principal-reduction method of accounting described in section 5 of Rev. Proc. 97–39, 1997–2 C.B. 485. The principal-reduction method of accounting is an aggregate method of accounting for de minimis OID (discount) on certain loans originated by the taxpayer.

(b) *Scope limitations inapplicable.* A taxpayer that wants to make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(c) *Description.* The principal-reduction method of accounting is a permissible method for use by taxpayers to account for discount on one or more categories of loans described in section 4.02 or 4.03 of Rev. Proc. 97–39. If the principal-reduction method is used to account for any loans in a category of loans, the method must be used for the entire category of loans. The principal-reduction method applies only to loans described in section 3 of Rev. Proc. 97–39.

(2) *Manner of making the change.*

(a) This change is made using a cut-off method and applies only to loans described in section 3 of Rev. Proc. 97–39 that were acquired on or after the first day of the year of change. *See* section 2.06 of this revenue procedure.

(b) The taxpayer must maintain books and records sufficient to satisfy the district director that old and new loans have been adequately segregated.

(3) *Additional requirements.* On a statement attached to the application, the taxpayer must:

(a) identify the categories of loans to which the new method will apply; and

(b) describe any "additional categories" permitted under section 4.03 of Rev. Proc. 97–39.

(4) *No audit protection.* A taxpayer does not receive audit protection under section 7 of this revenue procedure in connection with this change.

.02 *Pool of debt instruments.*

(1) *Description of change and scope.*

(a) *Applicability.* This change applies to a taxpayer that must change its method of accounting for a pool of debt instruments to comply with § 1272(a)(6) (as required by § 1004 of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788, 911), provided the change is for the taxpayer's first taxable year beginning after August 5, 1997.

(b) *Scope limitations inapplicable.* A taxpayer that must make this change is not subject to the scope limitations in section 4.02 of this revenue procedure. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the national office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(c) *Description.*

(i) Under § 1272, the holder of a debt instrument with original issue discount (OID) must include in income the sum of the daily portions of the OID for each day during the taxable year on which the holder held the instrument. Section 1272(a)(6) provides special rules to determine the daily portions of OID for certain debt instruments subject to prepayments. Under these rules, the daily portions of OID are determined, in part, by taking into account an assumption regarding the prepayment of principal on the debt instruments.

(ii) Section 1004 of the Taxpayer Relief Act of 1997, which is effective for taxable years beginning after August 5, 1997, extended the rules in § 1272(a)(6) to any pool of debt instruments the yield on which may be affected by reason of prepayments. In particular, § 1272(a)(6) now applies to a pool of credit card receivables subject to a grace period provision (under which, for example, a credit card issuer does not charge interest for a billing cycle if the credit card obligor pays off its account balance by a specified date, even though the balance is not due on that date). *See* H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 522 (1997). (A credit card receivable subject to a grace period provision has OID because none of the stated interest on the receivable is qualified stated interest under § 1.1273–1(c)).

(iii) The holder of a pool of credit card receivables subject to a grace period provision must accrue OID on the pool based on a reasonable assumption regarding the timing of the payments by the obligors of the receivables in the pool. Under §1272(a)(6), it is not reasonable for a holder to assume that all of the obligors will pay their balances by the specified grace period date and, based on this assumption, defer the inclusion of OID until the end of the grace period. If the payments in the pool occur soon after year end and before the holder files its tax return for the taxable year that includes such year end, the holder may accrue OID based on its actual experience rather than based upon a reasonable assumption. If the holder does not accrue OID based on its actual experience, the holder must make an adjustment to its income for the following taxable year to account for any difference between its accrual based on a reasonable assumption and its actual experience.

(2) *Additional requirements.* On a statement attached to the application, the taxpayer must provide a detailed description of the pool(s) of debt instruments and the proposed method (including the prepayment assumption used for each pool).

SECTION 12A. MARKET DISCOUNT BONDS (§ 1278)

.01 *Revocation of § 1278(b) election.*

(1) *Description of change and scope.* This change applies to a taxpayer that wants to change its method of accounting for market discount bonds by revoking its § 1278(b) election. Under § 1278(b), a taxpayer may elect a method of accounting under which market discount is currently included in gross income for the taxable years to which the discount is attributable. See Rev. Proc. 92–67, 1992–2 C.B. 429, for the procedures to make a § 1278(b) election (including a deemed § 1278(b) election). The procedures for revoking a § 1278(b) election were formerly provided in section 7 of Rev. Proc. 92–67.

(2) *Revocation of election.* The revocation of a § 1278(b) election applies to all market discount bonds that are held by the taxpayer on the first day of the first taxable year for which the revocation is effective (year of change), and to all market discount bonds that are subsequently acquired by the taxpayer. If a § 1278(b) election is revoked, then, for purposes of § 1276(a), accrued market discount with respect to any bond previously subject to the election means accrued market discount as defined in § 1276(b) less any market discount included in income while the bond was subject to the § 1278(b) election.

(3) *Manner of making the change.* This change is made using a cut-off method and applies only to market discount accruing on or after the first day of the year of change. Market discount accruing on a bond prior to the year of change was currently included in income and market discount accruing on the bond on and after the first day of the year of change is included in income generally upon disposition of the bond. See § 1276(a). Because cut-off treatment is prescribed for this change, the basis of any bond, adjusted for amounts previously included in income during the period of the election, is not affected by the revocation.

(4) *Additional requirements.* On a statement attached to the application, the taxpayer must provide:

(a) the reason(s) for revoking the § 1278(b) election (or deemed § 1278(b) election);

(b) a description of the method by which, and the date on which, the taxpayer made the § 1278(b) election (or deemed § 1278(b) election) that is being revoked; and

(c) a statement that, after the revocation, the taxpayer will not make a constant interest rate election for any bond that has been subject to the § 1278(b) election (or deemed § 1278(b) election) being revoked and for which a constant interest rate election was not effective in the year of acquisition.

(5) *Audit protection.* A taxpayer receives audit protection under section 7 of this revenue procedure in connection with this change. However, the audit protection applicable to this change does not preclude the Commissioner from examining the method used by the taxpayer to determine the amount of accrued market discount under § 1276(b) for a taxable year prior to the year of change.

.02 *Reserved.*

SECTION 13. SHORT-TERM OBLIGATIONS (§ 1281)

.01 *Interest income on short-term obligations.*

(1) *Description of change and scope.*

(a) This change applies to a taxpayer that wants to change its method of accounting to comply with § 1281 for interest income on short-term obligations.

(b) Under § 1281, a holder of certain short-term obligations, including a bank as defined in § 581, must include in gross income any accrued interest income on such obligations, regardless of the holder's overall method of accounting. Section 1281 applies to all types of interest income, including acquisition discount, original issue discount (OID), and stated interest. *See* S. Rep. No. 99–313, 99th Cong., 2d Sess. 903 (1986), 1986–3 (Vol. 3) C.B. 903.

(c) Section 1283(a)(1) generally defines a short-term obligation as any bond, debenture, note, certificate, or other evidence of indebtedness that matures in one year or less from its issue date. A short-term loan, including a short-term loan made in the ordinary course of the taxpayer's business, is a short-term obligation.

(d) Under §§ 1281(a) and 1283(c), a holder of a short-term obligation subject to § 1281 must include in gross income an amount equal to the sum of the daily portions of the acquisition discount or OID, whichever is applicable, on the obligation for each day during the taxable year that the obligation is held by the holder. See § 1283(b), as modified by § 1283(c), to determine the daily portions of acquisition discount or OID. In addition, § 1281(a) requires the holder to include in gross income any stated interest that is payable on the short-term obligation (other than stated interest taken into account to determine the amount of the acquisition discount or OID) as it accrues.

(2) *Section 481(a) adjustment period.* A taxpayer must take the entire § 481(a) adjustment into account in computing taxable income for the year of change.

.02 *Stated interest on short-term loans of cash method banks in the Eighth Circuit.*

(1) *Description of change and scope.*

(a) This change applies to a cash method bank in the Eighth Circuit that wants to change its method of accounting from accruing stated interest on short-term loans made in the ordinary course of business to using the cash method for that interest.

(b) In *Security Bank Minnesota v. Commissioner,* 994 F.2d 432 (8th Cir. 1993), *aff'g* 98 T.C. 33 (1992), the U.S. Circuit Court of Appeals for the Eighth Circuit held that § 1281 does not require a cash method bank to include in gross income stated interest on short-term loans made in the ordinary course of business as that interest accrues. The Service disagrees with the interpretation of § 1281 in *Security Bank Minnesota* and intends to pursue this issue in other circuits. In light of *Security Bank Minnesota,* however, cash method banks in the Eighth Circuit will be granted permission to change to the cash method of accounting for stated interest on short-term loans made in the ordinary course of business. If this change was made on or before November 6, 1995, the Service will not seek to deny cash method banks in the Eighth Circuit the use of the cash method on the ground that there was an unauthorized change in method of accounting.

(2) *Section 481(a) adjustment period.* A taxpayer must take the entire § 481(a) adjustment into account in computing taxable income for the year of change.

(3) *No ruling protection.* If the Service is later successful in further litigation on this issue in other circuits, or there is a change in law, then cash method banks in the Eighth Circuit may be required to use an accrual method of accounting for any taxable year not barred by the statute of limitations.

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26 CFR 601.602: Tax forms and instructions. (Also Part I, §§ 138, 220, 408, 408A, 529, 530, 1441, 1442, 1443, 3402, 3405, 3406, 6011, 6041, 6041A, 6042, 6043, 6044, 6045, 6047, 6049, 6050A, 6050B, 6050D, 6050E, 6050H, 6050J, 6050N, 6050P, 6050Q, 6050R, 6050S; 1.408–7, 1.408A–7, 1.1461–1, 1.1461–2, 31.3402(q)–1, 31.3404(r)–1, 31.3405(c)–1, 35.3405–1, 31.3406(a)–1, 31.3406(g)–2, 35a.3406–2, 1.6011–1, 1.6011–3, 1.6041–1, 7.6041–1, 1.6041A–1, 1.6042–2, 1.6044–2, 1.6045–1, 1.6045–2, 1.6045–4, 1.6049–4, 1.6050A–1, 1.6050E–1, 1.6050H–1, 1.6050J–1T, 1.6050N–1, and 1.6050P–1.)

Rev. Proc. 99–50

SECTION 1. PURPOSE

This revenue procedure permits combined information reporting by a successor business entity (*i.e.*, a corporation, partnership, or sole proprietorship) in certain situations following a merger or an acquisition and supersedes Rev. Proc. 90–57, 1990–2 C.B. 641 and Rev. Rul. 69–556, 1969–2 C.B. 242. This revenue procedure explains both the procedure otherwise required under the regulations (the "standard procedure") and an elective procedure (the "alternative procedure") for preparing and filing certain Forms 1042–S, all forms in the series 1098, 1099, and 5498, and Forms W-2G, in certain situations involving a successor business entity and a predecessor business entity (*i.e.*, a corporation, partnership, or sole proprietorship) when the successor acquires substantially all of the property (1) used in the trade or business of the predecessor (including certain situations when one or more corporations are absorbed by another corporation pursuant to a merger agreement), or (2) used in a separate unit of a trade or business of the predecessor.

SECTION 2. BACKGROUND

.01 *General Requirement of Return or*

Statement. Section 6011(a) of the Internal Revenue Code provides that, when required by regulations, any person made liable for any tax imposed by the Code, or for the collection of the tax, must make a return or statement according to the forms and regulations prescribed by the Secretary.

.02 *Certain Payments Reported on Forms 1042-S.* Payments under the Code sections described in this paragraph are reported on Forms 1042-S. Section 1441(a) generally provides that persons having the control, receipt, custody, disposal, or payment of items of gross income specified in § 1441(b) from sources within the United States of any nonresident alien individual or foreign partnership must deduct and withhold a tax equal to either 30 percent or 14 percent of those amounts. Section 1442 provides that, in the case of certain foreign corporations, a tax equal to 30 percent shall be deducted and withheld in the same manner and on the same items of income as provided in § 1441. Section 1443(a) provides that, in the case of certain foreign tax-exempt organizations, a tax equal to 30 percent of the amount of the unrelated business taxable income shall be deducted and withheld in the same manner as provided in § 1441. Section 1443(b) provides that, in the case of certain foreign tax-exempt organizations, a tax on gross investment income derived from sources within the United States equal to 4 percent of such amount shall be deducted and withheld in the same manner as provided in § 1441(a) or § 1442(a). Persons required to deduct and withhold taxes under § 1441, 1442, or 1443 generally must file Forms 1042-S reporting aggregate amounts for the calendar year, as provided in the Income Tax Regulations under § 1461.

.03 *Payments Reported on Forms 1098.* Payments and receipts under the following Code sections are reported on forms in the series 1098: §§ 6050H (returns relating to mortgage interest received in trade or business from individuals); and 6050S (returns relating to higher education tuition and related expenses).

.04 *Payments Reported on Forms 1099.* (1) *In general.* Payments under the following Code sections are reported on forms in the series 1099: §§ 220(h) (medical savings accounts); 408(i) (individual retirement arrangements); 529(d) (qualified state tuition programs); 530(h) (education individual retirement accounts); 6041 (information at source); 6041A (returns regarding payments of remuneration for services and direct sales); 6042 (returns regarding payments of dividends and corporate earnings and profits); 6043 (liquidating, etc., transactions); 6044 (returns regarding payments of patronage dividends); 6045 (returns of brokers); 6047 (information relating to certain trusts and annuity plans); 6049 (returns regarding payments of interest); 6050A (reporting requirements of certain fishing boat operators); 6050B (returns relating to unemployment compensation); 6050D (returns relating to energy grants and financing); 6050E (state and local income tax refunds); 6050J (returns relating to foreclosures and abandonments of security); 6050N (returns regarding payments of royalties); 6050P (returns relating to the cancellation of indebtedness by certain entities); 6050Q (certain long-term care benefits); and 6050R (returns relating to certain purchases of fish).

(2) *Persons Made Liable for Backup Withholding.* Section 3406 provides that payors of reportable payments (as defined in § 3406(b)) must, in certain circumstances, deduct and withhold a tax equal to 31 percent of the payment ("backup withholding"). Under § 3406(b), reportable payments generally are payments required to be shown on a return under §§ 6041 (relating to certain information at source), 6041A(a) (relating to payments of remuneration for services), 6042(a) (relating to payments of dividends), 6044 (relating to patronage dividends), 6045 (relating to returns of brokers), 6049(a) (relating to payments of interest), 6050A (relating to reporting requirements of certain fishing boat operators), and 6050N (relating to payments of royalties).

(3) *Persons Made Liable for Withholding on Pensions, Annuities, and Other Deferred Income.* Section 3405 provides that payors of pensions, annuities and certain other deferred income must, in certain circumstances, deduct and withhold a tax: (1) on periodic payments as defined in § 3405(e)(2), an amount that would be required to be withheld from such payment if such payment were a payment of wages; (2) on nonperiodic distributions as defined in § 3405(e)(3), 10 percent of the distribution; and (3) on eligible rollover distributions as defined in § 3405(c)(3), 20 percent of the distribution. Generally, the persons required to deduct and withhold taxes under § 3405 must file Forms 1099 reporting payments and distributions, as provided under § 35.3405–1 of the Temporary Employment Tax Regulations and § 31.3405(c)–1 of the Employment Tax Regulations.

.05 *Contributions Reported on Forms 5498.* Contributions under the following Code sections are reported on forms in the series 5498: §§ 138 (medicare+choice MSA); 220 (medical savings accounts); 408(a) (individual retirement account); 408(b) (individual retirement annuity); 408(k) (simplified employee pension); 408(p) (simple retirement account); 408A (Roth IRA); and 530 (education individual retirement account).

.06 *Payments Reported on Forms W-2G.* (1) *In general.* Section 7.6041–1 of the Temporary Income Tax Regulations provides that payments of winnings of $1,200 or more from a bingo game or slot machine play, and payments of winnings of $1,500 or more from a keno game, are reportable on Forms W-2G. Section 31.3406(g)–2(d) generally provides that under § 3406 a reportable gambling winning is any gambling winning subject to information reporting under § 6041. In addition, a gambling winning (other than a winning from bingo, keno, or slot machines) is a reportable gambling winning only if the amount paid with respect to the wager is $600 or more and if the proceeds are at least 300 times as large as the amount wagered.

(2) *Extension of Withholding to Certain Gambling Winnings.* Section 3402(q) provides that every person making a payment of winnings that are subject to withholding (defined in §§ 3402(q)(3) and 31.3402(q)–1) shall deduct and withhold a tax in an amount equal to 28 percent of such payment.

SECTION 3. SCOPE

This revenue procedure applies only when all of the following conditions are met:

(1) One business entity (*i.e.*, a corporation, partnership, or sole proprietorship) (the "successor") acquires from another business entity (the "predecessor") substantially all the property (a) used in the trade or business of the predecessor (including when two or more corporations are parties to a merger agreement under which the surviving corporation becomes the owner of all the assets and assumes all the liabilities of the absorbed corporation(s)), or (b) used in a separate unit of a trade or business of the predecessor;

(2) During the pre-acquisition portion of the "acquisition year" (the calendar year in which the acquisition occurs), the predecessor is required to file information returns as a result of making or receiving payments, or withholding or collecting taxes, as provided under the appropriate sections of the Code and regulations set forth above;

(3) During the post-acquisition portion of the acquisition year, the predecessor (for an acquisition described in section 3(1)(a)) or the separate unit of the predecessor (for an acquisition described in section 3(1)(b)) does not make or receive any such payments and does not withhold or collect any such tax;

(4) The requirements of section 5 of this revenue procedure are met; and

(5) The Internal Revenue Service instructions or publications relating to Forms 1042–S, a specific form in the series 1098, 1099, or 5498, or Forms W-2G do not prohibit use of the alternative procedure described in section 5.

SECTION 4. STANDARD PROCEDURE

Each person that makes or receives payments, or withholds or collects taxes, that are reportable on Forms 1042-S, forms in the series 1098, 1099, and 5498, or Forms W-2G, is responsible for information reporting of those transactions. Thus, unless the alternative procedure of section 5 of this revenue procedure is used, both the predecessor and the successor must file certain Forms 1042-S, forms in the series 1098, 1099, and 5498, or Forms W-2G for reportable transactions occurring in the acquisition year.

SECTION 5. ALTERNATIVE PROCEDURE

.01 The predecessor and the successor must agree that the successor assumes the predecessor's entire information reporting obligations for those Forms 1042-S (as described in section 2.02 of this revenue procedure), forms in the series 1098, 1099, and 5498, and Forms W-2G to which their agreement applies. The predecessor is relieved of its information reporting obligations for reportable transactions occurring in the acquisition year only if and to the extent that their agreement meets, and the successor satisfies, each of the requirements of section 5 of this revenue procedure.

.02 The predecessor and successor must agree upon the specific Forms 1042-S, forms in the series 1098, 1099, and 5498, and Forms W-2G to which this alternative procedure applies. The predecessor and successor may agree to (a) use the alternative procedure for all Forms 1042-S, forms in the series 1098, 1099, or 5498, or Forms W-2G; or (b) limit the use of the alternative procedure to (1) specific Forms 1042-S, forms in the series 1098, 1099, or 5498, or Forms W-2G; or (2) specific reporting entities (*i.e.*, any unit, branch or location within a particular business entity that files its own separate information returns). For example, if the only compatible computer or record keeping systems of a predecessor and successor are their dividends paid ledgers, they may use the alternative procedure for Forms 1099-DIV, and use the standard procedure for Forms 1042-S and all other forms in the series 1098 or 1099. Similarly, if the only compatible computer or record keeping systems of a predecessor and successor are in their branches located in the Midwest, they may use the alternative procedure with respect to the records maintained at those locations, and use the standard procedure with respect to the records maintained at all other locations. The sharing between the predecessor and successor of taxpayer identification numbers and other information obtained under § 3406 for information reporting and backup withholding purposes, for the sole purpose of complying with this revenue procedure, does not violate the confidentiality rules contained in § 3406(f).

.03 On each "appropriate form" (*i.e.*, each form to which the agreement in section 5 of this revenue procedure applies), the successor must combine (1) the payments made or received on account of a person by the predecessor in the pre-acquisition portion of the acquisition year with (2) the payments made or received on account of that person by the successor in that year, if any, and must report the aggregate amount(s) on account of that person for that year. In the case of amounts that are required or permitted to be reported transactionally (for example, broker sales of stock that are required to be reported on Forms 1099-B, Proceeds From Broker and Barter Exchange Transactions) the successor must report each transaction of the predecessor and each of its transactions on each appropriate form. The successor may include with the form additional information explaining to the recipient the combined reporting by the predecessor and successor.

.04 On each appropriate form, the successor must also combine the amount of any tax withheld under §§ 1441, 1442, 1443, 3402(q), 3402(r), 3405, and 3406(a) for a person by the predecessor in the pre-acquisition portion of the acquisition year with the amount withheld under such sections for that person by the successor in that year and, on the appropriate form(s), must report the aggregate amount for the year.

.05 The successor must file a statement with the Internal Revenue Service indicating that the appropriate forms are being filed on a combined basis in accordance with the provisions of this revenue procedure. This statement is needed to assist the Service in processing the forms filed under the alternative procedure. If tax has been withheld by the predecessor pursuant to §§ 3402(q), 3402(r), 3405, and 3406(a) during the acquisition year and reported by the predecessor on Form 945, Annual Return of Withheld Federal Income Tax, the total of the withholding amounts shown on the successor's Forms 1099 and W-2G for that year will exceed the total of the withholding amounts shown on the successor's Form 945. Therefore, the statement that must be filed with the Service must reflect the amount of any tax that

has been withheld by the predecessor and by the successor for each type of form (for example, Forms 1099-R or Forms 1099-MISC). Likewise, if any tax has been withheld under §§ 1441 and 1442 during the acquisition year and reported on Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, the total of the withholding amounts shown on the successor's Forms 1042-S for that year will exceed the total of the withholding amounts shown on the successor's Form 1042. Therefore, the statement that must be filed with the Service must reflect the amount of tax that has been withheld by the predecessor and successor for Form 1042-S.

.06 The statement required by section 5.05 of this revenue procedure must include the name, address, telephone number, and Employer Identification Numbers of both the successor and predecessor, and the name and telephone number of the person responsible for preparing this statement.

.07 The statement for Forms 1042-S must be **attached** to the Form 1042 and mailed to the address for filing the Form 1042 (appearing in the instructions to the form) on or before the date the Form 1042 is due.

.08 The statement for forms in the series 1098, 1099 and 5498, and Forms W-2G must be **filed separately** from such forms and Form 945. Unless directed otherwise by the instructions to the forms, the statement for forms in the series 1098, 1099, and 5498, and Forms W-2G must be mailed to the following address on or before the date those forms are due:

Internal Revenue Service
Martinsburg Computing Center
230 Murall Drive
Attention: Chief, Information Returns Branch
Mail Stop 360
Kearneysville, WV 25430

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 90–57, 1990–2 C.B. 641, and Rev. Rul. 69–556, 1969–2 C.B. 242, are modified and, as modified, are superseded.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for Forms 1042-S, forms in the series 1098, 1099, and 5498, and Forms W-2G filed after December 31, 1999. In addition, if a successor filed forms on or before December 31, 1999, in the circumstances described in section 3 of this revenue procedure, the predecessor's filing obligations are deemed to have been satisfied with respect to amounts shown on those forms if the predecessor and successor have substantially complied with all the requirements of section 5 of this revenue procedure (except for the statement requirement of section 5.05).

SECTION 8. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1667. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information is contained in section 5 of this revenue procedure which requires the filing of a statement that the alternative procedure has been elected. This information is required to aid the Service in processing Forms 1042-S, forms in the series 1098, 1099, and 5498, and Forms W-2G filed by successors who use the alternative procedure, reconcile discrepancies between the amounts reported on Forms 945 and Forms 1099 and W-2G filed by both predecessors and successors who use the alternative procedure, and reconcile discrepancies between the amounts reported on Forms 1042-S and Forms 1042 filed by predecessors and successors who use the alternative procedure. The likely respondents are business or other for-profit institutions.

The estimated average annual burden to prepare the statement is 5 minutes. The estimated number of respondents that will elect to use the alternate procedure is 6,000 and the estimated total annual reporting burden is 500 hours.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is A. Katharine Jacob Kiss of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure contact Ms. Kiss on (202) 622-4920 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters. (Also Part I, section 1361)

Rev. Proc. 99–51

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 99–3, 1999–1 I.R.B. 103, which sets forth areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Domestic) in which the Internal Revenue Service will not issue advance rulings or determination letters.

SECTION 2. BACKGROUND

Section 301.7701–3 of the Procedure and Administrative Regulations allows an eligible entity to elect to be classified as an association taxable as a corporation for federal tax purposes. Under § 301.7701–3(a), an eligible entity is a business entity not classified as a corporation under § 301.7701–2(b)(1), (3), (4), (5), (6), (7), or (8). A state law partnership is an eligible entity. Consequently, a state law limited partnership may elect to be classified as an association taxable as a corporation for federal tax purposes.

Section 1362(a) of the Internal Revenue Code allows an eligible corporation to elect to be taxable as an S corporation. For a corporation to be eligible to elect under § 1362(a), the corporation must be a small business corporation. Section 1361(b)(1)(D) requires that a small business corporation have no more than a single class of stock. A general partnership

interest includes rights and obligations not included in a limited partnership interest. If these obligations and rights result in general and limited partnership interests in a limited partnership having non-pro rata distribution rights, such interests are different classes of stock for purposes of § 1361(b)(1)(D).

Given the factual difficulties involved in determining whether the differences between the rights and obligations of general and limited partnership interests give rise to a second class of stock, the issue of whether a state law limited partnership complies with the single class of stock requirement is under extensive study. Accordingly, advanced rulings will not be provided on the issue until the Service resolves it through publication of a revenue ruling, revenue procedure, regulations, or otherwise.

SECTION 3. PROCEDURE

Rev Proc. 99–3 is amplified by adding the following to section 5.01:

Section 1361. — Definition of a Small Business Corporation. — Whether a state law limited partnership electing under § 301.7701–3 to be classified as an association taxable as a corporation has more than one class of stock for purposes of § 1361(b)(1)(D). The Service will treat any request for a ruling on whether a state law limited partnership is eligible to elect S corporation status as a request for a ruling on whether the partnership complies with § 1361(b)(1)(D).

SECTION 4. EFFECTIVE DATE

This revenue procedure applies to all ruling requests, including any pending in the National Office and any submitted after the date of this publication.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–3 is amplified.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Richard Castanon of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Richard Castanon at 202-622-3070 (not a toll free call).

Tax Avoidance Using Distributions of Encumbered Property

Notice 99–59

The Internal Revenue Service and Treasury Department have become aware of certain types of transactions, as described below, that are being marketed to taxpayers for the purpose of generating tax losses. This notice is being issued to alert taxpayers and their representatives that the purported losses arising from such transactions are not properly allowable for federal income tax purposes.

The transactions are cast in a variety of forms. In one typical arrangement, taxpayers act through a partnership to contribute cash to a foreign corporation, which has been formed for the purpose of carrying out the transaction, in exchange for the common stock of that corporation. Another party contributes additional capital to the corporation in exchange for the preferred stock of that corporation. The foreign corporation then acquires additional capital by borrowing from a bank and grants the bank a security interest in securities acquired by the foreign corporation that have a value equal to the amount of the borrowing. Thereafter, the foreign corporation makes a distribution of the encumbered securities to the partnership that holds its common stock. The effect of the distribution, combined with fees and other transaction costs incurred at the corporate level, is to reduce the remaining value of the foreign corporation's common stock to zero or a minimal amount. Although the distributed securities are encumbered by the bank debt (and the taxpayers or their partnership may be secondarily liable for the debt as guarantors), the foreign corporation has sufficient other assets to repay the debt, and it is the understanding of all parties that the foreign corporation will repay the debt with such other assets.

For example, if the taxpayers' partnership had contributed $100x for the common stock of the foreign corporation, the partnership might receive a distribution of securities with a fair market value of approximately $100x, and that distribution would have the economic effect of reducing the remaining value of the foreign corporation's common stock to zero. Nonetheless, because the distribution to the partnership is subject to the bank debt, the parties take the position, pursuant to § 301(b)(2) of the Internal Revenue Code, that the amount of the distribution is zero for purposes of § 301. On that theory, no part of the distribution is treated either as a dividend or as a reduction of stock basis under § 301(c).

The partnership is treated as having subsequently disposed of the stock of the foreign corporation, giving rise to a tax loss equal to the excess of the partnership's original basis in the stock ($100x in the example) over the fair market value of the common stock after the distribution of securities (zero). The deemed disposition of the stock may be based upon an election under § 301.7701–3(c) of the regulations to change the federal income tax classification of the foreign corporation from a corporation to a partnership, giving rise to a deemed liquidation of the foreign corporation, or by treating the partnership as a trader in securities which elects under § 475(f) to treat the securities that it holds, including the stock of the foreign corporation, as having been sold for their fair market value on the last business day of the taxable year.

Thereafter, typically in a later taxable year, the bank debt is repaid out of other assets held by the foreign corporation. Although the parties previously treated the debt as reducing the amount of the earlier distribution from the foreign corporation, promoters advise taxpayers to take the position that the foreign corporation's repayment of the debt is not treated as a distribution on its common stock.

A loss is allowable as a deduction for federal income tax purposes only if it is bona fide and reflects actual economic consequences. An artificial loss lacking economic substance is not allowable. See *ACM Partnership v. Commissioner*, 157 F.3d 231, 252 (3d Cir. 1998), *cert. denied*, 119 S. Ct. 1251 (1999) ("Tax losses such as these . . . which do not correspond to any actual economic losses, do not constitute the type of 'bona fide' losses that are deductible under the Internal Revenue Code and regulations."); *Scully v. United States*, 840 F.2d 478, 486 (7th Cir. 1988) (to be deductible, a loss must be a "genuine economic loss"); *Shoenberg v. Com-*

missioner, 77 F.2d 446, 448 (8th Cir. 1935) (to be deductible, a loss must be "actual and real"); § 1.165–1(b) ("Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.").

In the view of the Service and the Treasury Department, the arrangement described above (or any similar arrangement) does not produce an allowable loss. Through a series of contrived steps, taxpayers claim tax losses for capital outlays that they have in fact recovered. Such artificial losses are not allowable for federal income tax purposes.

The purported tax benefits from these transactions may also be subject to challenge under other provisions of the Code and regulations, including but not limited to §§ 269, 301, 331, 446, 475, 482, 752, and 1001 of the Code.

Additionally, the Service may impose penalties on participants in these transactions or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under § 6662, the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

The principal author of this notice is Ken Cohen of the Office of Assistant Chief Counsel (Corporate). For further information regarding this notice, contact Mr. Cohen on (202) 622-7790 (not a toll-free call).

Information Reporting – Royalty Payments

Notice 99–60

Section 6050N(a)(1) requires that every person who makes payments of royalties (or similar amounts) aggregating $10 or more to any other person during the calendar year shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the person to whom paid. Section 6050N(a)(2) imposes this requirement on every person who receives payments of royalties (or similar amounts) as a nominee and who makes payments aggregating $10 or more during any calendar year to any other person with respect to the royalties (or similar amounts) so received.

However, the reporting requirement of § 6050N does not apply to payments of royalties that are not subject to income tax because the royalties are derived directly by a noncompetent Indian from allotted and restricted land under the General Allotment Act, 25 U.S.C. §§ 331–358, or from land held under acts or treaties containing an exception provision similar to the General Allotment Act. *See* Rev. Rul. 67–284, 1967–2 C.B. 55, *modified on another issue by* Rev. Rul. 74–13, 1974–1 C.B. 14, and *amplified on another issue by* Rev. Rul. 94–16, 1994–1 C.B. 19.

The principal author of this notice is Eric Lucas of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact Mr. Lucas at (202) 622-4920 (not a toll-free call).

Weighted Average Interest Rate Update

Notice 99-61

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for November 1999 is 6.15 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
December	1999	6.00	5.40 to 6.30	5.40 to 6.60

Drafting Information

The principal author of Notice 99–61 is Todd Newman of Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, call the Employee Plans Actuarial hotline, (202) 622-6076 between 2:30 and 3:30 p.m. Eastern time (not a toll-free number). Mr. Newman's number is (202) 622-8458 (also not a toll-free number).

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 99–115

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

A & M Nutrition, Incorporated, Winnsboro, LA
Assist, Inc., Buffalo, NY
Children & Youth 2000, c/o Wolin & Rosen, Chicago, IL
Colorado Collective for Medical Decisions, Inc., Denver, CO
Friends of the Environment, Sacramento, CA
Glenville Community Festival Foundation, Cleveland, OH
Impact For Change Ministries International, Inc. Waldorf, MD
Jersey Shore Public Relations & Advertising Charitable Scholarship Trust, Princeton, NJ
Lewis IDA Community Development Corp, Lowville, NY
Lo Society Branch of Wisconsin Inc, Oshkosh, WI
MPA Foundation, New York, NY
Neighborhood Network Inc., Uniontown, PA
SGV Property Management, Los Angeles, CA
Vision Research Foundation Inc., Phoenix, AZ
Voters Organized to Educate, Compton, CA
West Tennessee Young Farmers & Homemakers Leadership Development, Columbia, TN
White Collar Crime, Inc., Roseland, NJ
Working With Women Transporting Service, Inc., Los Angeles, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Actions on Decisions; Correction

Announcement 99–116

This document corrects the Actions on Decisions published in 1999–35 I.R.B. 314. All 7 footnotes describing the "Acquiescence" or "Nonacquiesence" in each decision included the words "in result only," which were erroneous. The court cases are listed below, followed by the footnotes with the correct text.

The Commisioner ACQUIESCES in the following decisions:

Internal Revenue Service v. Waldschmidt (In re Bradley),[1]
(M.D. Tenn 1999)

Estate of Mellinger v. Commisioner,[2]
112 T.C. 4 (1999)

Hospital Corp. of America and Subsidiaries v. Commissioner,[3]
109 T.C. 21 (1997)

Boyd Gaming Corporation v. Commissioner,[4]
F.3d (9th Cir. 1999)

The Commissioner NONACQUIESCES in the following decisions:

Vulcan Materials Company and Subsidiaries v. Commissioner,[5]
96 T.C. 410 (1991)

St. Jude Medical, Inc. v. Commissioner,[6]
34 F.3d 1394 (8th Cir. 1994)

Hospital Corp. of America and Subsidiaries v. Commissioner,[7]
109 T.C. 21 (1997)

Social Security Contribution and Benefit Base for 2000

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (64 F.R. 57506, dated October 25, 1999) that the contribution and benefit base for remuneration paid in 1999, and self-employment income earned in taxable years beginning in 2000 is $76,200.

[1]Acquiescence relating to whether gain on the sale of the debtor's residence is excluded from gross income of the bankruptcy estate to the extent provided by I.R.C. §121 and in accord with section 1398.

[2]Acquiescence relating to whether, for estate tax valuation purposes, a minority interest in a closely held corporation held in a Qualified Terminable Interest Property (QTIP) trust, which is includible in the gross estate under I.R.C. §2044, is aggregated with a minority interest in the same corporation that is includible in a decedent's gross estate under other provisions of the Code.

[3]Acquiescence relating to whether the tests developed under the investment tax credit (ITC) prior to the 1981 adoption of the cost recovery system are applicable in determining a structural component for the purposes of Accelerated Cost Recovery System (ACRS) and Modified Accelerated Cost Recovery System (MACRS).

[4]Acquiescence relating to whether a meal furnished by the taxpayer/employer on its business premises to an employee is furnished for "the convenience of the employer" within the meaning of that phrase in section 119 of the Internal Revenue Code.

[5]Nonacquiescence relating to whether the term "accumulated profits" as used in the denominator of the section 902 deemed paid credit fraction before the Tax Reform Act of 1986 means all of a foreign corporation's accumulated profits for the taxable year. This revised action on decision clarifies the Service's position on this issue in cases appealable to the 11th Circuit.

[6]Nonacquiescence relating to whether section 1.861–8(e)(3) of the Income Tax Regulations is invalid as applied to DISC combined taxable income (CTI) calculations.

[7]Nonacquiescence relating to whether certain items treated as tangible personal property and depreciated over a 5-year recovery period were in fact structural components of the buildings to which they relate which must be depreciated over the same recovery period as the buildings, pursuant to I.R.C. §168.

"Old-Law" Contribution and Benefit Base

General

The "old-law" contribution and benefit base for 2000 is $56,700. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. The base is computed under section 230(b) of the Act as it read prior to the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) The Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(d) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

Domestic Employee Coverage Threshold

General

Section 2 of the "Social Security Domestic Employment Reform Act of 1994" (Pub. L. 103-387) increased the threshold for coverage of a domestic employee's wages paid per employer from $50 per calendar quarter to $1,000 per annum in calendar year 1994. The statute held the coverage threshold at the $1,000 level for 1995 and then increased the threshold in $100 increments for years after 1995. Section 3121(x) of the Internal Revenue Code provides the formula for increasing the threshold.

Computation

Under the formula, the domestic employee coverage threshold amount for 2000 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 1998 to that for 1993. If the amount so determined is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

Domestic Employee Coverage Threshold Amount

The ratio of the national average wage index for 1998, $28,861.44, compared to that for 1993, $23,132.67, is 1.2476485. Multiplying the 1995 domestic employee coverage threshold amount of $1,000 by the ratio of 1.2476485 produces the amount of $1,247.65, which must then be rounded to $1,200. Accordingly, the domestic employee coverage threshold amount is determined to be $1,200 for 2000.

(Filed by the Office of the Federal Register on October 22, 1999, 8:45 a.m., and published in the issue of the Federal Register for October 25, 1999, 64 F.R. 57506)

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The abbreviation and number in parenthesis following the index entry refer to the specific item; numbers in roman and italic type following the parenthesis refer to the Internal Revenue Bulletin in which the item may be found and the page number on which it appears. The I.R.B. page number is the same as the C.B. page number.

Key to Abbreviations:

Ann	Announcement
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

EMPLOYEE PLANS

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26 CFR 26.2601-1, amended; retention of a trust's exempt status for generation-skipping transfer tax purposes in the case of modifications, etc. (REG-103841-99) 49, *639*

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